

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

PUBLIC UTILITIES COMMISSION

IN RE: NARRAGANSETT ELECTRIC COMPANY :
LAST RESORT SERVICE : DOCKET NO. 3005

REPORT AND ORDER

I. LAST RESORT SERVICE FROM OCTOBER 2000 - JANUARY 2001

The Utility Restructuring Act (“URA”) requires electric distribution companies, such as Narragansett Electric Company (“Narragansett”), to provide Last Resort Service (“LRS”) “for customers who are no longer eligible to receive service under the standard offer,” and that “acceptance of bids by the electric distribution company and the terms and conditions for such last resort service shall be subject to approval by the Commission.”¹

At the request of Narragansett, a technical conference was conducted at offices of the Public Utilities Commission (“Commission”), 100 Orange Street, Providence, Rhode Island on September 21, 2000. The following appearances were entered:

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| FOR NARRAGANSETT: | Ronald T. Gerwatowski, Esq. |
| FOR DIVISION: | Paul J. Roberti, Esq. Assistant Attorney General |
| FOR TEC-RI | Andrew Newman, Esq. |
| FOR COMMISSION: | Adrienne Southgate, Esq. General Counsel |

¹ R.I.G.L. § 39-1-27.3(f).

At the conference, Mr. Gerwatowski explained that Narragansett had issued an RFP to acquire LRS supply for the upcoming months,² but that Narragansett was unable to follow the prior procedure of selecting a bid for LRS and then, after the passage of some period of time, obtain approval from the Commission of the bid selected as required by the URA.³ As a result of the volatility in the electric power market, competitive electric suppliers were no longer willing to guarantee a fixed bid price while awaiting the Commission's decision whether or not to approve the bid.⁴ To address this timing problem, Narragansett suggested an option, supported by The Energy Council of Rhode Island ("TEC-RI"), that the LRS price not be determined by a fixed bid price, but would float with the market.⁵

By letter dated September 25, 2000, Narragansett informed the Commission that it had issued a supplemental RFP to acquire a variable price LRS supply on a month-to-month basis. Noting that Narragansett's current arrangement for LRS supply would terminate at the end of October 2000, on October 6, 2000, Narragansett filed a request with the Commission for approval of Narragansett's selection of Consolidated Edison Energy, Inc. ("ConEd") as the supplier for LRS for the months of

² T. 9/21/00, p. 2.

³ *Id.*, pp 2-3.

⁴ *Id.*, pp 2-3.

⁵ *Id.*, pp 4-5, 8-11.

November 2000 through April 2001, as required by the URA.⁶ Under the new contract with ConEd, LRS power (for non-residential customers) would be priced under a formula intended to reflect the hourly market price of electricity, and Narragansett would retain the right to cancel the LRS supply contract with ConEd on ten days notice before the beginning of each month.⁷ Narragansett explained that it was not requesting any changes to its LRS tariff, however, because it currently sets the rate for residential LRS customers at the Standard Offer Service (“SOS”) rate, and sets the rate for non-residential LRS customers at 4.5 cents per kWh or the estimated market price for the month, whichever is higher.⁸

On October 16, 2000, the Division of Public Utilities and Carriers (“Division”) filed a response to Narragansett’s filing. The Division noted ConEd was selected among five bidders and ConEd’s bid contained the lowest fixed contribution for an administrative fee.⁹ The Division expressed its comfort with a spot-market-based approach for LRS for the next six months and supported Narragansett’s selection of ConEd as the new LRS supplier.¹⁰

On October 17, 2000, TEC-RI filed a letter stating it did not object to Narragansett’s purchasing strategy for LRS as reflected by the contract with ConEd.¹¹ However, TEC-RI requested that LRS customers receive

⁶ R.I.G.L. § 39-1-27.3(f).

⁷ Narragansett’s letter dated October 6, 2000.

⁸ Id. On October 12, 2000, Narragansett filed a redacted copy of the ConEd contract with the Commission.

