

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: NARRAGANSETT ELECTRIC COMPANY :
LAST RESORT SERVICE ACQUISITION PLAN : Docket No. 3605
FOR THE PERIOD BEGINNING SEPTEMBER 1, 2005 :

REPORT AND ORDER

I. Background

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

Rather than approving the actual LRS rates, the Public Utilities Commission (“Commission”) has been granted the authority by the General Assembly to approve a LRS acquisition plan, specifically, the acquisition procedure, the pricing options sought and the term of service. As long as Narragansett complies with an approved LRS acquisition plan, it is entitled to recover its costs associated with providing LRS.²

On December 17, 2004, the Commission approved Narragansett’s procurement plan for the period March 1, 2005 through August 31, 2005 for all customers, with an option for Narragansett to procure power for residential customers for additional periods if the average market price fell below certain specified levels. To better match the competitive market Narragansett would procure power for non-residential customers for only the first six month period. In accordance with the approved Acquisition Plan, Narragansett entered into a six-month all requirements, cost inclusive, load following

¹ R.I.G.L. § 39-1-27.3(c) (2002).

contract for LRS for residential and non-residential customers. No final responsive bids which complied with the terms of the approved Acquisition Plan were received for additional periods for residential customers. As a result, in accordance with the Acquisition Plan, Narragansett did not procure power beyond six months for LRS customers. Such procurement is the subject of this order.

Under R.I.G.L. § 39-1-27.3(c), the Commission is not required to conduct a full hearing regarding a proposed Acquisition Plan for each procurement and Narragansett may continue to procure power under the Acquisition Plan approved in this docket. However, “the Commission may periodically review the acquisition plan to determine whether it should be prospectively modified due to changed market conditions.”³ To determine whether the market conditions have changed since the Commission’s December 2005 decision in this docket, Narragansett was ordered to file with the Commission, by April 15, 2005, an assessment of the market as it exists at the time the procurement process would need to commence. The Division of Public Utilities and Carriers (“Division”) was required to provide the Commission with its position by May 15, 2005.

II. Narragansett’s Market Assessment

On April 15, 2005, Narragansett filed a Market Assessment, indicating that “based on its assessment of the New England wholesale and Rhode Island competitive retail markets and discussions with the Division...the Company recommends that it continue to procure LRS under the Current Acquisition Plan approved by the

² R.I.G.L. § 39-1-27.3(c) (2002).

³ R.I.G.L. § 39-1-27.3(c) (2002).

Commission in Docket No. 3605.”⁴ Specifically, Narragansett would procure LRS separately for two customer classes – residential and C&I for the period September 1, 2004 through February 28, 2005, with an option to enter into contracts for residential customers for the period March 1, 2005 through August 31, 2005.⁵ Specifically, Narragansett would procure the second six-month supply in the event that (1) the bids for the second six month period produce prices with an arithmetic average of less than or equal to ninety percent of the arithmetic average of the lowest price bidder for the first six-month period or (2) the arithmetic average of the monthly prices from the lowest bidder is less than or equal to ninety percent of the arithmetic average of the then current expected procurement cost (contract price plus fuel trigger adjustment component) of Standard Offer Service (“SOS”) for the same period or (3) the arithmetic average of the monthly prices from the lowest bidder is less than or equal to the arithmetic average of the lowest bid price for the first period, but only after consultation with and agreement from the Division.⁶

In arriving at its conclusion, Narragansett reviewed the following seven aspects of the market: (1) wholesale energy market trends; (2) lessons learned from previous RFPs; (3) wholesale market rule changes approved and implemented since the last procurement;

⁴ Narragansett Electric Last Resort Service Acquisition Plan April 2005 Market Assessment, filed April 15, 2005 (“Market Assessment”), p. 1.

⁵ Separating the customer classes is consistent with the 2003-2004 procurements because the residential LRS class does not presently have any realistic competitive supply choices and therefore, is relatively stable, whereas, over time, there has been a significant fluctuation in the number of customers and total loads on LRS which occurs when the timing of the LRS procurement does not track the market closely enough. In order to avoid market arbitrage where customers for whom a market is available use LRS as an alternative market supplier rather than as a true last resort option, Narragansett proposes only procuring LRS supply for the non-residential customers for a single six-month period. This will allow the LRS to more accurately reflect the market. Because of the significant fluctuations in LRS caused by non-residential customers, suppliers will calculate a higher “risk premium” into the bid price. Suppliers have indicated that requesting bids according to the two customer classes should mitigate the impact of this risk on residential customers. See Order No. 17532 (issued August 6, 2003).

