

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: NARRAGANSETT ELECTRIC COMPANY :
PROPOSED RATE REDUCTIONS TO STANDARD : DOCKET NO. 3402
OFFER RATE, TRANSITION CHARGE AND :
TRANSMISSION ADJUSTMENT FACTOR :

REPORT AND ORDER

I. BACKGROUND

The Utility Restructuring Act of 1996 (“URA”) requires each electric distribution company to arrange with wholesale power suppliers for a standard power supply offer to sell electricity to all customers at a stipulated rate. Pursuant to the URA, Narragansett Electric Company (“Narragansett”) entered into wholesale Standard Offer supply contracts with the following prices:

<u>Calendar Year</u>	<u>Price per kWh</u>
2001	3.8 cents
2002	4.2 cents
2003	4.7 cents
2004	5.1 cents
2005	5.5 cents
2006	5.9 cents
2007	6.3 cents
2008	6.7 cents
2009	7.1 cents

The wholesale Standard Offer supply contracts also provide for increases in the price per kilowatt-hour (“kWh”) of wholesale power supplied to Narragansett in the event fuel prices increase above certain levels. To the extent that the total cost of the wholesale power supply to Narragansett, including fuel charges, exceeds retail Standard Offer Service (“SOS”) and Last Resort Service (“LRS”) revenues, the under-collection is recoverable from Narragansett’s customers through the annual reconciliation provisions

of Narragansett's Standard Offer Adjustment Provision. Likewise, to the extent Narragansett collects more than its total cost of providing SOS, the ratepayers are entitled to recoup the benefit, with interest.

II. NARRAGANSETT

On November 23, 2001, Narragansett filed with the Rhode Island Public Utilities Commission ("Commission") a request to decrease the retail SOS rate from the present rate of 5.5 cents per kWh to 4.662 cents per kWh. Narragansett also proposed to decrease the transition rate from the present rate of .988 cents per kWh to .896 cents per kWh. Finally, Narragansett proposed to decrease the transmission adjustment factor from the present rate of .411 cents per kWh to .064 cents per kWh. The result for a typical residential customer using 500 kWh of service would be a decrease of 10.9% equal to \$6.66. Therefore, the average monthly residential bill would drop from \$61.02 to \$54.36.¹ In support of the proposed rate decreases, Narragansett presented the pre-filed testimony of Jeanne A. Lloyd, Principal Financial Analyst from National Grid USA Service Company, Michael J. Hager, Manager of Distribution Energy Services for National Grid USA Service Company and Anne M. Rodrigues, Senior Analyst in Transmission Regulation and Policy for New England Power Company.

A. Standard Offer Service

In his pre-filed testimony, Michael Hager explained that Narragansett has contracts with several non-affiliated generators to serve the load within its pre-merger ("Narragansett zone") and post-merger ("EUA zone") service territories. The contracts all run through December 31, 2009 and were the result of a FERC-approved Wholesale

¹ Narragansett Ex. 1A, Pre-filed testimony of Jeanne A. Lloyd, pp. 3-4, Exhibit JAL-16, p. 1.

Settlement from 1997.² Mr. Hager explained that the SOS contracts contain two price components – a base price and a fuel index adjustment provision. According to Mr. Hager, the fuel index adjustment contained in Narragansett’s Standard Offer supply contracts provide for additional payments to be made to suppliers in the event of substantial increases in the market price of No. 6 residual fuel and natural gas. The price is based on a six and twelve-month rolling average of oil and gas prices to a current trigger point. In order to determine the extent of any fuel index payments for the period January 2002 through December 2004, Mr. Hager based the fuel index adjustment provisions on future gas and crude oil prices on the average gas and crude oil prices as reported in the Wall Street Journal on November 13, 14 and 15, 2001. Based on the numbers examined, Mr. Hager determined that Narragansett would have to make fuel index trigger payments of .262 cents per kWh in the pre-merger Narragansett zone for only the months of January through March 2002.³ Thereafter, Mr. Hager did not foresee the need for further fuel index trigger payments. Therefore, the total SOS cost would equate to the contract price from April through December 2002 and during 2003 and 2004.⁴ It was Narragansett’s proposal to offset the fuel index trigger payments with the expected over-collection of SOS costs from October through December 2001.⁵

In her pre-filed testimony, Jeanne Lloyd noted that Narragansett’s proposed decrease of the SOS rate is based on a three-year weighted average of the cost Narragansett expects to incur under its SOS contracts from 2002 through 2004.⁶

² Narragansett Ex. 1B, Pre-filed testimony of Michael Hager, pp. 3-4.

³ Narragansett Ex. 1B, p. 7. No fuel index trigger payments would be due in the EUA service area. Id.

⁴ Id. Mr. Hager testified that the most recent Last Resort Service (“LRS”) contracts, entered into in August 2001, were 5.674 cents per kWh for the period September 2001 through February 2002 and 6.257 cents per kWh.

⁵ Narragansett Ex. 1A, p. 9.

⁶ Narragansett Ex. 1A, p. 5.

According to Ms. Lloyd, under its proposal, Narragansett expects to over-collect approximately \$30 million during 2002. During 2003, Narragansett expects to have a balance of approximately \$28 million in the SOS account. However, in 2004, Narragansett expects an under-recovery that would be set off by the over-recovery in 2002. Narragansett's calculations yield a three-year SOS rate of 4.662 cents per kWh for 2002, 2003 and 2004, assuming fuel prices do not increase drastically during this period. Ms. Lloyd explained, however, that even if the fuel index is triggered, the over-collection from 2002 would mitigate the impact on customers.⁷ She explained that it was Narragansett's goal to give consumers some rate stability in the wake of the consumer upset and confusion created by the rate instability during 2000 and 2001.⁸ Finally, Ms. Lloyd pointed out that a fixed price over the course of three years would provide customers and suppliers with a uniform price from which any long-term negotiated commodity arrangements can be compared.⁹

Ms. Lloyd did provide the Commission with alternative calculations for a one-year decrease and for a two-year weighted average.¹⁰ Ms. Lloyd stated that “[a]lthough the [one-year] rate is lower than the proposed three-year rate, the disadvantage of using a one year average is rate instability.”¹¹ Given the customer upset and confusion over the last two years, lowering the rate in 2002 only to raise it again in 2003 was “undesirable.”¹² Similarly, while the two-year rate provided a lower rate and some rate

⁷ Id. at 6-7.

⁸ Id. at 5-8.

⁹ Id. at 7.

¹⁰ A one-year rate decrease would set the SOS rate at 4.173 cents per kWh for 2002. A two-year weighted average SOS rate would be 4.438 cents per kWh for 2002 and 2003. Id. at 7-8.

¹¹ Id. at 7-8.

¹² Id. at 8.

stability, “[t]he two-year rate, however, stops one year earlier than the proposed three year plan and does not match [Narragansett’s] distribution rate freeze period.”¹³

Ms. Lloyd next addressed the reconciliation of an over-collection of SOS costs and an under-collection of LRS costs for the period October 2000 through September 30, 2001.¹⁴ Narragansett proposed offsetting the LRS under-collection of \$2,095,094 against the SOS over-collection of \$3,842,280, thus netting an over-collection of \$1,747,186 to be used in reducing the SOS rate.¹⁵ In addition, Narragansett estimated an over-collection of approximately \$3.9 million for the period October 1, 2001 through December 31, 2001. This over-recovery would be used to offset expected \$3.4 million in fuel index adjustment payments for the period January through March 2002.¹⁶

B. Transition Charge

In her pre-filed testimony, Ms. Lloyd explained that the transition charge is intended to recover the contract termination charge (“CTC”) that was billed to Narragansett by New England Power (“NEP”) when NEP released Narragansett from the requirements contract whereby Narragansett contracted to buy all the power from NEP that was required to serve its customer load.¹⁷ The Non-Bypassable Transition Charge Adjustment Provision was established in the merger agreement between Narragansett, Newport Electric Company and Blackstone Valley Electric Company.¹⁸

¹³ Id. at 8.

¹⁴ Narragansett testified that in the future, its filings for each calendar year will be based on the twelve-month period from October 1 of the previous year to September 30 of the current year in order to base the filing on actual, rather than projected numbers, thereby increasing the accuracy of the projections. This year, the filing is based on a nine-month period January 1 through September 30, 2001. See Narragansett Ex. 1A, p. 17-18.