⁹ Division’s Statement of Position, p. 1.

¹⁰ Id., p. 3.

¹¹ TEC-RI’s letter dated October 17, 2000.

notice of the estimated LRS market price at least 30, rather than 5, days before the beginning of the month, in order to give LRS customers more time to seek out lower-priced service from competitive suppliers.¹² TEC-RI suggested that Narragansett estimate the LRS market prices for each of the next six months and re-estimate LRS market prices for the last three months thirty days prior to the start of the last three months.¹³ In addition, TEC-RI recommended that any over- or under-collection of LRS costs be reconciled on an annual basis among all customers.¹⁴ On October 17, 2000, Narragansett responded to TEC-RI's letter, stating that Narragansett, the Division, TEC-RI, should be given more time to discuss the issue raised by TEC-RI, and pointing out that TEC-RI's proposal could result in a large deferral (or under collection) of Narragansett's LRS costs.¹⁵

At an open meeting held on October 18, 2000, the Commission reviewed the evidence presented and approved the selection of ConEd as the LRS supplier for the period November 2000 through April 2001 as being in the best interest of the ratepayers. The Commission noted that the contract permits Narragansett to cancel the contract upon 10 days notice prior to the commencement of each month thereof, and that the price for LRS will reflect a floating market price for electricity.

¹² Id.

¹³ Id.

¹⁴ Id.

¹⁵ Narragansett's letter dated October 17, 2000.

For the months of November and December 2000, the LRS rate was set at the SOS rate of 5.401 cents per kWh.¹⁶ For the month of January 2001, however, Narragansett set the estimated LRS rate at 7.750 cents per kWh.¹⁷ Narragansett's estimate of 7.750 cents was based on its review of electricity market price data for November and December 2000, demonstrating prices of 5.5 cents and 6.5 cents per kWh for each month, respectively, and prices for January 2001 being quoted in excess of 8 cents per kWh.¹⁸ Also, Narragansett noted these prices do not reflect the additional cost of Installed Capability ("ICAP").¹⁹

With regard to the ICAP requirement, Narragansett explained that historically, each load serving entity (LSE) in NEPOOL was required to show it had sufficient generation to support its load responsibility either through its own generation resources or through a contract with another entity having surplus generation resources to meet the LSE's requirement.²⁰ The basis of this ICAP responsibility was to assure that utilities build sufficient generation to meet their load obligations; if a LSE failed to have adequate generation resources and/or did not contract for ICAP, it would be assessed a deficiency charge of \$8,750 per MW/month.²¹

¹⁶ Narragansett's letters dated October 24 and November 22, 2000.

¹⁷ Narragansett's letter dated December 21, 2000.

¹⁸ Id.

¹⁹ Id.

²⁰ Id.

²¹ Id.

After the establishment of wholesale electricity market rules in 1998, the deficiency charge was eliminated and an ICAP auction market was established in which the market-clearing price for ICAP was at or near \$0 until the month of January 2000, when bids offered by ICAP sellers suddenly increased to \$10,000 per MW/month.²² In response, ISO-NE concluded that this bidding reflected an inappropriate exercise of market power, re-adjusted the ICAP bids to \$0, and proposed eliminating the ICAP requirement altogether.²³ By order dated June 28, 2000, however, FERC rejected ISO's request to eliminate the ICAP market entirely and instead instructed ISO to re-establish an administratively determined deficiency charge.²⁴

In response, the ISO filed a deficiency charge of \$170 per MW/month effective August 2000, which added a cost of only 0.05 cents per kWh to the cost of Narragansett's LRS.²⁵ In an order issued on December 15, 2000, however, FERC rejected the ISO's proposal of \$170 per MW/month, and instead ordered that the ICAP deficiency charge be re-established at \$8,750 per MW/month and be applied retroactively to August 2000.²⁶ As a result, Narragansett, which had been relying since August on ISO's significantly lower deficiency charge of \$170, would have to add an additional 2.5 cents per kWh, or approximately \$1 million per

²² Id.

