STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: PETITIONS TO PLACE THE NEWPORT NAVAL STATION ON THE G-62 RATE	: : :	DOCKET NO. 3551

REPORT AND ORDER

I. Narragansett Electric's Petition

On September 8, 2003, the Narragansett Electric Company ("Narragansett Electric"), a subsidiary of National Grid, filed with the Rhode Island Public Utilities Commission ("Commission") a petition requesting authority to transfer the Naval Station at Newport, Rhode Island ("Navy") onto Narragansett Electric's G-62 rate effective on the earlier of: (1) January 1, 2005 or (2) "the Commission's approved effective date for a new rate plan superseding the present rates in effect." Narragansett Electric requested approval of this proposal no later than October 1, 2003.

Narragansett Electric indicated that Congress directed a new round of Base Realignment and Closure ("BRAC") review to address excess military base capacity. Also, Narragansett Electric stated that the current round of BRAC is scheduled to commence later this year with the next round of BRAC recommendations scheduled to be implemented in 2005. Because Rhode Island has a large naval presence and because of the impact that an adverse BRAC decision would have on Rhode Island, the Rhode Island Economic Development Corporation ("EDC") requested that Narragansett Electric seek Commission approval to lower the Navy's electric delivery rate by placing the Navy on the G-62 rate.

Narragansett Electric explained that as of May 1, 2000, the Navy has been on the N-01 rate as a result of the Narragansett Electric Merger Rate Settlement approved in Docket No. 2930. Although the Navy would qualify for the G-62 rate, the Navy is the only customer on the N-01 rate. In addition, Narragansett Electric's distribution rates are frozen through December 31, 2004. Narragansett Electric estimated that transferring the Navy to the G-62 rate would save the Navy approximately $1.1 million in distribution charges.

Narragansett Electric argued that the Navy has a "vital role…in the economic well being" of Rhode Island and that an "adverse impact" would occur "if existing activities" of the Navy at Newport were "significantly curtailed or terminated" and that there would also be a "negative effect to Narragansett's other customers." Accordingly, Narragansett Electric declared "it is in the public interest to take actions that would reduce the electric delivery charges to and increase the competitiveness of, the Naval Station at Newport via non-discriminatory and equitable means."[1]

II. Navy's Petition

On September 11, 2003, the Navy filed with the Commission a petition requesting that the Navy be transferred from the N-01 rate to the G-62 rate as soon as possible.[2] The Navy argued that a transfer to the G-62 rate would serve economic development and would serve the interests of fairness and equity because it will allow the Navy to receive equal treatment to that of Narragansett Electric customers with comparable electric usage.[3]

[1] Narr. Ex. 1 (Narragansett Electric's Petition) pp. 1-4.
[2] On October 20, 2003, Narragansett Electric filed an objection to the Navy's petition requesting to be placed on the G-62 rate prior to December 31, 2004, the end of the rate freeze period.
[3] Narr. Ex. 1 (Navy's Petition), pp. 1-3.

In support of its petition, the Navy submitted the pre-filed testimony of Commander Michael J. Stoll. Mr. Stoll related that all other industrial customers who have a 12-month maximum demand of 3000 kW or larger pay the lower G-62 rate. The Navy has a monthly maximum demand exceeding 16000 kW. If the Navy were transferred to the G-62 rate the Navy would enjoy savings of $1.4 million per year. He noted that the Newport Naval Station's annual utilities budget is $19 million of which $10 million is for electricity. He stated that the Navy is the only Narragansett Electric customer in the higher N-01 rate class. Commander Stoll explained that prior to the merger, the Navy was Newport Electric's only industrial user of a large size and therefore, had its own rate class. He noted that the Navy was kept in its own rate class after the merger despite the existence of other similar-sized customers in Narragansett Electric's service territory on the G-62 rate. He argued that the Navy's "rate is based upon a precedent which is no longer applicable." Commander Stoll noted that the Newport Naval Complex employs over 7800 military and civilian personnel with combined annual salaries of $520 million. He recommended that the Navy be transferred to the G-62 rate as soon as possible.[4]

III. Division's Direct Testimony

On October 9, 2003, the Division of Public Utilities and Carriers ("Division") submitted the pre-filed testimony of Dr. John Stutz, its consultant. Dr. Stutz noted that the Navy is currently taking service under the N-01 rate pursuant to the Narragansett Electric Merger Rate Settlement in Docket No. 2930. He explained that the placement of the Navy on the N-01 rate following the merger lowered the Navy's annual distribution charges by $734,000. Also, he stated that the Narragansett Electric Merger Rate

[4] Navy's Ex. 2 (Stoll's pre-filed testimony), pp. 1-4.

Settlement is premised on the Navy being served on the N-01 rate through December 31, 2004. He concurred that based on its load, the Navy also qualifies for the G-62 rate. Accordingly, he recommended that the Navy be permitted to transfer to the G-62 rate on January 1, 2005. He emphasized that the annual savings to the Navy produced by the transfer from the N-01 rate to the G-62 rate would be $1.4 million or only .3 percent of the $520 million in annual salaries at the Newport Naval Station. He concluded that the amount of savings to the Navy for a quick transfer is modest.

Dr. Stutz indicated that if the Navy were to be transferred to the G-62 rate prior to the end of the rate freeze period, there would be a reduction in Narragansett Electric's earnings. Currently, Narragansett Electric is earning above 13 percent on its common equity. Under the Narragansett Electric Merger Rate Settlement, 75 percent of earnings above 13 percent return on common equity ("ROE") are refunded to ratepayers. Therefore, if earnings were reduced because the Navy was on the G-62 rate, ratepayers would, in effect, fund 75 percent of the Navy's savings and Narragansett Electric's shareholders would fund the remaining 25 percent. If earnings were between 12 to 13 percent then Narragansett Electric's share would increase to 50 percent. Dr. Stutz emphasized that in allocating costs associated with an immediate reduction in electricity costs to the Navy, equity is a concern, and thus, it would be equitable to allocate costs among all who benefit from the Navy's presence in Rhode Island. Because the Navy contributes substantially to the Rhode Island economy, the Navy's contribution improves the prospect of a continuing investment in the rate-based facilities upon which Narragansett Electric earns a return.[5]

[5] Div. Ex. 1 (Stutz's pre-filed testimony), pp. 5-7.

IV. October 21, 2003 Hearing

After published notice, a public hearing was conducted on October 21, 2003 at the Commission's offices at 89 Jefferson Boulevard, Warwick, Rhode Island. The following appearances were entered:

FOR NARRAGANSETT ELECTRIC:	Terry Schwennesen, Esq.
FOR THE DIVISION:	William Lueker, Esq. Special Assistant Attorney General
FOR THE ATTORNEY GENRAL:	Paul Roberti, Esq. Assistant Attorney General
FOR EDC:[6]	Mark Russo, Esq.
FOR THE NAVY:	Audrey Van Dyke, Esq.
FOR THE COMMISSION:	Steven Frias, Esq. Executive Counsel

The Commission received public comment from Mr. Henry Shelton of the George Wiley Center who stated that if the Navy were transferred to the G-62 rate then Narragansett Electric shareholders should absorb the cost. Mr. Andrew Dzykewicz of EDC and Keith Stokes of the Newport County Chamber of Commerce supported the Navy's transfer to the G-62 rate prior to the end of the rate freeze period.[7]

Narragansett Electric presented Mr. Carlos Gavilondo and Ms. Jeanne Lloyd as witnesses. Mr. Gavilondo explained that the Navy's N-01 rate was established in the

[6] There was no objection to the EDC's motion to intervene or the Attorney General's motion to intervene.

