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Luly Massaro, Clerk
Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02888

Re: Docket No. 4041 – Narragansett Electric Company d/b/a National Grid's Standard Offer
Procurement Plan and Renewable Energy Procurement Plan

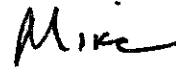
Dear Luly:

This office represents Constellation Energy Commodities Group, Inc. ("CCG") and Constellation
NewEnergy, Inc. ("CNE") (collectively, "Constellation") in the above docketed proceeding.

Enclosed please find ten (10) copies of Constellation's Post-Hearing Brief.

If you have any questions, please feel free to call.

Very truly yours,



Michael R. McElroy

MRMc/tmg
cc: Service List

ConstellationEnergy/4041/Massar06

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

Narragansett Electric Company d/b/a :
National Grid's Standard Offer : **Docket No. 4041**
Procurement Plan and Renewable Energy :
Procurement Plan :

**POST-HEARING BRIEF OF INTERVENORS
CONSTELLATION ENERGY COMMODITIES GROUP, INC.
AND CONSTELLATION NEWENERGY, INC.**

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Dated: September 22, 2009

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**POST-HEARING BRIEF OF INTERVENORS
CONSTELLATION ENERGY COMMODITIES GROUP, INC.
AND CONSTELLATION NEWENERGY, INC.**

Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (collectively, “Constellation”) hereby submit to the Public Utilities Commission (“Commission”) their Post-Hearing Brief with regard to the *Narragansett Electric Company d/b/a National Grid’s Standard Offer Procurement Plan and Renewable Energy Procurement Plan* submitted in the above referenced proceeding. In the instant proceeding, Narragansett Electric Company d/b/a National Grid (“National Grid”) submitted a Standard Offer Service (“SOS”) procurement plan for 2010, which relies on a full requirements service (“FRS”) structure (“FRS Structure”). Richard S. Hahn submitted direct and surrebuttal testimony on behalf of the Rhode Island Division of Public Utilities and Carriers, in support of an alternative procurement approach under which National Grid would purchase and manage on its own the individual products that make up SOS requirements (“Managed Portfolio Approach”).¹ Constellation submitted directed and rebuttal testimony in this proceeding in support of a FRS Structure over Mr. Hahn’s proposed use of a Managed Portfolio Approach.² At the Commission’s September 2, 2009 Open Meeting, finally, the Commission raised the possibility of procuring the final five (5) percent of National Grid’s 2010 SOS obligations through spot market purchases, and the consideration of a future SOS procurement structure that would require National Grid to procure 50 percent of its SOS

¹ See *Direct Testimony of Richard S. Hahn on Behalf of the Rhode Island Division of Public Utilities and Carriers*, Commission Docket No. 4041 (submitted July 22, 2009) (“RIPUC-Hahn Direct”); see also *Surrebuttal Testimony of Richard S. Hahn on Behalf of the Rhode Island Division of Public Utilities and Carriers*, Commission Docket No. 4041 (submitted Aug. 25, 2009).

² *Direct Testimony of Timothy Daniels on Behalf of Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc.*, Commission Docket No. 4041 (submitted June 24, 2009) (“Constellation-Daniels Direct”); see also *Joint Rebuttal Testimony of Timothy Daniels and Daniel Allegretti on Behalf of Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc.*, Commission Docket No. 4041 (submitted Aug. 14, 2009) (“Constellation Joint Rebuttal”).

obligations through the FRS Structure, and 50 percent of its SOS obligations through some form of Managed Portfolio Approach (the “50-50 FRS-MPA Structure”).

I. STATEMENT OF THE CASE

All parties can agree that, though the statutes state that electric restructuring “has not resulted in competitive markets for residential and small commercial industrial customers, lower overall prices, or greater diversification of energy resources used for electrical generation,”³ Rhode Island Law nevertheless *maintains* that “it is in the public interest to promote competition in the electricity industry,”⁴ and to do so while striving “to secure for Rhode Island, to the maximum extent reasonably feasible, the benefits of reasonable and stable rates, [and] least-cost procurement”⁵ With that backdrop in mind, it is imperative that the Commission continue to seek policies that will bring the benefits of competitive wholesale markets to retail customers, even when such customers are not shopping, but to do so while providing reasonable and stable rates – the FRS Structure is the most effective and efficient way to do so.

II. ARGUMENT

The record in the present proceeding demonstrates that the FRS Structure, with laddered procurements, achieves and exceeds all of the goals of the Managed Portfolio Approach: it provides to SOS customers both rate stability and the lowest costs consistent with market conditions. Moreover, the FRS Structure offers several benefits that the Managed Portfolio Approach cannot offer, including: (1) a plain-vanilla product that provides a fixed price to protect customers from volatility if costs of energy soar, and encourages retail shopping if the costs of energy decline; and (2) market and portfolio management risk mitigation. The FRS

³ Rhode Island Gen. Laws § 39-1-1(e)(2).

⁴ Rhode Island Gen. Laws § 39-1-1(d)(4).

⁵ Rhode Island Gen. Laws § 39-1-1(e)(4).

Structure takes advantage of the discipline of competitive markets to select the “best” portfolio of resources for supplying SOS.

In addition, the Commission *should not* require National Grid to procure the remaining five (5) percent obligation for the period January 1, 2010 through September 30, 2010 from the spot market rather than through FRS contracts, because: (1) no active party to this proceeding took issue with the approved FRS Structure for National Grid’s 2010 SOS obligations, 95 percent of which has been procured; and (2) such a policy decision is likely to be detrimental, rather than beneficial, to consumers’ interests.

Finally, the Commission *should not* consider any approach, whether for 2011 or for any other timeframe, akin to the 50-50 FRS-MPA Structure, as it: (1) will not provide the Commission with a useful comparison between the FRS Structure and the Managed Portfolio Approach; and (b) is likely to be significantly detrimental to consumers.

1. THE FRS STRUCTURE IS SUPERIOR TO THE MANAGED PORTFOLIO APPROACH AS IT OFFERS SIGNIFICANT AND UNIQUE BENEFITS AND MORE EFFECTIVELY ACHIEVES ALL OF THE GOALS OF THE MANAGED PORTFOLIO APPROACH.

