STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

PUBLIC UTILITIES COMMISSION

IN RE: CONSOLIDATION AND ADJUSTMENT OF RATES FOR
- NARRAGANSETT ELECTRIC COMPANY
- BLACKSTONE VALLEY ELECTRIC COMPANY
- NEWPORT ELECTRIC CORPORATION

DOCKET NO. 2930

REPORT AND ORDER

This proceeding was commenced on May 20, 1999 with the filing by Narragansett Electric Company ("Narragansett"), the Rhode Island operating subsidiary of the New England Electric System ("NEES"), and Blackstone Valley Electric Corporation ("BVE") and Newport Electric Corporation ("Newport"), the Rhode Island operating subsidiaries of Eastern Utilities Associates ("EUA"), of a proposed rate plan relating to the consolidation of BVE, Newport and Narragansett in connection with the merger of their respective parent companies, EUA and NEES.[1] The proposed merger of BVE, Newport and Narragansett (collectively, the "merged Company") was approved by the Division of Public Utilities and Carriers ("Division") on February 25, 2000. The filing before the Commission is for approval of a rate consolidation plan for the merged Company, which will have approximately one-half million customers, distributed as follows:

	Customers	Percent[2]
Narragansett	336,000	74%
BVE	87,000	19%
Newport	33,600	7%
	456,600	100%

[1] Filing letter dated May 20, 2000 (Filing Letter).
[2] Ex. AG-1, p. 14.

I. TRAVEL OF THE CASE.

A. ORIGINAL RATE PLAN FILING.

On May 20, 1999, Narragansett filed the testimony of Mr. Michael E. Jesanis,[3] Mr. Robert G. Powderly,[4] Mr. Lawrence J. Reilly,[5] Mr. David M. Webster,[6] Mr. James Molloy,[7] Mr. James J. Bonner, Jr.,[8] Mr. David J. Hoffman,[9] and Mr. Richard J. Levin[10] in support of a proposed rate plan for the merged Company (the "Original Rate Plan Filing"). This Rate Plan Filing, which would become effective within 120 days of the closing of the EUA-NEES merger or April 1, 2000, whichever occurred later,[11] sought approval to implement (i) a single set of distribution rates for the merged Company[12] that would be frozen through 2004[13] and produce an annual rate reduction of approximately $5.4 million,[14] (ii) the recovery of additional annual depreciation expenses for the merged Company of approximately $2.8 million through a rate increase of $0.039 per kWh beginning January 1, 2001,[15] (iii) the recovery of approximately $754 million of acquisition and transaction costs and expenditures incurred by (a) National Grid Group, plc, in connection with its acquisition of NEES, and (b) NEES in connection with its

[3] Narr. Ex. 2.
[4] Id.
[5] Id.
[6] Id.
[7] Narr. Ex. 3.
[8] Id.
[9] Narr. Ex. 4.
[10] Id.
[11] Narr. Ex. 2, p. 13 (lower right).
[12] Id. These distribution rates would consist of Narragansett's existing rates modified to include an additional charge of $0.00661 per kWh for Newport customers. Narr. Ex. 2 at p. 14; Narr. Ex. 3 at p. 39.
[13] Id.
[14] Id.
[15] Narr. Ex. 2, p. 192 (lower right).

acquisition of EUA,[16] and (iv) the consolidation of the accounting for certain utility assets and liabilities which are closely monitored by the Commission for ratemaking purposes.[17]

Motions to intervene in this proceeding were filed by The Energy Council of Rhode Island ("TEC-RI"), the United States Department of the Navy ("Navy"), National Grid Group, plc ("National Grid"), and the Rhode Island Attorney General ("Attorney General"), and were subsequently granted by the Commission.