[7] Tr. 10/21/03, pp. 11-14, 27. Mr. Dzykewicz was unable to tell the Commission if any other aspects of the Navy's budget were being addressed. Id. at 24-26. Mr. Stokes indicated that the Governor's Base Realignment Commission and the Special Study Commission in the House will look at other areas supporting the defense industry in Rhode Island and are currently studying costs and resources of military facilities in other states around the country but that utility rates need to be in place for the BRAC review. Id. at 32-33. The Commission also received letters in support of the Navy from R.I. House Majority Leader Gordon Fox and from the Rhode Island Congressional delegation.

settlement arising from Docket No. 2930. This N-01 rate was a 28 percent reduction in distribution costs for the Navy and noted the average rate reduction percentage for other Newport Electric customers was 28 percent when they transferred to Narragansett Electric.[8] He explained that at the time of the merger, the issues of "gradualism and transitional rate design were foremost" because if the Navy had been moved to the G-62 rate "the rate reduction that all other customers saw would have largely been wiped out." As a result, the rate design in 2000 considered "issues of transition, issues of fairness among customers and among customer classes" and that a further transition at the end of the rate freeze would occur at which time the Navy would be transferred to the G-62 rate. Mr. Gavilando further explained that a larger rate reduction for the Navy could have prevented former EUA customers from receiving rate reductions as a result of the merger. Mr. Gavilondo stated that Narragansett Electric is currently earning in excess of 13 percent ROE. Also, Mr. Gavilondo concurred that future Commissions are not bound to a prior settlement. He also stated that there is no evidence that the Navy would leave Rhode Island if it is not allowed to transfer to the G-62 rate immediately. Mr. Gavilondo stated that the Navy's departure from Rhode Island would harm Narragansett Electric's revenues.[9] Mr. Gavilondo stated in a 20 year base plan review a delay of one year in the transfer to the G-62 rate will likely not make a difference in the BRAC review. Ms. Lloyd indicated that the Navy is a standard offer service customer.[10]

The Division presented Dr. Stutz as a witness. Dr. Stutz stated that the parties to a settlement know a settlement "could possibly be overturned, but they have a strong expectation that they won't be overturned unless there's a compelling reason." Dr. Stutz

[8] Id. at 83, 96, 107-110, 170.
[9] Id. at 120, 128-129, 144, 148, 160-161.
[10] Id. at pp. 171, 177.

stated that if the Navy was transferred to the G-62 rate before January 1, 2005 then the cost should be distributed through the earnings sharing mechanism.[11]

V. Navy Settlement

On November 19, 2003, Narragansett Electric filed a settlement with the Navy and EDC. The proposed Navy Settlement allowed the Navy to receive a credit on its monthly bill of $.01209 per kWh, which is approximately $1.38 million per year, commencing December 1, 2003 and continuing until January 1, 2005 when the Navy will be transferred to the G-62 rate. In order not to impact earnings sharing pursuant to Section 11(A) of the Narragansett Electric Merger Rate Settlement, the monthly N-01 rate credit of $.01209 per kWh for the Navy will be paid through a reduction in the Storm Contingency Fund, which currently exceeds $12 million. The Navy agreed to forego receipt of its allowable share of any earning sharing or up to 20 percent of the N-01 rate credit actually received by the Navy, whichever is less. The amount foregone by the Navy would be returned to the Storm Fund.[12]

VI. November 25, 2003 Hearing

The Commission held a hearing at its offices on November 25, 2003 to review the proposed Navy Settlement. At the hearing, the Division's counsel stated the proposed Navy Settlement was "ill-advised" and contrary to the Commission's policy regarding the Storm Fund as set forth in earlier orders. Instead, the Division argued that the costs for the rate relief to the Navy should come from earnings. Also, the Division acknowledged that if it "had known the success of….shared earnings", the Division "would not have been opposed to moving the Navy to the G-62 rate five years ago." Also, the Attorney

[11] Id. at 196, 223-225.
[12] Joint Ex. 1.

General indicated he "cannot support the use of Storm Contingency funds" as a means to transfer the Navy to the G-62 rate and agreed with the Division's approach to use "the Company's excess earnings" to transfer the Navy to the G-62 rate. Counsel for Narragansett Electric objected to use of a reduction in earnings sharing as a means to transfer the Navy to the G-62 rate.[13]

The parties to the proposed Navy Settlement presented Mr. Gavilondo, Ms. Lloyd and Commander Stoll as witnesses. Mr. Gavilondo stated that the purpose of the Storm Fund is to allow Narragansett Electric the ability to recover its incremental costs associated with responding to an extraordinary storm event. He concurred that the vast majority of the Storm Fund is ratepayer money. He also stated that Narragansett Electric contributed "a lot of sweat equity" in the proposed Navy Settlement.

Mr. Gavilondo acknowledged that there is language in the order from Docket No. 2509 which limits charges to the Storm Fund for storm related costs. Mr. Gavilondo indicated that in 1991 Hurricane Bob resulted in approximately $7.7 million of storm damage.

He stated that Narragansett Electric's ROE in 2002 was 16.16 percent. He acknowledged that if the Navy left Rhode Island it could reduce Narragansett's revenues and reduce its earnings. Mr. Gavilondo stated that he had "confidence that the Commission will make the determination that's in the public interest" in this proceeding and has that authority in "their enabling statute".[14]

[13] Tr. 11/25/03, pp. 20-25, 33, 37-38.
[14] Id. at 56, 63, 66-70, 75, 85-88, 95.

At the end of the hearing, the Commission indicated that Narragansett Electric shareholders must contribute some portion of the cost to the transfer of the Navy to the G-62 rate. Accordingly, the Commission rejected the proposed Navy Settlement.

VII. Amended Navy Settlement

On December 9, 2003, Narragansett Electric filed an amended settlement with the Navy, EDC, the Division and the Attorney General. The proposed Amended Navy Settlement allowed the Navy to receive a credit on its monthly bill of $.01209 per kWh, which is approximately $1.38 million per year, commencing January 1, 2004 until January 1, 2005 when the Navy would be transferred to the G-62 rate or its equivalent rate. The rate reduction to the Navy would result in reduced revenues and, therefore, a reduction in shared earnings pursuant to Section 11(A) of the Narragansett Electric Merger Rate Settlement. The Navy agreed to forego receipt of its allowable share of any earnings sharing or up to 20 percent of the N-01 rate credit actually received by the Navy, whichever is less. The amount foregone by the Navy would be subject to earnings sharing.[15]

On December 10, 2003, the Commission staff issued a data request to determine if the parties would object to modifications of language in the Amended Navy Settlement. On December 11, 2003, the parties essentially indicated that they did not oppose modifications to the language. On December 15, 2003, Narragansett Electric filed a Revised Amended Navy Settlement incorporating the requested modifications to the language. At an open meeting, on December 18, 2003, the Commission reviewed the evidence and the law, and approved the Revised Amended Navy Settlement with the

[15] Amended Navy Settlement.

modifications agreed to by the parties on December 11, 2003, and filed with the Commission on December 15, 2003.

COMMISSION FINDINGS

I. Historical Background

At times, it may be difficult to determine the rationale for a particular rate or for an overall rate design. This is because electric ratemaking and rate design are the result of many competing principles and methods. The historical origins of a rate or a rate design can provide guidance as to its basis. As Justice Benjamin Cardozo explained, "history, in illuminating the past, illuminates the present."[16] Therefore to illuminate the rationale for a particular electric rate, such as the N-01 rate, it is necessary to look at the history of the rate and the overall electric rate design of which it is a component. As Justice Oliver Wendell Holmes once stated, "a page of history is worth a volume of logic."[17] Unfortunately, it will require more than a page to adequately describe the power struggle over the Navy's electric rate for the last three decades.

The controversy surrounding the Navy's electric rate began in 1973 after the withdrawal of the naval fleet from Newport. The first phase of the battle began on December 21, 1973, when the Commission raised rates by $198,000 on an interim basis because "the withdrawal of the naval fleet from Newport" had "just about eliminated the net income of Newport Electric" and therefore Newport Electric's "credit and financial standing" would be "seriously impaired without immediate rate relief."[18] But, this was just the beginning of a series of escalating rate increases for Newport Electric as a result of the Navy's action. On August 1, 1974, the Commission raised rates by $1,000,000 on

[16] Benjamin Cardozo, The Judicial Process p. 53 (1921).
[17] New York Trust Co. v. Eisner 256 U.S. 345, 349 (1921).
[18] Order No. 8913 (12/21/73).

an interim basis because "the withdrawal of the naval fleet" had "a devastating effect" on Newport Electric. Newport Electric lacked "cash to meet their every day operating expenses."[19]

On June 18, 1976, the Commission made the August 1, 1974 rate increase final thereby resulting in an average increase of 15.86 percent for all ratepayers and 17.98 percent increase for the Navy, specifically.[20] However, the Navy objected to the portion of the rate increase allocated to it because Newport Electric was earning a greater return on its service to the Navy than on any other Newport Electric customer. The Commission justified the rate increase on the Navy by stating that "for the past 20 years the planning of the Newport Electric Corporation has incorporated assumptions as to the permanence of the Navy as a significant customer" but this "assumption turned out to be unfounded". Because "the Navy's continued presence in the Newport area remains in the realm of the speculative", the Commission determined that it was "reasonable to characterize Newport's plant investment with respect to the Navy as an investment of relatively high risk." Due to the "volatile nature of the Navy as a customer", the Commission found it justified to have a higher return for Newport Electric on the Navy's rate than on any other customer class.[21]

