Thomas R. Teehan
Senior Counsel

July 28, 2010

VIA HAND DELIVERY & ELECTRONIC MAIL

Luly E. Massaro, Commission Clerk
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02889

RE: Docket No. 4149
2011 Standard Offer Service Procurement Plan
2011 Renewable Energy Standard Procurement Plan
National Grid Post-Hearing Memorandum

Dear Ms. Massaro:

Enclosed please find ten (10) copies of National Grid's Post-Hearing Memorandum in the above-captioned proceeding.

Thank you for your attention to this transmittal. If you have any questions, please feel free to contact me at (401) 784-7667.

Very truly yours,

Thomas R. Teehan

Enclosure

cc: Leo Wold, Esq.
Steve Scialabba, Division

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

RHODE ISLAND PUBLIC UTILITIES COMMISSION

2011 Standard Offer Service Procurement Plan

2011 Renewable Energy Standard Procurement Plan Docket No.4149

POST-HEARING MEMORANDUM OF
THE NARRAGANSETT ELECTRIC COMPANY,
D/B/A NATIONAL GRID

I. INTRODUCTION

In preparing its 2011 Standard Offer Service ("SOS") procurement plan, National Grid ("the Company") first conducted a comprehensive analysis of the various available procurement methods in order to determine the best approach for Rhode Island. On January 22, 2010, as directed by the Commission, the Company filed a report regarding that analysis. An essential part of that analysis was the SOS procurement study that was performed by the NorthBridge Group. It helped the Company conclude that significant reliance on full requirements service ("FRS") contracts as a procurement approach is the best way to balance the key goals associated with Standard Offer Service, including rate stability and low rate levels. The Company continues to believe that to be true. Competitively-solicited FRS contracts eliminate risks inherent in block purchases at a reasonable cost. For example, the NorthBridge study shows that the difference between the expected SOS rates under the representative FRS and block product procurement approaches is on average just $0.72 per megawatt-hour. However, the block procurement approach involves a much greater chance that supply costs could be much higher than

expected, while the FRS approach provides price guarantees for customers for the duration of the contract, and the risks are substantially shifted away from customers to the FRS suppliers.

The Company's proposed procurement plan will increase the spot market purchases component for the Commercial and Residential groups from the Commission-approved 5% to 10%. This will enable the Company to continue to be directly involved in the Independent System Operator-New England's day-ahead market and be in a position to mitigate customer exposure to the more volatile real-time market in the event of a supplier default. The increase in the amount of spot market purchases will not significantly increase rate volatility for customers since the balance of FRS contracts provide price stability. Nevertheless, to the extent that the Commission is concerned by the volatility introduced by this proposed amount of spot market purchases, the Company can reasonably adjust its plan to return to the 5% amount that the Commission had introduced into the procurement plan in the 2010 SOS proceeding.

The procurement plan is designed to transition from the existing plan to a steady state at the proposed procurement levels at the end of 2012. Once that happens, the Company will procure a 90% level of FRS contracts for the newly established Commercial and Residential customer groups' load. The balance will be procured through spot market purchases. Under this plan, customers' exposure to spot market would be maintained at 10% of the load in each and every hour of the SOS delivery period, as opposed to the block product approach recommended by the Division's consultant, which has no guaranteed limit of exposure to the spot market (i.e., in some hours the Company could be forced to buy significantly more spot energy, especially when load and market prices tend to be high).

The Company believes that the utilization of FRS contracts for the lion's share of the load, complemented by a modest amount of spot market purchases, is the most prudent and beneficial procurement approach for its Rhode Island SOS customers.

Finally, there are aspects of the proposed plan relating to the Commission's approval of winning bids, the timing and frequency of rate changes, and the default pricing option for Commercial class customers that were discussed during the hearing and can be adjusted to accommodate any Commission concerns.

II. DISCUSSION

A. Reliance on a significant amount of FRS purchasing provides the best value and protection for Rhode Island SOS customers.

The Company continues to believe that FRS contracts are superior to block products in balancing the goals of obtaining low prices for its customers while maintaining a reasonable level of price stability. FRS contracts are more effective in protecting SOS customers against the costs and risks associated with customer supply requirements. Yet a comparison of the expected SOS rates resulting from an FRS products approach or from a block procurement approach shows only a modest difference in the expected rates in light of the costs and risks that are avoided.