¹⁵ Id. at 10-11.

¹⁶ Id. at 11-12.

¹⁷ Id. at 12.

¹⁸ Id., see Order No. 16200 (issued March 24, 2000).

Narragansett reconciles transition revenues on an annual basis in accordance with the requirements of its Non-Bypassable Transition Charge Adjustment Provision. The provision requires an annual reconciliation of Narragansett's total CTC expense against Narragansett's total revenue from the Transition Charge. Any over or under-collection is to be refunded to or collected from customers, with interest. Ms. Lloyd indicated that the current rate of .988 cents per kWh produced an over-recovery of \$1,892,233 for the period January 2001 through September 30, 2001.¹⁹ In order to refund the over-collection in the 2001 transition charge reconciliation, Narragansett proposed to reduce the 2002 weighted average Transition Charge of .921 cents per kWh by a credit factor of .025 cents per kWh, producing a net transition charge of .896 cents per kWh.²⁰

C. Transmission Rate

In her pre-filed testimony, Ms. Lloyd outlined the four components of Narragansett's proposed reduction in the Transmission Adjustment Factor: (1) a decrease of .068 cents per kWh to represent a decrease in forecasted transmission costs for 2002; (2) a decrease of .081 cents per kWh to eliminate the transmission reconciliation factor from 1999; (3) a decrease of .076 cents per kWh to eliminate the transmission reconciliation factor from 2000; and (4) a decrease of .122 cents per kWh to refund an \$8.7 million over-collection from the 2001 transmission charge.²¹ The net result was a proposed decrease of .347 cents per kWh, reducing the Transmission Adjustment Factor from .411 cents per kWh to .064 cents per kWh.²²

¹⁹ Id. at 16-17. In order to provide the Commission with more accuracy in calculations, Narragansett is using only a nine month reconciliation period for 2001. Beginning with next year's reconciliation filing, Narragansett will be using the 12-month period October 2001 through September 30, 2002. Id. at 17-18.

²⁰ Id. at 17-18. The weighted average transition charge is based on a formula comparing the transition charges of the Narragansett zone and the EUA zone. Id. at 15-16.

²¹ Id. at 19.

²² Id. at Exhibit JAL-1, p. 1.

Narragansett forecasted total transmission costs for 2002 of approximately \$42.8 million, resulting in a unit cost of 0.583 cents per kWh for 2002, or .068 cents less than the 2001 average transmission expense of .651 cents per kWh. Also, Ms. Lloyd explained that the current transmission rate had created an over-collection as of September 30, 2001.²³ Narragansett proposed to return \$8.7 million of this over-collection to customers through a credit factor of .122 cents per kWh. Narragansett proposed to retain the remaining \$5.1 million, representing disputed ISO Tariff charges, as a deferred line item pending resolution of disputed ISO Tariff charges for the years 1999, 2000 and year-to-date 2001. Narragansett indicated that it expected a resolution of the matter within the next year. In the event arbitration is successful, Narragansett would then refund the \$5.1 million to customers. If, however, arbitration is unsuccessful, the Commission would have the opportunity to rule on the recovery of the expenses by Narragansett.²⁴ If recovery were allowed by the Commission, Narragansett would be able to recover those costs without raising rates.²⁵

Ms. Lloyd then noted that Narragansett's current transmission reconciliation adjustment factors of .081 cents and .076 cents per kWh, put into place on June 1, 2000 and January 1, 2001, respectively, to recover under-collections for the years 1999 and 2000, respectively, were no longer necessary as the balance in the transmission reconciliation account for those two years was expected to be an over-collection

²³ Ms. Lloyd did not testify to the total amount in her pre-filed testimony. However, at the hearing, Ms. Lloyd clarified that the over-collection was \$13.8 million, \$8.7 million to be returned through this rate filing and the remaining \$5.1 million to be held as a deferred line item for the benefit of the ratepayers. Tr. 12/10/01, pp. 175-76.

²⁴ Narragansett Exhibit 1A, pp. 21-22.

²⁵ Id.

\$260,116 as of December 31, 2001.²⁶ Therefore, Narragansett proposed to end the billing of these adjustment factors for consumption on and after January 1, 2002.

In her pre-filed testimony, Ms. Anne Rodrigues explained that since January 1, 1998, Narragansett has been taking transmission services on behalf of its entire customer base under two open access transmission tariffs approved by FERC. Under ISO-NE's FERC Electric Tariff No. 1, ISO-NE provides Scheduling System Control and Dispatch, Energy Administration Service, and Reliability Administration Service. In addition to these charges, Narragansett is charged certain energy uplift charges which are currently under dispute between Narragansett and its Standard Offer power suppliers and, therefore, are being deferred through the Transmission Adjustment Clause. Finally, during 2001, changes were made to NEPOOL's FERC Electric Tariff No. 1, with some of the charges made retroactive to September 1, 1998.²⁷

Ms. Rodrigues estimated Narragansett's total transmission and ISO-NE expenses for 2002 to be approximately \$42.8 million. She explained that her estimate included charges under NEP Tariff 9, NEPOOL's FERC Tariff No. 1, charges for congestion costs and charges under ISO-NE's tariff. Estimates for NEP Tariff 9 charges were based on NEP's actual expenses from September 2000 through September 2001 with two adjustments. Ms. Rodrigues indicated that she made a \$2.6 million increase to reflect additional costs associated with forecasted capital additions anticipated during the next rate period. Second, she made a decrease to reflect an estimated \$1.2 million refund to be made to Narragansett by the end of the first quarter of 2002.²⁸

²⁶ Id. at 23-24.

²⁷ Narragansett Ex. 1C, Pre-filed testimony of Anne M. Rodrigues, pp. 2-6.

²⁸ Id. at 6.

The estimated NEPOOL charges for 2002 were based on current rates with adjustments for an estimated annual increase to become effective June 1, 2002. Ms. Rodrigues' estimate included \$17 million in charges for certain Reactive power charges and for Black Start service, representing a \$12 million increase in prospective costs plus \$5 million in retroactive Black Start charges recently approved in NEPOOL's FERC Electric Tariff No. 1.²⁹

Ms. Rodrigues explained that congestion costs are the costs associated with transmission capacity shortages in New England. She further explained that the incremental congestion costs are currently allocated to all transmission customers throughout New England regardless of the location of the congestion. Ms. Rodrigues indicated that although, historically, there had been an escalating trend in congestion costs, actual congestion costs for 2001 were 48% lower than originally estimated, indicating that the congestion costs in New England have stopped escalating. Ms. Rodrigues explained that for 2002, she assumed no increase in congestion costs over 2001 because of three factors: (1) less new construction is expected in congested areas; (2) new generation is expected to be on-line in 2002; and (3) less summer load growth is expected in 2002 than that which occurred in 2001.³⁰

Finally, Ms. Rodrigues indicated that ISO-NE's 2002 tariff charges included the disputed Energy Uplift Expenses which, under a new methodology, are estimated at 50% of the average Energy Uplift for October 2000 through June 2001.³¹ Ms. Rodrigues concluded that her estimate of Narragansett's 2002 total expenses for transmission service, congestion costs and ISO-NE related services represented an overall 7.3%

²⁹ Id. at 6-7.

³⁰ Id. at 7-10.

decrease in the transmission costs recovered through transmission rates previously approved in Docket No. 3243.³²

III. DIVISION

In response, on December 7, 2001, the Division of Public Utilities and Carriers (“Division”) submitted a Memorandum prepared by Stephen Scialabba, its Chief Accountant.³³ Mr. Scialabba indicated that both he and Division expert, Dr. John Stutz, had reviewed the filing made by Narragansett. Mr. Scialabba indicated that after review, the Division supported the standard offer, transition and transmission rates proposed by Narragansett.³⁴

With regard to Narragansett’s proposal to set the SOS rate based on the averaging of the 2002-2004 SOS supply contract costs, Mr. Scialabba indicated that the Division had asked Narragansett to propose the option of a retail SOS rate averaged over the three-year period to coincide with the distribution rate freeze period. Mr. Scialabba opined that this pricing was beneficial in five ways. First, it provides extended price stability for the power supply component of a customer’s bill. Second, in the event of a spike in fuel prices, the proposal provides a “cushion against the fuel adjustment provision of the [SOS] supply contract.” Third, the averaged price of 4.662 cents per kWh provides a higher target for competitive suppliers to beat in 2002 than the 4.2 cents per kWh called for in the SOS supply contract. Mr. Scialabba noted that although the three-year pricing proposal results in a lower rate to beat in 2004 than the SOS supply contract price of 5.1 cents per kWh, in that year the Massachusetts standard offer expires, an event that would

³¹ Id. at 8, see Narragansett Ex. 1B, p. 11.