After its defeat at the Commission, the Navy echoed the words of the U.S. Navy's founder Captain John Paul Jones, who stated "I have not yet begun to fight!", and appealed the Commission's order. On appeal to the Rhode Island Supreme Court, the Navy argued that its 18 percent increase, in comparison to other rate classes was discriminatory because Newport Electric's return on its service to the Navy was 63.5

[19] Order No. 8963 (8/1/74).
[20] Order No. 9183 (6/18/76), U.S. v. P.U.C. 120 RI 959, 961 (1978).
[21] Order No. 9183 (6/18/76).

percent higher than the return on service to other customers. On November 1, 1978, the Rhode Island Supreme Court remanded the case back to the Commission in order for it to consider a cost of service study in setting rates for all of Newport Electric's customers.[22]

In the meantime, between the issuance of Order No. 9183 on June 18, 1976 and the remand on November 1, 1978, Newport Electric's distribution rates continued their unrelenting climb. On October 7, 1977, the Commission raised rates by $606,000.[23] On October 17, 1979, the Commission raised rates again by $902,000.[24] As a result of the remand, the Commission specifically reviewed Newport Electric's rate design and a cost of service study. In Order No. 10064, issued on February 20, 1980, the Commission noted "the lack of load stability which is inherent in a rate class consisting of a single large industrial customer" and discussed its concern as to "whether required plant expansion to meet the demands" of a single large customer "will be sufficiently utilized to enable the Company to recover the costs incurred." The Commission emphasized that the Navy's lack of past and future "load stability" constituted a "risk involved in providing service" to this "gigantic user of power". The Commission determined that this "risk factor" is "well in excess" of "the cost of supplying the more stable residential service." Accordingly, the Commission essentially rejected Newport Electric's cost of service study and slightly modified the rate the Navy had appealed in June 1976.[25] The Navy once again appealed, but this time, the Commission's order was sustained on December 4, 1981.[26]

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[22] U.S. v. P.U.C. 120 RI 959, 961, 967-968 (1978).
[23] Order No. 9402 (10/7/77).
[24] Order No. 9965 (10/17/79).
[25] Order No. 10064 (2/20/80).
[26] Secretary of Defense v. P.U.C. 437 A.2d 1342 (R.I. 1981).

In the interim, Newport Electric's distribution rates continued to move higher. On February 4, 1981, the Commission raised rates by $1,080,000 only to be followed later in the year by another $990,000 increase on September 13, 1981.[27] In one of these two orders the Commission noted that "the last two rate cases amounted to over $1,500,000 and constituted collectively the highest total percentage of rate relief granted in…the history of the Commission." The Commission was not only troubled by Newport Electric's high rates but its economic viability. It noted that Newport Electric has a very small service territory consisting of approximately 25,000 customers and suggested it could be bought by EUA, Blackstone Valley Electric's parent company.[28] Within less than a decade, the prophecy would be fulfilled.

After five distribution rate increases and two appeals in eight years, the Navy was paying a higher return for Newport Electric service, but other ratepayers had avoided a more dramatic rate shock and Newport Electric had appeared to regain its financial footing. Unfortunately, the demise of Newport Electric continued, but at a slower pace. During the second phase, from 1981 to 1990, Newport Electric received distribution rate increases of 3.4 percent on September 15, 1985 and 1.5 percent on August 7, 1987.[29] On both occasions, the rate increases were the result of settlements among Newport Electric, the Division and the Navy. Apparently, the Navy's new strategy was acceptance of the status quo even if it meant paying a higher return for electric service than other Newport Electric customers. Unfortunately, peace with the Navy was not enough to ensure Newport Electric's financial stability.

[27] Order No. 10372 (2/4/81) and Order No. 10527 (9/13/81).
[28] Order No. 10372 (2/4/81).
[29] Order No. 11796 (9/15/85) and Order No. 12405 (8/7/87).

In a series of proceedings beginning on October 6, 1989, Newport Electric's precarious financial position was exposed when it filed with the Division a request for permission to obtain $8 million in additional debt despite having only 27.4% of common equity in its capital structure. As a result of Newport Electric's financial situation, on December 6, 1989, the Division authorized Newport Electric to only obtain an additional $4 million of debt and required it to develop a plan to bring its equity level to 40% of its capital structure.[30] Following the Division's decision, Newport Electric's situation deteriorated rapidly. On December 22, 1989, the Division was informed that Rhode Island Hospital Trust National Bank was "very reluctant to provide additional funds" to Newport Electric because of "problems at the parent company level", NECO Enterprises. As a result, the Division reduced the prior authorization to $2 million in additional debt, which would now be escrowed with an agent of the Division.[31] The financial predicament of Newport Electric necessitated its sale to EUA, but not before NECO, Newport Electric's parent, attempted to require Newport Electric to pay various NECO expenses. On March 21, 1990, the Commission expressly prohibited this action and required any unusual expenditure by Newport Electric to be authorized by the Division.[32] The financial nightmare ended on March 27, 1990 with the purchase of Newport Electric by EUA.[33]

With its financial stability restored through its purchase by EUA, the third phase began in 1990. In December 1991, Newport Electric, under new leadership and with the financial backing of EUA, filed for a rate increase and received a rate increase of $3.6

[30] Order No. 13148 (12/6/89).
[31] Order No. 13155 (12/22/89).
[32] Order No. 13234 (3/21/90).
[33] Order No. 13257 (4/5/90).

million on September 28, 1992. The Commission approved only a 3.3 percent increase for the Navy while other rate classes received increases of 5.7 to 12.9 percent.[34] Apparently, as rates stabilized for Newport Electric customers and Newport Electric regained its financial firm footing, the Commission began the process of "moving the Navy and other customer classes closer to their cost of service." Starting with Order No. 14039, the Commission began "to accelerate the pace of equity" and became "proactive in trying to move Newport's various rate classes toward cost of service."[35] However, the 3.3 percent increase was too much for the Navy. The Commission explained that the Navy constituted "20 percent of the Company's service" and discussed the problem of "rate shock" and expressed the need for "rate continuity and gradualism in rate increases."[36] Although the Navy's service according to cost studies produced a 55 to 67 percent rate of return for Newport Electric, the Commission denied that it was required to shift the rate design and therefore increase the rates of other classes. As a result, the Navy resurfaced to do the battle with the Commission by appealing its order to the Rhode Island Supreme Court. Once again, the Commission's order was sustained on this issue. The Court validated the Commission's concerns relating to rate shock and rate stability and noted that the Navy's proposal would result in a 90 percent increase for some other rate classes.[37] Despite the Navy's appeal, the Commission continued the process of "moving the Navy and other customer classes closer to their cost of service." In Order No. 14569, issued on November 30, 1994, the Commission reduced the Navy's rate by

[34] Order No. 14039 (9/28/92); U.S. v. P.U.C. 635 A.2d. 1135, 1140-1143 (R.I. 1993).
[35] Order No. 14596 (11/30/94).
[36] Order No. 14039 (9/28/92).
[37] U.S. v. P.U.C. 635 A.2d. 1135, 1140-1143 (R.I. 1993).

$800,000, or 7 percent, through a new rate design, which shifted this cost to other ratepayers.[38]

This process nearly reached completion in Order No. 16200 when on March 14, 2000, the Commission approved the Narragansett Electric Merger Rate Settlement in which Newport Electric merged into Narragansett Electric and the Navy received a $734,000 annual reduction from the Navy's pre-merger rate with Newport Electric but was placed on its own N-01 rate instead of the G-62 rate.[39]

In earlier versions of the Narragansett Electric Merger Rate Settlement, the Navy was a signatory, and the Navy did not object to the Narragansett Electric Merger Rate Settlement even after the Navy withdrew from the settlement. Although the Navy did qualify as a G-62 customer, the Navy chose not to litigate the issue and press for a larger reduction by becoming a G-62 customer but instead accepted the $734,000 annual reduction of the N-01 rate. Apparently, the Commission accepted the N-01 rate as reasonable for the Navy because it was attempting to achieve various ratemaking objectives such as giving all ratepayers a reduction in rates and while establishing "one state, one rate" for as many customers as possible, but at the same time, providing Narragansett Electric with sufficient revenues so that it had a reasonable opportunity to earn a fair rate of return.

However, the Navy did not want to abide by the new agreement. On May 17, 2000, the Navy attempted to evade the effect of the Narragansett Electric Merger Rate Settlement by filing a petition requesting that it be transferred to the G-62 rate. A few months later on August 30, 2000, the Commission re-affirmed its decision by rejecting

[38] Order No. 14596 (11/30/94).
[39] Order No. 16200 (3/24/00). The Navy did not appeal this order.

the Navy's petition for placement on the G-62 rate on the basis of administrative finality.[40] At that time, the Navy failed to present any facts that the Navy could be placed on the G-62 rate while not hindering the achievement of the various ratemaking objectives of the Narragansett Electric Merger Rate Settlement. After three years of maintaining a fragile peace, on September 8, 2003, Narragansett Electric filed its petition, which re-opened the issue of the appropriate rate for the Navy.