The NorthBridge study analyzes the relative costs and risks of different approaches to serving mass market SOS customers. It uses actual empirical market data from over 40 different solicitations and considers 2,000 different scenarios. In his testimony, Scott Fisher, a principal of the NorthBridge Group, described that customers with block products are exposed to increased risk due to uncertainty regarding usage and price levels driven by factors such as unexpected weather patterns, changes in customer

usage patterns due to the economy or energy efficiency efforts, customer migration to an independent supplier, and plant or transmission line outages. (Fisher Rebuttal at 9; Tr. at 114)

Under the block procurement approach, when actual load is either higher or lower than the block product that was purchased, the Company would have to go to the market to either buy or sell from the spot market when the pricing would generally be unfavorable. This pricing would eventually be passed along to customers. Mr. Fisher explained that market prices tend to be higher when load is higher and conversely market prices tend to be lower when load is lower. Thus, with block products, when load is less than projected, the customers would suffer when the Company had to go into the market to sell excess supply at a loss, and when load is greater than projected, the customers would bear the brunt of going into the market to purchase additional supply at a time when prices are high. (Tr. at 111-116)

It should also be noted that whereas the Company's proposal has a modest amount of spot market purchases (10% of Residential and Commercial customers' actual load), the block product approach could expose customers to 50% spot market purchases in an hour when the actual load exceeds the amount of block purchased. (Tr. at 140) In fact, there is no limit on the percentage of spot market purchases that may be necessary to satisfy SOS load in any given hour under the Division's approach. Mr. Hahn, the Division consultant, acknowledged that, under his block-and-spot procurement plan, when load is higher than anticipated, it would be necessary to buy more than 10% spot. (Tr. at 176) This could expose SOS customers to significant levels of spot market purchases when prices are especially high.

The Company believes, and on cross examination Mr. Hahn acknowledged, that an important question for the Commission to address is whether or not it should be the supplier or the customers that are bearing the risks. (Tr. at 177) The attractiveness of FRS contracts is that if actual loads and market prices differ from suppliers' projections for any reason, customers are insulated from these risks and continue to receive the competitively-bid, fixed contract prices.

Mr. Fisher's testimony and Exhibit 10, his stacked comparison chart of expected SOS rates discussed during the hearing, demonstrate that when the costs and exposures associated with block products are factored in and the two procurement approaches are compared side by side, the expected rate differential between a block approach and an FRS approach is comparatively small and, in light of the protections that an FRS approach provides, it is prudent.[1] In one column, the chart shows the components of a representative FRS approach. The other column builds up the cost components of a representative block procurement approach including the costs of energy, capacity, ancillary services, renewable portfolio standards, customer migration, price-load uncertainty costs and residual compensation. These are all real costs, accepted in the

[1] As Mr. Fisher explained at the hearing, Mr. Hahn relied upon information from the NorthBridge study to develop his claim about the potential difference in rates, but he incorrectly assumed that the difference in expected rates is the $3.92 per MWH value. Mr. Hahn accounted for the fact that a certain component of the full requirements product price would be avoided if a block procurement approach were adopted, but he failed to properly account for the fact that, under the block procurement approach, customers bear certain offsetting expected costs instead – totaling $3.20 per MWH, as clearly shown in Exhibit 10 and on page 15 of the NorthBridge study. (Tr. at 23-25) Furthermore, Mr. Hahn's identification at the hearing of a $3.96 per MWH value calculated from figures provided by National Grid is similarly not supportive of his contention that the expected difference in SOS rates is about $4 per MWH because, as Mr. Hahn acknowledged on cross-examination, the $3.96 per MWH value refers to a component of the full requirements product price, which does not account for the offsetting costs under the block procurement approach. (Tr. at 170-171) Mr. Hahn counts the dollars saved by not paying a third party to assume certain costs and risks, but fails to properly reflect the expected costs to customers associated with the direct assumption of these types of costs and risks under the block procurement approach.