³² Narragansett Ex. 1C, p. 9, see Order No. 16636 (issued June 13, 2001).

³³ Division Ex. 1, Memorandum dated 12/7/01, p. 1.

³⁴ Id. at 1.

hopefully spark retail competition in the region. Fourth, Narragansett would retain no benefit from the 2002 over-collection, but rather, the surplus balance will accrue interest and be applied to pay the higher SOS supply contract cost of 5.1 cents in 2004. Fifth, Mr. Scialabba pointed out that when the SOS supply contract was initially accepted in 1997, there was a presumption that a competitive retail market would exist for all electricity customers by 2001. However, at this time, the competitive supply option is only available to the largest electricity customers.³⁵

Mr. Scialabba emphasized that “the three year pricing option provides long-term price stability, at what are objectively reasonable rates for Rhode Island customers...[in that] the combined rate in January 2002 for generation, transition, and transmission [is] about 20% less for a residential customer than the combined rate for those elements in effect in July 1997 (7.584 cents per kWh in 1997 vs. 6.058 cents per kWh in 2002).”³⁶

IV. HEARING

A public hearing was held at the Commission’s offices, 89 Jefferson Boulevard, Warwick, Rhode Island, on December 10, 2001. The following appearances were entered:

FOR NARRAGANSETT:	Ronald T. Gerwatowski, Esq.
FOR DIVISON:	William K. Lueker, Esq. Assistant Attorney General
FOR COMMISSION:	Cynthia G. Wilson, Esq. Senior Legal Counsel
	Steven Frias, Esq. Executive Counsel

³⁵ Id. at 1-2.

³⁶ Id. at 2 (emphasis added).

A. Public Comment

Following the entry of appearances, the Commission opened the floor to accept public comment. At that time, Mr. Jason Holt, Esq., special counsel to the House Corporations Committee entered his appearance and presented the written “Direct Testimony of Robert B. Stoddard on behalf of The Hon. John B. Harwood Speaker of the House of Representatives State of Rhode Island.” Mr. Stoddard is an economist with Charles River Associates, Incorporated, a consulting firm in Boston, Massachusetts.³⁷

The Division requested a brief recess to review the filing and Narragansett concurred. A forty-five minute recess was granted while the Commission and the parties reviewed Mr. Stoddard’s pre-filed testimony. In his pre-filed testimony, Mr. Stoddard noted that the URA stated, “lower retail electricity rates would promote the state’s economy and the health and general welfare of the citizens of Rhode Island.”³⁸ Therefore, he agreed that the reductions proposed by Narragansett would “represent a significant savings to Narragansett’s customers.” However, he believed that Narragansett’s three-year proposal would “create[] a substantial barrier to the development of retail electricity competition called for in the URA.”³⁹ Rather than approving the three-year plan, Mr. Stoddard recommended the Commission order the one-year plan because it was his opinion that the one-year plan would reduce rates and promote competition.⁴⁰

³⁷ Mr. Stoddard indicated that his “consulting practice centers on helping utilities, independent generation owners and other electricity market participants develop regulatory and business strategies to bridge the transition from regulated to decentralized markets.” Public Comment Ex. 1, Pre-filed Testimony of Robert B. Stoddard, p. 1.

³⁸ Id. at 2.

³⁹ Id.

⁴⁰ Id. at 5.

In offering his opinion, Mr. Stoddard made four points regarding Narragansett's proposal. First, he indicated that the averaging approach departed from normal cost-of-service ratemaking because the 2002 rates charged would be above the cost-of-service and the 2004 rates would be below Narragansett's cost-of-service.⁴¹ Second, Mr. Stoddard took issue with establishing a "rainy day fund" based on the Keynesian economic principle that spending should be encouraged during a recession. It was his opinion that providing the average household with an additional \$31 *over the course of 2002* would spur the economy.⁴² Third, Mr. Stoddard was concerned that only residential customers still taking SOS or LRS in 2004 would be able to recoup their above-cost payments in 2002.⁴³ Finally, Mr. Stoddard argued that *if* residential competition were to start in Rhode Island between 2002 and 2004, customers would be less likely to move off of SOS if the competitive suppliers were offering a rate below the 2004 SOS supply contract rate of 5.1 cents per kWh, but higher than the proposed averaged SOS rate of 4.662 cents. The result would be that a customer would have spent more between 2002 and 2004 and would now be reluctant to move to the competitive market because he or she would want to recoup his investment by remaining with the averaged rate.⁴⁴ He concluded that Narragansett's proposal would "effectively lock[] out widespread retail competition in Rhode Island until 2005."⁴⁵

Mr. Stoddard also argued that Narragansett did not put forth any evidence that a rainy day fund is necessary because it was his opinion that there is no evidence that the fuel price escalation that occurred relatively recently would be repeated. Therefore, he

⁴¹ Id. at 3-4.

⁴² Id. at 4 (emphasis added).

⁴³ Id.

⁴⁴ Id. at 4-5 (emphasis added).

also proposed an immediate refund to customers of a \$20 million credit recently received by Narragansett from its affiliate, New England Power Company (“NEP”), for the recent transfer of the SOS supply contract by NEP to another supplier. However, he proposed returning this SOS-related credit to all customers on Narragansett’s distribution system, regardless of their source of energy supply, by reducing the 2002 transition charge. This would result in an additional credit of \$19 to the average residential ratepayer *over the course of 2002*, or approximately \$1.58 per month, an amount Mr. Stoddard believed would spur the economy. In conclusion, Mr. Stoddard stated that “while Narragansett is to be commended for proposing lower rates as of January 1, [2002], the proposed rate design raises policy questions concerning its impact” on the economic health of Rhode Island and on competition.⁴⁶

The Commission reconvened after reviewing Mr. Stoddard’s pre-filed testimony. Mr. Stoddard took the stand and provided further direct testimony, highlighting points of his pre-filed testimony. He reiterated the fact that there were policy considerations for the Commission in Narragansett’s filing regarding whether the rates should be averaged over three years and whether the \$20 million credit Narragansett received from the transfer of the SOS contract from NEP to another supplier should be distributed to Narragansett’s ratepayers now.⁴⁷

Mr. Stoddard indicated that his concerns regarding the averaging of rates related to studies he had performed for an energy supplier regarding the cost to the supplier to enter the Rhode Island energy market.⁴⁸ Mr. Stoddard conceded, however, that even with

⁴⁵ Id. at 5.

⁴⁶ Id. at 5-8 (emphasis added).

⁴⁷ Tr. 12/10/01, pp. 11-15.

⁴⁸ Id. at 14.

the one-year option, “it may not be that even in 2004, we would see retail competition....” However, he wanted to keep the option open.⁴⁹

On cross-examination by counsel for Narragansett, Mr. Stoddard stated, “[a]ny attempt, though, to spark retail competition is a balancing act because the *only* way to really do it is to *raise the price to consumers* or to create a shopping credit against the distribution company’s rates that is actually confiscatory against a utility.”⁵⁰ Because this has not occurred, Mr. Stoddard indicated that there is currently not enough “headroom” to make it profitable for a competitor to enter the market.⁵¹

Mr. Stoddard agreed with counsel for Narragansett that a simplified definition of headroom is where a distribution company is forced to charge more than its actual cost for energy in order to give a competitor the opportunity to market its energy to a customer with a margin for profit.⁵² Mr. Stoddard indicated that 5.1 cents per kWh may be the price needed in order to spark competition.⁵³ Counsel for the Division pointed out that SOS energy prices rose to 6.3 cents per kWh in 2001. Mr. Stoddard responded that the competitive suppliers expected prices to again fall and as a result, in light of the SOS supply contract pricing, were not willing to enter the market.⁵⁴ Therefore, it was Mr. Stoddard’s position that the one-year plan would provide more opportunity in 2004 for a competitor to enter the market than would be provided by the three-year plan.⁵⁵

⁴⁹ Id. at 15.

