

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
PUBLIC UTILITIES COMMISSION**

**IN RE: NARRAGANSETT ELECTRIC COMPANY :  
d/b/a NATIONAL GRID STANDARD : DOCKET NO. 3960  
OFFER RATE ADJUSTMENT FILING :**

**REPORT AND ORDER**

**I. BACKGROUND**

Each electric distribution company is required by law, specifically R.I.G.L. §39-1-27.3, to arrange with wholesale power suppliers for a standard power supply offer (“Standard Offer”) to sell electricity to all customers at a stipulated rate, with certain adjustments permitted. Pursuant to the law, Narragansett Electric d/b/a National Grid (“NGrid” or “Company”) entered into wholesale Standard Offer supply contracts with the following prices:

<u>Calendar Year</u>	<u>Price per kWh<sup>1</sup></u>
2008	6.743 cents
2009	7.143 cents

The wholesale Standard Offer supply contracts also provide for increases in the price per kilowatt-hour (“kWh”) of wholesale power supplied to NGrid in the event fuel prices increase above certain levels. To the extent that the total cost of the wholesale power supply to NGrid, including fuel charges, exceeds retail Standard Offer Service (“SOS”) and Last Resort Service (“LRS”) revenues, the under-collection is recoverable, with interest, from NGrid’s customers through the annual reconciliation provisions of NGrid’s Standard Offer Adjustment Provision. Likewise, to the extent NGrid collects

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<sup>1</sup>In Docket No. 3496, the Commission approved a Settlement entered into between Narragansett and one of its standard offer suppliers to address responsibility for congestion costs in light of new locational marginal pricing rules in the wholesale electricity market. The settlement altered the base Standard Offer Service (SOS) cost in that contract. The pricing listed here is the weighted average impact on the overall pricing for all SOS contracts.

more than its total cost of providing SOS, the ratepayers are entitled to recoup the over-collection, with interest.

## II. PRE-FILED TESTIMONY

### A. NATIONAL GRID

On May 23, 2008, NGrid filed with the Rhode Island Public Utilities Commission (“Commission”) seeking approval to increase its Standard Offer Service (“SOS”) Rate from 9.2 cents per kWh to 11.5 cents per kWh for effect July 1, 2008 until December 2008. As an alternative to this six-month proposal, the Company proposed an eighteen-month rate commencing July 1, 2008 through December 2009 of 13.1 cents per kWh.

In support of the proposed rate increases, NGrid presented the pre-filed testimony of Jeanne A. Lloyd, Manager of Rates, New England in the Regulation and Pricing – Electricity Distribution and Generation department of National Grid USA Service Company, and John D. Warshaw, Principal Analyst in Regulated Electric Load and Distributed Generation for National Grid USA Service Company.

In her pre-filed testimony, Ms. Lloyd indicated that the purpose of the filing was to increase the SOS Rate to recover an estimated under-recovery resulting from NGrid’s increased contractual costs resulting from increased costs of oil and natural gas. She noted that in Docket No. 3902, the Division of Public Utilities and Carriers (“Division”) recommended that the Company consider adjusting its Standard Offer rate when its under-collection exceeded \$25 million<sup>2</sup>. The Company expects this under collection to

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<sup>2</sup> The parties, in their testimony, refer to a \$25 million under or over-collection as the amount which will prompt NGrid to file with the Commission for a change in the SOS rate. The Commission, in Docket No. 3788, ordered NGrid to monitor its over and under-collections and encouraged the Company to file for a change in the SOS rate if that over or under-collection exceeds \$23 million.

increase to approximately \$80 million by December 2008. She also noted that NGrid expects its fuel index payments to exceed \$429.3 million in 2009.<sup>3</sup>

Ms. Lloyd noted that based on the current prices of oil and natural gas, the current rate of 9.2 cents per kWh is insufficient to cover the SOS costs in the upcoming months. She explained that NGrid's estimate of the Standard Offer reconciliation balance, calculated at the current rate of 9.2 cents per kWh and projected expenses for the period October 2007 through December 2009, shows an estimated under-recovery of \$390.6 million as of December 31, 2009.<sup>4</sup>

Ms. Lloyd explained that the proposed 11.5 cent per kWh Standard Offer rate is calculated by summing the estimated expense for the six months minus the expected over-recovery as of June 30, 2008 and dividing the estimated Standard Offer kWh deliveries from the same period. She stated that if the 11.5 cent rate is implemented on July 1, 2008, the Standard Offer estimated rate for January 1, 2009 will be 13.9 cents per kWh, assuming current fuel price estimates are accurate through 2009. She noted that if the 11.5 cent rate was not implemented, the estimated Standard Offer rate beginning January 1, 2009 would be 15.1 cents per kWh.<sup>5</sup>