A FRS Structure, utilizing fixed-price full requirements contracts with staggered terms – as National Grid proposed in the instant proceeding – is the preferred approach for SOS. It gives SOS customers the benefits of competition and avoids shifting risks to them. In addition, the FRS Structure best meets the Managed Portfolio Approach’s own goal of balancing the needs for stability in SOS supply and the lowest costs for meeting National Grid’s consumers’ SOS requirements.

a. **The FRS Structure Offers Significant and Unique Benefits by (1) Offering a Plain-Vanilla SOS Product that Best Meets the Goals of the Restructuring Act and (2) Through such Structure, Providing Market and Portfolio Management Risk Mitigation.**

The FRS Structure offers important benefits by best meeting the goals of the *Electric Utility Restructuring Act* (“Restructuring Act”)⁶ through competitive electric markets and, in so doing, providing market and portfolio management risk mitigation in ways that a Managed Portfolio Approach cannot.

(1) The FRS Structure will provide an appropriate, low-risk, plain-vanilla backstop service for National Grid’s residential customers, facilitating retail shopping, consistent with the letter and spirit of the Restructuring Act.

The Restructuring Act is clear in its promotion of electric market competition, stating: “that lower retail electricity rates would promote the state's economy and the health and general welfare of the citizens of Rhode Island,” “that greater competition in the electricity industry would result in a decrease in electricity rates over time,” “that greater competition in the electricity industry would stimulate economic growth,” and “that it is in the public interest to promote competition in the electricity industry”⁷ Constellation witnesses Allegretti and Daniels testify that, in order to promote retail customers’ ability to obtain direct access to “greater competition in the electricity industry”:

[a]s a back-stop service, SOS should be fashioned as a plain-vanilla, low-risk product. In the spirit of retail competition, rather than forcing customers to assume certain risks as is the case under a Managed Portfolio Approach, the Commission should allow customers to choose to assume or manage risks for themselves. Those customers that place a low value on price stability, for instance, can leave the low-risk, stable-priced SOS

⁶ Codified in Rhode Island Gen. Laws § 39-1.

⁷ Rhode Island Gen. Laws § 39-1-1(d)(1)-(4).

provided under full requirements contracts, and instead choose a more volatile supply option from a competitive retail suppliers.⁸

Moreover, by utilizing full requirements supply contracts through a FRS Structure:

National Grid will insulate its customers from short-term increases in the costs of energy and take advantage of competitive wholesale markets by providing a competitively-procured, fixed-price SOS supply. In a market where prices decline after a full requirements procurement, customers will have the ability to take advantage of competitive retail markets by shopping for lower-priced supply from a competitive retail supplier.⁹

On the other hand, under the Managed Portfolio Approach customers who cannot or choose not to shop will be subject to short-term run ups in costs in a particular quarter due to the Managed Portfolio Approach's "open positions" and large reliance on spot market pricing. It appears that Mr. Hahn recommends through a Managed Portfolio Approach that at least *10 percent* of National Grid's portfolio for Residential and Small Commercial Customers should be an "open position" procured through spot market purchases.¹⁰ As Constellation's witnesses explain, this 10 percent represents "a *significant* portion of [customers'] SOS load," and "will not provide stability in SOS supply prices."¹¹

Moreover, under the Managed Portfolio Approach, SOS customers no longer will get the full benefits of competitive wholesale markets. Whereas under a FRS Structure, *all* costs for SOS supply "will be highly constrained through competition and the incentives for suppliers to drive down costs of managing SOS load,"¹² as Mr. Allegretti and Mr. Daniels testify, under a Managed Portfolio Approach, "a utility such as National Grid under a Managed Portfolio Approach has little economic incentive or duty to minimize costs, as it operates under an

⁸ Constellation Joint Rebuttal at p.15 (lines 5-11).

⁹ Constellation Joint Rebuttal at pp.16 (line 22) – 17 (line 4).

¹⁰ RIPUC-Hahn Direct at Exhibit RSH-8.

¹¹ Constellation Joint Rebuttal at p.13 (lines 15-17).

¹² Constellation Joint Rebuttal at p.26 (lines 7-9).

incentive to minimize regulatory risks.”¹³ Said another way, under a Managed Portfolio Approach, the utility has no economic incentive to produce an optimal least-cost portfolio through innovation, efficiencies or risk-taking.

(2) The FRS Structure appropriately places market and portfolio management risks on wholesale suppliers while the Managed Portfolio Approach shifts such risks to National Grid’s SOS customers.

The key difference between the FRS Structure and the Managed Portfolio Approach is that the FRS Structure protects customers from price volatility and the risks and responsibilities of portfolio management, while the latter shifts these risks *directly onto* National Grid’s retail customers. At a time when more Americans and consumers around the world are seeing merit in taking on less risk in their lives and their finances, it begs the question as to why a household receiving supply under National Grid’s SOS should be subjected to *greater* risks than it has experienced under the Restructuring Act since 1996, if it does not *affirmatively* choose to do so.

(a) The FRS Structure places all market and portfolio management risks on wholesale suppliers, rather than on National Grid’s SOS customers.

It is uncontroverted in the record that the FRS Structure puts *wholesale suppliers* at risk for delivering SOS supply at a fixed price, regardless of where market prices may go or what management decisions such wholesale suppliers may make over the course of their FRS contracts with National Grid. Constellation witnesses Allegretti and Daniels provide further evidence of this benefit by citing and attaching to their Rebuttal Testimony “[a]n independent study regarding utility load procurement [that] was issued last year by the Analysis Group (“Analysis Group Study”), a well-respected energy and economic consulting firm”¹⁴ In recommending full requirements procurements for utilities, the Analysis Group Study, conducted

¹³ Constellation Joint Rebuttal at p.21 (lines 3-5).

