



State of Rhode Island
Division of Public
Utilities & Carriers

To: Luly Massaro, Commission Clerk

From: Division of Public Utilities & Carriers

Date: April 1, 2019

Re: Dockets 4872,4893, 4816 & 4755:

(1) Introduction and Purpose of this Memorandum

On October 30, 2018, the Commission voted in Docket 4872 to allow the Division to further investigate two components of the Narragansett Electric Company's ("National Grid" or "Company") Gas Cost Recovery ("GCR") application: first, the prudence of the Company's maintenance practices in connection with the decommissioning of the Cumberland LNG facility; and second, the prudence of over \$28 million in fixed supplier demand charges that are being recovered through the GCR, subject to refund. For each matter, the Commission established a deadline of April 1, 2019.

One purpose of this memorandum is to provide the Commission a timely response. However, the Division asserts that these two matters can only properly be considered when placed within the broad context of the Company's natural gas distribution business. And so, a second purpose of this memorandum is to provide an update on the Division's investigation of a range of related matters now before this Commission that stem from the Company's management of its gas distribution business.

Since the Commission's October 30th open meeting, Rhode Island's natural gas sector has experienced a series of unprecedented events. First, on January 16th the Company set aside two years of project development work and withdrew its application for a combined heat and power project that would have increased gas consumption on Aquidneck Island. Second, on January 21st the Company initiated a gas service interruption to over 7,100 customers in response to low pressure conditions on Aquidneck Island. Third, on February 6th the Company reported to the Newport News that, "in light of January's outage, we are in the midst of reviewing how this impacts potential new load commitments".

(2) The Context of the Evolving Gas Industry

Over the last decade the business of natural gas distribution in New England has become significantly more complex as pipeline capacity has replaced commodity supply as the most critical component of supply costs.

One cause of change has been increasing regional reliance on natural gas for home heating and electric generation. As winter gas demand has grown, the steps needed to assure the reliable supply and delivery to the gas distribution system have become more complex. Gas distribution companies now must engage in a series of overlapping contractual arrangements to assure that the supply they need to serve customers will reach the right receipt points on the system on the coldest days of the year. Across New England, gas distribution utilities have seen an increasing portion of their total supply costs stem from the cost of assuring the flow of gas during the coldest hours of the year rather than from the commodity itself.

Unlike electric supply contracting, the gas procurement industry lacks a regional organization to manage dispatch. Gas distribution relies on separate suppliers, delivery paths, and receipt points on physically distinct interstate systems. While the regional electric system has ISO New England to assure reliable supply of a ubiquitous commodity throughout the region, the responsibility for the delivery and receipt of a reliable supply of natural gas falls to state regulatory commissions.

As a result, regulation of the gas industry has also changed. In years past, regulatory review of the gas distribution business was straightforward and relatively noncontroversial. Other than general rate cases, the most significant issues that came before the Commission related largely to reviewing supply contracts to provide a stable natural gas supply price for gas distribution consumers. Today, reviewing procurement decisions requires state regulators to understand the entire contract portfolio and how it is managed on a monthly, daily and even hourly basis.

(3) Distinct, But Related, Pending Gas Matters

The complexity of the regulatory review process can be seen clearly in a series of matters that have come before the Commission and the Division over the past 15 months. As these issues have emerged, the Division has identified important dependencies among dockets and trends in how the Company is managing its gas distribution supply procurements and distribution system planning.

These matters are enumerated below:

- (a) The prudence of the Company's inspection and maintenance practices relating to the premature closure of the Company's LNG storage tank in Cumberland and the lack of foresight in addressing the conditions and contingency plans of the facility before it failed (Docket 4893);
- (b) The prudence of the Company's fixed supplier gas demand charge commitments, the costs of which were included in the GCR (Docket 4872);

- (c) The Company's proposal filed in May of 2018 to provide firm gas service to a proposed CHP project that would have added 300,000 MMBTu's of incremental winter gas demand to Aquidneck Island. (Docket 4755);
- (d) The Company's Long-Range Plan filing in March 2018, which the Division found to be inadequate (Docket 4816);
- (e) The unavoidable linkage between long-range gas planning and the GCR cost recovery docket that the Division identified in its September 24, 2018 memorandum to the Commission, from which the Commission sought a joint proposal that was filed with the Commission on February 20, 2019 to change the way gas procurement planning and regulatory review occurs (as identified in Dockets 4816 and 4872);
- (f) The gas service outage on Aquidneck Island occurring on January 21, 2019, the causes of which are now under investigation in the Division's Summary Investigation; and
- (g) The practical limits on gas growth in the Company's service area, including the future of new gas connections on Aquidneck Island, as manifest in the recent news article reporting that National Grid has declined firm service for some customers on Aquidneck Island.¹

All of these matters have two major aspects in common: [REDACTED]

[REDACTED]

It is with this backdrop that the Division presents this memorandum to the Commission.