II. Appropriateness of Transferring the Navy to the G-62 Rate

At the outset, it is assumed as a matter of law that any utility rate ordered by the Commission is just, reasonable, and non-discriminatory unless it is reversed on appeal or until such time as the Commission alters the rate.[41] Therefore, the current N-01 rate is presumed to be reasonable. At this time, the Commission must determine if the N-01 rate is just, reasonable, and non-discriminatory under current circumstances.

Historically, the Navy has been in its own rate class. Prior to the merger, the Navy was a customer of Newport Electric. There were no other industrial customers of similar load size as the Navy in Newport Electric's service territory. In fact, the Navy constituted 20 percent of Newport Electric's load and Newport Electric's customer base was one-tenth as large as Narragansett Electric. While a customer of Newport Electric, the issue for the Navy was not being in its own rate class, but the price at which this rate was set. The Commission justified a higher rate for serving the Navy because the Navy was a high risk customer for Newport Electric in that it could terminate or significantly curtail its operations in Rhode Island at any time. This legitimate concern was prevalent

[40] Order No. 16437 (10/30/00). The Navy filed an appeal of this order, but withdrew it prior to a hearing.
[41] U.S. v. P.U.C. 120 R.I. 959, 964 (1978).

after the Navy's fleet departure from Newport in 1973. The risks to Newport Electric and its other ratepayers for the investment in plant to service the Navy if the Navy left Rhode Island were appropriately placed on the Navy. The Navy repeatedly challenged the Commission rate setting for it, and repeatedly, the Navy's appeals failed. However, as Newport Electric regained its financial stability and rates stabilized for other rate classes, the Commission gradually reduced the percentage of Newport Electric's revenue requirements placed on the Navy but did so in a manner that would not cause rate shock to Newport Electric's other ratepayers. Accordingly, until the merger with Narragansett Electric in 2000, the unique higher rate charged to the Navy by Newport Electric was just, reasonable, non-discriminatory and upheld by the Rhode Island Supreme Court.

After the merger, Narragansett Electric continued Newport Electric's practice of having the Navy on its own rate, the current N-01 rate. The N-01 rate arose from the Narragansett Electric Merger Rate Settlement and constituted a $734,000 annual reduction from the Navy's pre-merger rate with Newport Electric. Although the N-01 rate was an anomaly in the Narragansett Electric Merger Rate Settlement and the Navy did qualify as a G-62 customer, the Navy did not litigate the issue and press for a larger reduction by becoming a G-62 customer but instead accepted the $734,000 annual reduction of the N-01 rate. The Commission accepted this N-01 rate, in part, because the Navy chose not to litigate the issue when it had the opportunity. The Commission does not play the role of advocate for parties that are certainly capable of arguing for themselves. In addition, it appears that the Commission accepted the N-01 rate as reasonable for the Navy because it was attempting to achieve at least three significant ratemaking objectives in Docket No. 2930: (1) to give all ratepayers a reduction in rates,

(2) to establish a "one state, one rate" rate design for as many customers as possible, but (3) at the same time, provide Narragansett Electric with sufficient revenues so that it would have a reasonable opportunity to earn a fair rate of return. As a result, the parties crafted a settlement that allowed Narragansett Electric the opportunity to obtain a fair rate of return while giving rate reductions to all ratepayers and consolidating all rates into the "one state, one rate" approach except for one customer. The only exception was the Navy, which received an annual rate reduction of $734,000 but could not be placed onto the G-62 rate. Placing the Navy on the G-62 rate in 2000 could have reduced the rate reduction of other ratepayers or jeopardized Narragansett Electric's ability to earn a fair rate of return. Consequently, the Commission approved the Narragansett Electric Merger Rate Settlement as the best means of achieving just and reasonable rates in 2000. Since ratemaking is done on a prospective basis, based on the evidence in 2000, the N-01 was just, reasonable and non-discriminatory in the context of the overall Narragansett Electric Merger Rate Settlement.

The question is whether, at this time in 2003, there is any reasonable ratemaking policy to justify continuing the existence of the N-01 rate for the Navy. As noted by the Navy, the N-01 "rate is based upon a precedent which is no longer applicable." Placing the Navy on the G-62 rate or its equivalent will not affect the distribution rates of other ratepayers, nor will it directly prevent Narragansett Electric from earning its authorized ROE of 10.5 percent. In fact, Narragansett Electric is currently achieving earnings well in excess of 13 percent, and therefore, ratepayers will likely be refunded a portion of over-earnings in 2005. In addition, the elimination of the N-01 rate by transferring the Navy to the G-62 rate or its equivalent would complete the regulatory objective of "one

state, one rate". Therefore, the legitimate ratemaking policies requiring the Navy to take service on the N-01 rate no longer exist. Also, all the parties are in agreement that the Navy should be transferred to the G-62 rate or its equivalent by January 1, 2005. In addition, it is apparent that the Navy is comparable to other G-62 customers based on the size of its load and its service.[42] Accordingly, the Commission finds that the Navy should be transferred to the G-62 rate or its equivalent prospectively pursuant to R.I.G.L. Section 39-2-2, which prohibits unjust discrimination among similarly situated customers. Certainly, this transfer of the Navy to the G-62 rate or its equivalent rate should occur no later than at the end of rate freeze period in the Narragansett Electric Merger Rate Settlement, which is January 1, 2005.

III. Justification of Transferring the Navy to the G-62 Rate During the Rate Freeze

Since there was little dispute among the parties that the Navy should be transferred to the G-62 rate by January 1, 2005, the initial disagreement in this case surrounded whether the Navy should be transferred to the G-62 rate, or its equivalent during the rate freeze period in violation of the Narragansett Electric Merger Rate Settlement. The Commission will now examine if precedent and administrative finality is sufficient justification to deny the transfer of the Navy to the G-62 rate or its equivalent prior to the end of the rate freeze period. First, the Commission must determine if the transfer of the Navy to the G-62 rate or its equivalent would constitute a reversal of precedent.

[42] PUC Ex. 1 (Data Response 1-6).

Narragansett Electric argued that Commission Order No. 16437, which denied the Navy's petition for transfer to the G-62 rate, is precedent for denial of the Navy's transfer to the G-62 rate during the rate freeze. In that order, the Commission denied the Navy's request based on administrative finality noting that the Navy failed to litigate the issue of its appropriate rate classification in March 2000 when the Commission approved the Narragansett Electric Merger Rate Settlement in Order No. 16200.[43]

In regard to Order No. 16200, the Commission approved the Narragansett Electric Merger Rate Settlement, which included a specific provision requiring a rate freeze period to the end of calendar year 2004. If the Commission were to transfer the Navy to the G-62 rate, or an equivalent rate, before the end of the rate freeze period, it would be reversing this aspect of its Order 16200. Thus, the question for consideration is whether the Commission should depart from the precedent set in Order No. 16200 and allow the Navy to be transferred to the G-62 rate or its equivalent prior to the end of the rate freeze period.

Following consistent policies give certainty to regulator and regulated alike. As stated by Justice Felix Frankfurter following precedent or stare decisis "embodies an important social policy" because it "is rooted in the psychological need to satisfy reasonable expectations."[44] If judicial bodies were to ignore precedent, then, as noted by Justice Cardozo, "the labor of judges would be increased almost to breaking point" because "every past decision could be reopened in every case." Not surprisingly, Justice

[43] Order No. 16437, pp. 10-11 (10/30/00). If the Navy had chosen to litigate the issue of its appropriate rate classification in Docket No. 2930 during early 2000, the Commission conceivably could have required Narragansett Electric to increase the amount of the reduction in the settlement above $13.1 million so that the Navy could take service under the G-62 rate.
[44] Helvering v. Hallock, 309 U.S. 106, 119 (1940).

