Memorandum

To: L. Massaro

Commission Clerk

From: D. R. Stearns, Rate Analyst, DPUC
Stephen Scialabba, Chief Accountant, DPUC

Date: 6/16/2006

Re: Narragansett Standard Offer Filing: Docket 3739

On March 31, 2006 the Narragansett Electric Company d/b/a National Grid ("Narragansett", or "Company") submitted to the Commission a Standard Offer Rate Adjustment Filing ("Filing").

At that time, Narragansett proposed a reduction in the standard offer rate from the current $0.10 per kWh to $0.094 per kWh. The Company proposed that the standard offer rate reduction become effective May 1, 2006.

On April 21, Narragansett filed an update that reflected the increase in fuel prices which had taken place since the March 31, 2006 filing. Based on that increase, Narragansett revised its standard offer rate proposed for May 1, 2006 upward to $0.097 per kWh. The Division, after having performed some analyses, recommended that the Commission defer any action on the standard offer price at that time due to volatility in the fuel markets which affects the cost of standard offer service under some of the wholesale contracts.

At an open meeting on Wednesday, April 26, 2006 the Commission voted in favor of delaying any change in the rate, for at least 30 days, in order to allow the parties additional time to further monitor fuel prices.

On May 31, 2006 Narragansett submitted to the Commission a request to withdraw the Standard Offer rate adjustment filed March 31, 2006. While the Company explains that the actual Standard Offer over recovery as of April 30, 2006 is $6.3 million, "substantially" below the Commission initiated trigger of $23 million, at which point the Company may consider filing for a rate change, Narragansett states that, based upon current fuel and sales estimates, the present Standard Offer rate would result in an over recovery at December 31, 2006 of $48.4 million.

The Division requested, and the Company supplied a longer-range projection, taking into consideration the 4 mil increase in the base standard offer rate scheduled to take effect in January 2007. Continuation of the present Standard Offer rate of $0.10 per kWh results in an over collection of approximately $90 million at the end of 2007.

According to an analysis performed by the Division, a 10 percent increase over the projected fuel costs supplied by Narragansett from July 2006 through December 2007 still results in an over-recovery of about $58 million at year end 2007.

The Division performed a further analysis to determine whether the Standard Offer rate could be presently reduced while maintaining a previously stated objective of the Division and Commission for rate stability for the primarily residential and smaller commercial standard offer customers. In performing the analysis, to be conservative, we again assumed a 10% increase in the fuel payments (over what the Company's analysis used) for the period beginning in July 2006. Our analysis considered different rate levels going into effect at various points in time to determine the effect on the standard offer reconciliation account.

Based on our analysis, we recommend the current 10 cent Standard Offer rate be reduced to 9.6 cents effective July 1, 2006. If that rate were put in effect and Narragansett's required fuel payments stay within the 10% variance utilized in our analysis, we believe a further reduction could be put into effect on November 1, 2006 while maintaining the reconciliation account with a positive balance well into 2007. As stated, our analysis took into consideration the fact that the underlying standard offer base cost under the wholesale contracts is scheduled to increase from 5.9 cents to 6.3 cents effective January 1, 2007.

Given the history of volatility in the fuel market and the fact that any hurricane disturbance during the next few months would likely exacerbate that upward price volatility, we believe a potential phasing – in of a standard offer rate reduction is prudent, and allows the Commission to re-examine the fuel markets as we head in to the winter season before implementing a further potential reduction. Our proposal minimizes the possibility of incurring a large over or under recovery balance in the reconciliation account through next winter while providing immediate rate relief this summer and possibly again in November 2006, depending on the status of fuel prices at that time.

In summary, to promote both rate relief and stability, the Division recommends the Standard Offer rate be reduced to $0.0960 per kWh effective July 1, 2006, and the issue be re-examined no later than mid-October with the possibility of initiating a further reduction in the Standard Offer rate.

The Division further recommends the Company be ordered to continue submitting monthly Standard Offer reconciliation reports to the Commission.

Cc: Thomas Ahern,

Administrator, Division of Public Utilities and Carriers

Docket service list