

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: THE NARRAGANSETT ELECTRIC :
COMPANY d/b/a NATIONAL GRID REVIEW : DOCKET NO. 4929
OF POWER PURCHASE AGREEMENT :
PURSUANT TO R.I. GEN. LAWS § 39-31-1 TO 9 :

MEMORANDUM SUPPLEMENT



Jonathan Schrag, Deputy Administrator

April 12, 2019

Introduction

This Memorandum supplements the submission of the Division of Public Utilities and Carriers (Division) in this docket of April 5, 2019 to address the issue of remuneration for Narragansett Electric Company, d/b/a National Grid (National Grid or the Company), for a proposed twenty year Power Purchase Agreement (PPA) between National Grid and DWW Rev I, LLC, also known as the Revolution Wind offshore wind project developed by Ørsted U.S. Offshore Wind (Ørsted).

The proposed PPA was filed with the Commission on February 7, 2019 in accordance with the Affordable Clean Energy Security Act (ACES), [R.I. Gen. Laws § 39-31-1 et seq.](#) This memorandum accompanies direct pre-filed testimony offered by the Division's expert witness Matthew Kahal.

Mr. Kahal's testimony may be summarized here as advancing the following conclusions:

- The Company's request for compensation is not clearly connected to any additional cost that National Grid would incur;
- Any hypothetical costs related to an increased cost of capital or other costs related to the PPA would be recovered from ratepayers in normal ratemaking proceedings and any additional compensation through Renumeration would constitute double recovery;
- The Company's primary role is to serve as a passive administrator of funds and counterparty to the PPA;
- The PPA is a market price hedge provided by ratepayers to the project and does not increase any risk for the Company or its shareholders;
- Inclusion of a corporate profit element for a PPA is outside the mainstream for utility regulation;
- The requested remuneration of \$37 million (2018 NPV) is about 40 percent of the estimated \$91 million in customer net benefits of the proposed project;
- The valid basis for remuneration of some reasonable amount is that the Company is advancing state objectives in providing a beneficial transaction for ratepayers in support of important policy goals as defined by the ACES statute.

Based on the testimony of Mr. Kahal, the Division opposes both the rationale and the amount of the Company's request for remuneration. The Division does, however, recognize that there is a valid basis for a reasonable amount of remuneration. The Division now presents a series of considerations for the Commission's deliberation of what a reasonable amount of remuneration might be.

First, in the present proposal, the Company is fulfilling a unique, necessary and important role in

the development and execution of the PPA. However, the primary role of the Company – to administer funds and resell energy in the ISO energy market – is largely a *passive* role that derives from the exclusive right granted to the Company to aggregate funds from electric and gas ratepayers in Rhode Island. The role the Company plays in the PPA significantly contrasts with the role that it plays, for example, in the delivery of energy efficiency programs. In those programs, as this Commission is well-aware, the Company not only manages the regulatory review process but also designs the programs, recruits and trains contractors, markets programs to customers, and undertakes a range of related activities. The Division believes that the passive role in this instance merits remuneration of a significantly lesser degree than the remuneration which might otherwise be considered in the context of other performance incentive mechanisms that demand an active role of the Company.

Second, the Division believes that the remuneration amount should be in some relation to the direct benefits of the project, rather than purely the dollar size of the PPA. The proposed PPA might have been for a much larger or smaller aggregate amount without significantly changing either the level of effort on the part of the Company or the basis for remuneration. In fact, the Company should have an incentive aligned with ratepayers to achieve the outcomes of the project at the least cost. Linking remuneration with realization of benefits encourages the Company to negotiate and value the best deal possible on behalf of ratepayers.

Third, the Division acknowledges that there is ongoing consideration in Docket 4943 of the general parameters that should guide development of a performance incentive mechanism. As a result, the Division recommends deferral at this time of discussion of whether indirect benefits should contribute in the calculation of remuneration. However, the Division would note that one distinction the Commission could make would be to entirely discount indirect benefits when the utility plays a passive role while recognizing some indirect benefits when the utility plays a more active role.

