

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION**

NATIONAL GRID NATURAL GAS :
PORTFOLIO MANAGEMENT PLAN : **DOCKET NO. 4038**

REPORT AND ORDER

On February 24, 2009, National Grid (“NGrid” or “the Company”) filed its Natural Gas Portfolio Management Plan (“NGPMP”) with the Commission through which NGrid proposed changes to its current gas portfolio management plan. The changes include the Company discontinuing contracting with an asset manager as a full outsource supplier. NGrid plans to perform the functions previously performed by its asset manager. Additionally, the NGPMP proposes to guarantee Rhode Island customers an annual gas cost optimization benefit of \$1 million per year commencing each April 1 and provide these customers with 80% of all net proceeds in excess of the first \$1 million.

NGrid’s filing moved the Commission to grant it protective treatment pursuant to Commission Rule 1.2(g) and R.I. Gen. Laws §38-2-2(4)(i)(B). Specifically, NGrid seeks protection of references to portfolio management fees agreed to by Merrill Lynch and ConocoPhillips under the terms of Rhode Island portfolio-management contracts. Additionally, the filing contains information of the results of its asset management RFP in Massachusetts and Rhode Island. In support of its motion, NGrid asserts that the information is competitively sensitive and proprietary and that NGrid has agreed to keep the same confidential. Furthermore, the Company alleges that disclosure of the information would be commercially harmful to Merrill Lynch and ConocoPhillips and

their negotiating positions and give their competitors an unfair advantage and dissuade potential portfolio managers from providing services in Rhode Island.

NGrid filed direct testimony of Stephen A. McCauley, Elizabeth Danehy Arangio and Gary L. Beland. Mr. McCauley is the Director of Origination in Energy Portfolio Management for NGrid. He explained that under the NGPMP, NGrid will in-source the functions previously performed by the asset manager. He described the NGPMP as being designed to encourage NGrid to minimize gas costs to its customers by combining a least cost dispatch with an asset optimization program. Mr. McCauley stated that currently, the asset manager, Merrill Lynch, purchases gas for Rhode Island customers based on projections provided to it by NGrid. The goal of Merrill Lynch, as the asset manager, is to provide reliable low-cost supplies for these customers.¹

Mr. McCauley explained how the assets, particularly transportation contracts, underground storage contracts, peaking supplies and the Distringas Firm Combination Service (“FCS”) contract can be used to optimize the purchase and dispatch of gas supplies. He noted that the mix of these assets provides for greater flexibility and opportunities to optimize in a manner to create value for Rhode Island customers. Mr. McCauley identified the ways that the NGPMP is more beneficial to customers than the current third party asset manager plan. Specifically, NGrid managing its own portfolio will reduce the risk of performance failure by a third party such as financial distress or bankruptcy. Additionally, NGrid will have staff with expertise, market intelligence and contractual relationships to best meet future needs of its customers.²

¹ NGrid Exhibit 1, Natural Gas Portfolio Management Plan, Direct Testimony of Stephen A. McCauley filed February 24, 2009 at 1-4.

² *Id.* at 4-6.

Mr. McCauley described the financial benefits that would be realized by Rhode Island customers under the NGPMP which include a guarantee credit of \$1 million and 80% of any proceeds realized above the \$1 million guarantee. NGrid would receive 20% of the incremental benefit derived through optimization of the assets. This differs from the current plan which caps the financial benefit received by customers at the fixed guarantee. This guarantee is currently determined through a bidding process. The NGPMP does not propose to modify the current least cost purchase dispatch formula. Additionally, under the current plan, only the asset manager knows how much value is realized after providing the fixed guarantee to customers. NGrid's proposal requires the Company to file quarterly reports of the portfolio's realized value and an annual report of benefits sharing.³

The NGPMP will become effective April 1, 2009 and be reviewed with each Gas Cost Recovery ("GCR") filing. Additionally, NGrid will file a report showing the results of the plan for a twelve month period April 1 through March 31 by June 1. Mr. McCauley again described the revenue sharing provisions noting that each month, Rhode Island customers will receive 1/12 of the \$1 million guarantee and the additional 80% benefit discussed above will be applied to reduce amounts in the Company's GCR filing.⁴

Elizabeth Danehy Arangio, Director of Gas Supply Planning, described the role of the Gas Supply Planning Group in the procurement of the natural gas supply for Rhode Island customers. Ms. Arangio identified the goal of the gas supply planning process as ensuring that there are adequate gas supplies to reliably meet the needs of customers over the planning period. NGrid determines its load supply by: 1) establishing planning

³ *Id.* at 7-10.

