STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: NARRAGANSETT ELECTRIC COMPANY	:	
REQUEST FOR APPROVAL AND CORRESPONDING	:	Docket No. 3496
RATE TREATMENT FOR STANDARD OFFER	:	
SUPPLY CONTRACT AMENDMENT	:	

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:

Calendar Year	Price per kWh
2003	4.7 cents[1]
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

[1] The SOS rate increased to 5.5 cents per kWh commencing with usage on and after June 1, 2003, as a direct result of increased wholesale oil and natural gas costs. See Order No. 17495 (issued June 20, 2003).

power supply to Narragansett, including fuel charges, exceeds retail SOS revenues, the under-collection is recoverable from Narragansett's customers through the annual reconciliation provisions of the Narragansett's Standard Offer Adjustment Provision. Likewise, any over-collection is credited back to Narragansett's customers in the same manner.

Through its instant request, Narragansett is requesting that the Commission allow it to recover increased costs, due to congestion related charges, as a result of the implementation of ISO-NE's Standard Market Design ("SMD"). The effect of the recovery would be factored into the annual reconciliation of SOS, transmission and transition that occurs in December each year.

SMD is a set of rules and procedures for the wholesale electricity market in New England that is applied through a software system. The core components are Locational Marginal Pricing ("LMP"), a Multi-Settlement System, and the possibility to mitigate against the adverse effects of paying higher LMPs through Financial Transmission Right auctions. Prior to the implementation of SMD, New England operated under a "single energy clearing price wholesale market," where every region of New England paid the same spot market price for the generation of electricity. The purpose of LMP is to identify the areas on the New England transmission system where congestion occurs and to price the energy being delivered to those areas at a premium. According to ISO-NE, under LMP, the marginal cost of electricity will be calculated at locations on the New England transmission system and will be included in the commodity cost to account for the cost of congestion.[2] However, according to Narragansett, even though there is no

[2] Standard Market Design, "Background and Overview," pp. 1-5. ISO New England, Inc. (2003).

actual congestion in delivering power to the Rhode Island Zone, the market rules allow for electricity procured for consumption in Rhode Island to incur congestion costs if its contractual delivery point were at a location other than the Rhode Island Zone. Furthermore, under two of its SOS contracts, Narragansett was concerned that those costs could be passed through to Narragansett, rather than being paid for by the supplier.

II. NARRAGANSETT'S REQUEST

On February 28, 2003, Narragansett Electric Company ("Narragansett" or "the Company") filed a request with the Commission for approval and corresponding rate treatment for an amendment to one of Narragansett's Standard Offer Supply ("SOS") contracts. Narragansett indicated that two of its SOS contracts with one supplier contains unique language that is not found in any of the Company's remaining SOS contracts. Under the pre-SMD market rules, the terms of the SOS contracts at issue clearly delineated the allocations of costs between the Company and the Supplier. However, under the SMD and LMP rules, the Company and the Supplier disagree as to the appropriate cost allocations.

According to Narragansett, "under the supplier's interpretation, in reliance on language unique to this supplier's agreement, the supplier would have flexibility to deliver to any point on the NEPOOL PTF System without incurring any additional congestion cost, thereby leaving the Company and its customers to bear the incremental congestion cost burden." Furthermore, Narragansett asserted that it was unable to predict the magnitude of potential cost exposure under this interpretation. Finally, Narragansett maintained that only the Supplier, and not Narragansett, is in a position to mitigate the congestion costs under the new market rules.

Therefore, in order to avoid uncertainty associated with arbitration and/or litigation, Narragansett and the Supplier agreed to an Amendment to their SOS agreement. The Amendment, if approved, would increase the base amount of the SOS kWh charge for one of Narragansett's contracts commencing with usage on and after March 1, 2003 through the end of 2009, when the SOS term expires.

If recovery of costs under this Amendment is approved, the base SOS price for all customers will be as follows:

Calendar Year	Price per kWh
2003	4.737 cents[3]
2004	5.143 cents
2005	5.543 cents
2006	5.943 cents
2007	6.343 cents
2008	6.743 cents
2009	7.143 cents

According to Narragansett, the effect of the Amendment would be to raise the average SOS customer's bill 23 cents per month, or less than .4%. The additional amount paid to the supplier would be approximately $2.8 million per year (using 2002 deliveries as a base). However, this total amount could be higher or lower, depending on the total kWh deliveries for each year during which the Amendment is in effect.