(4) The Cumberland Prudency Issue

As the Commission is aware, the Cumberland LNG facility failed and was decommissioned in the 2016-17 time period. After it was taken out of service, the Division performed an investigation and issued a notice of probable violation (NOPV) on June 23, 2017, which included fines totaling \$160,000 pertaining to specific rule violations. On July 17, 2017 the Company paid the fines without disputing the Division's notice. Subsequently, the Company included certain costs associated with the decommissioning in the ISR filing for FY 2019. The Division and the Company negotiated settlement terms, through which the Company agreed to remove \$1.3 million in capital costs pertaining to the decommissioning from the FY 2019 ISR. In doing so, the Company made no admission of responsibility and reserved its right to dispute any Division claims in the future. Similarly, the Division reserved its right to review whether the Company acted prudently in its management of the facility to determine if there was a basis to seek disallowances of any incremental supply-related costs that arose as a result of the decommissioning of the LNG storage facility. In the GCR docket, the Commission allowed the Division time to conduct such a review.

¹ See <https://www.newportri.com/news/20190206/national-grid-halts-some-new-gas-connections-on-aquidneck-island>. This also has triggered further inquiry by the Division regarding the implications of the Company potentially halting new gas service connections on the island.

Following the Commission's decision on October 30, the Division engaged a consultant, Rod Walker of Rod Walker and Associates Consultancy, to perform a review. The initial review has been completed. It consisted of reviewing all the records accumulated through discovery and the Division's NOPV process, focusing on the inspection and maintenance practices of the Company. The consultant compared the regulations, industry standards, and best practices that apply to operations and maintenance, and resource planning of LNG storage facilities to the Company's practices from the time the Company acquired the LNG facility in 2006 to the time the tank failed.² After conducting that review, the Division's consultant concluded that there were significant and material deficiencies in the maintenance and inspection programs of the Company that contributed to the failure of the facility. Based on the consultant's conclusions, the Division believes there are grounds for finding the Company imprudent in the inspection, management, and maintenance of the facility.

While the Division believes there were deficiencies in the way in which the Company inspected and maintained the LNG tank, it does not end the inquiry. In fact, the more complicated part of the case relates to determining the incremental costs that may have been incurred by the Company and passed along to ratepayers as a result of the Company's operations.

The extent to which ratepayers have been harmed depends upon a finding of what costs would have been incurred had the Company acted prudently, compared to the costs actually incurred. The conclusion, of course, depends upon complex counterfactuals and the Company's contracting processes. Specifically, to the extent that the Company was performing inspections properly, would it have decided to close the facility sooner? Similarly, if the Company had been performing maintenance practices in a prudent fashion, would it have extended the life of the plant? If so, how long would the facility life been extended, given the fact that the condition of the facility when it was acquired was poor at the outset of ownership?

Once these issues are addressed, the next step will be to determine the incremental cost impact. Determining the level of cost, however, requires a review of the various purchasing decisions that were made by the Company to replace the lost LNG facilities. This is not a simple task, as the Company's purchasing decisions cut across the total management of its portfolio. It is here where the Cumberland prudence review overlaps with the other gas procurement and capacity management decisions that are implicated by the Company's long-range capacity procurement decisions and local capacity need analyses. It not only requires a review of the planning decisions actually made, but also an evaluation of how the extended operation or even earlier shutdown of the facility would likely have impacted the Company's gas procurement and capacity costs. This exercise cannot be done in isolation. It needs to take place in conjunction with evaluating the Company's supply procurement practices generally.

Given the cost issues that remain to be addressed, the Division cannot recommend any specific disallowance at this time. Instead, the Division will need to continue its review, which it will

² From the records review, it is apparent that the LNG tank had a problematic history and may not have been in good condition at the time it was acquired by National Grid from the prior owner, Southern Union Company, in 2006. The prudence question relates to National Grid's inspection and maintenance practices on the troubled facility after the acquisition.

need to conduct in conjunction with the other issues surrounding the Company's purchasing strategies and outcomes. As described in the final section of this memorandum, the Division is recommending a procedural conference be initiated to establish a hearing schedule in Docket 4839. The schedule would establish a date upon which the Division filed its complete case, supported by testimony. The Division is not in a position to be able to file a comprehensive case in the near term, given all the other complex and overlapping gas issues that are now under investigation.