Ms. Lloyd also described an eighteen-month alternative to the six-month rate. She explained that assuming current fuel price estimates are accurate through 2009, a rate of 13.1 cents per kWh would allow NGrid to recover all of its estimated expenses through December 2009 without further Standard Offer rate adjustments. Finally Ms. Lloyd

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<sup>3</sup> NGrid Exhibit 1a, Standard Offer Rate Adjustment Filing, Pre-filed Testimony of Jeanne A. Lloyd, May 23, 2008 at 2-3, Schedules JAL-1 and JAL-2.

<sup>4</sup> *Id.* at 4-7.

<sup>5</sup> *Id.* at 7-9; JAL-3.

noted that the impact of the 11.5 cent rate on a typical residential customer would be an increase in the monthly bill of \$11.98 or 15.6 percent.<sup>6</sup>

Mr. Warshaw provided pre-filed testimony to provide an estimate of the costs NGrid expects to incur under its SOS contracts from July 2008 through December 2009. All of the contracts expire at the end of 2009. Each contract has two price components: base price and a fuel index adjustment provision. The fuel index adjustment provision provides for additional payments to suppliers should there be an increase in the market price of oil and natural gas. The fuel index adjustment provision compares the sum of the twelve-month rolling average of oil and natural gas to a preset trigger point. If the sum of the fuel index values exceeds the trigger point, NGrid makes additional payments to suppliers in that particular month.<sup>7</sup>

Mr. Warshaw noted that NGrid estimated its costs under the fuel index adjustment provision, and an analysis shows NGrid paying an average fuel index adjustment payment of 7.031 cents per kWh for the Narragansett Zone load for July 2008 through December 2008 or 5.203 cents per kWh applicable to the Narragansett Zone and the EUA Zone. Mr. Warshaw also provided the arithmetic average fuel index adjustment payment for the period January 2008 through December 2009 to be 8.768 cents per kWh for the Narragansett Zone and 6.489 cents per kWh applicable to both zones.<sup>8</sup>

When questioned about whether he has any indication that natural gas and oil prices are likely to decline, Mr. Warshaw indicated that there is no indication that this is likely to happen. Mr. Warshaw also noted the two lawsuits filed by Constellation, one of

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<sup>6</sup> *Id.* at 9-10; JAL-4, JAL-6

<sup>7</sup> NGrid Exhibit 1b, Standard Offer Rate Adjustment Filing, Pre-filed Testimony of John D. Warshaw, May 23, 2008 at 1-4; JDW-1. The Company has 2 zones, the Narragansett Zone, its pre-merger territory, and the EUA Zone, formerly within the service territory of Blackstone Valley Electric.

<sup>8</sup> *Id.* at 4-5; JDW-3.

the Company's suppliers. One suit seeks to recover fuel index payments from January 2005 through 2009, and the other seeks to adjust current pricing of wholesale standard offer contracts to take into account forward capacity market costs.

#### B. DIVISION

On June 18, 2008, the Division of Public Utilities and Carriers ("Division") submitted a Memorandum prepared by Dr. John Stutz of Tellus Institute for the Division. Dr. Stutz indicated that he had reviewed NGrid's filing and recommended that the Commission approve the 11.5 cents per kWh Standard Offer rate. He noted that his concerns regarding oil and gas price volatility leads him to support NGrid's 11.5 cent per kWh proposal. He pointed out that if price levels were certain, NGrid's alternative 13.1 cent proposal could be an option, but the outlook for the economy has worsened over the last ten months. Dr. Stutz also contended that his concern about rate shock supports his recommendation to adopt the 11.5 cent per kWh proposal. He noted that adopting the 11.5 cent proposal results in a standard offer rate that is a 39 percent increase over 2007 rates. Finally, he opined that in light of the economic uncertainties, the more prudent course of action would be to set the rate at 11.5 cents per kWh and to review this rate at the end of 2008.<sup>9</sup>

#### C. ATTORNEY GENERAL

On June 9, 2008, Patrick C. Lynch, Attorney General for the State of Rhode Island, intervened. General Lynch noted that NGrid has been a "socially responsible corporate citizen." He recognized that fuel costs have caused the cost of electricity to skyrocket. He pointed out that in the last seven years, NGrid has requested an increase in Standard Offer Service rates and looking at each in isolation, it is hard to object to each