¹⁴ Constellation Joint Rebuttal at p.8 (lines 9-11).

by Dr. Susan F. Tierney, a nationally recognized energy policy expert, former Assistant Secretary for Policy at the U.S. Department of Energy and former Commissioner at the Massachusetts Department of Public Utilities, affirms that one of the benefits of such a structure is that “[i]t passes risk from consumers and the utility that is serving as their supply conduit over to the third party supplies.”¹⁵

Mr. Daniels explains in more detail why wholesale suppliers are better able to manage these risks than the utility or its customers, stating that, for wholesale suppliers such as Constellation:

[a] number of employees are involved in the process of providing full requirements service to utilities and customers around the country, including portfolio managers, traders, meteorologists, asset operators, power managers, schedulers, dispatchers and related regulatory and legal support.

For instance, Constellation employs a team of seasoned portfolio managers that manages large regional portfolios for serving Constellation’s customers’ full requirements loads. Constellation must ensure that it properly and fully accounts for any transaction that goes into its portfolio, and that requirements for the entire load are met continuously for every hour of every day of every week. A team of ‘strategists’ continuously develops and improves computer models to keep track of all of the variable inputs that go into providing full requirements service; these strategists provide and analyze various scenarios that Constellation’s portfolio managers may face. In addition, a ‘fundamentals’ group constantly researches basic supply and demand in fuel and power markets in order to monitor macroeconomic trends that affect the costs of serving load. Full-time meteorologists on Constellation’s team continually monitor and predict the weather, so that Constellation’s team can plan for weather effects on load requirements, and adjust supply accordingly. A 24-hour power trading desk trades power in the hour ahead, day ahead, and week ahead markets each day of the week, in order to help manage Constellation’s supply portfolio. Moreover, power managers and traders monitor and trade in not only ISO-NE’s market, but also those in Canada, New York, PJM, and other markets throughout the U.S.; fuel managers do the same as fuel markets directly affect power markets. Similar resources

¹⁵ See Constellation Rebuttal at Exhibit 2.2, *Pennsylvania’s Electric Power Future: Trends and Guiding Principles*, Susan F. Tierney, Ph.D., Analysis Group (January 2008) (“Analysis Group Study”) at p.11.

focus on fuel oil, currency, emissions and renewable energy markets. The task of meeting full requirements load supply additionally requires controllers, schedulers and dispatchers. Supporting all of these operations is a team of regulatory specialists and attorneys that monitor and participate in regulatory and legal activities impacting energy markets.

* * *

The expertise that such a team of employees as that assembled at Constellation, and their advanced programs and systems, drives costs down by utilizing a well-developed infrastructure and spreading the overhead for such activities across Constellation's entire portfolio, in this way producing a far better result than a small team of people at a regulated utility company or its consultant. The costs for providing such service for National Grid's customers is highly constrained by the very competitive nature of this business, because sophisticated wholesale suppliers throughout the market have operations similar in structure to those of Constellation, and compete through the RFPs to serve National Grid's SOS load at the lowest cost.¹⁶

In addition to this type of personnel and intellectual expertise that wholesale suppliers have built up over time and made more effective and efficient, there are implementation tools that wholesale suppliers have developed that a utility under a Managed Portfolio Approach does not possess. As National Grid witness Smithling points out, there are "implementation hurdles" for a Managed Portfolio Approach, including hurdles related to "software and technology, automation, reporting metrics, criteria, regulatory recovery, and you know, how it all fits into the regulatory world"¹⁷ He adds that "[t]here's a lot of hurdles in that way and in reporting and monitoring the metrics in order to execute the strategies."¹⁸

In this way, wholesale suppliers have more expertise than National Grid in managing the administrative costs associated with managing a portfolio, and under the FRS Structure, SOS

¹⁶ Constellation-Daniels Direct at pp.7 (line 141) – 9 (line 178).

¹⁷ Hearing Transcript at p.55 (lines 2-12).

¹⁸ Hearing Transcript at p.57 (lines 16-18).

customers get the benefit of the economies of scale and existing administrative capacity that full requirements suppliers possess. In addition, the Analysis Group Study concludes that:

[i]n states with retail choice where the local distribution company focuses [on] ‘delivering’ power and no longer carries out generation functions, the utility no longer has comparative advantages in power markets.¹⁹

From the record established in the instant proceeding, it is clear that wholesale suppliers, rather than National Grid and its SOS customers, are in the best position and are best equipped to bear the risks and responsibilities of portfolio management.

(b) A Managed Portfolio Approach, on the other hand, would place significant market and portfolio management risks directly on National Grid’s SOS customers.

Unlike a FRS Structure, as explained above, Mr. Hahn’s proposed Managed Portfolio Approach first places significant price risk on consumers; Mr. Hahn’s proposal cannot provide fixed prices to SOS consumers due in part to the “open positions” that such an approach utilizes to deal with load variation (e.g., due to changes in weather and customer migration). The Commission should be wary of subjecting non-shopping SOS customers to the large amount of risk that spot markets will rise sharply due to major market or weather events, and that National Grid will nevertheless have to buy 10 percent (or more, if National Grid has not accurately predicted load variation) of its SOS load obligations in such a high market, passing the costs through to its customers.

Second, Mr. Hahn’s Managed Portfolio Approach places portfolio management risks squarely on the backs of SOS consumers, rather than relying on wholesale suppliers to provide portfolio management services at a fixed price as part of their fixed price bids for serving a portion of National Grid’s SOS load. Day-to-day portfolio management decisions include, but

¹⁹ Analysis Group Study at p.11.

are not limited to, deciding what percentage of spot market purchases to include in a portfolio, predicting and accounting for changes in weather and customer usage patterns, deciding when and what energy, capacity and energy-related products and hedges to purchase, deciding on the terms and timing for all of such purchases, etc. The risks of placing such portfolio management decisions directly on consumers (rather than on wholesale suppliers) is made evident even through one of the examples which Mr. Hahn cites to – the Wellsboro Electric Company (“Wellsboro”) in Pennsylvania. Wellsboro is a relatively small Pennsylvania utility procuring its equivalent of SOS requirements through a Managed Portfolio Approach. As Constellation’s witnesses point out, Wellsboro:

faced a market “surprise” that forced it in 2008 to seek permission from the Pennsylvania Public Utility Commission (“Pennsylvania PUC”) to recover in excess of \$2-million in additional congestion costs from its customers because of an unexpected congestion event. Wellsboro’s customers did not have “insurance” provided by a FRS Structure for such an event and, as a result, had to bear the burden themselves for the surprise rise in costs, as the Pennsylvania PUC approved the pass through of such costs.²⁰

