

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: NARRAGANSETT ELECTRIC COMPANY :
LAST RESORT SERVICE ACQUISITION PLAN : Docket No. 3515

REPORT AND ORDER

I. BACKGROUND

The 2002 Amendments to the Utility Restructuring Act (“URA”) require electric distribution companies, such as Narragansett Electric Company (“Narragansett”) to provide Last Resort Service (“LRS”) to any customers who have left standard offer for any reason and are not otherwise receiving electric service from nonregulated power producers.¹ R.I.G.L. § 39-1-27.3(c) states:

In recognition that electricity is an essential service, each electric distribution company shall arrange for a last resort power supply for customers who have left the standard offer for any reason and are not otherwise receiving electric service from nonregulated power producers. The electric distribution company shall procure last resort service supply from wholesale power suppliers. Prior to acquiring last resort supply, the electric distribution company will file with the commission a supply acquisition plan or plans that include the acquisition procedure, the pricing options being sought, and a proposed term of service for which last resort service will be acquired....All such components of the acquisition plans, however, shall be subject to commission review and approval. Once an acquisition plan is approved by the commission, the electric distribution company shall be authorized to acquire last resort service supply consistent with the approved acquisition plan and recover its costs incurred from providing last resort service pursuant to the approved acquisition plan.²

Rather than having the authority to approve the actual LRS rates, the Commission has been granted the authority to approve a LRS acquisition plan, specifically, the acquisition procedure, the pricing options sought and the term of service. As long as

¹ R.I.G.L. § 39-1-27.3(c) (2002). During the hearing, the Commission expressed concern that customers be given enough information upon which to make an informed decision to move from a Standard Offer Service (“SOS”) rate to a LRS rate.

² R.I.G.L. § 39-1-27.3(c) (2002).

Narragansett complies with an approved LRS acquisition plan, it is entitled to recover its costs associated with providing LRS.

II. TECHNICAL RECORD CONFERENCE

On April 28, 2003, the Commission conducted a Technical Record Conference to advise the Commission regarding the status of the electricity market, to provide an overview of LRS since September 2002 and to discuss options for the LRS procurement process for 2003.

III. ACQUISITION PLAN

On May 7, 2003, Narragansett filed its proposed LRS acquisition plan, through the pre-filed direct testimony of Michael J. Hager, the Director of Energy Supply – NE for National Grid USA Service Company. Mr. Hager testified that Narragansett’s proposed procedure for acquiring LRS is similar to the procurement in 2002 and would include ten steps: (1) issuance of an RFP to all interested wholesale power suppliers; (2) receipt of initial responses to the RFP, including background information, indicative pricing and proposed changes to the proposed power supply agreement; (3) review of the initial responses and resolution of any disputed contract language; (4) sharing of the initial responses with the Division of Public Utilities and Carriers (“Division”); (5) receipt of final, binding prices; (6) evaluation of the final, binding prices in consultation with the Division; (7) selection of a supplier; (8) execution of a power supply contract; (9) filing of the resulting LRS rates with the Commission; and (10) filing of a summary of the bids received on a confidential basis with the Commission for its review.

Next, Mr. Hager indicated that with regard to the pricing options sought and the proposed term of service, Narragansett would seek pricing on an “as delivered” basis,

meaning that Narragansett would only be required to pay for LRS that is actually consumed by its LRS customers. Consequently, there would be no demand charges incurred and no minimum or maximum load requirements. Finally, a responsive price would have to include all commodity-related charges associated with the supply of LRS.³

Mr. Hager indicated that Narragansett would procure LRS separately for two customer classes – residential and C&I for the period September 1, 2003 through February 28, 2004, with an option to enter into contracts for residential customers for the period March 1, 2004 through August 31, 2004 in the event the bids for the second six month period produce prices with an arithmetic average at least 10% below the arithmetic average of the lowest price bidder for the first six-month period. He noted that suppliers could bid for either one or both six-month periods and for one or both of the customer classes and that the winning bidder for both periods could be the same or different, depending on their proposals.⁴

Mr. Hager indicated that the customer classes were being separated because the residential LRS class does not presently have any realistic competitive supply choices and therefore, is relatively stable, whereas, since August 2002, there has been a significant fluctuation in the number of customers and total loads on LRS. According to Mr. Hager, the fluctuation has occurred mainly because customers taking competitive supply have left the market to take lower priced LRS. The reason the LRS is lower than the current market price is because it was procured back in August 2002, when projections of market prices for the current six-month period were lower. In order to avoid market arbitrage where customers for whom a market is available use LRS as an

³ Id. at 7.