²³ Id.

²⁴ Id.

²⁵ Id.

²⁶ Id.

month, to its cost of supplying LRS for the period August through December 2000, unless FERC withdraws the retroactive effect of the order.²⁷ Narragansett stressed that, in estimating the market price of electricity for the month of January 2001, it could not ignore the potential prospective effect of the December ICAP ruling by FERC, and therefore would attempt to obtain ICAP at a price less than \$8,750 per MW/month.²⁸ In light of the uncertainty created by FERC's ICAP order, Narragansett expected that its market price estimate of 7.750 cents per kWh would understate the actual market price.²⁹

On December 27, 2000, TEC-RI responded by requesting that the LRS rate for January 2001 be set at the SOS rate for January 2001 and that ICAP charges be deferred pending further review and final resolution of the issue by FERC and the courts.³⁰ TEC-RI also implied that the difference between the January 2001 LRS rate and the SOS rate was only attributable to the ICAP charge of \$8,750 per MW/month ordered by FERC.³¹

On December 28, 2000, Narragansett objected to TEC-RI's request, stating that its rate of 7.75 cents per kWh was a good faith estimate of the market price of electricity in January 2001.³² Narragansett also disagreed with TEC-RI's analysis, stating that the 1.85 cents per kWh

²⁷ Id.

²⁸ Id.

²⁹ Id.

³⁰ TEC-RI's letter dated December 27, 2000.

³¹ Id.

³² Narragansett's letter dated December 28, 2000.

difference between LRS and SOS prices for January 2001 was not entirely attributable to the ICAP charge. In fact, as Narragansett pointed out, its estimate of the market price for December 2000, of between 6.50 cents and 8.25 cents per kWh, excluded the impact of ICAP.³³ According to Narragansett, TEC-RI is already receiving the benefit of a conservative market price.³⁴ In light of FERC's ICAP order, Narragansett obtained ICAP for LRS at the cost of \$5.25 per KW/month, or 1.44 cents per kWh, for the month of January 2001. This will result in a total LRS cost of 7.94 cents per kWh for January 2001, assuming that the market price for all other components of LRS is 6.50 cents per kWh.³⁵

On January 2, 2001, TEC-RI requested that if Narragansett is obtaining new bids for LRS, it seek bids for terms of from one to three years in order to reduce the current volatility of LRS monthly pricing, and to allow LRS customers a reasonable opportunity to consider competitive supply options.³⁶ TEC-RI argued that under the current process, in which the LRS rate is not available until five days before the beginning of the month, an LRS customer is effectively prevented from obtaining power from a competitive supplier until the new LRS rate becomes effective.³⁷

³³ Id.

³⁴ Id.

³⁵ Id.

³⁶ TEC-RI's letter dated January 2, 2001.

³⁷ Id.

II. LAST RESORT SERVICE FROM FEBRUARY 2001-APRIL 2001

On January 4, 2001, Narragansett formally requested a hearing for the Commission to consider the Company's selection of a new LRS supplier for the period February through April 2001.³⁸ Due to FERC's ICAP order and continuing price volatility in the wholesale electricity market, Narragansett expressed its desire to issue a new RFP for bids to supply LRS by January 20, 2001; otherwise, Narragansett's present LRS supply contact with ConEd would automatically remain in effect for the month of February 2001.³⁹ Narragansett recommended that on the day prior to the Commission hearing on the selection of the LRS supplier, Narragansett would receive LRS bids. At the hearing the following day, Narragansett would recommend the selection of the winning bid to the Commission and the Commission would issue a bench decision.⁴⁰ Then, after a brief recess in the hearing, Narragansett would confirm with the winning bidder that its bid is still valid; upon receipt of such confirmation, no further proceedings would be necessary.⁴¹ In the alternative, the Commission could reject all bids and allow Narragansett to continue under its present contract with ConEd.⁴² Narragansett noted that this was a short-term proposal, and it expected that by the end of April 2001, a more permanent solution for LRS could be implemented.⁴³

³⁸ Narragansett's letter dated January 4, 2001.

