STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE:	**THE NARRAGANSETT ELECTRIC COMPANY STANDARD OFFER SERVICE PROCUREMENT PLAN**	**) DKT. 4041**

POST-HEARING BRIEF OF THE DIVISION OF PUBLIC UTILITIES AND CARRIERS

I. INTRODUCTION AND AGREED TO ISSUES

The Division of Public Utilities and Carriers ("Division") has recommended that the Commission order The Narragansett Electric Company, d/b/a National Grid ("National Grid" or the "Company"), in the "next procurement filing to be filed by March 1, 2010," to:

(i) Modify its proposed definition of procurement groups for Standard Offer Service ("SOS"):

- Residential – A16 / A60
- Small Commercial – C06, S10/S14, G02
- Large Commercial / Industrial – G32 / B32 & G62 / B62

(ii) Modify its proposed delivery schedule to "better comport with the start of the capacity year;"

(iii) Undertake an alternative procurement approach for large commercial and industrial ("C & I") customers—100% spot market pricing; and

(iv) To implement a Managed Portfolio Approach for SOS procurement.

With respect to the first three of these recommendations, the entire Record supports the Division's positions. National Grid agreed to redefine its proposed procurement groups as recommended by the Division, acknowledging that "Mr. Hahn's recommended customer groups result in procurement groups that would be sufficiently large enough to elicit economic price bids from suppliers."[1] Smithling Rebuttal at 6.

Although the Company continued to believe that establishing a April 1st / October 1st delivery schedule would be "beneficial to the Small Customer Group," National Grid stated that it would observe market developments and "make an informed decision regarding SOS supply procurement for the delivery periods to which Mr. Hahn's recommendation pertains." Smithling Rebuttal at 8. Nowhere did the Company deny that adjusting the effective dates to comport with the capacity year would not help "reduce the risk premium included in [suppliers] bids." Hahn Direct at 25.

Lastly, National Grid also agreed to consider 100% spot market prices rather than full requirements service contracts with three month terms for the largest customers G32/B32, G62/B62). Smithling Rebuttal at 6-7. No evidence refuted Mr. Hahn's conclusion that 100% spot market prices for the Large C&I group will "eliminate the solicitation activities for one of the three SOS procurement groups" and "avoid the high risk premium associated with volumetric risk and rate impact of the loss of several very large customers on the remaining customers that stay on SOS supply." Hahn Direct at 23.[2]

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[1] National Grid indicated that it "*may propose*" adding the "Small Commercial to the Residential" class in its next filing. Smithling Rebuttal at 4. Even if the Commission were to consider National Grid's suggestion in this regard as a proposed modification to the Division's recommendation (which it is not), the entire weight of the evidence at hearing shows that the load shape of the Small Commercial class, C06, is far more similar to the load shape of the S10/S14 commercial class than to that of the residential class. See Exhibit RSH-7; 8/27/2009 Tr. at 204-07. Thus, C06 customers are far more likely to switch to competitive suppliers while residential customers are "least likely" to switch to such suppliers. Hahn Surrebuttal at 18; 8/27/2009 Tr. at 203.

[2] TEC-RI's Public Comments are not part of the evidentiary record, nonetheless even TEC-RI "strongly suggests that spot market pricing be introduced gradually" until after March [1], 2011 (emphasis in original), and that under the right conditions "such pricing could . . . bring potential benefits by providing signals which in turn will spur certain customers to make economically optional choices including price response and contracting with competitive suppliers." TEC-RI Public Comments at 6-7.

The entirety of the evidence on the Record supports the conclusions of the Division relating to the proposed composition of procurement groups, proposed delivery schedule, and the Division's recommendation to transition the large C&I customer group to 100% spot market pricing. The Commission, therefore, should order the Company to incorporate the Division's conclusions and recommendations relating to these three issues in its next procurement plan to be filed by March 1, 2010. See New England Tel. & Tel. Co. v. Public Utilities Comm'n, 446 A.2d 1376, 1380 (R.I. 1982) (Commission's findings of fact and rulings of law must be "fairly and substantially supported by the evidence"); Narragansett Electric Co. v. Public Utilities Comm'n, 773 A.2d 237, 240 (R.I. 2001) (matters within the administrative discretion of the agency must still conform to APA requirements of reasonableness).