(5) Fixed Supplier Demand Charges

In the GCR docket 4872, the Company included forecasted costs for over \$28 million in supplier demand costs. These costs related to several contracts entered into in order to assure that gas supply would be available at certain delivery points at a stipulated price. In other words, the Company paid a fixed charge in order to call on a specified amount of gas at a unit price [REDACTED]. However, the Company had no obligation to actually purchase the gas. The Division's consultant, Greg Lander of Skipping Stone, has reviewed these contracts and believes that four of the contracts were not well-structured or managed to result in the lowest costs to ratepayers. However, it is necessary to wait for the end of the winter to see what actually occurred under the contracts in order to recommend a specific rate adjustment. The issue is explained below.

The Company entered into several contracts with [REDACTED] for the winter of 2018-19.³ Of those contracts, the Division takes issue with two of the four of them and may have minor issues with another. In addition, the Company entered into a contract with [REDACTED] which the Division takes issue with for the same reasons:

“Two [REDACTED] Contracts: These contracts included total fixed costs of \$ [REDACTED] and [REDACTED], respectively. For contract quantities of [REDACTED] and [REDACTED] dekatherms, respectively. However, in the Company's GCR filing (NGC-EDA-2 pages 1-9), the Company was forecasting zero dekatherms would be purchased under normal weather conditions. Thus, the cost of the insurance policy to be able to call-on the gas was [REDACTED]. The Division estimates that if the Company had sold all of the quantities for which it had the right to purchase but was projected as going unused, it should have netted proceeds of [REDACTED]. This amount would be netted against the \$ [REDACTED] fixed cost.⁴

“[REDACTED]”: The Company also had a fixed cost contract for deliveries to Dracut, at a total fixed cost of \$ [REDACTED], for a contract quantity of [REDACTED] dekatherms. The Company's GCR filing was forecasting that only [REDACTED] dekatherms would be used during normal weather conditions. The Division estimates that if the Company had sold all of the quantities for which it

³ It is important to distinguish these [REDACTED] contracts from the one that was in place for the winter of 2017-18, for which the Commission allowed recovery in Docket 4872. These [REDACTED] contracts were for the winter of 2018-19 and included in the total of new fixed supply commitments.

⁴ There also was a contract for “[REDACTED]” supply. But the Company projected 93.5% usage. This contract also should be tracked, but the analysis only suggests a netting of [REDACTED].

had the right to purchase but was unused, it should have netted proceeds of [REDACTED]. This amount would be netted against the \$ [REDACTED] of fixed cost.

It will become important for the Company to provide very specific buying/purchasing information from these contracts. We do not know what the Company did, if anything, with those “on-call” quantities. Thus, any review of the financial outcome of these contracts needs to wait for the end of the winter period, when an accounting by contract should be provided. This also may implicate the terms of the Natural Gas Portfolio Management Plan (NGPMP) to determine the extent to which ratepayers earned any credit through that plan. But the Division is concerned that any use of the NGPMP in this instance might have an unjust result for ratepayers. An evaluation of the impact of these fixed contracts, however, needs to await the outcome of the winter and a final accounting.

While the Division’s consultant analyzed these contracts individually and estimated an adjustment, the Division believes this contracting approach should be subject to a much broader review of the procurement practices of the Company. The Division’s consultant believes that other purchasing strategies could have been employed to potentially lower the cost of the delivery insurance policy that these contracts represented. The alternative structures can be explored when the Division files its final review of the matter after reviewing the actual costs.

(6) The CHP Project Proposal on Aquidneck Island

While the Cumberland LNG tank and the supplier demand charges address the two issues for which the Commission expected a report by April 1, the Division believes it is important to identify another matter that implicates the forecasting and planning of the Company.

This matter highlights the Company’s lack of awareness of the reliability risks on Aquidneck Island before the events of January 21.

Specifically, months before the outage on Aquidneck Island occurred, the Division became concerned about the Company’s capacity planning for Aquidneck Island. In Docket 4755, the Company proposed to pay a \$7.2 million incentive to the Navy in order to help finance a 7.9 mega-watt combined heat and power (CHP) facility in Newport, which project would receive firm gas service. In the end, the Company withdrew its proposal. However, the Company’s responses to the questions asked in the case about gas planning remain quite relevant.

When the Company first proposed to serve the CHP project with firm service, the Division asked how this was possible and whether the additional costs associated with pipeline capacity that might be needed to serve such a large load were considered in the financial analysis. As it turned out, the Division’s question exposed the fact that the Company had made a significant planning error. (See Division 9-6 and 9-7) The Company had made a promise to the Navy for firm service that it could not keep. The engineering group responsible for assuring reliable firm gas service failed to analyze the issue.