industry.[2] (Tr. at 111) With respect to the customer migration component, Mr. Fisher testified that given the relatively lower migration risk associated with small customers, it represents only a small piece of NorthBridge's calculation of costs in the comparison of expected SOS rates from FRS products and from block products.[3] (Tr. at 111) When the SOS rates are compared between the two representative procurement approaches, the actual expected rate difference is only about $0.72/MWH, or $2.2 million when applied to the approximately 3 million MWH of Rhode Island residential load. The FRS product approach, however, would allow customers to avoid incremental supply cost surprise of $19 million and potential cost deferrals of $39 million associated with the representative block procurement approach, as well as other costs and risks not quantified in the NorthBridge study.

B. Maintaining a portion of spot market purchasing provides customers benefits particularly in the situation where a supplier defaults.

The Commission's inclusion of spot market purchases in the Company's current procurement plan allows the Company to be continuously involved in the day-ahead power market. Although the Company's contracts with FRS suppliers require the daily posting of a certain level of mark-to-market collateral, during times of financial distress or default, the posted collateral may quickly become insufficient to cover costs in a rising market. (Tr. at 158-159) In the event of a supplier default, the Company's continuing direct involvement in the spot market allows the Company to move quickly to make

[2] As a matter of fact, in Division Data Request Response NG 2-23, Mr. Hahn acknowledges the existence of positive expected costs under the block procurement approach associated with "MP Residual Compensation."

[3] On the other hand, Mr. Allegretti testified that while the total customer migration to competitive supply in Rhode Island stands at 30 percent, based on his experience in Massachusetts and Connecticut where migration is about 50 percent, he would expect it eventually to accelerate in Rhode Island as well. (Tr. at 184)

purchases in the day-ahead market and protect customers from real-time pricing in a rising market. The amount of spot market purchasing in the Company's plan is limited to 10% of the Residential and Commercial customer groups' loads. The Division agrees with the Company that this is a reasonable level of involvement in the spot market.

C. Including Commission review of winning bids as part of the procurement plan would provide greater certainty around the finality of a contract.

Commission review of solicited bids is already part of the Company's procurement plans in Massachusetts and New Hampshire. Witness Margaret Janzen testified that the current process, whereby the Commission approves the Company's procurement plan but does not approve the results of particular solicitations, has operated effectively. Nevertheless, it is feasible to adopt a process whereby the Commission would review and approve the rates resulting from each solicitation process and, if warranted, reject the solicited bids. Such process would allow the Commission to better monitor the Company's procurement activities. Although the Company does not currently follow this procedure in Rhode Island with respect to electric procurement, it is not new to Rhode Island. There is a similar provision in the Company's Gas Purchase Incentive Plan, under which decisions by the Division and Company to accelerate mandatory purchases are submitted to the Commission and are subject to a three-day review by the Commission.[4] Equally important, having a Commission approval process of solicitation results has become standard in most jurisdictions that rely on FRS contracts. Knowledge

[4] Section III.D.f of the Gas Purchase Procurement Plan provides: "The Company and the Division may agree to accelerate a portion of the mandatory hedges. They will notify the Commission of any such plan and provide 3 business days for the Commission to object."

that the Commission must approve, or otherwise not reject, any contract to be executed may therefore lead to more favorable results for SOS customers.[5]

D. Pricing Options for the Commercial Customer Class

For the new Commercial Group, the Company is proposing both a fixed and a variable price option, with the customary (default) pricing option for this group to be the variable pricing option. Under the variable price option, prices would vary monthly based on the contract prices for that customer group for a six month period, including an estimate of procuring a portion of the load through the spot market. The fixed price option, on the other hand, would contain a fixed price for the pricing period that reflects the weighted average of the contract prices for the period in addition to the estimated cost of a portion of the load that is procured through the spot market. The customer would have the ability to switch once every 12 months to a different pricing option. The Company would provide education to customers to alert them to the existence of these options and the limitations on switching.