II. THE MANAGED PORTFOLIO APPROACH

Much of the debate that occurred at the August 27, 2009 hearing centered upon the relative merits of the Managed Portfolio Approach, proposed by the Division, and a modified version of the Full Requirements Service ("FRS") structure, proposed by Constellation Energy Commodities Group, Inc. ("Constellation").[3] While both approaches allow laddering of products in order to promote price stability, 8/27/2009 Tr.

[3]Constellation currently supplies over 50% of Rhode Island's load, solely by means of FRS contracts 8/27/2009 Tr. at 110. Although Constellation will have "an opportunity to bid in on the wholesale side" even with the Managed Portfolio Approach, 8/27/2009 Tr. at 140, any transition to such an approach will reduce the profitability of Constellation's Rhode Island business as profit margins on FRS contracts are substantially greater than the margins on block products. 8/27/2009 Tr. at 130. Constellation's concession at hearing that it possesses a fiduciary duty to its shareholders to maximize profits and to ensure that its business remains "healthy," firmly establishes that the company possesses a vested interest in maintaining a SOS procurement structure that consists of FRS contracts, rather than less profitable block products. 8/27/2009 Tr. at 104, 132.

at 98, and both approaches are created through competitive solicitations, 8/27/2009 Tr. at 158, the uncontradicted evidence adduced at hearing shows that *only* the Managed Portfolio Approach:

- Mitigates the risk of reliance on a single procurement product;
- Reduces risk premiums associated with FRS contracts;
- Provides flexibility through open positions to deal with load fluctuations and customer migration; and
- Leads to lower, more stable power supply costs for ratepayers.

For these reasons, the Commission should reject the recommendations of Constellation, and require National Grid to adopt the Managed Portfolio Approach as discussed by Mr. Hahn in his Direct and Surrebuttal Testimonies in the Company's next procurement plan to be filed by March 1, 2010.

A. The Managed Portfolio Approach Mitigates The Risk Of Reliance On A Single Procurement Product.

As proposed, the FRS structure will consist of a ladder of FRS contracts with three-month or six-month terms (depending upon the procurement group) with a fixed but separate price for each month. See APS-1; Hahn Direct at 19. By contrast, as proposed by the Division, the Managed Portfolio Approach will consist of:

> a prudent mix of long-term contracts (either blocks of energy and capacity, or for unit entitlement purchases), purchase of blocks of capacity with shorter terms (such as one or two years), and come spot market purchases for a small portion of the portfolio, [as well as] other products . . . such as heat rate index contracts.

Hahn Direct at 25. The FRS structure, then, relies primarily on a single product—FRS contracts[4], while the Managed Portfolio Approach "diversif[ies] the contents of the portfolio among various available products." Hahn Direct at 27.

The Record reflects, and Constellation does not deny, that that the current SOS procurement structure consists entirely of a single *type* of product—long-term FRS contracts with fuel adjustment clauses. 8/27/2009 Tr. at 101. In 2003, 2006 and 2008, Rhode Island ratepayers absorbed millions of dollars in additional fuel, capacity and congestion costs arising under power purchase agreements. Regardless of Constellation's argument that shorter term contracts without fuel adjustment provisions might mitigate the *particular* risk (fuel cost increases) that confronts ratepayers under these contracts, 8/27/2009 Tr. at 112-13, the undeniable fact remains that under the proposed FRS structure, the risk and all of the costs associated with that risk, will remain concentrated in a single type of product. 8/27/2009 Tr. at 101.

Product diversification through the Managed Portfolio Approach, by contrast, will mitigate the risks associated with a single product by spreading those risks among a variety of diverse products. Thus, when unexpected costs are encountered with any single product, the impact of those costs on ratepayers will be felt less heavily under the Managed Portfolio Approach than under the FRS structure because the product at issue constitutes only a fraction of the entire portfolio.

[4] SOS procurement would consist of two products, at most, if National Grid continues to utilize financial swaps.