Whether or not this particular type of “surprise” could happen in Rhode Island due to differences in market structure does little to controvert the value that the example may provide: a utility using a Managed Portfolio Approach faced an event that it did not prepare for, and its customers had to directly bear the burden for the surprise rise in costs. Under the type of FRS Structure proposed by National Grid in this proceeding, and supported by Constellation, a wholesale supplier would be *required* to meet its SOS supply obligations at the *fixed price* that it contracted for, even in the event that the wholesale supplier made a misstep or misjudgment – the wholesale supplier will bear the burden of such a mistake, rather than National Grid’s SOS customers. Moreover, as was pointed out by Constellation witness Allegretti on cross-examination, the use

²⁰ Constellation Joint Rebuttal at pp.26 (line 23) – 27 (line 5).

of medium-term (3 years or less) FRS contracts can further eliminate the pass-through adjustments for regulatory events and changes in fuel prices which have historically been contained in Rhode Island SOS contracts.²¹

Mr. Hahn attempts to support a Managed Portfolio Approach by holding up testimony by a Wellsboro witness in Pennsylvania that purportedly compares the costs of Default Service for Wellsboro with other larger utilities in that state and elsewhere. Though parties in this proceeding did not have the opportunity to cross Mr. Hahn on the findings of the Wellsboro witness (the testimony referenced by Mr. Hahn was not provided to parties until after the hearings in the instant proceeding), it is apparent that the comparison is flawed. Mr. Hahn agrees that at the very least, “such comparisons are difficult” and “[t]hey’re not perfect.”²² In particular, the testimony – and any such comparison – is flawed because under any attempt to compare Wellsboro to another similarly situated utility that employs a FRS Structure, the evaluator cannot account for events that *do not occur* over the comparison’s timeframe. Full requirements products are inherently unique in nature, especially due to the “insurance” provided by a supplier through a FRS Structure. As Constellation’s witnesses explain, the fact that wholesale prices *did not* actually spike or drop in a particular year – for any reason – does not mean that it was not valuable to have protection in place against that risk – for all reasons.²³ “If we don’t get sick in a year, we don’t look back and say ‘we shouldn’t have bought health insurance last year; that was a bad decision.’”²⁴

²¹ Hearing Transcript at pp.112-113 (lines 20-24, 1-5).

²² Hearing Transcript at pp.225 (line 24) – 226 (line 6).

²³ Constellation Joint Rebuttal at p.27 (lines 10-12).

²⁴ Constellation Joint Rebuttal at p.27 (lines 12-13).

b. The FRS Structure Will Be More Effective than the Managed Portfolio Approach at Balancing and Achieving the Goals of (1) Providing Rate Stability and (2) Providing Customers with the Lowest Costs.

The Commission and its Legal Counsel through cross-examination of Mr. Hahn at the Commission's Hearings raised astute questions regarding the goals of a Managed Portfolio Approach and how the achievement of such goals may be measured. As the Commission's Legal Counsel, Ms. Wilson-Frias pointed out, Mr. Hahn stated that reasonable "goals" of a Managed Portfolio Approach would be to (1) provide stability and (2) achieve the lowest cost possible.²⁵ By answering the same questions asked of Mr. Hahn by the Commission, it is apparent that a FRS Structure will be more effective than a Managed Portfolio Approach in balancing and achieving both of these goals.

(1) The FRS Structure is more effective than a Managed Portfolio Approach at providing rate stability for SOS customers.

Ms. Wilson-Frias asks Mr. Hahn several times and in several ways, "So how would you measure whether or not your [Managed Portfolio Approach] plan achieved . . . stability?"²⁶ In his written testimony, Mr. Hahn states that his Managed Portfolio Approach will "smooth out fluctuations and result in more stable prices over time" due to "the use of layering and laddering of shorter term purchases."²⁷ As Constellation explains, however, "*both* the current FRS Structure *as well as* Mr. Hahn's proposed Managed Portfolio Approach utilize a staggered schedule with a variety of supply terms."²⁸

²⁵ Hearing Transcript at p.229 (lines 11-12).

²⁶ Hearing Transcript at p.230 (lines 19-20).

²⁷ RIPUC-Hahn Direct at p.27 (lines 14-15).

²⁸ Constellation Joint Rebuttal at p.12 (lines 19-20).

Upon cross examination, Mr. Hahn additionally points out that the Commission “can look at the prices” that result from a Managed Portfolio Approach as a metric.²⁹ With respect to this second metric, however, it cannot be disputed that the prices resulting from a FRS Structure, inevitably will compare favorably to a Managed Portfolio Approach, due to the Managed Portfolio’s use of significant spot market purchases and the risks of price adjustments due to misjudgments and market surprises as detailed above. The inherent nature of the FRS Structure – relying only on fixed price contracts with suppliers for all of National Grid’s SOS obligations – allows for greater certainty in providing rate stability at the outset. In this way, the Managed Portfolio Approach will result in greater, rather than less, rate stability for SOS customers.

(2) The FRS Structure is more effective than a Managed Portfolio Approach at providing lowest costs for SOS customers.

With respect to Mr. Hahn’s stated goal of achieving the lowest costs for SOS customers, Ms. Wilson-Frias asks Mr. Hahn, “[W]ould it be possible at various points in time to say okay, we have achieved the lowest cost possible . . . ?” Mr. Hahn explains that it would be difficult, at the very least.

Well, if you did my plan, you wouldn't have anything then to compare it to which is have you done -- in other words, you won't know whether -- if you had done the company's proposal . . . you don't know what the world would have been, so it's hard to do my plan and then compare it to some other plan that you didn't do.

* * *

Well, I think if you select any plan, not just mine, if you select any plan as your preferred approach, you don't have a benchmark because you're only doing one procurement method, so I don't know how you can tell after the fact.

* * *

²⁹ See, e.g., Hearing Transcript at p.231 (line 10).