Cardozo declared that "adherence to precedent should be the rule and not the exception."[45]

It should be emphasized that the Commission's ratemaking authority is a legislative function. The legislature may change its policy at will. Similarly, the Commission is not bound by precedent and can change approaches or methodologies to establish just and reasonable rates. Although this Commission is not required to follow precedent, it does make an effort to develop and follow consistent regulatory approaches. Also, this Commission has determined that when it changes a regulatory policy it will "provide an explanation for such departures."[46]

There are circumstances when precedent should be discarded. According to William Blackstone, in the common law, "precedent and rules must be followed, unless flatly absurd or unjust."[47] The passage of time causes circumstances to change and therefore can make a precedent seem "unjust". As noted by Justice Oliver Wendell Holmes, "precedents survive in the law long after the use they once served is at an end and the reason for them has been forgotten."[48] Consequently, precedents must be reexamined and scrutinized in light of current conditions. As noted by Justice Cardozo, in the law, the "work of modification is gradual. It goes on inch by inch. Its effect must be measured by decades." Change moves at the pace of a "glacier".[49]

In deciding whether to overrule a prior decision, the U.S. Supreme Court has declared its reliance on "whether facts have so changed or come to be seen so differently,

[45] Benjamin Cardozo, The Nature of the Judicial Process, p. 149 (1921).
[46] New England Telephone & Telegraph Co. v. P.U.C. 446 A.2d 1376, 1389 (R.I. 1982).
[47] Blackstone's Commentaries bk . 1, p. 70 (1765).
[48] Oliver Wendell Holmes, Jr., The Common Law, p. 35 (1881).
[49] Benjamin Cardozo, The Judicial Process, p. 25 (1921).

as to have robbed the old rule of significant application or justification."[50] If facts have so changed that the precedent loses its justification, a judicial body should depart from precedent. As Justice Frankfurter once noted: "Wisdom too often never comes, and so one ought not to reject it merely because it comes late."[51] For any judicial body to stubbornly adhere to precedent although it has lost justification would be unreasonable. As discussed by Justice Holmes: "It is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV. It is still more revolting if the grounds upon which it was laid down have vanished long since, and the rule simply persists from blind imitation of the past."[52] However, for a judicial body to depart from precedent, it must do so on a basis "grounded truly in principle, not as compromises with…political pressures" because a judicial body's "legitimacy depends on making legally principled decisions" and "to overrule under fire in the absence of the most compelling reasons…would subvert" a judicial body's "legitimacy beyond any serious question."[53]

As discussed earlier, the original legitimate ratemaking policies justification for having the Navy to be on the N-01 rate no longer exist. The only reason for it to remain on the N-01 rate is because of the terms of the Narragansett Electric Merger Rate Settlement. However, based on current circumstances, a transfer of the Navy to the G-62 rate would not reduce the reductions other ratepayers received as a result of the merger or cause Narragansett Electric shareholders to have its earnings fall below 10.5 percent ROE. In fact, transferring the Navy to the G-62 rate, or its equivalent, would further the

[50] Planned Parenthood of S.E. of Pa.. v. Casey 505 U.S. 833, 855 (1992).
[51] Henslee v. Union Planters Bank, 335 U.S. 595, 600 (1949) (Frankfurter dissenting).
[52] Oliver Wendell Holmes, Jr. "The Path of the Law," 10 Harv. Law Rev. 457, 469 (1897).
[53] Planned Parenthood of S.E. of Pa. v. Casey 505 U.S. 833, 865-867 (1992).

objective of consolidating pre-merger rates in order to achieve "one state, one rate". Therefore, allowing the Navy transfer to the G-62 rate, or its equivalent, before December 31, 2004, does not hinder any ratemaking objectives and actually furthers another ratemaking policy.

More importantly, under these circumstances, if the Commission were not to allow the early transfer of the Navy to the G-62 rate, it could be in violation of R.I.G.L. Section 39-2-2, which prohibits "unjust discrimination". Pursuant to R.I.G.L. Section 39-1-1, the Commission must set just and reasonable rates without unjust discrimination. Under R.I.G.L. Section 39-3-11, the Commission must periodically review rates to insure they are just, reasonable and non-discriminatory. Pursuant to R.I.G.L. Section 39-2-2, public utilities are prohibited from engaging in unjust rate discrimination. Unjust rate discrimination can occur if a public utility charges a customer greater or less compensation for a service than it charges another customer "for a like and contemporaneous service, under substantially similar circumstances and conditions."[54] Rate discrimination did not occur when rates were set in March 2000 because in the Narragansett Electric Merger Rate Settlement, the Navy received a rate reduction in proportion with other Newport Electric customers. Furthermore, in Docket No. 2930, the Commission had other legitimate ratemaking objectives that at that time could have prevented the Navy from being transferred to a G-62 rate if the Navy had chosen to litigate the issue. Rate discrimination did not occur prior to the merger rate case in March 2000 because the Rhode Island Supreme Court upheld this Commission when it took into account factors such as investment risk, rate shock and rate continuity when the

[54] R.I.G.L. Section 39-2-2.

Commission denied the Navy's requests for rate relief.[55] However, at this time there are no other ratemaking policy objectives that would prevent the Navy from receiving the G-62 rate.

Accordingly, under the current circumstances, with Narragansett Electric shareholders and other ratepayers likely to receive portions of over earnings, it could be unjust discrimination under R.I.G.L. Section 39-2-2 to prevent the Navy to transfer to the G-62 rate, or its equivalent. Therefore, the Commission will allow the Navy from transferring to the G-62 rate or its equivalent before the end of the rate freeze because it will not prevent the achievement of any important ratemaking objectives and therefore under current circumstances could constitute rate discrimination under R.I.G.L. Section 39-2-2.[56] A precedent should be discarded when it no longer serves a legitimate ratemaking purpose and could therefore cause a rate to violate a statute.

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[55] Secretary of Defense v. P.U.C. 437 A.2d 1342 (R.I. 1981); U.S. v. P.U.C. 635 A.2d 1135 (R.I. 1993).

[56] When asked in a Commission data request how the Navy's current petition differed from the request denied by the Commission in Order No. 16347, the Navy responded that it "does not seek any subsidization by other customers of a utility company but, by the same token does not want to pay rates that are not reflective of the costs the Navy imposes on a utility system." In addition, the Navy stated that "some Commission staff, unfortunately ill-advise their commissioners and companies" to "go along with such unfortunate approaches." PUC Ex. 2 (Data Response 1-12). In regards to the Navy's consistency in arguing against subsidization, it should be noted that during the time period when the Navy was on its own higher electric rate from Newport Electric, it was arguing for its own lower water rate from Newport Water. Order No. 12185 (11/25/86). Furthermore, until April 1, 2000, the Navy's water rate was provided "significantly below" the "cost to serve the Navy" and the Navy also enjoyed the benefits of water priced based on declining block rates in violation of R.I.G.L. Section 46-15.4-6. As a result, the Commission increased the then "current Navy's rate by 150 percent of the overall increase in rates." Order No. 16235 pp. 14, 31-32 (6/19/00). As for the Commission staff ill advising Commissioners, the Navy had every opportunity to litigate the issue of the N-01 rate in Docket No. 2930, and could have pursued appeals of Order Nos. 16200 and 16437. The Navy chose not to pursue appeals of these orders. As noted by counsel for the Navy in discussing the consequences of the Navy's litigation strategy in 2000: "As it turned out we were wrong. We took a risk and we lost." Tr. 10/21/03, p. 239. It appears that maybe the Navy was ill-advised in 2000. Fortunately for the Navy, the Commission staff did not solely rely upon the evidence and arguments presented by the Navy in this case to determine if the Navy should be transferred to the G-62 rate before the end of the rate freeze, but instead conducted independent research of historical ratemaking principles, and reviewed their relevance to the current circumstances. Seeking rate relief by blaming "some Commission staff" is not a very persuasive argument. Generally, when we are not successful in an endeavor, the "fault" does not lie in others or "in our stars, but in ourselves." William Shakespeare, Julius Caesar, Act I, Scene 2, lines 140-141(1623).

IV. Legality of the Transferring the Navy to the G-62 Rate

As a matter of policy, the Commission deems it reasonable to transfer the Navy to the G-62 rate, or its equivalent, before the end of the rate freeze period. At this stage, the question is whether the Commission can order this transfer as a matter of law. The apparent obstacle is the Narragansett Electric Merger Rate Settlement approved and incorporated by Order No. 16200. Section 6(A) of the agreement specifically indicates that distribution rates including the N-01 rate will be "frozen" through the end of the Narragansett Electric Merger Rate Settlement.