After the Company discovered the “error” while attempting to respond to the Division, instead of withdrawing the filing and explaining to the Commission and the Division what had occurred,

the Company provided answers that appeared to attempt to conceal the error. (See the responses to Division 2-4 and Division 3-3) It took the Division numerous sets of data request to finally determine what had occurred.

During the discovery process, the Division also asked what type of impact the CHP project could have had on the gas distribution system on Aquidneck Island if it had been operating with firm service on the coldest day of a given year. It is worth reading the response in light of what happened on January 21. The Company's description reads like a prophetic description of the low-pressure condition that occurred on January 21. (See Division 9-2)

Also troubling was the Company's capacity need analysis. The Division asked a question on November 27, 2018, requesting the Company's forecast of when the Company could no longer serve new firm gas load on Aquidneck Island. The answer was not provided until four days after the January 21, 2019 outage event. The Company stated that based on its forecasts, the Company would not need new capacity until the winter of 2022-23. (See Division 10-25, original answer) This was closer in time than one might have expected, but it still left time for planning before any moratoriums would have to be implemented on the island.

Then, on March 1, 2019, the Company filed a surprising correction to Division 10-25. It acknowledged that it had made a calculation error in its forecast. With the correction, the need date moved up to the winter of 2018-19. However, the Company did not suggest that any moratorium of any kind was needed. Instead, the Company made a statement [REDACTED] [REDACTED] indicating that it had an "Operational Balancing Agreement" (OBA) with Algonquin that allowed the Company to balance all its gas supply across all its receipt points in Rhode Island. The implication of this response was that although a forecasting error had occurred, there was nothing to be concerned about because of the rights the Company apparently had in the way the OBA was managed between the Company and Algonquin.⁵

[REDACTED]
[REDACTED]
[REDACTED] In the meantime, the Division continues to support the Commission's decision to leave this docket open, as other related issues may emerge in the future.

(7) Long-Range Planning Docket

In March of 2018, the Company filed its "Long-Range Gas Plan," as is required by statute. When the plan was filed, the Division immediately recognized that the plan itself was not linking well to the actual procurement activities that the Company was undertaking. As a result, the lack of sufficient detail in the plan hampered the ability of the Division and the Commission to gain a comprehensive understanding of the Company's long-range plans. After several rounds of data

⁵ [REDACTED]

requests, the Division filed a letter with the Commission on September 24, 2018, identifying the need for a more complete review of the long-range plan that linked the plan to the GCR filing.

The Commission recognized the concerns raised by the Division and, as a part of its decision in the GCR Docket 4872, directed the Company to work with the Division to develop a joint proposal that would enhance the planning process. That joint proposal was filed on February 20, 2019. The Division believes the new proposed planning process is now more important than ever. Accordingly, the Division looks forward to the Commission reviewing the proposal and providing feedback or approval, as the Commission finds appropriate.

(8) Division Summary Investigation into the Service Interruption on Aquidneck Island and Future Gas Reliability on Aquidneck Island

The investigation into the service interruption on January 21st [REDACTED]
[REDACTED] The Division is advancing discovery that will address the specific events on Aquidneck Island. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

(9) Recommendations

Given the matters described above, the Division respectfully recommends the Commission take the following actions:

- (A) Schedule a procedural conference in Docket 4893 to establish a schedule for the filing by the Division of a complete case regarding the prudence of the Company's inspection & maintenance practices relating to the decommissioned Cumberland LNG tank, including an estimate of the financial consequences, if any, to ratepayers that needs to be addressed. In addition, the schedule should include the Company's opportunity for rebuttal testimony. The schedule needs to take into account the overlapping reviews that are taking place in the coming months as a direct result of events that have occurred in National Grid's gas business subsequent to the October 30th open meeting. Given the legislative request for a report to be filed in the Aquidneck Island investigation, and the fact that the Division is using the same experts in that endeavor, the Division will be requesting that the deadline for testimony be established on or after July 17, 2019;
- (B) Direct the Company to provide a granular monthly accounting of purchases, uses, and sales of natural gas that occurred under the supply contracts discussed above, which will permit the Division to complete its review of those contracts prior to the Company's next GCR filing; and

(C) Provide guidance to the Division and the Company regarding the joint memorandum filed on February 20, 2019 in Docket 4816, which recommends changes to the way the Company's long-range planning is reviewed, including without limitation formalizing the proposed approval process for future gas supply/transportation agreements (as defined in the joint memorandum).