⁶ Market Assessment, p. 1.

(4) anticipated wholesale market rule changes that may become effective during the period covered by the next solicitation; (5) recent procurement practices of other New England utilities; (6) changes in the number of customers taking competitive retail supply in Rhode Island; and (7) changes in the number of customers enrolled in LRS or the quantity of load to be served.⁷

First, Narragansett summarized recent wholesale market trends, noting that the clearing price in the wholesale energy spot market has shown an upward trend over the last few years. Narragansett opined that this trend will continue.⁸ Second, Narragansett indicated that the main lesson it has learned from previous RFPs is that suppliers have been unwilling to provide pricing beyond six months due to the volatility of the LRS customer base and uncertainty in the wholesale energy market prices.⁹ Third, Narragansett summarized recent and anticipated market rule changes. Narragansett indicated that any changes that could affect costs have been addressed in the power supply contract and put responsibility for any of those costs on suppliers.¹⁰ Fourth, Narragansett indicated that after a review of RFPs that have been issued by its affiliates and other New England distribution companies since the December 2004 LRS solicitation in RI, the Company believes that the process initially approved by the Commission in May 2004 and reaffirmed in December 2004 still represents the best

⁷ *Id.* at 2.

⁸ *Id.*

⁹ *Id.* at 3.

¹⁰ *Id.* at 3-4. Specifically addressing anticipated new Locational Installed Capacity (“LICAP”) rules, Narragansett noted that the supplier will be responsible for meeting its LICAP obligation for each month. If the supplier has sufficient power in its portfolio to meet the requirement, there will be no additional payments due. If the supplier has to procure additional power, there will be additional payments to the supplier from LRS customers through the annual reconciliation process. However, those payments will be capped at the market clearing price for each month regardless of the actual cost to the supplier. According to Narragansett, this approach will limit exposing LRS customer to premium prices due to LICAP market incentives. Under this scenario, Narragansett’s filed LRS rates will include an estimate of the LICAP costs.

practices for the procurement of LRS for the next six months.¹¹ Fifth, Narragansett indicated that the number of customers taking competitive supply since May 2004 has decreased by 99 customers or 3% since the November 2004 market assessment, the number of industrial customer taking competitive supply increased by 36, indicating both a willingness of Narragansett's largest customers to review competitive offers and take service from a competitive supplier. Furthermore, Narragansett noted that based on net customer count changes for LRS and SOS, it appears that approximately 336 SOS industrial customers may have elected to take service from competitive suppliers and that competitive suppliers have been able to compete against the SOS and LRS prices currently in effect.¹² Sixth, Narragansett indicated that the number of customers taking LRS has increased 15% since the last filing in November 2004 and that the load has decreased by 24%. The entirety of the increase was attributable to the residential and commercial customer groups. There was no increase in the number of industrial customers taking LRS.¹³ Finally, Narragansett reiterated that as part of its routine review of all contracts, it has made changes to clarify terms, and has reserved the right to negotiate specific contract changes with the suppliers, but will ensure that any changes do not shift risks or obligations described in the Acquisition Plan to customers. The Company also advised that it is in the process of developing a master power supply agreement to streamline the procurement process.¹⁴

In the event a final FERC decision is issued prior to the date when final, binding bids are due, the Company indicated that it may request suppliers to include the cost of LICAP in their bids. Id. at 3-4.

¹¹ Id. at 4.

¹² Id. at 5.

¹³ Id.

¹⁴ Id. at 5-6.