B. COST OF SERVICE FILING.

On July 13, 1999, the Commission ruled that the Company's Original Rate Plan Filing did not comply with the Part 2 Filing Requirements of the Commission's Rules of Practice and Procedure in that the Filing did not contain the requisite cost of service information. On September 16, 1999, Narragansett filed a consolidated cost of service for the rate year 2000 ("Cost of Service Filing") which indicated a revenue excess or (deficiency) for each company as follows:[18]

Company	Excess (Deficiency)
Narragansett	($11,265,000)
BVE	($ 125,000)
Newport	$ 1,308,000
Total Revenue Deficiency	($10,081,000)

[16] Narr. Ex. 2, p. 72 (lower right); Ex. TEC-RI 1-35.
[17] Narr. Ex. 2, pp. 46-48 (lower right).
[18] Narr. Ex. 8 at p. 31 (lower right).

C. TESTIMONY OF OTHER PARTIES.

In response to the Original Rate Plan Filing, on September 27, 1999, the Navy filed the testimony of Dr. Allan Rosenberg,[19] on October 29, 1999, TEC-RI filed a statement of position, and on October 31, 1999, the Division filed the testimony of Mr. David Effron[20] and Dr. John Stutz.[21] On November 19, 1999, the Division filed additional testimony of Mr. Effron[22] and Dr. Stutz[23] in response to the Cost of Service Filing. The Division's witnesses presented testimony supporting a combined revenue excess of approximately $10 million, as follows:[24]

Company	Excess Revenues
Narragansett	$ 5,794,000
BVE	$ 2,983,000
Newport	$ 2,685,000
(Less: Increased depreciation)	($ 1,051,000)
Total Excess Revenues	$10,411,000

On November 19, 1999, the Attorney General filed the testimony of Mr. Bruce R. Oliver,[25] Ms. Andrea C. Crane[26] and Mr. Richard W. LeLash[27] in response to both the Original Rate Plan Filing and the Cost of Service Filing. The Attorney General's witnesses presented testimony supporting a combined revenue excess of $13.3 million.[28]

[19] Ex. Navy-1.
[20] Ex. Division-3.
[21] Ex. Division-1.
[22] Ex. Division-4.
[23] Ex. Division-2.
[24] Ex. Division-4, p. 26.
[25] Ex. AG-1.
[26] Ex. AG-3.
[27] Ex. AG-2.
[28] Ex. AG-1, pp. 89-90.

On the same day, the Navy filed the testimony of Dr. Allan Rosenberg in response to the Cost of Service Filing.[29]

D. SIMPLIFIED RATE PLAN.

On December 7, 1999, Narragansett filed the rebuttal testimony of Mr. Michael E. Jesanis,[30] Mr. Michael D. Laflamme,[31] Mr. Augustine Camara,[32] Mr. Charles Olson,[33] and Mr. James M. Molloy.[34] In its rebuttal testimony, Narragansett modified the Original Rate Plan Filing and presented a "Simplified Rate Plan." The Simplified Rate Plan requested approval to implement (i) a single set of rates for the merged Company that would produce an annual rate reduction of approximately $9.3 million,[35] (ii) the recovery of approximately $113 million of acquisition and transaction costs and expenditures incurred by NEES in connection with its acquisition of EUA,[36] and (iii) the consolidation of the accounting for certain assets and liabilities which are closely monitored by the Commission for ratemaking purposes. The rebuttal testimony included a modified cost of service that now indicated a combined revenue excess for the companies of $4.2 million:[37]

[29] Ex. Navy-3.
[30] Narr. Ex. 12.
[31] Id.
[32] Id.
[33] Id.
[34] Narr. Ex. 13.
[35] Narr. Ex. 12, pp. 14-17 (lower right).
[36] Id.
[37] Narr. Ex. 12 at p. 75 (lower right).

Company	Excess Revenues
Narragansett	$ 234,000
BVE	$2,631,000
Newport	$1,350,000
Total Revenue Excess	$4,215,000

Narragansett further proposed to defer filing of a fully allocated cost of service study for the merged Company until after the merger.

E. FULLY ALLOCATED COST OF SERVICE FILING.

At an open meeting on December 13, 1999, the Commission ordered Narragansett to submit forthwith a fully allocated cost of service study using the modified cost of service filed with the Simplified Rate Plan. On January 28, 2000, a fully allocated cost of service study was filed with the Commission.