The prices for SOS service that result from a particular plan and you can look at those and offer some conclusion that you believe that's a reasonable result. Without a benchmark comparison, I don't know that you'd have anything to compare it to.³⁰

Said another way, under a Managed Portfolio Approach, there is no way of looking back and, in hindsight, being able to determine whether the costs of procuring SOS – including the costs of managing the portfolio – were the lowest costs for supplying such services.

On the other hand, under a FRS Structure, there *is* in fact a clear benchmark to compare the costs of SOS supply – including the costs of suppliers' management of portfolios of products to meet such obligations – all of the bids submitted in a particular procurement under that FRS Structure. As the Commission succinctly states, under a FRS Structure:

it's pretty easy, they went out to bid, they got eight bidders, they picked the lowest cost bid and they -- that's what rates are based on . . . it's a pretty easy analysis.³¹

In this way, the Commission, National Grid and its SOS customers can be assured that they obtained the lowest costs for the stable, low risk full requirements product – a product that includes all of the generation supply costs of SOS – by taking the lowest bids for the all-in product.

In his written testimony and elsewhere in his cross-examination, Mr. Hahn refers to “risk premiums” that are included in suppliers' bids under a FRS Structure, and that “[b]uying block products [under a Managed Portfolio Approach] instead of Full Requirements Service contracts can help reduce the risk premiums contained in the price of those products,”³² purportedly making his Managed Portfolio Approach a less costly alternative to the FRS Structure.

³⁰ Hearing Transcript at pp.230 (line 11) – 231 (line 16).

³¹ Hearing Transcript at pp.232 (line 23) – 233 (line 7).

³² RIPUC-Hahn Direct at p.27 (lines 15-17).

It is important at the outset to define the term, “risk premium.” As Constellation’s witnesses explain, what Mr. Hahn refers to as a ‘premium’ is better described as a ‘monetization’ of risk. Constellation’s witnesses add clarity with respect to such monetization for load variation, explaining that:

[w]holesale suppliers bidding on a full requirements contract may place a certain value on the risk that they assume, for instance, for customer migration. The calculation for this monetization will depend on an individual wholesale supplier’s perception of the level of such risk, its ability to manage the risk and its appetite for assuming the risk.³³

No party to this proceeding disputes that volumetric risk, including customer migration risk, is *not* eliminated under the Managed Portfolio Approach, but rather shifted to SOS customers. Moreover, no party has provided clarity as to why it would be better for these risks to be borne by National Grid’s customers, rather than being efficiently priced and diversified through large competitive markets. “In other words, it is a zero sum game,” according to Mr. Allegretti and Mr. Daniels.³⁴

Customers bear the “cost” of migration either in a monetized price or in the form of an assumed risk. This type of shifting of risks directly to [SOS] consumers fundamentally alters the nature of the SOS product being provided by National Grid.³⁵

Nevertheless, despite these allocations and monetizations of risk under the FRS Structure, important reasons exist to support the notion that SOS customers will be better off and achieve the lowest costs for a stable product under a FRS Structure.

³³ Constellation Joint Rebuttal at p.14 (lines 3-8).

³⁴ Constellation Joint Rebuttal at p.14 (line 10).

³⁵ Constellation Joint Rebuttal at p.14 (lines 10-13).

(a) The FRS Structure will result in competitive prices for consumers through its competitive process.

Mr. Daniels explains in his testimony that bids for full requirements supply for National Grid's customers will be "highly constrained by the very competitive nature of this business, because sophisticated wholesale suppliers . . . [will] compete through the RFPs to serve National Grid's SOS load at the lowest cost."³⁶ As evidence for the strength of competition in full requirements procurements, Mr. Allegretti and Mr. Daniels point to examples from recent experiences in Ohio, New Jersey, Maryland and Connecticut. In Ohio, for instance:

the FirstEnergy-Ohio utilities held a procurement for FRS products earlier this year that attracted 12 bidders and resulted in nine (9) different winning bidders. The PUC-Ohio's Chairman Alan R. Schriber remarked:

We are more than pleased that ratepayers in northern Ohio, many of whom have been victimized by the economy, will benefit from the outcome of this energy auction . . . We're proud of the way the auction was conducted and commend the participants, the auction manager and our consultant for making this such a success.³⁷

In addition, Mr. Allegretti and Mr. Daniels point out that:

New Jersey's competitive procurement for FRS products in February of this year resulted in 11 different *winning* bidders. Maryland's FRS Structure elicited participation from 22 qualified bidders in its April 2009 procurement process for procuring SOS load. That April 2009 RFP resulted in ten (10) different winning bidders.³⁸

³⁶ Constellation Direct at p.9 (lines 174-178).

³⁷ Constellation Joint Rebuttal at p.41 (lines 13-20) (quoting from *New Release: PUCO Accepts FirstEnergy Auction Results*, Public Utilities Commission of Ohio ("PUC-Ohio") Case No. 08-935-EL-SSO (issued May 14, 2009)).

³⁸ Constellation-Allegretti Rebuttal Testimony at p.42 (lines 1-4) (citing the *Decision and Order*, State of New Jersey Board of Public Utilities ("NJ BPU") Docket No. ER08050310 (issued Feb. 6, 2009); *Annual Final Report on the 2009 BGS FP and CIEP Auctions*, Boston Pacific Company, Inc., NJ BPU Docket No. ER08050310 (filed Apr. 22, 2009); and *Direct Testimony of Richard A. Mazzini, The Liberty Consulting Group, on Behalf of the Staff of the Public Service Commission of Maryland*, Maryland Public Service Commission Case No. 9056 (filed Apr. 23, 2009)).

Thus, as concluded in the Analysis Group Study, a utility such as National Grid “can make good use of competitive markets to find lowest-cost supplies of ‘full requirement’ power to meet the needs of [SOS] customers,”³⁹ and standard block procurements possess no inherent advantage over full requirements procurements with respect to competition.

(b) The administrative costs for procuring SOS under the Managed Portfolio Approach are unknown, not subject to competitive pressures and present significant risks to consumers.