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<sup>9</sup> Memorandum of John D. Stutz filed June 18, 2008.

increase which by itself is reasonable and necessary. However, General Lynch opined that in light of the current economic climate, it may be necessary to look at the entire bill from NGrid, including the components that it has some control over.<sup>10</sup>

General Lynch pointed out that utility distribution companies are allowed to recover their rising costs through rates, while not bearing any of the economic pain felt by their ratepayers, and are allowed by state law to have rates high enough to protect investors' return on equity. He suggested that the Commission revisit NGrid's allowable return on equity and consider adjusting it so that ratepayers will not have to bear the full economic impact of increasing fuel costs. He requested that the Commission cease the current piecemeal approach to ratemaking and look at all of the components of the monthly bills to determine where cuts can be made to offset the current increases.<sup>11</sup>

### III. SUPPLEMENTAL FILING

On July 3, 2008, NGrid filed updated schedules of Jeanne Lloyd reflecting more recent fuel prices. In that filing, NGrid noted that 12.4 cents per kWh rate for effect July 15, 2008 was necessary to eliminate the projected under recovery. NGrid pointed out that if its originally proposed rate of 11.5 cents per kWh were approved for effect July 15, 2008, an under-recovery of approximately \$27.9 million would result by December 31, 2008. It also noted that from the time the Commission approved its Standard Offer Service Rate of 9.2 cents per kWh in November of 2007, the price of crude oil and natural gas has increased by more than 60%.<sup>12</sup>

In addition to updating the 11.5 cents per kWh proposal for effect July 15, 2008 through December 31, 2008, NGrid revised its alternative proposal from 13.1 cents per

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<sup>10</sup> Position Memorandum on Behalf of Patrick C. Lynch, Attorney General filed June 12, 2008 at 1-2.

<sup>11</sup> *Id.* at 2-3.

<sup>12</sup> NGrid Exhibit 3, Updated Schedules filed July 3, 2008.

kWh to 14.4 cents per kWh, for effect July 15, 2008 through December 31, 2009. NGrid indicated that should the Commission choose to approve the originally filed 11.5 cents per kWh, it would need a rate of 15.8 cents per kWh rate in January 2009 in order to cover expenses and the expected under-recovery through the end of December 2008.<sup>13</sup>

#### IV. HEARING

A public hearing was held at the Commission's offices, 89 Jefferson Boulevard, Warwick, Rhode Island, on July 9, 2008. The following appearances were entered:

FOR NGRID:	Thomas R. Teehan, Esq.
FOR DIVISION:	Paul J. Roberti, Esq. Assistant Attorney General
FOR ATTORNEY GENERAL:	Adam Sholes, Esq. Special Assistant Attorney General
FOR COMMISSION:	Patricia S. Lucarelli, Esq. Chief of Legal Services

At the hearing, Ms. Lloyd and Mr. Warshaw testified on behalf of NGrid in support of the requested rate change. Ms. Lloyd testified that NGrid's July 3, 2008 filing, which is based on end of June fuel indices, indicates that a rate of 12.4 cents per kWh would be appropriate. She also explained that the standard offer rate, which is based on NGrid's contracts with its suppliers, is set in January each year. She noted that fuel indices are monitored through the year and report is filed with the Commission each month. If at any time NGrid believes there will be either a significant over or under collection, it has the option of filing for a rate adjustment. Ms. Lloyd pointed out that the rate for cost recovery is exactly the amount paid by NGrid under the terms of its

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<sup>13</sup> *Id.*

contracts. It makes no profit or loss from the sale of the commodity. She explained that two things are causing the rate to increase. The first reason is the scheduled increase in the base portion of the contract, which was designed to increase four mills every year, and the second reason is the increase in the fuel index payments caused by changes in expected future prices of oil and natural gas. Ms. Lloyd noted that the rate for the 18-month alternative would be 14.4 cents per kWh.<sup>14</sup>

Dr. Stutz testified on behalf of the Division. He recommended that the Commission approve the increase in the standard offer rate from 9.2 cents to 12.4 cents per kWh, noting that it was the most reasonable and appropriate option at the current time. He testified that he was not comfortable with the 18-month rate proposed by NGrid given the state of the market. He testified that he believed asking NGrid to come in when their under collection is \$25 million or more is reasonable.<sup>15</sup>

## V. COMMISSION FINDINGS

At its open meeting on July 10, 2008, the Commission accepted NGrid's first alternative in the supplemental filing to set the SOS rate at 12.4 cents per kWh effective for consumption on and after July 15, 2008. This rate is designed to recover the under-collection by December 31, 2008. The Commission considered the numerous public comments it received, both oral and written, but noted that to do nothing and defer any increase would only result in an under collection of \$104 million by the end of the year. In explaining its decision, the Commission expressed that it had an extraordinarily difficult decision to make, especially in light of the heart wrenching testimony it had received during the public comments. It noted that NGrid realizes no profit or loss from

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<sup>14</sup> Transcript of July 9, 2008 Hearing ("T.") at 12-20, 37.