B. <u>The Managed Portfolio Approach Reduces Risk Premiums Associated With FRS Contracts.</u>

In his Direct Testimony, Mr. Hahn details how National Grid developed "risk premiums" for FRS contracts. <u>Hahn Direct</u> at 14-15, and observes that "buying block products instead of Full Requirement Service contracts can help reduce the risk premium contained in the price of those products." <u>Hahn Direct</u> at 27. Mr. Smithling concurred with Mr. Hahn's recommendation:

> Q. And would you agree that a prudent mix of products [under the Managed Portfolio Approach] might consist of block products?
>
> A. Correct
>
> Q. And those can help reduce risk premiums contained in full requirements service contracts? Would you agree with that?
>
> A. I agree.

<u>8/27/2009 Tr.</u> at 70.

Neither at hearing nor in the testimonies of Mr. Allegretti and Mr. Daniels did Constellation provide evidence to the contrary. In fact, in their Rebuttal Testimony, Mr. Allegretti and Mr. Daniels conceded that "load variation, including, but not limited to, variation due to customer migration" are not "priced into the cost of standard block products." <u>Constellation Rebuttal</u> at 16. Mr. Allegretti observed that "fixed costs for the added benefits of full requirement products are highly constrained through the competitive nature of those products." <u>Constellation Rebuttal</u> at 16. He then conceded that the procurement of standard block products occurs in an even more competitive environment:

> MR. ROBERTI: What is your knowledge relative to the volume of bidders that National Grid would see if – between an FRS approach or doing block purchases…
>
> MR. ALLEGRETTI: …[A]s I testified earlier, we [Constellation] see on the low side around five, six bidders and on the high side around 15 to 20. I think you would see *at least those numbers if you went out to bid for blocks*. (Emphasis added).

8/27/2009 Tr. at 158.

Since the Managed Portfolio Approach, "better facilitates more competition because it allows more bidders to participate," Hahn Direct at 34, the Record soundly supports the Managed Portfolio Approach's superior ability (as compared to FRS contracts) to constrain the monetization of risks through reduced risk premiums and a more competitive solicitation environment.

C. The Managed Portfolio Approach Provides Flexibility Through Open Positions To Deal With Load Fluctuations And Customer Migration.

In his Direct Testimony, Mr. Hahn observed that "an open position" which the managed portfolio "supplies by spot market purchases . . . can effectively deal with load fluctuations and any migration or switching that might occur." Hahn Direct at 27. Again, Mr. Smithling of National Grid concurred with Mr. Hahn's assessment of this benefit of the Managed Portfolio Approach:

> Q. And leaving an open position can effectively deal with load fluctuations and any migration of switching that might occur, is that correct
>
> A. Correct.

8/27/2009 Tr. at 70.

Constellation did not provide any reasoned argument counter to Mr. Hahn's conclusion that spot market purchases within a managed portfolio can deal with load fluctuations and customer migration. Rather, Constellation attempted to direct the argument in another direction, asserting that the "Managed Portfolio Approach . . . places all of the risks of switching on the backs of Residential and Small Commercial Customers through significant and inappropriate levels of spot market positions." Constellation Rebuttal 17. However, even this misdirected contention is without merit.

Nowhere did Constellation present any evidence showing that the proposed level of spot positions is "significant" or "inappropriate." Nor did Constellation remotely show how the proposed level of spot positions shifts "*all* of the risks of switching" to "Residential and Small Commercial Customers" when the level will be a small percentage of the entire portfolio. See Exhibit RSH-8. Without such evidence, the Commission should accord no weight to Constellation's misdirected effort to discredit this aspect of the Managed Portfolio Approach.