⁵⁰ Id. at 17-18 (emphasis added). According to Mr. Stoddard, a shopping credit is an additional amount charged against the utility company that may substantially exceed the utility’s cost of providing power, thereby raising the cost of taking SOS service. When people leave SOS, the utility company is not allowed to recover the difference between its true cost and the shopping credit. See id. at 57-58.

⁵¹ Id. at 18.

⁵² Id. at 26. “Headroom is if the cost is 4.2 and suppliers will come in and say please make Narragansett charge five cents so I can sell it for [4.8].” Id.

⁵³ Id. at 18, 56.

⁵⁴ Id. at 43-44.

⁵⁵ Id. at 15-18.

Mr. Stoddard agreed with counsel for Narragansett that the three-year plan could be viewed as a form of hedging by Narragansett, with the goal of hedging to create price stability.⁵⁶ Noting that SOS service had increased in price during 2000 and 2001 due to the escalating fuel prices, counsel for Narragansett pointed out that the three-year pricing option would enable Narragansett to take advantage of the decreases in fuel costs, reduce rates to customers and still create the likelihood of stable rates. Mr. Stoddard responded that “[i]n the absence of viable retail competition it could well be prudent to allow Narragansett to engage in some fuel hedging.” Mr. Stoddard then acknowledged that residential retail competition has still not developed in Rhode Island. Nevertheless, he did not believe the three-year approach was the most beneficial option because it would take money out of the economy in the short-term and not return it until 2004.⁵⁷ However, he also agreed that low rates and price stability are positive aspects of rates as well.⁵⁸

With regard to the return to customers of the \$20 million credit received by Narragansett in connection with the transfer of the SOS supply contract from NEP to another supplier, counsel for Narragansett asked Mr. Stoddard whether the money should flow back to customers immediately or whether it should be held as a cushion in the event fuel prices escalate rapidly. Mr. Stoddard indicated that he did not see evidence of escalating fuel prices in the near future.⁵⁹ However, he also admitted that the sudden

⁵⁶ Hedging is price insurance against high gas prices. Kenneth Costello & John Cita, Use of Hedging by Local Gas Distribution Companies, NRRI 01-08, p. 40. The Commission has previously held that “...in this state, hedging is a form of price insurance that this Commission has felt is a necessary precaution, and that price stability is an important objective.” See Order No. 16745 (issued October 17, 2001).

⁵⁷ Tr. 12/10/01, pp. 19-24.

⁵⁸ Id. at 24.

⁵⁹ Id. at 34-5.

increase in fuel costs that only stabilized less than a year ago was a surprise to him and that he could not predict where fuel prices would go in the future.⁶⁰

Mr. Stoddard testified that if the one-year approach was followed and the \$20 million SOS-related credit was returned to every customer on the distribution system, not just to the customers taking SOS, an average residential SOS customer would see a decrease or savings of \$4.20 per month over the cost of the three-year plan during the course of 2002. If the \$20 million credit was not taken into account, the average residential customer would still see a decrease of approximately \$2.55 per month over the cost of the three-year plan during 2002. However, under the one-year approach, the average residential SOS customer would see an increase of \$2.40 annually or 20 cents per month, over the cost of the three-year plan in 2003 and an increase of \$33.60 annually or \$2.80 per month, over the cost of the three-year plan in 2004.⁶¹ Mr. Stoddard conceded, however, that he had done no studies to determine whether the residential electric customers in Rhode Island would prefer to have the certainty of price stability over several years or to pay a lower rate for an initial twelve month period, knowing the rate was almost guaranteed to rise a year later.⁶²

The Commission also heard testimony from Mr. Michael J. Swider, a Market Strategist from Strategic Energy, an energy retailer. Mr. Swider indicated that when the time is right, Strategic Energy would like to enter the Rhode Island market. Mr. Swider testified that the fixed three-year SOS price would be difficult to beat.⁶³ Therefore, Mr. Swider argued that in order to boost competition in Rhode Island, the Commission should

⁶⁰ Id. at 78-9.

⁶¹ Id. at 39-41.

⁶² Id. at 53.

⁶³ Tr. 12/10/01, p. 212.

keep to the SOS contract pricing schedule of 4.2 cents per kWh in 2002, 4.7 cents in 2003 and 5.1 cents in 2004.⁶⁴ However, under pointed questioning from the bench, Mr. Swider stated that he was unable to indicate at what SOS price Strategic Energy would be able to enter the market.⁶⁵ Furthermore, Mr. Swider could give the Commission no assurance that Strategic Energy would ever enter the Rhode Island market.⁶⁶

B. Narragansett's Testimony

At the hearing, Mr. Hager, Ms. Lloyd and Ms. Rodrigues testified on behalf of Narragansett. Ms. Lloyd made some changes to her pre-filed testimony. She indicated that when the filing was made, she had based her transition charge calculations on estimates. In the time between the filing and the hearing, she was able to perform the calculations using actual data, resulting in a greater decrease in the transition charge than expected. The revised proposed transition charge was \$.00874 per kWh rather than \$.00896 per kWh.⁶⁷ Ms. Lloyd also testified that she had made a calculation error when determining the transmission charge. A rectification of her error resulted in a greater decrease in the transmission charge as well. The revised proposed transmission charge was \$.00063 per kWh rather than \$.00064 per kWh.⁶⁸ The result for a typical residential customer using 500 kWh of service would be a decrease of 11.1% equal to \$6.78. Therefore, the average monthly residential bill would drop from \$61.02 to \$54.24.⁶⁹

⁶⁴ Id. at 215-17.

⁶⁵ Id. at 217-18.

⁶⁶ Id. at 223.

⁶⁷ Tr. 12/10/01, p. 158.

⁶⁸ Id. at 159-60.

⁶⁹ Narragansett Ex. 1A, Exhibit JAL-16, REVISED, p. 1.

1. Standard Offer Service

a. Methodology

Ms. Lloyd testified that the three-year plan presented a very good probability of rate stability over the three-year period 2002-2004. Although she indicated that it was possible that fuel prices could rise enough to trigger the fuel index payment provision of the SOS supply contract, Mr. Hager testified that in the time from the filing of this case to the hearing date, fuel prices had not changed significantly. In addition, he explained that the fuel index trigger price in the SOS supply contract was scheduled to rise in 2002 and again in 2003, thus providing more of a cushion against the possibility of rising fuel prices affecting the SOS price.⁷⁰

In regards to the expected fuel index payments during the first quarter of 2002, Ms. Lloyd explained that Narragansett was anticipating an over-recovery for the fourth quarter of 2001 and would use that over-recovery to pay the amounts due in 2002. Mr. Hager elaborated on Ms. Lloyd's testimony, explaining that the SOS rate reduction had taken the additional fuel index payments in 2002 into account by applying the over-recovery anticipated through September 30, 2001 to the SOS rate reduction.⁷¹

Finally, Mr. Hager testified that in the past, competitive suppliers and customers have indicated that it would be beneficial for a benchmark price to be established for a period of time. This would provide customers with a certain comfort level from which they could compare prices and would provide suppliers with a known price to beat.⁷²

⁷⁰ Tr. 12/10/01, pp. 163-167.

⁷¹ Id. at 168-69.