One approach is to terminate the Narragansett Electric Merger Rate Settlement. The Commission has the authority independent of any request by a party and without the consent of all the parties to end the continuation of a settlement. By ending the Narragansett Electric Merger Rate Settlement, the Commission would transfer the Navy to the G-62 rate as well as review Narragansett Electric's rates and require over earnings to be given to ratepayers. However, there is a less dramatic approach the Commission can adopt, which is to exercise its statutory authority to modify a rate as expressly provided in Section 24(G) of the agreement.[57]

The General Assembly delegated its ratemaking power to establish just and reasonable rates to the Commission. The Commission can establish just and reasonable rates through various means. One such means is the settlement process outlined in Commission Procedure Rule 1.24. The utility and the Division can reach a settlement agreement through which just and reasonable rates are produced. Although the Commission is not a party to the settlement, it is an indispensable participant who must

[57] Through cross-examination, EDC implicitly argued for this approach at the hearing on October 21, 2003.

ensure that the settlement agreement is in the public interest prior to its approval.[58] All settlement agreements approved by the Commission are merely a means to achieve its statutory duty to set just and reasonable rates. Pursuant to R.I.G.L. Section 39-1-1, the Commission's approval of a settlement does not modify or abrogate its statutory obligation to modify rates to protect the public from improper and unreasonable rates.[59] All settlement agreements approved by the Commission either expressly or implied in law are subject to the Commission's statutory obligations to set just and reasonable rates. Section 24(G) merely expressly recognizes the fact that the Commission can at any time modify rates set by the Narragansett Electric Merger Rate Settlement if the Commission deems the rate to be improper and unreasonable. Section 24(G) serves as a reservation of statutory rights for the Commission to perform its statutory obligations. Therefore, the Commission retains the statutory authority to modify a rate settlement after its approval, independent of any request by a party and without the consent of all the parties. The Commission's authority is not at issue, but merely whether and how it is to be exercised.

The Commission's authority to modify a rate settlement after it has been approved has some similarities to a court's ability to modify a consent decree. The primary difference is that the Commission has greater latitude to modify a settlement because it has an affirmative statutory obligation to protect the public interest.[60] As Justice Brennan once declared, a ratemaking agency "is not intended to be a passive arbiter but the guardian of the public interest."[61]

[58] Order No. 17524, pp. 71-72 (8/1/03).
[59] Order No. 16200 (3/14/00).
[60] Where there is an uncontested decree, and the nature of the case suggests that the "state's interest" is clear, the burden "to vacate the decree is less heavy.. In Re Julie 114 R.I. 419, 423 (1975).
[61] Baltimore Ohio R. Co. v. United States, 386 U.S. 359, 427-430 (1967) (Brennan concurring).

In order to simplify the legal analysis, the Commission will, for illustrative purposes, use the more stringent federal standard required of a court to modify a consent decree. The United States Supreme Court has suggested that a court can modify a consent decree pursuant to Federal Civil Procedure Rule 60(b).[62] Rhode Island Civil Procedure Rule 60(b) conforms to the federal rule and Commission Procedure Rule 1.28(b) mirrors both rules.[63] The power to modify a decree is necessary because, as noted by Justice Cardozo: "Life is never static."[64] The United States Supreme Court has stated that there is no doubt that a court may modify a consent decree "in adaption to change conditions", and that even if this "reservation had been omitted" in the decree, the court still would have the power "by force of principles inherent" in its jurisdiction.[65] The United States Supreme Court explained that a consent decree may be modified if there has been "a significant change in facts or law" that "warrants revision of the decree and that the proposed modification is suitably tailored to the changed circumstances."[66]

The Commission will now consider whether it should exercise Section 24(G) of the settlement to transfer the Navy to the G-62 rate prior to the end of the rate freeze period. There are numerous factors to consider when determining whether the Commission should exercise its authority to modify a rate in a settlement agreement after the Commission has approved it. In these circumstances, the Commission will first review whether there has been a significant change in circumstances since the time the settlement was approved to warrant the Commission's exercise of its statutory authority

[62] Rufo v. Inmates of Suffolk County Jail 502 U.S. 367, 383-384 (1992).
[63] Decisions of the federal courts interpreting a federal rule identical to the state rule serves as a guide in interpretation. Egan's Laundry & Cleaners, Inc. v. Community Hotel Corp., 110 R.I. 719, 721 (1972).
[64] United States v. Swift & Co. 286 U.S. 106, 119 (1932).
[65] Id. at 114.
[66] Rufo v. Inmates of Suffolk County Jail 502 U.S. at 393.

to modify a rate approved in a currently effective settlement agreement.[67] The Commission should only modify a single rate specifically approved through a full rate case proceeding when "facts have so changed" that the rate in question has been "robbed" of significant "justification".[68] As discussed earlier, the reasons for initially putting the Navy on the N-01 rate no longer exist. The ratemaking objectives of "one state, one rate", and providing all ratepayers with reductions as a result of the merger while providing Narragansett Electric shareholders with a reasonable opportunity to obtain a fair rate of return can be achieved, while transferring the Navy to the G-62 rate or its equivalent. Shareholders are over earning and ratepayers will likely receive a share of these over earnings at the end of the rate freeze. These facts were not known nor clearly foreseeable at the time the Narragansett Electric Merger Rate Settlement was approved.

Second, the Commission should determine if this change in circumstances constitutes a compelling reason to modify the rate at this time. The Commission should not modify a single rate specifically approved through a full rate case proceeding "in the absence of the most compelling reasons" because it would subvert the legitimacy of this institution.[69] The compelling reason in this case is that to deny the Navy a transfer to the G-62 rate or its equivalent, under current circumstances could constitute a violation of Rhode Island's anti-rate discrimination statute: R.I.G.L. Section 39-2-2. In determining whether to continue the application of a settlement provision or to fully implement a statute, it is for this Commission to exercise its judgment. Chief Justice John Marshall once declared that it is "the very essence of judicial duty" to determine which of the

[67] Id.
[68] In some respects, this standard parallels the approach for determining when to reverse precedent. Planned Parenthood of S.E. of Pa. v. Casey 505 U.S. at 855.
[69] Id. at 865-867.

"conflicting rules governs the case."[70] Under the current circumstances, the Commission can not provide a reasonable ratemaking justification to explain why the N-01 rate for the Navy continues not to be "unjust discrimination" pursuant to R.I.G.L. Section 39-2-2. Certainly, a violation of Title 39 would constitute a compelling reason for the Commission to exercise its statutory authority under Section 24(G) of the settlement.

Now, the Commission will determine how it should exercise Section 24(G) of the settlement to transfer the Navy to the G-62 rate, or its equivalent, prior to the end of the rate freeze period. The Commission should modify the rate only in a manner that is suitably tailored to the changed circumstances.[71] First, the Commission should modify the rate in a manner that will not require other significant modifications to the settlement. The more modifications to a settlement agreement that a rate change would require, the more likely the Commission should simply end the settlement. In these circumstances, transferring the Navy to the G-62 rate, prior to the end of the rate freeze, will not necessarily require a change to any other provision of the Narragansett Electric Merger Rate Settlement. The transfer of the Navy to the G-62 rate would merely reduce prospectively Narragansett Electric's over earnings through a reduction in revenues.

Second, the Commission should modify the rates in a manner so that the impact on all concerned parties would be fair and balanced. The ratemaking process involves a balancing of interests.[72] When the Commission modifies a rate after it approves a settlement, it could tip this balance dramatically in favor of one of the parties. As a result, the harmed party would have lost the benefit of the bargain for which it negotiated and signed the settlement. In these circumstances, the Navy is a clear beneficiary, but

[70] Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177-178 (1803).
[71] Rufo v. Inmates of Suffolk County Jail 502 U.S. at 393
[72] Federal Power Commission v. Hope Natural Gas Co. 320 U.S. 591, 603 (1944).

neither Narragansett Electric shareholders nor other ratepayers are significantly harmed. Narragansett Electric shareholders will be able to achieve its authorized rate of return for the rate freeze period. Also, other ratepayers will not have the rate reduction implemented as a result of the merger diminished. The only impact from the transfer of the Navy to the G-62 rate would be to reduce over earnings by Narragansett Electric shareholders and other ratepayers' share of these over earnings. Maintaining the maximum level of over earnings was not a central concern of the Commission in March 2000 nor was it probably the primary focus of the parties to the settlement. Narragansett Electric may wish to achieve the highest level of earnings, but it is not entitled to retain over earnings under the 14th Amendment of the U.S. Constitution.[73]

Based on the standard outlined above, the Commission finds that it would be reasonable to exercise its statutory authority, as expressly provided for in Section 24(G) of the settlement, to modify the Navy's rate by allowing it to transfer to the G-62 rate, or its equivalent.[74] The Narragansett Electric Merger Rate Settlement could remain in effect, at this time, except that the Navy could take service under the G-62 rate, or its equivalent. The Commission is cognizant that modifying a rate in a prior approved settlement agreement creates a shadow of uncertainty to fall on the parties. However, the Commission must emphasize that the settlement agreement was entered into by the parties and approved by the Commission with all parties fully aware that the Commission could at a future date modify a rate agreed upon in the settlement.[75] The Commission's

[73] Narragansett Electric v. Burke 505 A.2d 1147, 1148-1149 (R.I. 1986).
[74] It is ironic that the Commission is utilizing its authority expressly recognized under Section 24(G) to grant rate relief to the Navy when it was the insertion of Section 24(G) in the Narragansett Electric Merger Rate Settlement that caused the Navy to withdraw as a signatory to the agreement. Order No. 16437, pp. 2-4 (10/30/00).
[75] Order No. 16200 (3/14/00).

reservation of its statutory authority to modify rates was explicit in Section 24(G). In order to comfort the concerns of the parties, the Commission will exercise restraint in exercising its statutory authority to modify rates approved in a settlement agreement while the settlement is in effect. If the Commission were to engage in regulatory activism to modify rates after a settlement is approved and in effect, it would deter the parties from entering into settlements. As a result, the Commission would never be able to set just and reasonable rates through the settlement process, but only through litigation. The Commission prefers to keep both means available to it for setting just and reasonable rates. Thus, the Commission will exercise regulatory restraint in its statutory authority to modify a rate in a settlement agreement in effect.

