

## Memorandum

TO: Steve Scialabba, RI Division of Public Utilities and Carriers

FROM: John Stutz, Tellus Institute

TOPIC: Proposed Increase in SOS charge of National Grid  
RIPUC Docket 3960

DATE: June 18, 2008

The current charge for Standard Offer Service (SOS) is 9.2 cents per kWh. In its May 23 filing, Narragansett (the Company), has proposed raising the charge to 11.5 cents per kWh for the remainder of 2008. This reflects an increase in the Company's estimate of the component of SOS supply cost that depends on the market price of gas and oil. As Ms. Lloyd's schedule JAL-3 shows, the 11.5 cent charge is designed to cover currently estimated costs through the end of 2008. Based on estimated costs through the end of 2009, Narragansett has developed, but not proposed, a rate of 13.1 cents per kWh. I have reviewed the company's filing, including the testimony of Mr. Warshaw on fuel prices and markets. Based on my review I recommend adoption of the 11.5 cent rate.

While I generally favor stability as a ratemaking goal, concern about oil and gas price volatility leads me to support adoption of the Company's proposal. Based on the information available today, the likelihood is for high oil and gas prices in 2009 as shown in Mr. Warshaw's schedule JDW-2. Were prices at these levels reasonably certain, adoption of the 13.1 cent rate might be appropriate. However, over the last 10 months the outlook for the economy has worsened. Anticipated growth in 2008 has fallen to 1.1 percent, half of what was expected last October. High oil prices have finally begun to put pressure on the cost of providing a wide range of goods and services, leading to lower profits, layoffs, and inflation. Efforts to "fight inflation" could cause growth to slow even more. Very slow growth or an actual recession could reduce the pressure on oil and gas prices. Economic conditions are so unsettled today that a short term perspective – resetting the SOS charge based on anticipated oil and gas prices for the remainder of 2008 rather than for 2008 and 2009 – is appropriate.

Concerns about rate shock also support limiting the current revision to the proposed 11.5 cent charge. The current 9.2 cent charge is itself roughly 11 percent higher than last year's charge of 8.3 cents per kWh. A mid-year increase to 11.5 cents pushes the increase over the 2007 level to about 39 percent. An increase to 13.1 cents would produce an increase of about 58 percent over the 2007 level. While an increase of 39 percent is not "good news", it is certainly better than 58 percent. Of course, there is the possibility that a larger increase will be required in 2009 if the 11.5 cent rather than the 13.1 cent SOS charge is adopted now. However, I would point out that the last spike in SOS charge – to 10 cents in January of 2006 – was followed by declines not further increases. In light of the economic uncertainties noted above, setting the rate for a shorter time horizon and further reviewing economic conditions and fuel data the end of 2008 may be a more prudent course of action.

The company's proposal to set the SOS charge for the remainder of 2008 to cover currently estimated supply costs for 2008 provides a reasonable and balanced response to the range of concerns—rapidly rising oil and gas prices, the possibility of an economic slowdown or even a recession and rate shock— that face us today. Conditions are simply too uncertain and the rate impact too great to pursue longer term rate stability, through setting a higher rate, at this time.