Narragansett has requested approval under R.I.G.L. § 39-1-27.3(b), which allows the Company to collect its costs arising out of wholesale standard offer supply arrangements approved by the Commission after January 1, 2002. According to

[3] See supra note 1 and accompanying text.

Narragansett, this Amendment will terminate if not approved by the Commission on or before June 27, 2003. Finally, in a response to a Commission Request, Narragansett noted that currently, the parties are acting in accordance with the Amendment, but will true up, as if the agreement were never executed, if the Amendment is not approved.

Finally, Narragansett argued that under R.I.G.L. § 39-1-27.3(b) (as amended in 2002), the ratepayers will be liable for all congestion costs incurred by Narragansett from this supplier if the Commission does not approve the Amendment.

III. DIVISION'S POSITION

On June 13, 2003, the Division submitted a memorandum authored by its expert witness, Dr. John Stutz of the Tellus Institute. Dr. Stutz summarized Narragansett's position and highlighted data provided in Narragansett's Third Supplemental Response to Commission Data Request 1-9. This data showed that if the Supplier is correct in its interpretation of the contract provision in question, the total congestion costs that would have been incurred by Narragansett for the months March through May 2003 is $3,210,463, whereas, under the agreement, the payment to the supplier is $725,507. Therefore, he indicated that "analysis shows that, if the right of the Supplier to select the delivery point were affirmed, the cost of either paying congestion costs or purchasing hedges would likely be much greater than the costs associated with the Amendment." Because there was no evidence that supported a position that the Supplier would not prevail on its claim of the appropriate contract interpretation, Dr. Stutz recommended approving recovery under the Amendment.

IV. HEARING

Following notice, a public hearing was conducted on June 19, 2003, at the Commission's offices, 89 Jefferson Boulevard, Warwick, Rhode Island. The following appearances were entered:

FOR NARRAGANSETT ELECTRIC:	Terry L. Schwennesen, Esq.
FOR THE DIVISION:	Paul J. Roberti, Esq. Assistant Attorney General
FOR THE COMMISSION:	Cynthia G. Wilson, Esq. Senior Legal Counsel

Narragansett presented Michael Hager, Vice President of Energy Supply New England for National Grid USA Service Company and Jeanne A. Lloyd, Principal Financial Analyst in the Distribution Regulatory Services Department of National Grid USA Service Company in support of its proposal. The Division presented Dr. John Stutz in support of its position.

A. Congestion Costs

Mr. Hager explained that congestion occurs on a transmission system when there is a physical inability of the system to transmit power from one location to another. For example, the lines may not be large enough to get the power from one area to the next. This happens when the ISO conducts an economic dispatch of generation in the lowest economic order. Mr. Hager indicated that when the next lowest cost generator is in location A but the power cannot be delivered to location B for use, there is congestion. In that situation, the dispatcher passes over the lower cost generator in location A in favor of a higher cost generator physically situated in location B in order to meet reliability requirements for the system. When the higher cost generator is dispatched out of

economic order, there is an economic incremental cost that has to be paid to the generator and allocated to the members of the power pool.[4]

Under LMP, each location, or zone, in the system has a separate energy price at any given hour. During periods when there is no congestion, the locational prices are the same in each zone. During hours when there is congestion, the area where there is congestion will experience higher energy costs than other areas. The difference between the zones is the congestion cost.[5]

According to Mr. Hager, Narragansett, like any distribution company, can be exposed to congestion costs if it has distribution obligations in one area and its generation comes from another area where there is a difference in cost due to congestion and the different locational pricing. To the extent that either the power Narragansett purchases for its customers is delivered directly to the Rhode Island Zone or the supplier is responsible for the costs under the two SOS contracts, Narragansett would not incur separate congestion costs. However, Narragansett could incur separate congestion costs if the power Narragansett purchases for its customers is not delivered to the Rhode Island Zone and Narragansett were to be found responsible for the cost difference between the delivery zone and the Rhode Island Zone. Furthermore, there are separate nodes within the Rhode Island Zone that may experience slightly different locational prices. Therefore, it is possible that congestion costs could be incurred even if the power were delivered directly to the Rhode Island Zone.[6]

However, Mr. Hager maintained that the Supplier is in a position to hedge against increased congestion costs, whereas, Narragansett would not be able to hedge against

[4] Tr. 6/19/03, pp. 12-13.
[5] Id. at 13-14.
[6] Id. at 14-18.