<sup>15</sup> T. at 50-51, 59-60.

the standard offer charge. This portion of the rate is the result of contractual charges that NGrid must pay in order to purchase the electricity it will distribute to homes and businesses. The effect of the Commission's decision is an increase of the SOS charge from 9.2 cents per kWh to 12.4 cents per kWh. The effect on the typical residential customer using 500 kWh per month will be an overall monthly bill increase of \$16.67 from \$76.77 to \$93.44, or 21.7%. The Commission noted that this decision is consistent with past Commission practice to adjust rates to avoid accrual of large under-collections.

The necessity for this increase is attributable to increases in the cost of wholesale oil and natural gas. As part of NGrid's SOS agreements with suppliers, when the fuel charges increase above a certain level, NGrid must pay the suppliers an additional amount in addition to the base contract price for SOS, which, for 2008 is 6.743 cents per kWh. The law provides that NGrid be allowed to recover the costs it incurs in providing the standard offer arising out of its contracts to obtain this power.<sup>16</sup> Therefore, in each request for an increase relative to wholesale fuel prices, the Commission attempts to balance the legal requirement of the increase against a desire for stability.

The Commission has also established a policy of not allowing a large under-collection to accrue in the SOS account. The Commission has historically implemented steady rate increases in order to avoid a large under-collection that could lead to rate shock. If the Commission were to deny a rate increase until NGrid's annual reconciliation filing, NGrid projected the under-collection to be approximately \$104 million as of December 31, 2008. This new rate of 12.4 cents per kWh is designed to collect NGrid's costs of providing SOS to customers through the end of 2008, with no significant over or under-collection. Even though the General Assembly voted in favor

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<sup>16</sup> R.I. Gen. Laws §39-1-27.3.

of electric restructuring based on the theory that competition will ensure lower energy prices, the Commission has seen wholesale market prices increase dramatically during the past year because of the higher cost of fuels used to generate the electricity. As stated above, the Commission has no control over these commodity prices. The Commission regulates NGrid, but does not regulate or control wholesale oil and natural gas prices.

NGrid shall continue to report monthly on the projected balance of the SOS account as of December 2009. Because of the fact that NGrid's annual reconciliation filing is scheduled to be made in mid-November 2008, only four months after the effective date of these new rates, the Commission will not utilize the \$23 million benchmark for an over- or under-collection for analyzing the need for a rate adjustment. Instead, the Commission will revisit this issue in the annual reconciliation filing regarding 2008 rates. Finally, the Commission approved unanimously a motion by the Chairman to conduct an audit of NGrid for the purpose of verifying that NGrid's energy procurement is made in compliance with its approved contracts and verifying the numbers submitted by NGrid for recovery of the cost of fuel. The cost of this study shall be borne by NGrid, not its ratepayers.

Accordingly, it is hereby

(19378) ORDERED:

1. NGrid's proposed retail Standard Offer Service Rate of 12.4 cents per kWh is approved to become effective for service on and after July 15, 2008.
2. NGrid shall file monthly reconciliations of the SOS account.
3. NGrid shall conduct and pay for an audit for the purpose of verifying that NGrid's energy procurement is made in compliance with its contracts and

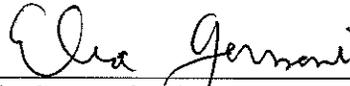
verifying the numbers submitted by NGrid for recovery of the cost of fuel.

The cost of this audit shall be borne by NGrid, not its ratepayers.

4. NGrid shall comply with all other findings and instructions as contained in this Report and Order.

EFFECTIVE AT WARWICK, RHODE ISLAND PURSUANT TO OPEN MEETING DECISIONS ON JULY 10, 2008 and AUGUST 7, 2008. WRITTEN ORDER ISSUED AUGUST 20, 2008.

PUBLIC UTILITIES COMMISSISON

  
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Elia Germani, Chairman

  
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Robert B. Holbrook, Commissioner

  
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Mary E. Bray, Commissioner