First, the costs of administering a Managed Portfolio are unknown based on the evidence in the record. As discussed above, National Grid witness Smithling himself states on cross-examination that at this time there are “implementation hurdles” for a Managed Portfolio Approach, including hurdles related to “software and technology, automation, reporting metrics, criteria, regulatory recovery, and you know, how it all fits into the regulatory world”⁴⁰ He adds that “[t]here’s a lot of hurdles in that way and in reporting and monitoring the metrics in order to execute the strategies.”⁴¹ No party has presented any other evidence in this proceeding regarding the costs of administering a portfolio of supply under a Managed Portfolio Approach (and the level of diversification that could be achieved in a portfolio under a particular cost structure). On the other hand, as noted above, Constellation has explained in depth wholesale suppliers’ level of expertise in managing the administrative costs associated with managing a portfolio, and that under the full requirements approach, SOS customers get the benefit of economies of scale and existing administrative capacity that full requirements suppliers possess.

³⁹ Analysis Group Study at p.11.

⁴⁰ Hearing Transcript at p.55 (lines 2-12).

⁴¹ Hearing Transcript at p.57 (lines 16-18).

Second, a significant drawback under the Managed Portfolio Approach is the lack of competitive pressure that the utility – or its consultant – will be subject to in meeting its functions as a portfolio manager. As Constellation’s witnesses explain:

a utility such as National Grid under a Managed Portfolio Approach has little economic incentive or duty to minimize costs, as it operates under an incentive to minimize regulatory risks . . . Said another way, under a Managed Portfolio Approach, the utility has no economic incentive to produce an optimal least-cost portfolio through innovation and efficiencies.⁴²

On the other hand, in order to supply SOS – including all portfolio management functions – “wholesale SOS suppliers possess a need, a duty *and* an incentive to provide such SOS load at the lowest possible costs.”⁴³ In addition, it is important to point out that, coupled with the procurement of any long term contracts within a portfolio of supply, the Managed Portfolio Approach:

creates an incentive for a utility to discourage customers from shopping or otherwise taking actions to reduce SOS load use (e.g., through demand response or energy efficiency programs) in order to prevent a “stranded cost.” This is one of the risks that Rhode Island sought to avoid by mandating generation asset divestiture in connection with retail choice implementation.⁴⁴

The only way to optimize a portfolio is to create the proper incentives that will encourage portfolio managers – whether they be the FRS suppliers under the FRS Structure or National Grid under a Managed Portfolio Approach – to serve load at the lowest cost.

Third, the administrative costs of procurement under the Managed Portfolio Approach present significant risks to consumers due to the potential for misjudgment or other mistakes on the part of the portfolio manager. These missteps can drive up costs to SOS consumers. As

⁴² Constellation Joint Rebuttal at p.21 (lines 3-8).

⁴³ Constellation Joint Rebuttal at p.20 (lines 8-9).

⁴⁴ Constellation Joint Rebuttal at p.17 (lines 13-17).

explained earlier, if a utility using a Managed Portfolio Approach faces an event that it did not prepare for, its SOS customers will directly bear the burden for the surprise rise in costs. On the other hand, under a FRS Structure, a wholesale supplier would be *required* to meet its SOS supply obligations at the *fixed price* that it contracted for, even in the event that the wholesale supplier made a misstep in portfolio management – the wholesale supplier will bear the burden of such a mistake, rather than National Grid’s SOS customers.

(c) The FRS Structure will be better than the Managed Portfolio Approach at mitigating perceived monetizations of risk which bidders include in bids under both procurement structures.

As Constellation explains,

In fact, block products include all of the same risks – and, in turn, monetization of risks – as full requirements products for items including, but not limited to, rising fuel costs, inflation, new energy taxes, market rule changes, market price changes prior to bid acceptance, and changes in credit standing.⁴⁵

It follows that the only risk that may not be priced into the costs for standard block products, is that of load variation, including variation due to customer migration. However, as explained above, if the fixed costs for the added benefits of full requirements products – *including* for load variation – are highly constrained through the competitive nature of full requirements procurements, then it would be difficult to imagine that the Managed Portfolio Approach could result in more competitive prices – for all services – than those achieved under a FRS Structure.

2. THE COMMISSION SHOULD NOT ORDER THAT FIVE (5) PERCENT OF NATIONAL GRID’S REMAINING 2010 SOS SUPPLY BE MET THROUGH SPOT MARKET PURCHASES.

In response to the Commission’s Sept. 2 Meeting Request, Constellation submits that the Commission *should not* require National Grid to procure the remaining five (5) percent obligation for the period January 1, 2010 through September 30, 2010 from the spot market

⁴⁵ Constellation Joint Rebuttal at p.15 (lines 19-22).

rather than through FRS contracts, because: (a) no active party to this proceeding took issue with the approved FRS Structure for National Grid's 2010 SOS obligations, 95 percent of which has been procured; and (b) meeting the final five (5) percent of 2010 SOS supply obligations through spot market purchases is likely to be detrimental, rather than beneficial, to consumers' interests.

a. **No Active Party to this Proceeding Took Issue with the Approved FRS Structure for National Grid's 2010 SOS obligations.**

It is clear from the record of the instant proceeding that no party to this proceeding took issue with National Grid's FRS Structure as approved for the period of January 1, 2010 through September 30, 2010. National Grid summarized the positions of the parties well at the hearings in this proceeding, stating that:

National Grid's proposed plan to acquire the remaining power for SOS requirements for the small customer class is not controversial, and to my understanding, is not opposed by anybody who's participating in this docket. Obviously, it's subject to the Commission's review and comment, but at least the parties appearing seem to be in agreement that that plan is appropriate and reasonable.

* * *

So I think it's fair to say that to a large extent, if not completely, at least the parties appearing in the docket are in a fairly -- pretty much in the same place with regard to what should happen in 2010 both with respect to the SOS supply requirement plan, procurement plan and with respect to the RES procurement plan.

* * *

In our view, to sort of summarize, we are really just at the starting line. We think we have in place an appropriate plan to procure power for 2010. We don't think that's controversial.⁴⁶

Constellation cautions that a Commission decision to implement a policy that was not considered by parties in testimony, was not considered by bidders in National Grid's previous procurements

⁴⁶ Hearing Transcript at pp.9 (line 13) – 16 (line 8).

for 2010 SOS supply, and which goes against all active parties' agreement on the appropriate procurement structure for 2010 SOS supply may create undue and unnecessary regulatory uncertainty.

b. Meeting the Final Five (5) Percent of 2010 SOS Supply Obligations Through Spot Market Purchases Is Likely to Be Detrimental, Rather than Beneficial, to Consumers' Interests.