⁴ *Id.* at 10-11.

criteria, 2) preparing a demand forecast under normal weather conditions for firm-service customers including those transportation customers and 3) converting the normal weather load requirement to a design weather load requirement.⁵

Ms. Arangio noted that every month, the Gas Supply Planning group determines the base load volume amounts for delivery to the Tennessee and Algonquin citygates. On a daily basis, that group nominates a separate incremental volume for delivery if needed. The incremental volume can come from transportation capacity, storage, citygate purchases and/or additional company assets. The Gas Supply Planning group is also responsible for ensuring compliance with contractual terms and managing the pipeline balancing activity. Finally, Ms. Arangio stated that NGrid is fully capable, by building a capable staff and with prior experience in New Hampshire, New York and Massachusetts, of managing its natural gas portfolios.⁶

Gary L. Beland, Manager in the Pricing and Regulatory Department, provided testimony to explain the relationship between the Gas Purchase Incentive Plan (“GPIP”) and the proposed NGPMP. He noted that under the GPIP, NGrid tries to stabilize prices by locking in gas prices over a twenty-four (24) month period in an attempt to protect customers from the impacts of large price swings. Mr. Beland indicated that NGrid’s proposed NGPMP will have no effect on the GPIP and that the two plans are independent of each other. He described the GPIP as a hedging plan using financial instruments to stabilize gas costs that is separate from the Company’s physical purchase of supply. On

⁵ NGrid Exhibit 1, Natural Gas Portfolio Management Plan, Direct Testimony of Elizabeth Danehy Arangio filed February 24, 2009 at 1-3.

⁶ *Id.* at 4-7.

the other hand, Mr. Beland described the NGPMP as an asset management plan designed to optimize the total gas supply portfolio in order to minimize costs to the customer.⁷

Finally, Mr. Beland noted that NGrid will not seek to recover any incremental staffing costs in this filing. However, there will be certain costs associated with the Company conducting the supply and asset management process including minimal trading fees that NGrid considers part of expects to recover as a gas cost.⁸

On March 20, 2009, the Division of Public Utilities and Carriers (“Division”) filed the testimony of Bruce R. Oliver to address NGrid’s proposal. Mr. Oliver noted that with two exceptions, he supported the Commission adopting the proposal. Mr. Oliver’s two exceptions are: 1) that the language in paragraph II.C. be deleted because the general representation that NGrid will operate the plan in a way that parallels the current practices is unnecessary and 2) that the reporting requirements be expanded.⁹

Mr. Oliver noted that NGrid’s proposal appears to offer the potential for increased ratepayer benefits without considerable risk. He opined that over time, the Commission and Division should exercise oversight into the appropriateness of the level of the guaranteed minimum credit provided to ratepayers, the transparency of the asset value determinations and the reasonableness and appropriateness of costs charged to asset management transactions. Mr. Oliver noted that should NGrid assume its asset management, the market-based assessment of value that occurs with the competitive

⁷ NGrid Exhibit 1, Natural Gas Portfolio Management Plan, Direct Testimony of Gary L. Beland filed February 24, 2009 at 1-5.

⁸ *Id.* at 5-7.