⁷² Id. at 170-71.

b. Reconciliation Account Off-Set

Narragansett's filing proposed to offset the LRS under-collection for the period October 2000 through September 2001 against the SOS over-collection for the same period. Ms. Lloyd and Mr. Hager explained that although the LRS under-collection developed during October 2000 through September 2001 period, the majority of the under-collection resulted from the fact that between November 2000 and January 2001, due to highly volatile market prices, Narragansett was unable to enter into a fixed-price contract for LRS service for each month. As a result, the LRS charges established for each month were based on an estimate of what the upcoming highly volatile market prices were likely to be, in light of the previous month's prices, and released to customers five days prior to the following month. For example, Mr. Hager stated that on November 25, 2000 Narragansett looked at November's wholesale energy clearing prices and estimated December's LRS charges. However, because energy prices rose dramatically in December 2000, there was an under-collection of LRS costs of nearly a million dollars for December 2000.⁷³ Ms. Lloyd further explained that during the period November 2000 through January 2001, non-residential customers made up approximately 55% of the total customers taking LRS. In contrast, as of September 2001, non-residential customers made up only 12.3% of the total customers taking LRS.⁷⁴ Ms. Lloyd also confirmed that Narragansett has the ability to determine who was taking LRS during the period of time when the under-collection was incurred.⁷⁵

Ms. Lloyd conceded that while it was Narragansett's position that the offset proposal for recovering the LRS under-collection created a "seamless way of eliminating

⁷³ Id. at 190-93.

⁷⁴ Id. at 194-95.

the expense without impacting customer bills,” customers taking SOS are impacted by the fact that there could have been a greater reduction in the SOS rate but for the off-set proposal.⁷⁶ She also agreed that the customers taking SOS were not factors in the creation of the LRS under-collection.⁷⁷ Finally, she acknowledged that the non-residential customers who took LRS during the period of time in question and then went to competitive suppliers, only taking distribution from Narragansett, would not be assessed with the recovery of the LRS under-collection.⁷⁸

Nevertheless, Narragansett moved to admit its response to Commission Data Request 1-7 wherein Narragansett made four arguments regarding why its offset proposal for recovering the LRS under-collection was the best choice for the Commission to approve. First, Narragansett argued that approval of its proposal would not have any precedential effect because of the unique circumstances surrounding the accumulation of the LRS under-collection. Narragansett argued that the under-collection occurred at the end of a transition period when the LRS price was not directly tied to the cost of service, but rather, was based on an estimation of upcoming market prices. Because the transition period is over and LRS is now based on the cost of entering into LRS fixed-price contracts, Narragansett does not expect the same under-collection situation to arise again.⁷⁹ At the hearing, Mr. Hager testified that he believed Narragansett would, in the future, be able to enter into fixed-price contracts for LRS.⁸⁰

⁷⁵ Id. at 195-96.

⁷⁶ Id. at 196.

⁷⁷ Id. at 202.

⁷⁸ Id. at 198, 200-01.

⁷⁹ Narragansett Ex. 2, Response to Commission Data Request 1-7, p. 1.

⁸⁰ Tr. 12/10/01, pp. 205-06.

Second, Narragansett argued that because some of the LRS customer accounts that contributed to the under-collection are no longer active, there would be a small cross-subsidization among the subset of former LRS customers if the Commission ordered Narragansett to recover the under-collection from the LRS accounts that were active when the under-collection developed. Furthermore, Narragansett argued that because of cycle billing, there would be no way to determine an LRS customer's exact usage during the period of time when the under-collection developed. Therefore, Narragansett indicated that an adjustment factor would not be precise.

Narragansett also indicated that previously, a SOS under-collection for 2000 was combined with the LRS under-collection for the same period of time and then charged back to all customers on the distribution system through the standard offer adjustment factor ("SOAF").⁸¹ At the hearing, Ms. Lloyd asserted that Narragansett's current proposal is similar because in this case, Narragansett is still adding the two balances together and simply coming out with a net over-collection.⁸² However, at the hearing, Ms. Lloyd acknowledged that any customers that left the distribution system prior to the implementation of the SOAF were not assessed for the under-collection that occurred while they were on the system.⁸³

Third, Narragansett argued that the assessment of a surcharge on the non-residential customers who took LRS during the period of time when the under-collection was created and had since left LRS to take energy from a competitive supplier would create customer upset and confusion.⁸⁴ At the hearing, Ms. Lloyd acknowledged that the

⁸¹ Narragansett Ex. 2, Response to Commission Data Request 1-7, p. 2.

⁸² Tr. 12/10/01, pp. 196-97.

⁸³ Id. at 201-02.

⁸⁴ Narragansett Ex. 2, Response to Commission Data Request 1-7, p. 2.

non-residential customers on LRS between November 2000 and January 2001 were aware that the prices they were paying were only estimates.⁸⁵ On the other hand, Mr. Hager opined that while the larger non-residential customers may have been aware that their payments were based on estimates which could lead to an under-collection of actual LRS costs, they probably did not believe they would be made responsible for such charges once they left LRS to purchase energy from a competitive supplier.⁸⁶

Fourth, Narragansett argued that customers taking LRS during the period when the under-collection was created are a subset of the total current LRS customers. Assessing recovery for the under-collection against only that subset would be administratively burdensome because the billing system is not set up for that function. Narragansett stated that it is able to assess charges on the entire customer base or even a specific rate class. However, assessing charges on a subset of a rate class for a relatively short period of time would require hand billing.⁸⁷

2. Transition Charge

Ms. Lloyd explained that the proposed transition charge included a credit of \$.025 per kWh to account for an over-recovery for the period January 2001 through September 2001. She explained that the transition charge has a required yearly reconciliation provision. The reconciliation is filed in late November of each year in order to go into effect for January 1 of the following year. As a result, the reconciliation, if based on the twelve-month period January through December, would have to include estimations for October through December. She further explained that because calculations are more accurate if performed with actual figures rather than with estimations, Narragansett was

⁸⁵ Tr. 12/0/01, pp. 202-03

⁸⁶ Id. at 203-04.

proposing to use the nine-month calculations for 2001 and to use the twelve-month period of October through September for each year thereafter.⁸⁸

3. Transmission Rate

On cross-examination, Ms. Lloyd clarified that the amount of the transmission over-collection was \$13.8 million.⁸⁹ Her pre-filed testimony had indicated that there was an over-collection of transmission charges in the amount of \$8.7 million. She had then stated that the company was proposing to refund that amount back to the ratepayers through the new proposed rate. However, she had also stated that Narragansett was proposing to retain the remaining \$5.1 million, representing disputed ISO Tariff charges, as a deferred line item until the dispute was resolved.⁹⁰ Therefore, on cross-examination, she explained that the proposed \$8.7 million was the correct amount to be refunded and the \$5.1 million was to be collected from ratepayers, earning interest on behalf of the ratepayers until the disputed ISO Tariff charges were resolved, expected during 2002.⁹¹

Mr. Hager explained that the disputed ISO Tariff charges included uplift related expenses in the energy market, certain ISO tariff expenses, and further miscellaneous charges. One supplier has taken the position that it did not have responsibility for the miscellaneous expenses. Narragansett agreed to abide by the terms of the contract while resolving the matter through arbitration. In the meantime, the funds representing charges that would be due in the event Narragansett was unsuccessful at arbitration would be held by Narragansett until resolution.⁹²

⁸⁷ Narragansett Ex. 2, Response to Commission Data Request 1-7, pp. 2-3.

⁸⁸ Tr. 12/10/01, pp. 173-75.

⁸⁹ Id. at 175-76.

⁹⁰ Narragansett Ex. 1A, pp. 21-22.

⁹¹ Tr. 12/10/01, pp. 176-77.

⁹² Id. at 178-79.

Finally, Ms. Rodrigues explained that in 2001, FERC ordered Black Start generators to receive compensation retroactively to September 1998. Many Black Start generators submitted bills to ISO during 2001 and Narragansett was billed for those charges. However, another generator was in the process of submitting two years worth of bills to ISO and Narragansett was expecting to be billed for these charges in January 2002. Ms. Rodrigues confirmed that she had included the anticipated charges in the calculations for this filing.⁹³

4. \$20 million Credit

Regarding the \$20 million credit received by Narragansett from NEP in connection with the transfer of the SOS supply contract from NEP to another supplier, Narragansett testified that it had not proposed to return the money to customers because retaining the sum creates a cushion against a potential fuel price spike similar to that which occurred less than a year before the filing of this case.⁹⁴ In addition, Mr. Hager pointed out that the transfer of the SOS supply contract to the current supplier at the same SOS rates was weighed against a supply contract that would only provide a benefit to SOS customers from 2007 through 2009. Therefore, Mr. Hager testified that the issue raised a policy concern regarding whether the \$20 million should be returned to customers when the rates were already dropping or whether it should be left in an interest-bearing account to assist customers as the SOS rate begins to rise.⁹⁵ However,

⁹³ Id. at 180. Black start generators are those generators that can self-start without the use of electricity from another source. These are generators that can re-energize the transmission system in the event it loses power.