V. Cost of the Navy's Transfer to the G-62 Rate

The Commission has determined that the transfer of the Navy to the G-62 rate or its equivalent during the rate freeze period is reasonable as a matter of regulatory policy and allowed under the law. The final issue for the Commission to decide is who will absorb the cost for the transfer of the Navy to the G-62 rate, or its equivalent. Theoretically, there are three approaches: (1) ratepayers absorb the cost in its entirety; (2) Narragansett Electric shareholders absorb the cost in its entirety; or (3) the cost be shared between ratepayers and Narragansett Electric. The Commission will examine each approach.

A. Ratepayers Absorb All the Costs

The approach to have ratepayers absorb all the costs was initially recommended by Narragansett Electric. It was manifested in the proposed Navy Settlement, which transferred revenue from the Storm Fund to subsidize the transfer of the Navy

immediately to the G-62 rate. The settlement using Storm Funds essentially insured that Narragansett Electric's revenues and earnings would not be diminished as a result of the Navy's transfer. Instead, the costs would be borne entirely by the ratepayers since the Storm Fund is funded essentially with ratepayer money.[76] The Commission rejected this approach for numerous reasons.

First, this approach requires the Commission to depart from precedent and ignore a prior order. In Order No. 15360 the Commission adopted settlements relating to the Storm Fund and indicated that revenues from the Storm Fund could only be used for severe storms. Essentially, Narragansett Electric was asking the Commission to ignore a past order and approved settlements, and unrestrict a restricted account for the purpose of insuring that Narragansett Electric's over earnings would not be diminished as a result of the Navy's transfer. Protecting the ability of a utility's shareholders to over-earn is not a compelling ratemaking reason to justify departing from precedent and to unrestrict a restricted account. If the Commission allowed the Storm Fund to subsidize the transfer of the Navy to the G-62 rate so as to help Narragansett Electric to over-earn, the Commission could spend the entire Christmas holidays playing Santa Claus with the Storm Fund for various special interest groups seeking funding for their particular "bright idea". The Storm Fund is a restricted account: a proverbial "lock box". It should be used for storm damage or returned to ratepayers. The Commission will not allow Narragansett Electric's shareholders to pick its lock.

Second, the proposed Navy Settlement was not signed by the Division. The Division is required by law to represent the interest of ratepayers. It would be

[76] The proposed Navy Settlement required a contribution by the Navy to the Storm Fund after the rate freeze. For purpose of the analysis, this fact is irrelevant since the Navy is a ratepayer. The Navy's contribution would have been $84,000 as of December 31, 2002. PUC Ex. 3 (Data Response 2-1).

unprecedented for the Commission to approve a settlement with a utility that is not signed by the Division. A settlement not signed by the Division is prima facie not in the best interest of ratepayers.[77] This is a very difficult presumption for a utility to rebut. Although Narragansett Electric was able to obtain the support of the EDC for its proposed Navy Settlement, EDC's interests are not necessarily in the best interest of all ratepayers. Narragansett Electric was unable to show that its proposal was in the public interest or appropriately balanced the interests of ratepayers and shareholders.

Third, Narragansett Electric benefited from the higher N-01 rate for the Navy and would be harmed if the Navy left Rhode Island. Narragansett Electric's over earnings are due in part because the Navy has been charged more in its distribution rates than other customers. Furthermore, the continued presence of the Navy in Rhode Island benefits Narragansett Electric because if the Navy left Rhode Island, Narragansett Electric's revenues and earnings would diminish. Accordingly, Narragansett Electric shareholders must contribute to the transfer of the Navy to the G-62 rate or its equivalent.

B. Shareholders Absorb All the Costs

At first glance, the approach to have shareholders absorb all the costs is rather attractive. Narragansett Electric is clearly over earning while ratepayers are experiencing increases in their non-distribution rates. However, the Commission must stay committed to its duty to follow the public interest. As discussed earlier, the Commission is modifying a rate in the Narragansett Electric Merger Rate Settlement. To require Narragansett Electric shareholders to absorb 100 percent of the Navy's transfer to the G-

[77] The inverse of this logical proposition is not necessarily true. The Commission will not presume that a settlement signed by the Division is in the best interest of ratepayers because the Commission must independently protect the public interest and the interest of ratepayers. Order No. 17524, pp. 36,81,161-162 (8/1/03).

62 rate would require additional modifications to the Narragansett Electric Merger Rate Settlement. It could also be deemed to be unfair to Narragansett Electric since all parties benefited from having the Navy on the N-01 rate but only one party would bear the cost of the transfer. If the Commission determined that Narragansett Electric should absorb 100 percent of the costs for the Navy's transfer, it could necessitate an end to the settlement, a cost of service case, and notice that Narragansett Electric's over earnings would be returned to ratepayers. This dramatic approach is unnecessary for the transfer of the Navy to the G-62 rate, or its equivalent.

C. Share the Costs Between Ratepayers and Shareholders

As discussed earlier, Narragansett Electric has benefited from charging the Navy the N-01 rate and would be harmed if the Navy left Rhode Island. Furthermore, ratepayers have benefited from the Navy being on the N-01 rate through the earnings sharing mechanism in Section 11(A) of the Narragansett Electric Merger Rate Settlement. Therefore, the costs for the transfer of the Navy should be allocated according to the earnings sharing mechanism.[78] The transfer of the Navy will reduce Narragansett Electric's revenues and therefore its earnings. This reduction in earnings would be reflected in the earnings sharing mechanism. Because Narragansett Electric is currently earning above a 13 percent ROE, ratepayers would absorb 75 percent of the costs through a reduction in potential over earnings while Narragansett Electric would absorb 25 percent of the costs through a reduction in potential over earnings. If Narragansett Electric's over earnings were to fall between 12 percent and 13 percent ROE, then ratepayers and Narragansett Electric would each share 50 percent of the reduction in potential over earnings.

[78] The Division first raised this approach in its pre-filed testimony.

Admittedly, this earning sharing mechanism approach to allocating the costs of the Navy transfer is not ideal since it allows shareholders to pay for less of the cost, as the company's earnings grow. In fact, generally, the more a utility's shareholders over earn, the more they should contribute to a rate modification. However, there is no provision in the Narragansett Electric Merger Rate Settlement to address the absorption of the costs for a rate modification under Section 24(G) of the agreement. The Commission would be required to construct a provision for funding the cost of the Navy's transfer and insert it in the settlement. The Commission finds it acceptable for shareholders to contribute to the cost of the Navy's transfer where such an approach does not require the Commission to draft and insert new provisions in the Narragansett Electric Merger Rate Settlement.

The Revised Amended Navy Settlement gives the Navy a credit starting January 1, 2004, which effectively causes the Navy to be charged for electric distribution service as would a G-62 customer. The cost for the credit will cause a reduction in revenues to Narragansett Electric. As a result, there will be a reduction in potential earnings sharing that will be allocated between Narragansett Electric and the ratepayers through the earnings sharing mechanism in Section 11(A) of the Narragansett Electric Merger Rate Settlement.[79] Accordingly, the Commission accepts the Revised Amended Navy Settlement as a reasonable means of allowing the Navy to transfer to the G-62 rate, or its equivalent, prior to the end of the rate freeze period while requiring Narragansett Electric shareholders to pay a portion of the cost through the earnings sharing mechanism. The Revised Amended Navy Settlement is in the public interest and the best interest of ratepayers.

[79] Also, in order to obtain the consent of the parties for this early rate relief, the Navy agreed to forego its share of earnings sharing for the rate freeze period or 20 percent of the N-01 credit it will receive in 2004, whichever is less.