III. Division's Recommendation

On May 10, 2005, the Division submitted a Memorandum of Stephen Scialabba, its Chief Accountant. Mr. Scialabba summarized Narragansett's filing and recommendations. He noted that prior to filing its Market Assessment, the Company had consulted with the Division regarding the state of the market and the upcoming procurement process. He indicated that "the Division agrees that the Last Resort Service procurement should continue in the same manner as was done in the prior power procurement."¹⁵

IV. Commission Findings

On May 11, 2005, at an open meeting, the Commission considered the filings made by Narragansett and the Division and approved Narragansett's proposal to procure LRS for customers in accordance with the Acquisition Plan approved in this docket in Order Nos. 17903 and 18122. The Commission finds that, based on Narragansett's market assessment and the Division's recommendation, the Acquisition Plan will provide power supply contracts which are in the best interest of the residential and non-residential ratepayers who are current or future purchasers of electricity through the LRS supply.

Although not specifically addressed by the parties, the Commission also finds that continuation of the agreement between the parties in Docket 3444, as approved in Commission Order Nos. 17203, 17903 and 18122, is a reasonable approach to the issue of the Commission's right to review the prudence of Narragansett's discretionary actions

¹⁵ Division's Memorandum, filed December 1, 2004.

under the approved Acquisition Plan as well as to review Narragansett's actions for compliance with the Plan.¹⁶

Accordingly, it is hereby

(18250) ORDERED:

1. Narragansett Electric Company's proposal to continue following the Last Resort Service Acquisition Plan approved by the Commission in Order No. 17903 and Order No. 18122 for the purposes of procuring power for residential and non-residential customers for the six-month period, September 1, 2005 through February 28, 2006, with the option for additional procurements for residential customers in accordance with the terms of the Acquisition Plan is hereby approved.
2. On or before November 1, 2005, Narragansett Electric Company shall file with the Commission a Market Assessment or proposed Last Resort Service Acquisition Plan for review.
3. Within thirty (30) days from Narragansett Electric Company's filing of a Market Assessment or proposed Last Resort Service Acquisition Plan, the Division shall file with the Commission a recommendation for review.
4. The Commission shall have the right to review Narragansett Electric Company's Last Resort power supply contracts for compliance with the

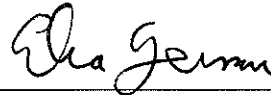
¹⁶ Under the agreement, Narragansett may exercise discretion. However, "...Narragansett's discretionary actions under an approved LRS acquisition plan should also be subject to an after-the-fact prudence review. Such a review would most likely be prompted if Narragansett's discretionary action, such as a decision to accept a non-conforming bid, had an adverse impact on the ratepayers. The review would be based on a review of the facts before Narragansett at the time it exercised its discretion. The letter concluded with the statement that, "with these limitations, Narragansett agrees that, notwithstanding the notification to the Division and Commission...the Commission retains the authority to conduct a retrospective review of the exercise of Narragansett's discretion undertaken under an approved plan. Narragansett's actions would

approved Acquisition Plan, and to review the prudence and reasonableness of any discretionary actions taken by Narragansett under the approved Acquisition Plan.

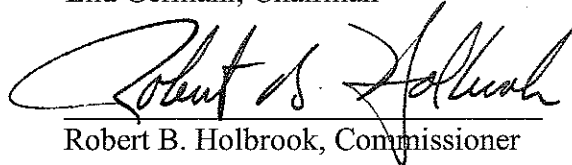
5. Narragansett Electric Company and all Parties shall comply with all other findings and instructions contained in this Report and Order.

EFFECTIVE AT WARWICK, RHODE ISLAND PURSUANT TO AN OPEN MEETING DECISION ON MAY 11, 2005. WRITTEN ORDER ISSUED MAY 24, 2005.

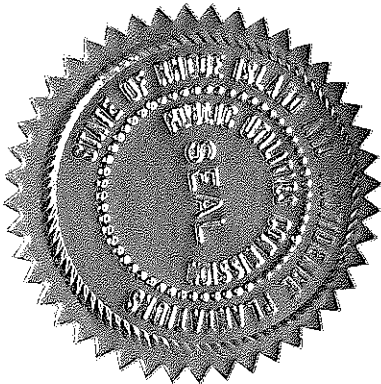
PUBLIC UTILITIES COMMISSION



Elia Germani, Chairman



Robert B. Holbrook, Commissioner



also be subject to review for compliance with the Plan approved by the Commission.” July 17, 2002 Letter from the parties to the Commission in Docket No. 3444.