The variable pricing option would provide better market price signals for customers making consumption decisions and those who may be searching for competitive supply alternatives. It also would better align revenue with underlying contract prices and will tend to mitigate over/under collections. Restricting migration between the options to "once every 12 months" would avoid the "gaming" scenario where customers could switch back and forth between the fixed and variable pricing depending on which pricing

[5] In some jurisdictions, if bids are not rejected by a commission within a few days, they are "deemed" approved. This provides the commission the flexibility to take action if necessary prior to a utility's commitment to enter into an SOS contract obligation, but does not require a commission to affirmatively approve the results of each solicitation.

was higher or lower, thereby potentially saddling the remaining customers with additional costs.

The Company believes that ultimately over a six month period, two customers with the same usage patterns would pay essentially the same amount under either pricing options. (See Company Response to Commission RR-7.) If, however, the Commission is concerned that certain small businesses in the Commercial customer group would be better served by the fixed pricing option, the Company would recommend that the fixed price option be the customary option for the C-06 rate class, and that the variable pricing option remain as the customary option for the remaining rate classes in the Commercial Group.

E. Frequency of Rate Changes

The Company has proposed two semi-annual reconciliations. Reconciling costs and revenues on a more frequent basis will allow the Company to minimize deferrals that could otherwise accumulate. The Company has proposed that those reconciliations would be effective on April 1 and October 1. The Company has also proposed two SOS pricing changes for effect January and July. As an alternative to having four price changes annually, the Company could schedule the reconciliations to occur in January and July, thereby reducing the number of rate changes from four to two.

III. CONCLUSION

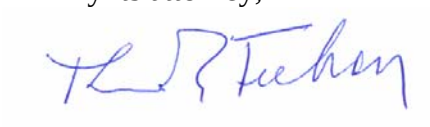
In light of the comprehensive procurement analysis that was recently conducted, the Company submits that a procurement plan that relies in significant part on FRS contracts, with a modest amount of spot market purchases for the Commercial and the Residential Groups, best serves the needs of its customers and achieves a balance between the key goals associated with Standard Offer Service, including rate stability and low rate levels, while transferring many of the risks inherent in a block procurement approach to suppliers and away from customers.

The Company respectfully requests that the Commission approve its proposed 2011 SOS procurement plan as well as the 2011 RES plan submitted in this docket.

Respectfully submitted,

THE NARRAGANSETT ELECTRIC COMPANY

By its attorney,



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Thomas R. Teehan (RI #4698)
280 Melrose Street
Providence, RI 02907
(401) 784-7667

Dated: July 29, 2010

Certificate of Service

I hereby certify that a copy of the cover letter and/or any materials accompanying this certificate were electronically submitted, hand delivered and/or mailed to the individuals listed below.

Joanne M. Scanlon — July 29, 2010 (Date)

Docket No. 4149 National Grid – 2011 SOS and RES Procurement Plans
Service List updated 6/3/10

Name/Address	E-mail Distribution	Phone/FAX
Thomas R. Teehan, Esq. National Grid. 280 Melrose St. Providence, RI 02907	Thomas.teehan@us.ngrid.com Joanne.scanlon@us.ngrid.com	401-784-7667 401-784-4321
Leo Wold, Esq. Dept. of Attorney General 150 South Main St. Providence, RI 02903	Lwold@riag.ri.gov Dstearns@ripuc.state.ri.us Sscialabba@ripuc.state.ri.us Mtobin@riag.ri.gov dmacrae@riag.ri.gov	401-222-2424 401-222-3016
Michael McElroy, Esq. Schacht & McElroy PO Box 6721 Providence, RI 02940-6721	McElroyMik@aol.com Timothy.daniels@constellation.com Daniel.W.Allegretti@constellation.com Joseph.Donovan@constellation.com	401-351-4100 401-421-5696
Richard Hahn LaCapra Associates One Washington Mall, 9th floor Boston, MA 02108	rhahn@lacapra.com apereira@lacapra.com afreitas@lacapra.com	617-778-2467 617 778-2481
File an original & nine (9) copies w/: Luly E. Massaro, Commission Clerk Public Utilities Commission 89 Jefferson Blvd. Warwick, RI 02888	Lmassaro@puc.state.ri.us Cwilson@puc.state.ri.us Nucci@puc.state.ri.us Anault@puc.state.ri.us ADalessandro@puc.state.ri.us DShah@puc.state.ri.us	401-780-2017 401-941-1691