³⁹ Id.

⁴⁰ Id.

⁴¹ Id.

⁴² Id.

⁴³ Id.

On January 5, 2001, the Division responded favorably to the process requested by Narragansett to obtain fixed price LRS bids for the period February through April 2001.⁴⁴ The Division noted that this process would allow the parties to work on a longer-term arrangement for obtaining LRS supply during this time of volatile and rising wholesale electricity prices.⁴⁵

Following due notice, a public hearing was conducted at offices of the Commission, 89 Jefferson Blvd, Warwick, Rhode Island on January 18, 2001. The following appearances were entered:

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|-------------------|---|
| FOR NARRAGANSETT: | Ronald T. Gerwatowski, Esq. |
| FOR DIVISION: | Paul J. Roberti, Esq. Assistant Attorney General |
| FOR TEC-RI | Andrew Newman, Esq. |
| FOR COMMISSION: | Steven Frias, Esq. Senior Legal Counsel |

At the hearing, many members of TEC-RI provided public comment on the effect of rising electricity prices on their businesses. Michael Hoffer, on behalf of Toray Plastics, stated that Toray Plastics is a LRS customer that employs 649 individuals and contributes approximately \$82 million to the Rhode Island economy.⁴⁶ Mr. Hoffer believed it would be appropriate to increase, by a small amount, the electric bill of a residential customer rather than jeopardize the continued employment of

⁴⁴ Division's letter dated January 5, 2001.

⁴⁵ Id.

⁴⁶ T. 1/18/01, p. 6

many residential customers.⁴⁷ Mr. Hoffer also discussed the need for long-term bids for acquiring electricity and promoted the idea of allowing LRS customers to return to SOS.⁴⁸ Under cross-examination by Mr. Gerwatowski, Mr. Hoffer admitted Toray had voluntarily left SOS to obtain lower priced power from a competitive supplier, and that Toray knew when it left SOS it would not be able to return to SOS.⁴⁹ Representatives from other TEC-RI companies that had left SOS and were presently on LRS also testified: ACS Industries, which employs approximately 50 individuals; Uvex Safety, which employs approximately 350 individuals; Seville Dye, which employs approximately 400 individuals; and Clariant Corporation which employs approximately 300 individuals.⁵⁰ As in the case of Toray Plastics, these business entities acknowledged they were aware at the time they left SOS that they would not be able to return to it.⁵¹

Michael Hager, the Manager of Distribution Energy Services for National Grid USA Service Company, testified for Narragansett. He recommended that the Commission select Bid B on Sheet 2A, which includes an ICAP charge, because it would provide certainty as to the LRS rates for the upcoming three months and prevent an under-collection of LRS costs from occurring.⁵² Mr. Hager estimated that the

⁴⁷ Id., p. 8.

⁴⁸ Id., p. 9.

⁴⁹ Id., p. 11-12.

⁵⁰ Id., pp. 24, 33, 44, 50

⁵¹ Id., pp. 26, 35, 45, 51.

⁵² Id., pp. 79-80.

ICAP charge included in Bid B was approximately \$3 to \$4 per KW/month, which is less than the \$8.75 per KW/month ICAP charge ordered by FERC.⁵³ Mr. Hager also stated that the ICAP market was presently trading at approximately \$3 to \$4 per KW/month, and that fixing the price of the ICAP charge would avoid market or regulatory uncertainty concerning the appropriate ICAP charge.⁵⁴

Dr. John Stutz, a consultant for the Division, testified on behalf of the Division. Dr. Stutz also recommended that the Commission select Bid B on Sheet 2A, which includes an ICAP charge.⁵⁵

At the hearing, TEC-RI's original position was to request that a LRS rate of 6.75 cents per kWh be charged to non-residential LRS customers, and that a bid excluding the ICAP charge be selected.⁵⁶ TEC-RI was informed that setting a 6.75 cents rate for non-residential LRS customers would require a change in the LRS tariff and that at present, the Commission was only considering the approval of LRS bids.⁵⁷ Counsel for TEC-RI deemed the selection of a bid including ICAP as "foolishness" because in his opinion, "there is no chance" that the ICAP charge of \$8.75 per KW/month would be enforced due to the outcry from the elected officials of New England.⁵⁸ After a recess in the hearing, TEC-RI stated it would take no position on whether or not to accept the bids

⁵³ Id., pp. 80-81.