D. <u>The Managed Portfolio Approach Leads To Lower, More Stable Power Supply Costs For Ratepayers.</u>

In his Direct and Surrebuttal Testimonies and at hearing Mr. Hahn convincingly demonstrated how the Managed Portfolio Approach "will produce better results in terms of lower, more stable prices for those consumers least likely to switch to a competitive supplier." <u>Hahn Direct</u> at 35. At hearing, in response to questions as to which approach—the Managed Portfolio or FRS structure—would produce superior results for ratepayers, Mr. Hahn testified:

> A. Clearly, I prefer a managed portfolio approach; that's based on my experience and knowledge in the business. I have tried to provide as much evidence as I can find in terms of *comparison.* These *comparisons* are actually pretty good. They're the same utilities operating under the same conditions in the same markets (emphasis added). . .
>
> Q. Mr. Allegretti testified that the administrative costs that would be included in standard offer service for a managed portfolio approach would be higher than the profit margins that would be contained in a full requirements service structure. Do you have an opinion as to Mr. Allegretti's statement in that regard?
>
> A. I would respectfully disagree with that . . . I believe that in the long run they will save money for customers on standard offer service using a managed portfolio approach and that their administrative costs to do so will not be excessive or anywhere near the price of FRS. [<u>8/27/2009 Tr.</u> at 197-98] . . .
>
> Q. "...I believe during the course of this [hearing] two of our Commissioners have indicated that . . . the goals they would see for a managed portfolio would be the lowest cost possible and price stability . . . are those realistic and achievable goals in your managed portfolio?
>
> A. Absolutely.

<u>8/27/2009 Tr.</u> at 221.

The benchmark comparisons to which Mr. Hahn referred are referenced in his Direct Testimony, and detailed with greater particularity in his Surrebuttal Testimony. These comparisons irrefutably show:

- Managed portfolio rates (including congestion costs) for Citizens-Wellsboro, which utilizes a Managed Portfolio Approach, are lower than rates of the utilities that rely upon FRS contracts;

- Had congestion costs been excluded from the comparison, the managed portfolio rates [of Citizens-Wellsboro] would have been even more favorable; and

- A comparison of costs of Massachusetts municipal electric systems that used the Managed Portfolio Approach for the years 2003-2007 versus Massachusetts investor owned utilities, which rely upon FRS contracts, "demonstrates that the Managed Portfolio Approach produced superior results."

Hahn Surrebuttal at 5-8.

By contrast, nowhere in the testimonies that were filed on behalf of Constellation, is there an iota of evidence demonstrating that the FRS structure is equal to or superior to the Managed Portfolio Approach in terms of stability and price. All of the evidence points to the exact opposite conclusion. When Chairman Germani probed Constellation's witnesses as to how FRS contracts could be "less expensive" than "block products," in the face of "empirical evidence . . . that demonstrates otherwise," Mr. Allegretti could only weakly (and generically) opine: "you can find anecdotal evidence that shows both ways." 8/27/2009 Tr. at 169.

The Citizens-Wellsboro and Massachusetts municipal electric benchmark cost comparisons provides compelling, unrefuted evidence showing that the Managed Portfolio Approach leads to lower, more stable power supply costs for ratepayers. The Commission, therefore, should reject Constellation's arguments to the contrary. New

England Tel. & Tel. Co., 446 A.2d at 1380 (fact and rulings of law must be "fairly and substantially supported by the evidence").

E. National Grid's Future Procurements Should Facilitate the Transition to a Managed Portfolio.

In National Grid's accelerated procurement plan that was accepted by the Division and approved by the Commission, the Company has already procured SOS power supplies for 95% of the Small Customer Class through October 2010 and 50% from November 2010 through March 2011. These purchases have committed the Company to a particular procurement methodology and defer any of the changes recommended by the Division until April 2011 at the earliest. The Division accepts this outcome, but recommends that the Company engage in future purchasing activities only to the extent necessary to fill its remaining SOS obligations through March 2011. This will allow the Company to smoothly transition to the Managed Portfolio Approach and effectively make the other changes recommended herein as soon as possible.

III. CONCLUSION

For all of the above reasons, the Division respectfully requests the Commission to require National Grid, to file its next procurement plan (by March 1, 2010) so as to comport with the recommendations and conclusions of the Division in this matter, including, but not limited to: (i) modifying the the Company's proposed definition of procurement groups for Standard Offer Service, (ii) modifying the Company's proposed delivery schedule, (iii) implementing 100% spot market pricing for large C & I customers; and (iv) implementing a Managed Portfolio Approach substantially in conformity with Exhibit RHS-8.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on the 22nd day of September, 2009, the enclosed Post-Hearing Brief was forwarded by e-mail to the Service List in the above-entitled docket.