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Memorandum

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From: Steven Estomin, Ph.D., Senior Economics Consultant
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Date April 17, 2020

Subject: **Docket No. 4978 National Grid's LRS Filing for Planning Period Starting January 1, 2021**

Introduction and Summary

We reviewed National Grid's filing for authorization of its Last Resort Service (LRS) plan for the period starting January 1, 2021. The Company's proposal included with the filing is that the plan remains in place until a material change is proposed by the Company, which would require authorization from the Commission, or the Commission requests the Company file a new or modified plan. For this review, we considered the following plan elements:

- Procurement approach;
- Products being procured to meet LRS requirements;
- Proposed schedule of procurements;
- Contingency plan;
- Reconciliation mechanism;
- Award mechanism; and
- Relevant documents (e.g., Master Power Agreement).

Procurement Approach

The Company has used, and proposes to continue to use, a two-step sealed-bid method where potential suppliers bid on the products being solicited, but separate bids are required for each six-month period for the commercial and residential loads. As an example, if a two-year product is being solicited, say a full-requirements, load following product representing five percent of the residential load, each bidder is required to submit four separate bids representing supply in each of the four (4) six-month periods that constitute the two-year period. The lowest cost bid for each of the six-month periods is then given a provisional award within the day of the bid. A bidder, therefore, could be awarded the load for only a single six-month period or up to four (4) six-month periods.

The two-step approach allows the non-price elements of the solicitation (e.g., ability to serve, financial capability, experience, and past history) to be evaluated in advance of the price bidding, thus permitting an award to be made relatively quickly, that is, within the day rather than several days or more. The ability to make an award quickly reduces the degree of market risk that the bidders face which in turn translates into lower bids than would otherwise be the case. In addition, if bids were not able to be accepted within a reasonably short time, some firms may not be willing to bid at all since they may not be willing to incur the market risk, that is, the risk that wholesale market prices will rise between the time that the bid is made and the time that the bid is awarded. Since supplies are generally not locked in by the suppliers until after notification of award, some degree of risk is borne by either the potential supplier or by the wholesale supplier that quoted a price to the bidder that is open for the specified duration. The within-the-day timeframe is generally acceptable since wholesale suppliers (i.e., bidders) are comfortable with dealing with utilities that require time for evaluation and perhaps approval by the relevant regulatory commission.

The alternative approach to a sealed-bid is to conduct a descending-clock online auction, whereby bidders offer prices against other bidders on an internet-based bidding platform with successive bids being made at lower prices. When multiple products are being procured for different customer classes covering different time periods, the bidding process can get a bit complicated since the bids being made are not entirely independent from the perspective of the bidder. Also, certain decisions would need to be made regarding how the auction would be conducted, for example, whether the auction would be conducted using a "hard clock" or whether time would be added if bids are received close to the end of the bid period. The auction process also needs to be sufficiently sophisticated so as to be able to detect possible collusive behavior on the part of the participants.

It is not clear that the online auction platform provides superior (that is, lower-cost) bids than the sealed-bid approach used by the Company. Both approaches are widely used, with many utilities tending to opt for the sealed-bid method due to its lower administrative costs.

A common alternative to the six-month bid requirement is a two-year product. For example, fixed-price bids are requested for a product that covers the two-year period. There are advantages inherent in each of the approaches and the approach employed by the Company is not unreasonable.

The principal advantage to the method of using a single bid price for a longer-than-six-month product is that winning bidders are assured of a larger number of MWh associated with the successful bid, which makes participation more attractive and provides a broader base over which to spread administrative costs. There is no reason to believe that the Company's approach would entail either fewer bidders or measurably higher priced bids than the alternative.

Products Being Procured

The Company proposes to rely on the following products to serve its LRS customers:

- Residential: Full-requirements, load-following contracts (FRCs) of between six-months' and two years' duration to serve a specified percentage of the residential load in each hour at a fixed price for 90 percent of the residential load with the remaining 10 percent served through spot market purchases.
- Commercial: The same types of products as for the residential class, but specifically procured for commercial LRS customers.
- Industrial: FRCs of three months' duration.