⁹⁴ Id. at 182-83.

⁹⁵ Id. at 186-87.

despite Narragansett's statements, Mr. Gerwatowski stated that Narragansett had not thoroughly considered the distribution of the \$20 million for purposes of this filing.⁹⁶

C. Division's Testimony

The Division presented Mr. Stephen Scialabba, Chief Accountant for the Division and Dr. John Stutz, Vice President of the Tellus Institute, as witnesses.⁹⁷ Mr. Scialabba adopted his December 7, 2001 memorandum to the Commission as his pre-filed testimony in this matter. The Division presented its witnesses to specifically respond to the testimony of Mr. Stoddard.⁹⁸

Dr. Stutz testified that despite Mr. Stoddard's testimony, which Dr. Stutz found useful, his position had not changed regarding the company's three-year pricing proposal.⁹⁹ Dr. Stutz stated that the decision regarding the proposal presented a policy issue for the Commission.¹⁰⁰ He testified that he agreed with Mr. Stoddard's statement, "[b]asically, while concern over potential rate volatility is prudent, the Commission should weigh that risk against the benefits of lower rates."¹⁰¹ Dr. Stutz then stated that while he agreed with the statement, he wished to speak in favor of rate stability.¹⁰²

Dr. Stutz reminded the Commission that the effects of the high fuel prices from 2000 and 2001 had not been forecasted. Furthermore, Dr. Stutz indicated, future fuel price trends can not be adequately forecasted. Therefore, he stated that the main question

⁹⁶ Id. at 185.

⁹⁷ Dr. Stutz has had extensive experience with energy-related matters, particularly with regard to public utilities. Since 1977 he has appeared before Public Utility Commissions in 36 states, the District of Columbia, and three Canadian provinces. In total, he has appeared in approximately 140 utility proceedings. He has testified on a variety of topics involving planning, pricing, and regulatory policy in cases involving electric, gas, and telephone companies. See Tellus Institute Website.

⁹⁸ Id. at 110.

⁹⁹ Id.

¹⁰⁰ Id.

¹⁰¹ Id. at 100-11.

¹⁰² Id. at 111.

for the Commission was whether they wanted to approve a “rainy day” or hedge fund to promote rate stability.¹⁰³ Dr. Stutz pointed out that Mr. Stoddard had testified that people dislike uncertainty. Dr. Stutz agreed with this statement and indicated that he believed stability has economic benefits because, although “[t]hey’re not the fiscal shot in the arm, they give people comfort spending money.”¹⁰⁴ He opined that when people are able to have more certainty when budgeting their money, they are more willing to spend.¹⁰⁵

With regard to the issue of competitive market development, Dr. Stutz stated that he believed having a stable price to beat is a good feature. However, he voiced concerns about attempting to engineer a price to beat. He noted that 2004 is a relatively long time from December 2001, given the difficulty in predicting the fuel price market over the course of only a few months. He also believed that it will be relevant to observe what happens to residential customers when the Connecticut and Massachusetts standard offer contracts expire in 2005. Finally, he stated that nobody wanted to move customers into the market only to see them stranded a year later. As a result of these concerns, he recommended following the Narragansett proposal in order to afford customers some certainty.¹⁰⁶

Addressing the netting of the LRS under-collection against the SOS over-collection, Dr. Stutz stated that when the Commission had approved the transition period during which LRS rates were estimated because of extreme market price volatility, it had left open the option of how to handle any over- or under-collection that might result. He testified that every situation has to be looked at in the context in which it is presented. In

¹⁰³ Id. at 112-13.

¹⁰⁴ Id. at 113-14.

¹⁰⁵ Id. at 114.

¹⁰⁶ Id. at 115-16.

his view, Narragansett's proposal made sense because, even with the offset, there would be a rate reduction for customers taking SOS. However, he also acknowledged that absent a rate reduction, he might not be making the same argument.¹⁰⁷

Mr. Scialabba prefaced his testimony by stating, "in my opinion the jury is still very much out on whether electric competition will ever take hold at the residential and small commercial level...."¹⁰⁸ Mr. Scialabba pointed out that even when the SOS rate had risen to 6.3 cents per kWh, competition for these customers still did not occur. "[T]he price to beat is maybe – if it's 4.8, 4.9, 4.7, we have had the rate significantly higher than that for the past 15 months or so and there still hasn't been any...activity in the retail market for small commercial or residential customers."¹⁰⁹ Furthermore, he noted that the effect on the market between Mr. Stoddard's plan and Narragansett's plan was really in the third year. He noted that under Mr. Stoddard's proposal, the 2002 SOS retail rate would be lower than Narragansett's proposal, thus providing marketers with even less incentive to enter the market in 2002. Second, in 2003, the difference between Narragansett's proposed retail rate and the SOS contract price was minimal (4.662 cents per kWh versus 4.7 cents per kWh). Third, Mr. Scialabba opined that if the market were going to open up in New England, it would likely occur subsequent to 2004, after the Connecticut and Massachusetts' standard offers expire by state statute. Therefore, in his opinion, it was reasonable for SOS rates to remain as stable as possible through 2004, after which there may be more opportunity and more incentive in the market for residential and other small customers to go to competitive suppliers.¹¹⁰

¹⁰⁷ Id. at 128-39.

¹⁰⁸ Id. at 116.

¹⁰⁹ Id. at 118.

¹¹⁰ Id. at 116-17.

Mr. Scialabba agreed that price stability is important to all customers, commercial, industrial and residential. He testified that when energy rates were volatile, the Division became aware of instances of customer upset and confusion. For example, Mr. Scialabba explained that many members of The Energy Council of Rhode Island (TEC-RI), made up of large industrial customers, had ceased taking SOS in order to buy electricity from a competitive supplier. In doing so, however, they were subjected to even more price volatility and higher prices than those remaining on SOS. Given the high rates and price volatility in the market, TEC-RI ultimately motioned the Commission for permission for its members to return to SOS.¹¹¹ Mr. Scialabba also pointed out that the Commission has given guidance regarding the issue of price stability. For example, in the gas arena, the Commission has approved gas supply purchasing programs that, rather than relying entirely on the market, promote price stability.¹¹²

With regard to the \$20 million credit received by Narragansett in connection with the transfer of its SOS supply contract to a new supplier, Mr. Scialabba testified that his initial inclination was to build up the money on behalf of the ratepayers to be used to reduce the rates during the final few years of the SOS contract.¹¹³ However, he had not made a final determination regarding the Division's position and believed that there was nothing so pressing that the issue could not be further examined after January 1, 2002.¹¹⁴

Addressing the netting of the LRS under-collection against the SOS over-collection, Mr. Scialabba testified “[f]or this particular filing,” the Division did not oppose Narragansett's proposal. Mr. Scialabba explained that because the LRS rate was

¹¹¹ *Id.* at 125-26. Current law prohibits any customer that has left SOS from returning to it. See R.I.G.L. § 39-1-27.3.

¹¹² *Id.* at 124.

¹¹³ *Id.* at 120.

set based on estimates of upcoming energy prices in a volatile market, rather than being allowed to float even higher market-based rates, a situation he did not expect to occur again, Narragansett's proposal was reasonable.¹¹⁵

V. OPEN MEETING DECISION

At an open meeting on December 13, 2001, the Commission considered the evidence presented and approved Narragansett's rate proposal as just and reasonable and in the best interests of the ratepayers.

VI. COMMISSION FINDINGS

The purpose of the URA is to promote competition in order to *reduce retail electricity rates*.¹¹⁶ The URA states in part, "[t]hat lower retail electricity rates would promote the state's economy and the health and general welfare of the citizens of Rhode Island..."¹¹⁷ Unfortunately, due to the high cost of oil and natural gas during 2000 and into 2001, electricity retail rates increased. As a result of the increased residential retail rates, on May 8, 2001, the Rhode Island House of Representatives passed House Resolution 2001 – H 6402, "Calling for a Review of Rhode Island's Utility Restructuring Act of 1996."¹¹⁸ The House indicated that because residential retail rates had increased

¹¹⁴ Id. at 121.