CONCLUSION

Rhode Island has been linked to the U.S. Navy since the War for American Independence. During the American Revolution, British Admiral Lord Rodney declared that Rhode Island has "the best and noblest harbor in America".[80] It was while serving at the Newport Naval War College that Captain Mahan wrote his classic work entitled The Influence of Sea Power Upon History, a work that inspired the naval arms race between Great Britain and Germany which helped trigger the First World War.[81] Mahan's thesis that the controlling factor of history is sea power is a matter of debate, but there can be no dispute that the Navy's presence in Rhode Island has been a major factor in this State's development.

One of the most traumatic events in recent Rhode Island history was the departure of the Navy's fleet from Newport in 1973. This event was so significant that ripples, if not tidal waves, were apparent all over the state, even in the underwater coral caves of ratemaking. As a result of the fleet's departure in 1973, Newport Electric's revenues crashed and the utility's financial stability became questionable. The losses would either be absorbed by shareholders or by other ratepayers in rate hikes. However, the Commission, utilizing its expertise and discretion, devised a revenue requirement and rate design whereby the Newport Electric received a very high rate of return for its service to the Navy. This was justified by the high investment risk associated with servicing the Navy, its largest customer who could leave abruptly. It was also justified because of the need for rate stability and the avoidance of rate shock to other ratepayers. The Rhode Island Supreme Court repeatedly upheld this Commission in its ratemaking

[80] Captain A.T. Mahan, The Influence of Sea Power on History 1660-1783, p. 530 (1890).
[81] Barbara W. Tuchman, The Proud Tower, pp. 150-151 (1966);Robert K. Massie, Dreadnought, pp. xxiii-xxv (1991).

policies towards the Navy.[82] Over the course of years, as ratepayers obtained rate stability and Newport Electric gained financial stability, the burden on the Navy was reduced incrementally.

In March 2000 with the merger, the Navy received a rate decrease in proportion with other Newport Electric customers. The Navy could have seized the opportunity to litigate and achieve total victory by being placed on Narragansett Electric's G-62 rate. Instead, the Navy accepted a stalemate in which it was placed on the N-01 rate with the expectation that it would be placed on the G-62 rate in 2005.[83]

Now, in the fall of 2003, the Navy has set sail for the G-62 rate. At first, it attempted to reach its destination through joining a convoy of parties consisting of Narragansett Electric and the EDC in the proposed Navy Settlement. However, this convoy did not include the Division or the Attorney General. The route taken in this proposed Navy Settlement to transfer the Navy to the G-62 rate was the riskiest because it required that all costs be borne by ratepayers. The attitude of this convoy was similar to Admiral Farragut who declared: "Damn the torpedoes! Full speed ahead!" However, the parties were not as skillful as Admiral Farragut because the Commission torpedoed the proposed Navy Settlement.

The Commission indicated that the Navy should be transferred to the G-62 rate prior to end of the rate freeze through a reduction in revenues/over earnings to Narragansett Electric. At this point in the battle, Narragansett Electric was aware that change was inevitable. The question was whether it would be achieved through consent

[82] Secretary of Defense v. P.U.C. 437 A.2d 1342 (R.I. 1981); U.S. v. P.U.C. 635 A.2d 1135 (R.I. 1993).
[83] The Navy was a party to an earlier settlement placing it on the N-01 rate during the rate freeze period and transferring the Navy to the G-62 rate at the end of the rate freeze period. Even after withdrawing from the settlement, it did not object to the Commission approving the Narragansett Electric Merger Rate Settlement. Order No. 16347, pp. 2-4 (10/30/00).

or coercion. Narragansett Electric chose to give its consent through a Revised Amended Navy Settlement. This was a wise choice by Narragansett Electric's parent, National Grid. Its very name "National Grid" bespeaks its designs on this nation's electric transmission system. However, while National Grid still owns Narragansett Electric, a local distribution company, it must answer to the local concerns of this state Commission.

The Commission finds no ratemaking policy to justify preventing the Navy from transferring to the G-62 rate, or its equivalent, at this time except a strict adherence to a precedent that no longer serves a useful purpose. Fortunately, for the Navy, the Commission will not be swayed by Melville's Captain Vere, who argued that a court can not be merciful but instead must adhere to precedent "however pitilessly that law may operate."[84]

Three decades of a higher rate is enough. Like Coleridge's Ancient Mariner, the N-01 rate has been hung about the Navy's neck like an albatross. The Navy can now throw off the N-01 rate and let it sink "like lead into the sea."[85]

Accordingly, it is

(17644) ORDERED:

1. Narragansett Electric's petition filed September 8, 2003 is hereby denied.
2. The Navy's petition filed September 11, 2003 is hereby denied.
3. The Navy Settlement filed on November 19, 2003 is hereby denied.
4. The Revised Amended Navy Settlement filed on December 15, 2003 is hereby approved.

[84] Captain Vere was the naval captain who argued for execution of innocent Billy Budd. Herman Melville, Billy Budd, p. 69 (1924).
[85] Samuel Taylor Coleridge, "The Rime of the Ancient Mariner", line 291 (1798).

EFFECTIVE AT WARWICK, RHODE ISLAND ON JANUARY 1, 2004, PURSUANT TO A BENCH DECISION ON NOVEMBER 25, 2003 AND PURSUANT TO AN OPEN MEETING DECISION ON DECEMBER 18, 2003. WRITTEN ORDER ISSUED DECEMBER 23, 2003.

PUBLIC UTILITIES COMMISSION

_____
Elia Germani, Chairman

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Kate F. Racine, Commissioner

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Robert B. Holbrook, Commissioner

Racine, K., concurring.

I agree with the ultimate decision of the Commission to allow the Navy to receive an N-01 credit commencing January 1, 2004. However, I want to clarify the reasoning by which I reached my decision. I reached my decision, not on the basis of economic development arguments, but rather, on the basis that the need that existed in 2000 to keep the Navy on the N-01 rate no longer exists.

A primary justification raised by these parties to justify transferring the Navy to the G-62 rate prior to the end of the rate freeze period was economic development. Economic development is one of those abstract terms like "equal protection" or "due process" that seem to mean different things to different people at different times. I believe that an appropriate definition of economic development is a measure which assists in job creation or expansion.

I note that in the past, this Commission has developed rates in an effort to promote economic development. The Commission generally tied these economic development rates to job growth requirements.[86] The reason for this nexus between an economic development discount for electricity rates and the requirement that more jobs be created by the employer is to ensure that the discount actually results in more employment or the discount would essentially become a mask for corporate welfare.

Furthermore, in ratemaking, the purpose of an economic development rate is to encourage new employers to enter the state and for current employers to be assisted in expanding operations necessitating the need to hire more employees.[87] Therefore, the

[86] Order No. 14479. (6/17/94) In this order, the Commission required that an economic development discount rate be tied to an increase in load or job creation.

[87] Ken Costello, Douglas Fulp and Calvin Monson, "Incentive and Economic Development Rates as a Marketing Strategy for Electric Utilities", Public Utilities Fortnightly, pp. 27, 34 (May 15, 1986).

concept of economic development in ratemaking is properly limited to increasing current employment levels and energy consumption levels.

In this case, EDC and the Navy have argued that placing the Navy on the G-62 rate before the end of the rate freeze will further economic development.[88] No evidence or argument was made that an N-01 credit applied before January 1, 2005 would cause the Navy to hire more employees or would even assure that the Navy would not terminate or significantly curtail its operations in Rhode Island.

Economic development rate discounts cost real dollars and therefore must produce real jobs. No one has argued that this discount for the Navy will produce any new benefits for the state, but at most, may allow the status quo to remain in place. Therefore, while I agree with the Commission on the ultimate determination to allow the Navy to begin receiving an N-01 credit prior to the end of the rate freeze, I did not base my decision on the economic development arguments.

Finally, I believe that, as in the past, if a distribution company proposes a rate discount of any kind, including an economic development rate, shareholders should contribute to the cost of the proposed rate discount.

Kate F. Racine, Commissioner

[88] Specifically, EDC argued that the transfer to the G-62 rate must be done as soon as possible so that it is considered during the BRAC review. I did not find these arguments to be particularly persuasive. First, it should be noted that the Navy specifically indicated that the BRAC review will consider future costs as well as current costs so a transfer of the Navy to the G-62 rate on January 1, 2005 would be considered in the BRAC review. PUC Ex. 2 (Data Response 1-5). Second, a transfer to the G-62 rate or a modified N-01 rate on January 1, 2005 would provide sufficient time for it to be considered by the BRAC commission because the Secretary of Defense will not make a recommendation to the BRAC commission until May 16, 2005 and the BRAC commission will not make a recommendation to the President until September 23, 2005. Div. Ex. 3.