Fourth, the Division recognizes that reasonable remuneration would be based on action taken by the utility – execution of the PPA as a counterparty – that has already occurred. The Division believes that this should not be a bar to remuneration. There are many instances of current economic life in which compensation for services comes after the service has been performed. For example, real estate brokers commonly earn commissions after the deal has been executed. Similarly, restaurant staff commonly earn a gratuity after the service has been performed. Usually that gratuity recognizes past service and is a part of a continuing relationship in which goods and services are exchanged on an ongoing basis¹. The Division recognizes that the threat of climate change and the need to decarbonize the electricity sector over the coming decades will require the ongoing collaboration of the electric utility under ACES which justifies this remuneration for a past act.

Fifth, the Commission has recognized in other areas of regulation a division of shared savings on a scale of 80-20 or 90-10, with the majority accruing to ratepayers. This shared savings approach

¹ See: Orn Bodvasson and William Gibson: Economics and Restaurant Gratuities: Determining Tip Rates. American Journal of Economics and Sociology. Vol 56, No. 2 pp. 187-203.

might be useful in consideration of a maximum remuneration amount. An allocation of 10 percent of savings with an additional discount applied of 50%, for example, for the passive role of the Company might be one method to arrive at a high-end estimate of reasonable compensation. Accordingly, a 5 percent of net benefit remuneration level would be consistent with existing principles and practice. This amount is not presented as a recommendation but rather as a possible methodology the Commission might use as a guardrail to determine a maximum “reasonable level”. Alternatively, the Commission could award the Company a number of basis points, such as 20 basis points or about \$1 million, in return for taking a range of actions to assist state goals. Again, this remuneration level is not a recommendation but offers a lesser guardrail to help determine “a reasonable level”.

Sixth, the Division respectfully suggests that it may be illuminating to apply the principles propounded by this Commission on the design of incentive mechanisms to the Company’s request for remuneration.

What are the specific objectives of the proposed remuneration?

To reward the Company for administrative collaboration in execution of a large PPA with benefits to ratepayers and in furtherance of state energy and environmental goals.

Does the proposed remuneration promote the realization of new consumer and societal benefits?

Yes, in that the PPA for a new resource, offshore wind, is not likely to develop without the role of Company as a counterparty to the PPA.

Does the proposed remuneration promote behavior that the utility otherwise would not take?

Yes. The Company has no “natural incentive” to undertake this activity and its collaboration under ACES is voluntary.

Is there a clear nexus between the design of the proposed remuneration and the expected benefits?

As proposed by the Company there is not. Therefore, the Division recommends reforming the remuneration to better correlate with the benefits.

Is there a clear and stated reason why the proposed remuneration is needed to achieve the specific objectives?

Yes, the PPA would not be viable without a financially strong counterparty.

Is the proposed remuneration designed to promote superior utility performance and significantly advance the expected benefits as efficiently as possible?

This is unclear as currently proposed by the Company. No performance metrics have been identified.

Is the proposed remuneration designed so that customers receive most of the benefit?

In the Company’s proposal it would receive about 40 percent of the benefits. This is significantly greater than the Commission has historically entertained.

Is the proposed remuneration designed to grant increasing levels of rewards to the utility for higher levels of performance?

No, it is not.

Will the design and implementation of the proposed remuneration be completely transparent and fully document and reveal inputs and methodologies to ensure no duplication of incentives across various ratepayer funded programs?

In both cases the accounting is expected to be completely transparent.

Is it possible to compare the cost of achieving the proposed remuneration to the potential benefits?

The costs to achieve the remuneration should not be in excess of standard administrative costs in execution of the PPA.

Are there opportunities for National Grid to earn multiple incentives for attaining the objectives?

The Division is not aware that opportunities for duplication exist.

Conclusion

The Division of Public Utilities and Carriers is satisfied that the conditions of the ACES have been satisfied with this proposed project and that the aggregate benefits exceed the costs for Rhode Island ratepayers. In addition, the Division finds that the project represents a strategic opportunity to address the goals of the electric system as codified in Docket 4600. For these reasons, the Division supports some reasonable amount of remuneration for the Company. However, the Division and its expert witness believe that the rationale and the amount proposed by the Company is without basis and would conflict with existing principles.