F. PUBLIC COMMENT.

The Commission traveled to the following locations and conducted duly noticed public hearings for the purpose of accepting public comments on the Company's filing:

November 2, 1999 Warwick City Hall, Warwick, RI

November 9, 1999 Pawtucket City Hall, Pawtucket, RI

November 15, 1999 Newport City Hall, Newport, RI

On November 17, 1999, an additional public hearing for the same purpose commenced at 10:00am in the Commission's hearing room located at 100 Orange Street in Providence.

II. UNCONTESTED STIPULATION AND SETTLEMENT.

On January 31, 2000, a Stipulation and Settlement entered into between Narragansett, BVE and Newport and the Division, the Attorney General, and the Navy, regarding rates for the merged Company, was filed with the Commission. On February 9, 2000, an Amended Stipulation and Settlement, adding TEC-RI as a party and containing certain other changes, was filed with the Commission. Public hearings on the Amended Stipulation and Settlement were conducted in the hearing room of the Commission at 100 Orange Street in Providence on February 11, 15, 18 and 29, 2000. The following appearances were entered:

FOR THE COMPANIES	Ronald T. Gerwatowski, Esq. David A. Fazzone, Esq. David A. Fazzone, PC McDermott, Will & Emery
FOR THE DIVISION	Elizabeth A. Kelleher, Esq. Special Assistant Attorney General
FOR THE ATTORNEY GENERAL	Paul J. Roberti, Esq. Assistant Attorney General
FOR TEC-RI	Andrew J. Newman, Esq. Rubin and Rudman, LLP
FOR THE NAVY	Audrey Van Dyke, Esq.
FOR NATIONAL GRID	Patricia French, Esq. LeBoeuf, Lamb, Green & MacRae, LLP
FOR THE COMMISSION	Lindsay A. Johnson, Esq.

Following the conclusion of the hearings, a Second Amended Stipulation and Settlement, containing a number of changes in response to concerns raised by the Commission during the hearings, was filed with the Commission on March 3, 2000. The

Navy was not a party to the Second Amended Stipulation and Settlement, having withdrawn from the settlement following the hearings. However, by letter dated March 2, 2000 to Narragansett, the Navy indicated that it would not object to the approval of the settlement by the Commission. A Third Amended Stipulation and Settlement dated March 14, 2000, adding National Grid as a party and containing certain final changes, was subsequently filed with the Commission for approval (the "Settlement").[38]

The Settlement produces an initial annual revenue reduction in the amount of $13.1 million[39] More specifically, the Settlement provides that: (i) following the merger, Blackstone and Newport customers will be billed at Narragansett's rates; (ii) the merged Company's revenues will be reduced by an annual amount of $2.7 million;[40] (iii) the merged Company's rates, subject to certain conditions,[41] will be frozen through December 31, 2004;[42] and (iv) to the extent that the Company can demonstrate that its total post-merger cost of service has been reduced on an ongoing basis, the merged Company will be allowed to retain a share of the merger savings following the rate freeze period, as summarized below and more fully described in the Settlement.

Following the rate freeze period, the merged Company's revenue requirements will continue to be governed by traditional cost-of-service ratemaking principles, with certain modifications. In particular, the merged Company will be permitted to include

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[38] A copy of the Third Amended Stipulation and Settlement dated March 14, 2000 is attached as Appendix A hereto and incorporated by reference herein. Notwithstanding the description of the Settlement contained in this Report and Order, the terms and provisions contained in the Settlement are controlling. References herein to Settlement page numbers refer to the numbers on the lower right-hand page corner.

[39] Settlement, p. 4 (lower right). See pp. 10-11 for an analysis of the revenue reduction.