⁴ Id. at 6, 8.

alternative market supplier rather than as a true last resort option, Narragansett proposes only procuring LRS supply for the non-residential customers for a single six-month period. This will allow the LRS to more accurately reflect the market. Finally, Mr. Hager explained that because of the significant fluctuations in LRS caused by non-residential customers, suppliers will calculate a higher “risk premium” into the bid price. According to Mr. Hager, suppliers have indicated that requesting bids according to the two customer classes should mitigate the impact of this risk on residential customers.⁵

Mr. Hager testified that the indicative bids provide Narragansett with the ability to initially rank the bids and perform a review of each bidder’s qualifications, including the bidder’s financial strength. He explained that the winning supplier would be chosen from those bidders that have the following characteristics: a demonstrated ability to provide service during the six-month period; either acceptable financial strength or the ability to provide required financial security; and the willingness to execute a power supply contract that is acceptable to Narragansett. Once Narragansett has narrowed the field solely to those bidders with the above characteristics, Narragansett will then choose the bidder offering the lowest price.⁶ It is possible that a supplier may provide bids for more than one block of power. It is also possible that a supplier may be the lowest bidder for one block, but not another, but require that it be awarded both blocks in order to agree to provide service. In such a case, the Company may elect to award the combined service to the supplier if analysis determines that doing so will provide the lowest overall cost to ratepayers.⁷

⁵ Id. at 7-9.

⁶ Id. at 8.

⁷ Id. at 11.

With regard to an acceptable power supply contract, Mr. Hager noted that individual wholesale power suppliers typically request contract changes that are not intended to shift the risks or costs between the supplier and Narragansett, but rather to add clarity to the contract. However, he also indicated that “to the extent a contractual change would shift risks or costs between the supplier and the Company, the Company will evaluate the economic cost of the proposed shift and factor the cost into the bid price.” He stated that any such analysis would be included in Narragansett’s information filing to the Commission.⁸ In addition to that kind of analysis, Narragansett’s confidential informational filing with the Commission would contain a summary of the initial and final bids as well as the final executed power supply contract.⁹

In accordance with the notice requirements of R.I.G.L. §§ 39-3-10 and 39-3-11, Narragansett will file the LRS rates for the six-month period commencing September 1, 2003 with the Commission no later than August 1, 2003. Residential customers taking LRS will continue to pay the SOS rate while non-residential customer will pay the actual LRS rate for each month.

IV. DIVISION’S TESTIMONY

On May 22, 2003, the Division submitted the pre-filed testimony of its expert witness, Dr. John Stutz of the Tellus Institute. Dr. Stutz summarized Narragansett’s proposed LRS procurement plan and recommended the Commission approve the plan as filed.¹⁰

⁸ Id. at 9-10.

⁹ Id. at 10. In addition to filing a complete copy of the power supply contract under a request for proprietary treatment, Narragansett will also file a redacted public version.

¹⁰ Div. Ex. 1 (Pre-filed testimony of John Stutz), pp. 4-5.

V. HEARING

Following notice, a public hearing was conducted on May 29, 2003, at the Commission's offices, 89 Jefferson Boulevard, Warwick, Rhode Island. The following appearances were entered:

FOR NARRAGANSETT ELECTRIC: Terry L. Schwennesen, Esq.

FOR THE DIVISION: Paul J. Roberti, Esq.
Assistant Attorney General

FOR THE COMMISSION: Cynthia G. Wilson, Esq.
Senior Legal Counsel

A. Proposed Acquisition Plan

Michael Hager testified on behalf of Narragansett. He summarized the proposed LRS Acquisition Plan, explaining that it is very similar to the plan that was approved in 2002.¹¹ However, there are three differences in the plan before the Commission in this docket. First, rather than aggregating residential and non-residential customers together, Narragansett proposes to ask suppliers to separately price service to the residential customer group and a separate price for the commercial and industrial customers. He indicated that the number of residential customers taking LRS is small and their load is stable, whereas there is a large fluctuation in customer counts and loads associated with the commercial and industrial customers.¹²

Narragansett believes that it will be able to obtain a rate for residential customers that would have a lower risk premium than the rate for the commercial and industrial customers. Mr. Hager explained that when the suppliers are preparing their bids, they look at the amount of load they will be supplying and base the rate on that level. They

¹¹ Tr. 5/29/03, pp. 9-10.