Changing course and adopting a decision to meet the final five (5) percent of National Grid's 2010 SOS load through spot market purchases rather than through the FRS Structure is likely to have a detrimental, rather than beneficial, effect on consumers interests. First, regulatory uncertainty resulting from such an unexpected change in policy, as described above, can have a detrimental impact on supplier interest in future procurements for 2011 and beyond, whether under a FRS Structure *or* under a Managed Portfolio Approach. Reduced interest in procurements may result in reduced competition, which may have a detrimental effect on consumers' interests. As the NARUC Procurement Study included as Exhibit 2.3 to the Constellation Joint Rebuttal points out:

Providing and clearly demonstrating regulatory support for the approaches being used in the utility's solicitations will help inspire a competitive response . . . These signals will reduce market and regulatory uncertainty faced by both utilities and third-party suppliers and will contribute positively to more competitive and less costly incremental supplies for ratepayers.⁴⁷

Second, as discussed earlier, altering the nature of the SOS product by including excessive volatility through spot market purchases is not consistent with the fundamentals of retail competition. As Constellation witnesses Allegretti and Daniels point out:

[a]s a back-stop service, SOS should be fashioned as a plain-vanilla, low-risk product. In the spirit of retail competition, rather than forcing

⁴⁷ Constellation Joint Rebuttal at Exhibit 2.3, *Competitive Procurement of Retail Electricity Supply: Recent Trends in State Policies and Utility Practices*, the Analysis Group, Dr. Susan F. Tierney and Dr. Todd Schatzki, Commissioned by NARUC (issued July 2008) ("NARUC Procurement Study") at Executive Summary, p.v.

customers to assume certain risks . . . the Commission should allow customers to choose to assume or manage risks for themselves. Those customers that place a low value on price stability, for instance, can leave the low-risk, stable-priced SOS provided under full requirements contracts, and instead choose a more volatile supply option from a competitive retail suppliers.⁴⁸

Third, it is especially unwise to place too much risk of spot market fluctuations on smaller customers, who tend to favor fixed, stable prices. If a major market or weather event was to occur which caused spot prices to rise sharply, even though only five (5) percent of the portfolio would be exposed, customers would experience its volatile effects. As noted earlier, a key advantage of reliance on staggered fixed-price FRS products is the price stability that it affords, especially to smaller customers. Moreover, differences in costs between full requirements bids and potential spot market purchases, *if any*, will be attributable to the significant difference in product offerings – as a full requirements product provides a fixed-price “insurance” on market changes.

Finally, there is no reason to believe that inclusion of spot market purchases at this juncture would result in lower SOS supply costs. As Constellation notes in its testimony, “The movement of future market prices is inherently uncertain, and there is no reason to believe that a utility can outperform a procurement process that relies on a predetermined, periodic schedule for purchases.”⁴⁹ Regulators *similarly* have no inherent advantage, relative to competitive wholesale FRS suppliers, that would allow them to do a better job of determining the optimal mix of spot supply in a portfolio of products. In fact, it is reasonable to expect that wholesale suppliers – who make that judgment routinely as part of the process of determining their competitive bids – would be more skilled at such judgments.

⁴⁸ Constellation Joint Rebuttal at p.15 (lines 5-11).

⁴⁹ Constellation Joint Rebuttal at p.35 (lines 18-20).

3. THE COMMISSION SHOULD REFRAIN FROM CONSIDERING ANY APPROACH TO PROCURE 50 PERCENT OF SOS OBLIGATIONS THROUGH THE FRS STRUCTURE AND 50 PERCENT THROUGH A MANAGED PORTFOLIO APPROACH.

Faced with the complicated and difficult question of how best to meet consumers' needs in ever-evolving restructured energy markets, it is understandable that the Commission may seek to have the most concrete analysis possible to make its determinations on the appropriate structures through which to procure consumers' SOS requirements. However, the Commission must be careful not to let the pursuit of short term data cloud its judgment with respect to long term policy goals for consumers. Evidence in this proceeding supports that, as retail electric markets continue to develop, the FRS Structure is best equipped to efficiently and effectively provide to non-shopping SOS customers the benefits of competitive wholesale markets, while providing reasonable and stable rates – an appropriate long term policy goal for SOS. If the Commission seeks appropriate data on the effectiveness of this approach, it need only look to the FRS Structure's successful track record in other jurisdictions and the success that the approach is sure to have in Rhode Island for 2010 and beyond – a track record of providing stable, *fixed price*, competitively procured, reliable, *all-requirements* energy service, with no surprises. With this in mind, Constellation strongly urges the Commission to refrain from considering any form of the 50-50 FRS-MPA Structure, whether for 2011 or for any other timeframe, as such a structure: (a) will not provide the Commission with a useful comparison between the FRS Structure and the Managed Portfolio Approach; and (b) is likely to be significantly detrimental, rather than beneficial, to consumers' interests.

a. **The 50-50 FRS-MPA Structure Will Not Provide the Commission with a Useful Comparison Between the FRS Structure and the Managed Portfolio Approach.**

The 50-50 FRS-MPA Structure will not provide the Commission with a useful comparison because it will not adequately account for the significant and important “insurance” benefits of the FRS Structure, and will provide a comparison of only a snapshot in duration.

As explained in great detail earlier, the FRS Structure provides significant benefits over a Managed Portfolio Approach, significantly because of the “insurance” benefits that it provides to consumers who may have difficulty dealing with the ups- and downs- of the market and of missteps in managing load. As stated previously, any such comparison is flawed because under any attempt to compare a Managed Portfolio Approach to a FRS Structure, the evaluator cannot account for events that *do not occur* over the comparison’s timeframe, *or that may occur in the future*. Full requirements products are inherently unique in nature, especially due to this “insurance.” As Constellation’s witnesses explain, the fact that wholesale prices *did not* actually spike or drop in a particular year – for any reason – does not mean that it was not valuable to have protection in place against that risk – for all reasons.⁵⁰ Whereas, for example, a FRS product may have a highly constrained and monetized cost for the low risk it provides, it may look cheaper in comparison to a Managed Portfolio Approach in a particular three-year timeframe where spot prices rose significantly and unexpectedly due to a natural gas or other fuel crisis or unexpectedly active hurricane seasons, but may look more expensive in a different three-year timeframe where there were no unpredicted congestion hiccups and limited unpredicted increases in commodity costs.