In general, the goal of product selection for residential and commercial customers should be to provide a degree of market risk protection, avoid large rate swings, and to reasonably reflect market conditions/prices so as not to seriously adversely affect the ability of competitive suppliers to compete with the utility. The market risk protection and rate stability considerations are less important for industrial customers who can more easily evaluate and procure alternative supplies.

There are numerous variations that are currently used by other utilities to provide similar default service for commercial and residential customers, including 100 percent FRCs procured on a specified schedule (for example, the Maryland utilities rely on two-year contracts procured every six months for 25 percent of the load for residential customers); or FRCs combined with fixed-price block product purchases as has been previously adopted by some of the Pennsylvania utilities. Industrial customers are typically treated much differently than residential and commercial customers with the recognition that industrial customers can more readily participate in the competitive market. Some utilities, such as Baltimore Gas and Electric, provide default service to industrial customers only on a real-time pricing basis.

The LRS products specified by the Company, with the exception of the spot market pricing component that makes up 10 percent of the residential and commercial requirements, entail the pass-through of capacity costs. That arrangement ensures that any credits from ISO New England that go back to wholesale suppliers are forwarded to the LRS customers. Absent the pass-through arrangement or something with a similar effect, any capacity credits that may emerge during the supply period would be retained by the wholesale suppliers as a windfall and not be available to LRS customers. We view the capacity cost pass-through specification as an acceptable method by which to protect the LRS customers.

The products proposed by the Company, and relied on for its current Standard Offer Service (SOS), are reasonably consistent with what is relied on elsewhere.

Proposed Schedule of Procurements

The objective of procurement schedules for the purpose of securing wholesale power to meet LRS loads is to reduce pricing risk by temporally diversifying the supply portfolio. Achieving portfolio diversification, however, needs to be balanced against the goal of keeping administrative costs to a manageable level and, at the same time, having products that can reflect current market conditions so as not to adversely affect the development of a viable competitive retail market. The Company proposes to use quarterly solicitations for each of the three customer classes. For residential and commercial LRS customers:

- One of the four annual solicitations would be for FRCs covering a 24-month period for a total of 15 percent of the relevant class load, bid in the first quarter for deliveries starting in the second quarter of the same year;
- One solicitation would be for FRCs covering a 12-month period for a total of 20 percent of the relevant class load, bid in the second quarter for deliveries starting in the fourth quarter of the same year;
- One solicitation would be for FRCs covering an 18-month period for a total of 20 percent of the relevant class load, bid in the third quarter for deliveries starting in the fourth quarter of the same year; and
- One solicitation would be for FRCs covering a 6-month period for a total of 15 percent of the relevant class load, bid in the fourth quarter for deliveries starting in the second quarter of the following year.

In aggregate, these solicitations would result in bids that would cover 90 percent of the residential and commercial LRS loads in each hour. The remaining 10 percent of load would be met through purchases on the spot market.

For industrial customers, in each quarter, 100 percent of the LRS load would be solicited for the following calendar quarter. No spot market purchases would be relied upon.

For the residential and commercial customer classes, the schedule of procurements, in combination with the products being procured, establish what we consider to be an acceptable balance among competing goals of price stability, avoidance of excessive market risk, and support of the continued development of a competitive market. We note that there is ample room for disagreement with this assessment. For example, residential consumer groups could prefer more stable prices, relying on products that are based on longer-term contracts and forgoing a spot market component; competitive suppliers may prefer prices that would be more reflective of current market conditions than what has been proposed by the Company, which includes purchases of products that extend out two years at prices fixed at the time of procurement. The Company's proposal, which includes approximately 50 percent relatively short-term purchases (products purchased for periods of one year or less for the residential and commercial LRS customers) and all of the industrial LRS load comprised of three-month contracts, combined with the quarterly procurement schedule under which those supplies are procured, is assessed to be an acceptable approach to balancing and meeting competing objectives.