¹² Id. at 11.

would then lock in that amount of power through contracts. However, if there is the possibility for a large fluctuation in the amount of load that would either need to be purchased or sold on the spot market, which could result in a loss of profit for the supplier. Therefore, the supplier factors that risk into the bid. On the other hand, if the load is relatively stable, there is a lower risk to the supplier, producing a lower risk premium in the bid.¹³

The second change, rather than posting the first month's LRS rates five business days prior to the effective date, customers will receive thirty days notice because the rates will be filed with the Commission on August 1, 2003, for effect with usage on and after September 1, 2003.¹⁴ This complies with the notice requirements of R.I.G.L. § 39-3-11.

The third change is that rather than procuring two six-month contracts for commercial and industrial customers taking LRS, Narragansett will only be procuring supply for one six-month period. Mr. Hager noted that the graphs in his schedules MJH-1 and MJH-2 show that commercial and industrial customers have options for power supply in the competitive market. The graphs also show that when market prices are higher than LRS prices, the customers move back and when the market is lower, the customers take competitive supply. Therefore, it appeared from the trends that customers were using LRS, not as a last resort, but as a competitor of the market. One reason this occurred was because when Narragansett procures power for a period of time greater than six months, it is more likely the LRS rate will not reflect the market that exists at the time of usage. This is what led to Narragansett's proposal to only procure supply for one six-

¹³ *Id.* at 26-27, 47-48.

¹⁴ Residential LRS customers will continue to pay the SOS rate.

month period for commercial and industrial customers.¹⁵ Narragansett's proposal to procure power for residential customers for a second six-month period if rates for the second six-month period averaged out at least 10% below the average of the first six-month period. The purpose of this was to provide certainty to Narragansett, the Division, ratepayers and the Commission with regard to one standard of reasonableness under the Acquisition Plan.¹⁶

As noted above, Narragansett was requesting Commission approval of an acquisition plan that would seek bids that included pricing on an "as delivered" basis with no demand charges, no minimum or maximum load requirements and which included all commodity related costs.¹⁷ A conforming bid would have all of these characteristics. Narragansett was also seeking flexibility or discretion under the LRS acquisition plan to enter into power supply contracts with non-substantive changes, to analyze any non-conforming bids that might shift risks between Narragansett and the supplier to enter into such contracts if Narragansett's analysis showed a benefit to the ratepayer. The parties stipulated on the record to continue under the 2002 agreement and Commission findings regarding the Commission's authority if Narragansett exercised flexibility under its proposed Acquisition Plan.¹⁸

¹⁵ Id. at 49-55.

¹⁶ Id. at 80.

¹⁷ Mr Hager also discussed the type of analysis would be done in determining the lowest cost bid in the event a supplier with the lowest bid for one class of customers but not for the other class, would only if it won the entire LRS load.

¹⁸ In Docket No. 3444, Narragansett filed a letter with the Commission, setting out the agreement between the Division, the Attorney General and itself regarding the flexibility to be afforded Narragansett under the proposed acquisition plan and the suggested scope of the Commission's review of Narragansett's actions thereunder. First, the letter stated that the approved LRS acquisition plan should provide Narragansett with some flexibility or discretion, when faced with a non-conforming bid, to make a decision that it believes would be to the benefit of ratepayers.

Second, the July 17th letter stated that "[i]f Narragansett retains discretion within the plan to modify the procurement process, it should also have the responsibility to exercise that discretion reasonably. Thus the exercise of discretion under the plan should be subject to review." More particularly,

The Division presented Dr. Stutz on its behalf. Dr. Stutz adopted his pre-filed testimony indicating that he agreed with the six-month procurement period, the 10% benchmark for the second six-month procurement for residential customers and with the separate procurements for the two rate classes as reasonable on behalf of the ratepayer.¹⁹

B. Duration of the Procurement Plan

In response to questions from the Bench, Narragansett agreed that if market conditions have not changed significantly at the time Narragansett is to procure power for the second six-month period, under R.I.G.L. § 39-1-27.3(c), the Commission is not required to conduct a full review of a proposed Acquisition Plan and that Narragansett may continue to procure power under the Acquisition Plan approved in this docket. The Division also agreed with the conclusion.²⁰

However, in order to determine whether the market conditions have changed, Narragansett agreed to provide the Commission with an assessment of the market as it exists at the time the procurement process would need to commence. This date was set at

the letter indicated that this review should occur during the process when Narragansett is deciding which supplier and which contract option to accept. As part of its plan, Narragansett has agreed to consult with the Division regarding each of the initial bids, including those, if any, that do not conform to the requirements in the acquisition plan. Narragansett has also agreed to advise the Commission immediately if Narragansett decides to choose an option that does not conform to the requirements of the approved acquisition plan. Because the Division will be privy to all available options, it will have the opportunity to raise concerns regarding Narragansett's choice and whether it conforms to the approved LRS acquisition plan. Finally, Narragansett would include the basis for its decision to accept a non-conforming bid in its informational filing with the Commission "after the commitment is made, but just prior to the effective date of the purchase." Accordingly, this will provide the Division and Commission with a number of opportunities to review Narragansett's actions during the selection process.