such costs in an effective way.[7] He explained that because the supplier does not need to provide Narragansett with the delivery location prior to delivery and in fact, has up to a day after delivery to provide that information, there will always be a mismatch between where Narragansett physically takes delivery and where the Supplier delivers for financial purposes.[8] Furthermore, Mr. Hager indicated that even if Narragansett were to try to hedge through purchases of Financial Transmission Rights ("FTR"), it will not know the exact load level or the place of delivery, thus making it impossible to effectively hedge costs in this manner.[9] Mr. Hager noted, however, that the Supplier can buy FTRs with the knowledge of the location of their settlement responsibilities versus the location of their generation and thus, predict the load and risk in a way Narragansett cannot.[10]

B. Amendment Costs versus Congestion Costs

Mr. Hager testified that Narragansett's pre-SMD analysis indicated that the Amendment is in the best interests of ratepayers and is very reasonable. The analysis compared the Amendment charges to the charges that could be incurred if the power was delivered to one of forty (40) possible locations. According to Mr. Hager, the analysis showed that the prices resulting from the Amendment were reasonable and "that there [were] quite a number of locations that perhaps could have been chosen for delivery points that would have incurred much higher congestion cost exposure than the proposed

[7] Id. at 88-89.
[8] Id. at 89-90, 91-92. "Physically, Narragansett's customers are always taking load off of the system through the Narragansett zone…[but] it is possible for suppliers to put all their contracts at a particular – one single location for financial settlement purposes even though physically, [the] load is throughout New England." Id. at 92-93.
[9] Id. at 90-91.
[10] Id. at 112-113.

price."[11] In fact, Mr. Hager testified, that the post-SMD analysis showed that congestion costs have been more than double the costs charged under the Amendment for the first three months that SMD has been in effect.[12]

Mr. Hager indicated that the per kWh settlement amount was a negotiated number between Narragansett and the Supplier.[13] Ms. Lloyd testified that the estimated effect of the Amendment on the base SOS kWh rate is an increase of .043 cents per kWh beginning on March 1, 2003. Ms. Lloyd explained that this is a blended rate, where the effect of the Amendment to two SOS contracts is spread over all of the SOS contracts which all ratepayers will pay through 2009. She further explained that the amount is an estimate based on 2002 usage.[14] Finally, Ms. Lloyd testified that if the Commission were ordering recovery through rates immediately, the impact on an average residential customer using 500 kWh of electricity per month would be approximately 23 cents or a .39% increase on the total bill based on rates in effect as of June 1, 2003.[15]

Dr. Stutz testified that the Division had reviewed the materials submitted by Narragansett to determine whether it is reasonable to accept the Amendment. Dr. Stutz discussed the fact that there was no evidence to show Narragansett's likelihood of success at arbitration, nor was there evidence to show the Supplier's likelihood of success. He further maintained that Narragansett's likelihood of success would have to be "fairly high" in order to make rejecting the Amendment a more attractive option than

[11] Id. at 36-38, Narr. Exs. 5-7.
[12] Tr. 6/19/03, pp. 38-44, Narr. Exs. 6-7, PUC Ex. 9 (Narragansett's Third Supplemental Response to Commission Data Request 1-9).
[13] Tr. 6/19/03, p. 86.
[14] Id. at. 45-47, Narr. Ex. 8.
[15] Tr. 6/19/03, pp. 48-49, Narr. Ex. 9. The Commission's decision in the instant docket will not affect rates immediately. However, the effect of the Amendment will be to increase rates. The impact will be addressed in Narragansett's annual reconciliation filing in November 2003, for effect January 1, 2004. Therefore, Narragansett and the Commission provided public notice in accordance with R.I.G.L. § 39-3-11.

submitting the issue to arbitration. Therefore, his recommendation was that the Commission accept the Amendment.[16]

C. Level of Review

Mr. Hager agreed that Narragansett is currently seeking approval of recovery of costs associated with the Amendment under R.I.G.L. § 39-1-27.3(b)(2), which states, "The electric distribution company will be entitled to recover its costs incurred from providing the standard offer arising out of…power supply arrangements that are approved by the commission after January 1, 2002." In order to provide the Commission with a basis upon which to determine whether the Amendment is reasonable, Mr. Hager indicated that the Supplier agreed to a unique situation where Commission approval did not need to be provided for three months. Noting that the Amendment has produced lower payments than actual congestion costs for the first three months of SMD, Mr. Hager argued that even if there had been no actual congestion costs during those same months, "it's still my belief that this is a fantastic arrangement for customers because it provides them certainty over the long period of time that we have to be exposed to these costs."[17]