Contingency Plan

The Company's contingency plan governs the steps to be taken in the event that no bids (or just one bid) are received for a particular product in a particular solicitation or if a significant market event occurs that could adversely affect the bidding process. The Company is relying on the same contingency plan put forward in the Company's March 1, 2013 filing in Docket 4490 (2015 Standard Offer Service Procurement Plan; 2015 Renewable Energy Standard Procurement Plan), Direct Testimony of Margaret M. Jansen, pp. 19-23, with modifications in accordance with the Agreement between the Company and the Rhode Island Division of Public Utilities and Carriers (Division) as contained in a letter dated June 25, 2014 from the Company's Senior Counsel to the Commission Clerk. Fundamentally, the contingency plan specifies that if no bids are received or a significant market event occurs, the solicitation will either be reissued a week later or, if insufficient time exists between the solicitation and initial deliveries, the spot market will be relied upon until the next solicitation is scheduled. If only one bid is received, the Company and the Division will review the bid to determine whether it is reasonable based on then-current market conditions and, if so, make an award. If not, the same procedure governing the "no bid" situation will be used.

These same contingency plan arrangements have been in place for approximately five years and are broadly consistent with the types of contingency plans in place in other states with open retail access. We do not see any major concerns regarding the in-place contingency plan.

Reconciliation Mechanism

The reconciliation mechanism is used to force the match between the Company's costs for providing LRS and the LRS revenue received by the Company. Desirable characteristics of a reconciliation mechanism are that it results in a true-up charge (or credit) that is relatively small so as not to distort incentives to either leave or stay on LRS, to not impose potential hardships on LRS customers, and to avoid adverse impacts to the competitive market. Given that prices for LRS are based on fixed-price, per-MWh bids for 90 percent of the commercial and industrial LRS load and 100 percent of the industrial LRS load, it is not expected that the reconciliation adjustment (either positive or negative) can be persistently large. Further, the reconciliation adjustment is amortized over 12 months, which further reduces its impact and allows for the potential of off-setting adjustments. We view the 12-month amortization period as being much preferred to shorter periods (e.g., three-month reconciliation) in place in certain other states.

Award Mechanism

Following the receipt of final price bids, the Company notifies the bidders of the results of the RFP process within the day. As noted previously, this time frame is acceptable as a method to provide sufficient time for evaluation while at the same time avoid the necessity of bidders incorporating significant risk premiums into their bids as would be required with a longer open period between the submission of the bids and notice of award.

The Company proposes to employ a six-step process (from issuance of the RFP to award and filing a summary document with the Commission and the Division) which would be a modification to what the Company has done previously. In the past, the Company has notified the Commission and the Division of the indicative prices (submitted by the potential bidders with the submission of the preliminary, non-price documents) and the final prices, along with other information related to the solicitation and the receipt of bids, within 24 hours of receiving the indicatives and the final bids. The Company proposes to eliminate these two steps since the sixth step in the process is the submission of an RFP summary report to the Commission, typically within two weeks of the awards being made. Given the submission of the summary report filing, the Company sees the submission of the information related to the indicatives and the final bids within 24 hours of receipt to be redundant (see p. 21 of the Direct Testimony of Ruebenacker and Pieri). The Company's request to eliminate the two steps appears reasonable since the same information is provided in the summary report filing, assuming the Division is comfortable with the slight delay in when the information would be made available.

Review of Documents Attached to the Filing

We have reviewed the changes proposed by the Company to the RFP Template, the Master Power Agreement, the Form of Guaranty document, and the Credit Support Annex document. The changes proposed are non-substantive and accommodate administrative/clerical issues, clarify the currently existing language as determined to be needed, and relocate certain language to more appropriate placement within the documents. As such, we do not see any issues associated with the changes proposed by the Company.