The July 17th letter also indicated that Narragansett's discretionary actions under an approved LRS acquisition plan should also be subject to an after-the-fact prudence review. Such a review would most likely be prompted if Narragansett's discretionary action, such as a decision to accept a non-conforming bid, had an adverse impact on the ratepayers. The review would be based on a review of the facts before Narragansett at the time it exercised its discretion. The letter concluded with the statement that, "with these limitations, Narragansett agrees that, notwithstanding the notification to the Division and Commission...the Commission retains the authority to conduct a retrospective review of the exercise of Narragansett's discretion undertaken under an approved plan. Narragansett's actions would also be subject to review for compliance with the Plan approved by the Commission."

¹⁹ Tr. 5/29/03, pp. 122-123, 129.

November 1, 2003. The Division indicated that it would need approximately two weeks to review Narragansett's assessment and provide the Commission with a position.²¹

C. Massachusetts' Default Service

In addition to testimony regarding Narragansett's proposed Acquisition Plan, there was a discussion of a generic proceeding that recently occurred in Massachusetts regarding the acquisition of Default Service.²² According to Mr. Hager, the Massachusetts DTE has ordered that distribution companies layer their procurements and charge an averaged rate to customers in the service territory. What this means is that the distribution company will procure 100% of the default service power for six months and an additional 50% for the remaining six months. After that initial procurement, the distribution company will procure 50% of the default service load every six months for the following twelve months. The rate charged for each month will then be the average of the two procurements for that month.²³

IV. COMMISSION FINDINGS

At its May 30, 2003 open meeting, the Commission approved Narragansett's LRS Acquisition Plan as filed with the understanding that the Commission shall have the right to review Narragansett's final LRS power supply contract for compliance with the approved Plan and to review the prudence and reasonableness of any discretionary actions taken by Narragansett under the Plan. The Commission finds that Narragansett's proposal is in the best interest of ratepayers at this time.

²⁰ Id. at 73-75.

²¹ Id. at 75-77.

²² In Massachusetts, customers who were not on SOS as of March 1, 1998 and who are not taking competitive supply are on the Default Service Rate.

²³ Id. at 33-35.

Narragansett shall file a market assessment by November 1, 2003 in order to determine whether the Company should continue to procure LRS in accordance with the Plan approved in this docket. The Division should make a responsive filing by December 1, 2003. In accordance with the statute, if the market has not changed significantly in six months, the Commission may allow Narragansett to continue to procure LRS under the same acquisition plan until such time as the competitive market conditions change.

The Commission also finds that the continuation of the agreement between the parties in Docket 3444, as approved in Commission Order 17203, is a reasonable approach to the issue of the Commission's right to review the prudence of Narragansett's discretionary actions under the approved Acquisition Plan as well as to review Narragansett's actions for compliance with the Plan.

Accordingly, it is hereby

(17532) ORDERED:

1. Narragansett Electric Company's proposed Last Resort Service Acquisition Plan covering the six-month period, September 1, 2003 through February 28, 2004, is hereby approved.
2. Narragansett Electric Company's proposed Last Resort Service Acquisition Plan covering the optional second six-month period, March 1, 2004 through August 31, 2004, is hereby approved.
3. Narragansett shall file a market assessment by November 1, 2003.
4. The Division will make a responsive filing to Narragansett's market assessment which includes a recommendation regarding whether Narragansett

should procure the six-month period March 1, 2004 through August 31, 2004 under the Last Resort Service Acquisition Plan filed today.

5. The Commission shall have the right to review Narragansett's Last Resort power supply contracts for compliance with the approved Acquisition Plan, and to review the prudence and reasonableness of any discretionary actions taken by Narragansett under the approved Acquisition Plan.
6. Narragansett Electric Company shall comply with all other findings and instructions contained in this Report and Order.

EFFECTIVE AT WARWICK, RHODE ISLAND PURSUANT TO AN OPEN MEETING DECISION ON MAY 30, 2003. WRITTEN ORDER ISSUED AUGUST 6, 2003.

PUBLIC UTILITIES COMMISSION

Elia Germani, Chairman

Kate F. Racine, Commissioner

Robert B. Holbrook, Commissioner