¹¹⁵ Id. at 126-28.

¹¹⁶ See R.I.G.L. § 39-1-1(d).

¹¹⁷ R.I.G.L. § 39-1-1(d)(1). The URA also states in part, "that current research and experience indicates that greater competition in the electricity industry would result in a decrease in electricity rates over time." R.I.G.L. § 39-1-1(d)(2). The Commission notes that the research was current five years ago, in 1996.

¹¹⁸ The Resolution stated:

WHEREAS, Residential customers of Narragansett Electric Company were paying electricity rates that were the sixth highest in the nation before seeing their bills increase five times since June, 2000; and
WHEREAS, Most Rhode Islanders now pay 30% more for electricity than they paid just nine months ago;
and

WHEREAS, Narragansett Electric's "Standard Offer Rate", the rate most Rhode Islander's pay, has risen from 3.8 cents per kilowatt hour in June, 2000 to 6.302 cents per kilowatt hour in April, 2001...an increase of 66%; and

WHEREAS, Rhode Island citizens must be protected from excessive electric-rate increases, especially our senior citizens, the disadvantaged, and those on a fixed income; and

since the passage of the URA, the House wished to re-examine the continuation of the Act.¹¹⁹

Wholesale gas and oil prices began to stabilize in early 2001. Since the passage of the House Resolution, those prices have even begun to fall. In addition, transmission congestion in New England has stabilized, causing transmission rates to also stabilize. As a result, the Commission is faced with the pleasant task of approving electric retail rates that are 14% below those charged in December 1997.¹²⁰ Having been faced with the difficult task of approving rate increases to cover spiking fuel prices during 2000 and 2001, the Commission is pleased to approve what may very well be the lowest SOS rates in New England.¹²¹ Because of the arguments that low SOS rates are the main reason for a lack of residential competition in Rhode Island, the Commission is keenly interested in

WHEREAS, The Utility Restructuring Act of 1996, intended to deliver industry competition and lower energy prices to Rhode Islanders, must be revisited and thoroughly examined; and

WHEREAS, In order to avoid the disastrous situation that exists in California today, where 30 blackouts are predicted for this summer, we must take immediate action; and

WHEREAS, The House of Representatives must determine whether said act should be repealed, amended, or left in its current form; and

WHEREAS, The Rhode Island House Corporations Committee will be asked to hold hearings on said 1996 law, to determine if the deregulated electricity industry in Rhode Island has been a failure, and to explore all available options to provide rate relief to all Rhode Island citizens; now, therefore be it

RESOLVED, That this House of Representatives of the State of Rhode Island and Providence Plantations hereby calls for a review of Rhode Island's Utility Restructuring Act of 1996 in order to bring energy costs under control and to make electricity affordable for all Rhode Islanders. 2001 H – 6402 House Resolution Calling for a Review of Rhode Island's Utility Restructuring Act of 1996.

¹¹⁹ *Id.* See “Alarmed over rising electric rates, Speaker Harwood calls for a review of R.I.’s electricity deregulation law,” Released by the Legislative Press and Public Information Bureau, 5/4/01. “Alarmed over skyrocketing *residential electricity rates*, House Speaker John B. Harwood today called for a comprehensive review and possible repeal of the state law, passed in 1996 by the General Assembly, that deregulated Rhode Island’s electricity generating industry.” *Id.* (emphasis added).

¹²⁰ The Commission notes that in December 1997, the average residential customer’s monthly electric bill was \$61.92 and will now be reduced to \$54.24, or a decrease of 14%. In addition, although the Commission made the difficult decisions to approve rate increases totaling approximately 27% between July 2000 and April 2001, the ratepayers now reap the benefits of the second rate reduction since October 2001, totaling approximately 27%.

¹²¹ The Commission takes note of the SOS rates charged by other New England Utilities (current as of 12/12/01): Central Maine Power - 4.95 cents per kWh effective 3/1/02; Bangor Hydro Electric - 5.0 cents per kWh effective 3/1/02; Maine Public Service Company - 5.689 cents per kWh effective 3/1/02, then moving to 5.802 cents per kWh effective 3/1/03; Boston Edison - 6.376 cents per kWh effective 1/1/02;

whether widespread retail competition develops in Massachusetts and Connecticut in connection with the expiration of SOS rates in those states in 2004.

In considering Narragansett's three-year SOS pricing proposal, the Commission acknowledges that this case presents a question of policy regarding how to best serve the interests of Rhode Island ratepayers. Mr. Stoddard, on the one hand, contends that competition, even if spurred by raising rates or by allowing rates to fluctuate with the market, best promotes the interests of ratepayers in the long-term, based upon the theory that while rates may increase early on, they will necessarily decrease as competition expands. The Division and Narragansett, on the other hand, contend that stable rates, even if they are, arguably, too low to spur the development of widespread residential retail competition, best serve the interest of Rhode Island's residential customers.¹²²

A. Competition for the Sake of Competition

Mr. Stoddard argued that the only way to promote competition is to raise the retail rates, either through the creation of headroom or by creating "shopping credits" that are confiscatory against Narragansett. The Commission has two responses to this recommendation. First, the Commission notes that, over the last five years, marketers have repeatedly testified that if the Commission would just raise the retail rates by a small amount, they could compete.¹²³ However, no marketer has provided the

Granite State Electric - 4.871 cents per kWh effective 1/1/02; Mass. Electric - 5.626 cents per kWh effective 1/1/02.

¹²² The Commission notes that a competitive retail electricity market does exist for Rhode Island's large customers. In Docket No. 3005, The Energy Council of Rhode Island ("TEC-RI"), an organization whose members include the largest commercial and industrial electric customers in Rhode Island, filed a letter to the Commission dated August 1, 2001, stating that all TEC-RI members had left LRS and were buying power from competitive electric suppliers.

¹²³ The rate "to beat" has crept up over time as the market price has also increased. However, it seems that Rhode Island is always just below the price where competition could begin. For example, in 1998, when the SOS rate was set at 3.2 cents per kWh, marketers argued that they could compete with a rate of 3.8 cents per kWh. See Order No. 15520 (issued July 10, 1998). Now the Commission is faced with the

Commission with any assurances that it would enter the Rhode Island residential market. Indeed, although SOS rates have been above 5.1 cents per kWh during the entirety of 2001, with the exception of large industrial customers with large electric loads, widespread retail competition – and, in particular, residential competition - still has not developed in Rhode Island. Therefore, the Commission finds that not a scintilla of evidence was presented to prove that residential retail competition is viable in Rhode Island.

Second, Mr. Stoddard acknowledged that headroom and shopping credits are ways of artificially increasing retail prices in order to spark competition.¹²⁴ However, this Commission has consistently held that it will not approve requests to raise the retail electric rates of Rhode Island residents simply for the sake of promoting competition.

The Commission has stated:

...it must be emphasized that the creation of *competition is beneficial only if it produces savings for ratepayers*. The payment of higher prices to create a competitive market, just for the sake of having a competitive market, is economic logic turned upside down. The Commission rejects it.¹²⁵

The Commission should not have to “create” a competitive residential market for the benefit of marketers and suppliers. If a competitive residential market is going to develop, it should be through a natural development, not through the imposition of artificially inflated prices designed to benefit the marketers and suppliers to the detriment of residential ratepayers.

Furthermore, this Commission believes that the intent of the General Assembly in passing the URA in 1996 and in revisiting the legislation in 2001, was not to promote

argument that the SOS rate would need to be at least 5.1 cents per kWh; even then, however, marketers cannot make a commitment to enter the residential electric market. See Tr. 12/10/01, pp. 18, 56.

¹²⁴ Tr. 12/10/01, p. 58.

residential retail competition *at any cost*, but only if competition would provide an economic benefit to ratepayers. This is especially evident in the language of House Resolution 2001 – H 6402, wherein the House stated “Rhode Island citizens must be protected from excessive electric-rate increases....”¹²⁶ Accordingly, the Commission believes it is reasonable to follow a course that is designed to promote competition *if the outcome is to reduce retail electric rates*.