⁵⁴ Id., pp. 82, 86.

⁵⁵ Id., p. 133

⁵⁶ Id., pp. 149-150.

⁵⁷ Id., pp. 147-148. 150-151.

⁵⁸ Id., p. 150.

for LRS presented before the Commission, and in fact, indicated it would rather stay with the present contract with ConEd, which provides a floating price for electricity.⁵⁹ Counsel for TEC-RI emphatically argued that Narragansett should not purchase ICAP but instead await a further decision from FERC as to the appropriate ICAP deficiency charge.⁶⁰

After an additional recess, TEC-RI's new position was that the Commission accept Bid B on Sheet 1A, which did not include the ICAP charge, and that if a ICAP charge was ultimately assessed, "the customers on LRS would pay for the ICAP."⁶¹ Roger Buck, Executive Director of TEC-RI, explained that he understood that the Commission could subsequently assess only non-residential LRS customers with ICAP charges, as well as assess an ICAP charge on any non-residential LRS customer who leaves LRS prior to paying its ICAP charges.⁶² However, members of the Commission expressed concern that by selecting a bid that did not include ICAP, an under-collection of LRS costs could occur, and that TEC-RI could subsequently dispute its members' obligation to pay the uncollected ICAP charges.⁶³ The Commission also noted that the approval of a fixed-price LRS bid would enable non-residential LRS customers to entertain offers from competitive electric suppliers knowing what the price for LRS would be in the upcoming three months.

⁵⁹ Id., pp. 152, 154.

⁶⁰ Id., p. 156.

⁶¹ Id., p. 167.

⁶² Id., p. 173.

⁶³ Id., pp. 176; 177, 178-179.

In a bench decision at the conclusion of the hearing, the Commission considered the evidence presented and found Bid B on Sheet 2A to be in the best interest of the ratepayers. After a brief recess, Narragansett confirmed to the Commission that Bid B on Sheet 2A was still valid and that Bidder B had confirmed the transaction.⁶⁴ It was then disclosed that Bidder B was Select Energy, and that the new LRS rates which include ICAP charges, for the period February through April 2001, were as follows:

8.925 cents per kWh for February 2001,

8.505 cents per kWh for March 2001, and

7.875 cents per kWh for April 2001.⁶⁵

Accordingly, it is

(16638) ORDERED:

1. The bid of Consolidated Edison to supply Last Resort Service power to Narragansett Electric Company for the November 2000 through April 2001 contract period is hereby approved.
2. Narragansett Electric Company shall terminate its contract with Consolidated Edison to supply Last Resort Service power for the months of February 2001 through April 2001.

⁶⁴ Id., p. 190.

⁶⁵ Id., at 191; Narragansett's letter dated January 23, 2001.

3. The bid of Select Energy, which includes Installed Capability (ICAP) charges, to supply Last Resort Service power to Narragansett Electric Company for February 2001 through April 2001 contract period is hereby approved.
4. Narragansett shall comply with all the other findings and instructions contained in this Report and Order.

EFFECTIVE AT PROVIDENCE AND WARWICK, RHODE ISLAND,
ON OCTOBER 18, 2000 AND JANUARY 18, 2001, PURSUANT TO OPEN
MEETING AND BENCH DECISIONS. WRITTEN ORDER ISSUED JUNE
14, 2001.

PUBLIC UTILITIES COMMISSION

Elia Germani, Chairman

Kate F. Racine, Commissioner

Brenda K. Gaynor, Commissioner