⁵⁰ Constellation Joint Rebuttal at p.27 (lines 10-12).

Once again, it is helpful to think in terms of the current hot-topic of healthcare – “[i]f we don’t get sick in a year, we don’t look back and say ‘we shouldn’t have bought health insurance last year; that was a bad decision.’”⁵¹ Suffice to say, we also should not look forward and decide that we will not purchase health insurance for next year, because we did not come down with an unpredictable ailment last year. As another frame of reference, a comparison of the two approaches – even if for the same marketplace over the same period of time – is like comparing a “growth” mutual fund with a “fixed income” mutual fund; even in the same marketplace, depending on which market cycle the evaluation occurs, different conclusions may be reached with respect to their relative success.

b. The 50-50 FRS-MPA Structure Is Likely to Be Significantly Detrimental, Rather than Beneficial, to Consumers’ Interests.

The 50-50 FRS-MPA Structure is likely to be significantly detrimental, rather than beneficial, to consumers’ interests, as it will maintain all of the negative characteristics of a Managed Portfolio Approach highlighted herein and negatively affect certain competitive market benefits that otherwise would be encouraged through the FRS Structure.

First, evidence in the record clearly points to important drawbacks to a Managed Portfolio Approach, including exposing consumers directly to greater market price risks, the risks of missteps in assembling and managing a portfolio of supply, greater volatility and higher costs for managing a portfolio. Is it a benefit that the 50-50 FRS-MPA Structure will limit all of these drawbacks such that they result in only 50 percent of the detriment that they otherwise may have caused?

In addition, it is important to note that the 50-50 FRS-MPA Structure will undermine an important benefit of the FRS Structure – the FRS Structure’s ability to provide a fixed, all-in

⁵¹ Constellation Joint Rebuttal at p.27 (lines 12-13).

price for SOS supply. Under the 50-50 FRS-MPA Structure, consumers will no longer have this transparent, all-in price to consider when making supply decisions, and suppliers will no longer have as clear a benchmark against which they may compete – a significant hurdle to being able to provide tailored competitive retail energy options to consumers.

Finally, under a 50-50 FRS-MPA Structure, the Commission risks undermining competition in the competitive procurements for *both* the FRS portion of SOS supply *and* the Managed Portfolio portion of SOS supply. As even Mr. Hahn points out in cross-examination, “it’s like any other business, the more volume you buy, the more market presence you command.”⁵² By decreasing the volume available in each structure’s procurements, the Commission risks decreasing interest in such procurements. Moreover, as market participants may look at the timeframe covered by a 50-50 FRS-MPA Structure as a “transitional” time-period in which the Commission is evaluating how to progress in developing electric markets, the marketplace may be weary of the regulatory uncertainty that such a hybrid structure may cause. As explained earlier, regulatory uncertainty can have a detrimental impact on supplier interest in procurements, this reduced interest may result in reduced competition, and this will have a detrimental effect on consumers’ interests – a concern that the NARUC Procurement Study echoes.

III. CONCLUSION

The benefits of the FRS Structure and the shortcomings of the Managed Portfolio Approach are evident based on the record in this proceeding. The Commission’s choice between reliance on the FRS Structure or implementation of the Managed Portfolio Approach presents one policy decision regarding who is best equipped to bear the risks and responsibilities of

⁵² Hearing Transcript at p.225 (lines 15-17).

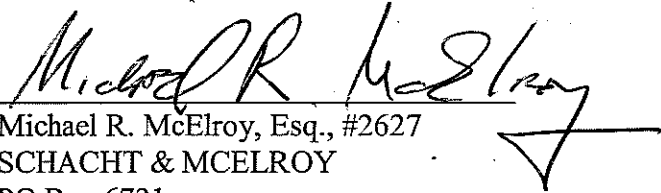
portfolio management. As the only risk that may not be priced into the costs for standard block products is that of load variation, including variation due to customer migration, herein lies a more narrow policy decision for the Commission – whether the “risk-takers” should be National Grid’s residential customers, or whether the “risk takers” should be wholesale suppliers – the entities most capable of understanding and managing volumetric risk and who must compete to do so at the lowest cost.

Along with this policy decision, however, the Commission must carefully weigh the risks inherent in the Managed Portfolio Approach, including, significantly, the detrimental effect of the Managed Portfolio Approach may have. The Managed Portfolio Approach may harm the very customers – *i.e.*, National Grid’s residential customers – for whom a well balanced (stable, reliable and competitive) SOS supply may be most crucial.

The Commission also must be careful to resist making an unexpected shift in policy in considering whether to require the use of spot market purchases for National Grid’s remaining 2010 SOS supply obligations. Such a change in policy at this time is likely to have detrimental, rather than beneficial, effects on consumers.

Finally, the Commission must refrain from pursuing short term data at the expense of long term policy goals through a 50-50 FRS-MPA Structure, as such a structure will not provide useful and accurate analytical data, and as such a policy is likely to cause harm to consumers’ short- and long-term interests.

Respectfully Submitted,



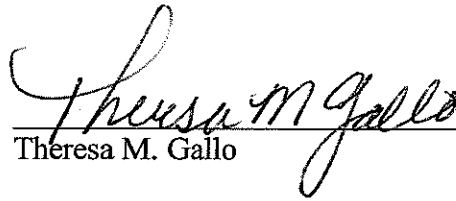
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*On Behalf of Constellation Intervenors: Constellation
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NewEnergy, Inc.*

September 22, 2009

CERTIFICATE OF SERVICE

I hereby certify that on the 22nd day of September, 2009, I sent a true copy of the foregoing to the attached service list.


Theresa M. Gallo

**Docket No. 4041 National Grid – SOS and RES Procurement Plans
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