B. Rate Stability

One aspect of the testimony was undisputed – people want certainty.¹²⁷ The Commission has previously noted that its “...longstanding policy is to promote rate stability and to avoid unnecessary fluctuations in rates. Minimizing the rate changes in this fashion should promote competition by providing competitors with a relatively fixed price against which to compete....”¹²⁸ In fact, Mr. Scialabba noted in his memorandum to the Commission that the 4.662 cents per kWh rate provides potential suppliers with a higher target to beat in 2002 than exists under the SOS contract rate of 4.2 cents per kWh. Furthermore, a three-year proposal provides both marketers and ratepayers a stable rate by which to compare competitive rates.¹²⁹

The Commission notes that the energy market is inherently uncertain. There are market price fluctuations each and every day. Both Mr. Stoddard and Dr. Stutz

¹²⁵ Order No. 15520 (issued July 10, 1998), Order No. 15521 (issued July 10, 1998) (emphasis added).

¹²⁶ 2001 H – 6402 House Resolution Calling for a Review of Rhode Island’s Utility Restructuring Act of 1996.

¹²⁷ Tr. 12/10/01, pp. 70 (Mr. Stoddard stated, “I think what people dislike most is uncertainty.”), 113 (Dr. Stutz stated that he agreed with Mr. Stoddard’s statement), 118 (Mr. Scialabba stated that he agreed that “customers like stable rates in Rhode Island), 171 (Ms. Lloyd adopted and reiterated her statement that customers have expressed “concern about the ups and downs that occur[ed] [with the rates].”)

¹²⁸ Order No. 15735 (issued December 31, 1998).

¹²⁹ The Commission has previously received testimony that stable prices over a longer period of time is preferred by competitive suppliers and assists customers in budgeting their energy costs. Order No. 16635 (issued June 13, 2001).

acknowledged that the market fluctuations that occurred in 2000 and 2001 were unforeseeable. In fact, none of the witnesses was willing to predict what the energy market would do next.

Mr. Swider testified that marketers have the ability to provide a level of certainty to customers when compared with the option of paying a different spot market price each day. However, there are no marketers currently marketing to residential customers in Rhode Island. Furthermore, this Commission notes that previously, residential customers were persuaded to leave SOS in order to take competitive supply, only to be stranded within a year in a non-existent market, with no choice but to take LRS when their supplier pulled out of Rhode Island. Therefore, until such time as a competitive market develops, this Commission will continue to follow its long-standing policy of approving rates designed to promote rate stability as being in the best interests of the ratepayers.

C. Standard Offer Service

The Commission finds that Narragansett's three-year SOS pricing proposal provides ratepayers with a level of rate stability necessary after the volatility of the past two years. Furthermore, we find the 4.662 cents per kWh charge to be just and reasonable. It will provide both customers and competitors with a benchmark by which to compare competitive rates.

We note that in the end, even Mr. Stoddard testified that he would favor a two-year pricing approach. However, we find that the three-year approach will hopefully provide Narragansett's ratepayers with a sense of stability and predictability through 2004. In 2004 when SOS is no longer an option for Connecticut and in 2005 when SOS is no longer an option for Massachusetts customers, the Commission will be looking at

the level of residential competition that develops in those states to determine whether there is a probability of successful residential competition for Rhode Island ratepayers.

With regard to the request by Narragansett that it be allowed to offset the LRS under-collection with the SOS over-collection, we first note that the majority of the \$2 million LRS under-collection at issue was incurred by large commercial and industrial customers who, having previously gone to competitive supply, returned to LRS at a time when the competitive market was quite volatile and energy prices were high. We also note that the LRS under-collection was created during a transition period when monthly LRS prices were set at estimated costs and not based on the actual market prices. Furthermore, we note that, as energy prices have stabilized, most of the large commercial and industrial customers have since left LRS to purchase their energy from competitive suppliers.

The Commission has the flexibility to allow recovery of an under-collection in several ways. It may order Narragansett to collect the balance from all customers, from those who were taking supply during the period of under-collection, or through any other reasonable means.¹³⁰ In this case, Narragansett can identify those customers who were on LRS during the period of under-collection, despite the fact that they have moved to competitive supply. Furthermore, in 2000, TEC-RI acknowledged that it understood LRS prices to be estimates that had the potential of producing an under-collection that would have to be recovered from customers.¹³¹ Therefore, there is no question that the Commission could require Narragansett to collect the balance from TEC-RI members as

¹³⁰ See Order No. 15639 (issued July 10, 1998) (citations omitted).

¹³¹ Order No. 16638 (issued June 14, 2001).

well as from any other non-residential customers who contributed to the LRS under-collection but have since gone to competitive supply.

However, in this case, Narragansett has proposed, and the Division supports, a method of collection that recovers the balance from all current SOS customers while still affording them a rate decrease. Given the unique circumstances surrounding the creation of the LRS under-collection, which are unlikely to reoccur, the Commission approves Narragansett's proposal as reasonable in this case. The Commission notes however, that it has held in other cases that customers who leave a balance when they move to competitive supply must compensate the Company. Therefore, the Commission emphasizes that it does not view this decision as a departure from past practice given the unique circumstances surrounding the creation of the LRS under-collection at issue. Furthermore, Narragansett and the Division have both indicated that, in light of the ability to procure fixed-price LRS supply contracts, it is unlikely such a situation will occur in the future.

D. Transition Charge

The Commission approves Narragansett's proposed transition rate of \$.00874 per kWh, finding it to be just and reasonable and supported by the evidence.

E. Transmission Rate

The Commission approves Narragansett's proposed transmission rate of \$.00063 per kWh, finding it to be just, reasonable and in the best interests of the ratepayers. The Commission is hopeful that the congestion charges in New England will remain stable, thus allowing the transmission rate to also remain stable.

The Commission notes that Narragansett is not refunding the entire amount of the transmission over-collection, pending resolution of disputed ISO Tariff charges. However, the Commission finds it to be reasonable that Narragansett hold the remaining \$5.1 million as a deferred line item. In the event Narragansett is unsuccessful in its challenge, it will have the opportunity to request the Commission approve recovery of the \$5.1 million without raising rates. On the other hand, if Narragansett is successful, it will return the balance to the ratepayers with interest.

F. \$20 million SOS Contract Credit

The Commission finds that it is reasonable for Narragansett to retain, for the benefit of the ratepayers, the \$20 million SOS contract credit through the Spring of 2002, with interest, to mitigate the impact on ratepayers of any unexpected energy price spikes that may occur. However, the Commission intends to schedule public hearings in the near future to consider how the \$20 million SOS contract will be used to achieve the maximum benefit for Rhode Island ratepayers.

V. CONCLUSION

The Commission is hopeful that the advent of competition truly will mean lower rates for all electric customers. To date, with regard to residential ratepayers, the Commission has only received testimony from marketers and suppliers indicating that SOS rates are too low for competition to develop. However, raising residential electric rates simply for the sake of promoting competition is not palatable and is not in accordance with the plain language of the URA. We note that large industrial customers are actively participating in the competitive electric supply market. As of August 2001,

all members of TEC-RI were purchasing energy from competitive suppliers. That is an encouraging sign for economic development.

It is also a sign that competitors are interested in supplying to customers with a large demand for electricity. Perhaps it is also a sign that if aggregation were allowed for residential customers, competitors may be interested in pursuing them as well.

Accordingly, it is hereby

(16916) ORDERED:

1. Narragansett Electric Company's proposed retail Standard Offer Service Rate of 4.662 cents per kWh is approved to become effective for service on and after January 1, 2002 through December 31, 2004.
2. Narragansett Electric Company's proposed Transition Rate of .874 cents per kWh is approved to become effective for service on and after January 1, 2002.
3. Narragansett Electric Company's proposed retail Transmission Rate of .063 cents per kWh is approved to become effective for service on and after January 1, 2002.
4. Narragansett Electric Company shall comply with all other findings and instructions as contained in this Report and Order.

EFFECTIVE AT WARWICK, RHODE ISLAND PURSUANT TO AN OPEN MEETING DECISION ON DECEMBER 13, 2001. WRITTEN ORDER ISSUED FEBRUARY 15, 2002.

PUBLIC UTILITIES COMMISSISON

Elia Germani, Chairman

Kate F. Racine, Commissioner

Brenda K. Gaynor, Commissioner