D. Confidentiality

Narragansett requested confidential and proprietary treatment of certain information under the APRA, specifically, under §§ 38-2-2(4)(B) and (E). No member of the public requested review of the information during the proceeding. In accordance with the Commission's Rules of Practice and Procedure, a preliminary finding of confidentiality was made by the presiding commissioner. The issue was also addressed at

[16] Tr. 6/17/03, pp. 51-52.
[17] Id. at 80. See id. at 77-82 (discussing the performance of the Amendment for the first three months of SMD).

the hearing and the Commission allowed Narragansett to submit confidential exhibits together with a public redacted version.[18] At the hearing, counsel for the Division indicated that:

> normally our policy is to put as much information in the public record [as possible]. I can say that I'm comfortable with the approach on behalf of the Attorney General and the Division. My client is also comfortable with the approach in which the Commission is dealing with this because ultimately it's in the best interest of customers to have these safeguards in place.[19]

V. COMMISSION FINDINGS

After consideration of all of the evidence presented, the Commission rendered a Bench decision approving recovery of costs as a result of the Amendment between Narragansett and one of its Suppliers.[20] The Commission finds that the Company has met its burden of showing that the Amendment is reasonable and in the best interests of the ratepayers. The Amendment provides rate certainty, whereas absent the Amendment, ratepayers would be at a potential risk of paying significantly higher rates. Furthermore,

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[18] R.I.G.L. § 38-2-2(4)(B) exempts from the public record, "trade secrets and commercial or financial information obtained from a person, firm or corporation which is of a privileged and confidential nature." The SOS contracts and this Amendment contain competitively sensitive information with regard to the unique terms and clauses that contained in each. Furthermore, with regard to the Amendment, the specific per kWh pricing is sensitive, both to National Grid and the Supplier. The Supplier may be in the process of addressing similar disputes with other distribution companies and National Grid/Narragansett may be attempting to address disputes with other suppliers as well. Neither wishes to adversely impact their bargaining positions.

R.I.G.L. § 38-2-2(4)(E) exempts from the public record "any records which would not be available by law or rule of court to an opposing party in litigation." In this case, Narragansett has provided the Commission and Division with everything they have asked for through data requests - much of which is legal analysis of the contract provisions, analysis of success at arbitration, analysis of the cost/benefit analysis of the impact on ratepayers between the respective costs at market and under the amendment. This information would not be available to an opposing party at litigation.

Accordingly, Narragansett and the Supplier requested the following information be kept confidential: (1) Supplier identity; (2) Price terms shown in Section 5 and Appendix A of the Amendment; (3) Security provisions and the Form of Guaranty provided in Article 7 and Appendix B to the original agreement, respectively; (4) Supplier Responsibilities shown in the second and fifth paragraphs of Article 3 on Page 5 of the original agreement; and (5) The definition of Delivery Point on Page 2 of the original agreement and Section 3 of the amendment. Narragansett also requested that it not be asked during a public hearing to do either of the following: (1) Make any admissions with respect to the strengths and weaknesses of its position or relative chances of success or failure at arbitration; (2) Reveal litigation strategy.

[19] Tr. 6/17/03, p. 35.

[20] The Commission has reviewed the confidential and public evidence as part of its deliberations.

the outcome of an arbitration and/or litigation between Narragansett and the Supplier is uncertain. Therefore, this solution also avoids protracted costs and uncertainty associated with dispute resolution.

The Commission also notes that the Division, as the ratepayer advocate before the Commission, recommended approval of Narragansett's request for recovery of the additional charges under the Amendment.

Finally, the Commission declines to address Narragansett's claim that under R.I.G.L. § 39-1-27.3(b), as amended in 2002, if Commission approval were not granted, Narragansett would automatically recover any congestion related costs from ratepayers, in the event it were unsuccessful in arbitration or litigation with its Supplier.

Accordingly, it is hereby

(17592) ORDERED:

1. Narragansett Electric Company's request to recover costs associated with the Amendment to its Standard Offer Supply Contract is approved.
2. Narragansett Electric Company shall comply with all other findings and instructions contained in this Report and Order.

EFFECTIVE AT WARWICK, RHODE ISLAND PURSUANT TO A BENCH DECISION ON JUNE 19, 2003. WRITTEN ORDER ISSUED OCTOBER 28, 2003.

PUBLIC UTILITIES COMMISSION

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Elia Germani, Chairman

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Kate F. Racine, Commissioner

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Robert B. Holbrook, Commissioner