⁹ Division Exhibit 1, Direct Testimony of Bruce R. Oliver filed March 20, 2009 at 2-3.

bidding process would be lost, and therefore periodic review of the guaranteed minimum annual credit is warranted.¹⁰

Mr. Oliver stated that the \$1 million guaranteed minimum annual benefit is reasonable in light of the uncertainty regarding the expected value of natural gas assets. He noted that this guarantee coupled with 80% of the incremental revenue to benefit firm gas sales service customers is reasonable and prudent. Regarding the necessity for transparency of transactions and costs incurred to conduct transactions, Mr. Oliver noted that the loss of market based determination of value will leave the Commission with few, if any, external benchmarks against which to measure the Company's actions. Transparency will enable the Commission and the Division to gain confidence that NGrid's transactions and costs are both reasonable and appropriate. Even with the transparency, Mr. Oliver pointed out that it will be incumbent upon NGrid to assist the Commission and the Division in understanding the levels of costs and benefits because of the lack of historical or comparable data to measure the performance of the in-house activities.¹¹

Mr. Oliver opined that the in-sourcing of the asset management activities provides the potential for greater customer benefits. He also noted that in light of the current financial times, while a well drafted contract may provide protection from the third party's financial problems, the amount of protection contracted for may reduce the levels of benefits offered by the asset manager. Mr. Oliver pointed out that NGrid has the size and experience to offer the in-sourcing as an alternative to contracting with a third party asset manager. Additionally, he noted that under no circumstances will customers

¹⁰ *Id.* at 5-7.

¹¹ *Id.* at 7-10.

receive less in credit than what they are currently receiving and those customers could in fact receive more should the net asset management revenue exceed \$1 million in a year. Mr. Oliver recommended that the Commission review the program in two years and then again in four years to allow for further refinement or termination if necessary.¹²

On March 25, 2009, the Commission conducted a hearing to further investigate NGrid's proposal to discontinue the use of a third party asset manager and the benefits of assuming the duties of the asset manager in house. Richard A. Rapp, Jr., Senior Vice President of Energy Portfolio, testified on behalf of NGrid. He explained the proposal and stated that NGrid had no objection to and would comply with the suggestions made by Mr. Oliver, namely that paragraph II.C be deleted, that the reporting requirements be expanded and that the program be reviewed by the Division and the Commission in two years and then again in four years.¹³

Mr. Oliver reiterated his prefiled testimony and noted that asset management is becoming a common practice in the gas industry. NGrid has the size and experience to in-source its asset management efficiently and with some economies of scale. He noted four areas of oversight that he recommended the Commission focus on: transparency to ensure confidence in the reasonableness of the market transactions undertaken, tracking and ensuring economies of scale are achieved and ratepayers receive some benefit, the relationship between the minimum guarantee and asset values to ensure the Company is rewarded for the value it adds in the process, and ensuring the program is structured so that ratepayers are never exposed to a negative credit to their cost of gas. He pointed out

¹² *Id.* at 10-13.

¹³ Transcript of Hearing ("T."), March 25, 2009, at 34-35.

that the minimums proposed in the Company's program ensure that ratepayers will never be exposed to a negative credit.¹⁴

The Commission finds that NGrid's proposal to assume the duties of the third party asset manager in house is in the best interest of ratepayers. The proposal will guarantee ratepayers more than the \$1 million they receive from the current arrangement. The transparency of the proposal and the 80% of proceeds realized by the Company to be given to ratepayers will certainly provide them with a better situation than currently exists with third party situation and no transparency. The Commission commends the Company and the Division for being proactive in trying to lower costs for all ratepayers.

Accordingly, it is

(19627) ORDERED:

1. The Motion for Protective Treatment to protect as confidential references to portfolio management fees agreed to by Merrill Lynch and ConocoPhillips under the terms of Rhode Island portfolio-management contracts and information of the results of its asset management RFP in Massachusetts and Rhode Island is approved.
2. National Grid's in-sourcing and performing the functions previously performed by its third party asset manager in house is approved.
3. National Grid shall comply with the reporting requirements and all other findings and directives contained in this Report and Order.

¹⁴ T. at 38, 40, 44-47.

EFFECTIVE IN WARWICK, RHODE ISLAND PURSUANT TO OPEN MEETING
DECISION ON MARCH 31, 2009. WRITTEN ORDER ISSUED APRIL 24, 2009.



PUBLIC UTILITIES COMMISSION

Elia Germani

Elia Germani, Chairman

Robert B. Holbrook, Commissioner*

Mary E. Bray

Mary E. Bray, Commissioner

*Commissioner Holbrook did not participate in the decision.