[40] Ibid.at p. 5 (lower right).

one-half of any proven merger savings, as more specifically defined by the Settlement, in future cost of service rate cases through the year 2019, [43] but only in the event that either (i) the percentage increase in rates is less than the cumulative amount of 1.9% per year through 2009 and 80% of the cumulative annual change in the Gross Domestic Product Implicit Price Deflator[44] ("GDPIPD") from 2010 through 2019,[45] or (ii) the merged Company proves the continued existence of the merger savings.[46] Notwithstanding the foregoing, however, if the percentage increase in rates is greater than the cumulative change in the applicable index referred to in clause (i) above,[47] the portion of the shared savings that caused the applicable index to be exceeded will be excluded from the merged Company's cost of service, unless such excess is due to cost increases caused by Federal and/or State-initiated cost changes or regulatory cost reallocations, as defined in the Settlement.[48] In the latter case, the merged Company must prove the continued existence of merger savings in order to continue recovering its savings share.[49]

In addition, in the event that the Company's actual earnings exceed the 10.5% rate of return on equity allowed under the Settlement,[50] the merged Company will be required to refund a portion of the excess earnings.[51]

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[41] Settlement, pp. 11-13 (lower right). The conditions are that the rates could be increased if inflation exceeds 4% during the period of the rate freeze or if Federal or State-initiated cost changes cause a change in revenue requirements by more than $750,000 and $375,000, respectively.
[42] Settlement, p. 10, (lower right).
[43] Ibid., pp. 16-27 (lower right).
[44] Tr. 2/15/00, p. 34.
[45] Settlement, pp. 16-27 (lower right).
[46] Id.
[47] The growth in the GDPIPD index is measured from the year 2000. Settlement, pp. 26, 96 (lower right).
[48] Id.
[49] Id.
[50] Settlement, pp. 29-32 (lower right).
[51] During the period of the rate freeze the Company is required to refund 50% of return on equity earnings between 12% and 13% and 75% of earnings in excess of 13%. For the post-rate freeze period the

The Settlement also provides for:

1. The expansion of the availability of the Low Income Rate A-60 to include all customers who are eligible for assistance through the State's Low Income Home Energy Assistance Program ("LIHEAP") program.[52]

2. The adoption of service quality performance standards with financial penalties in the event that such standards are not maintained.[53]

3. The prohibition on recovery in rates by the merged Company of "golden parachute" and severance payments.[54]

4. The implementation of higher depreciation rates and deferred tax accounting for the cost of removal.[55]

5. The retention by Narragansett of a $17.5 million lump sum credit to its Contract Termination Charge account to fund a portion of the deficiency in Narragansett's deferred tax reserve.[56]

6. The creation of an Environmental Response Fund to satisfy remedial and clean-up obligations of Narragansett, BVE and Newport arising from the ownership and/or operation of manufactured gas plants and sites associated with the operation and disposal activities from such gas plants.[57]

7. The consolidation of the companies' transmission rates in two steps. For the year 2000, a separate transmission adjustment factor shall be calculated for customers in the Newport, BVE, and Narragansett service territories to continue the present allocation of transmission costs currently assigned to each company. Beginning in the year 2001, however, the merged Company will eliminate these zonal adjustment factors and apply one transmission adjustment factor for all customers.

8. The phase-in of uniform transition charges.

The Settlement proposes six types of rate changes to implement the $13.1 million revenue reduction.[58] First, the application of Narragansett's rates to BVE and Newport

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Company is required to refund 50% of the first 1% of earnings over the allowed return on equity and 75% of any earnings in excess thereof.

[52] Settlement, p. 40 (lower right).
[53] Ibid., pp. 39-40; 108-116 (lower right).
[54] Ibid., pp. 18, 39 (lower right).
[55] Ibid., p. 28 (lower right).
[56] Id.
[57] Ibid., pp. 33-35 (lower right).
[58] Ibid., p. 4 (lower right).

customers will produce annual customer savings totaling $8 million.[59] Second, the rate for the Navy will be reduced to produce annual savings of $734,000.[60] Third, the expansion of the availability of the Low-Income Rate A-60 will create $600,000 of savings.[61] Fourth, at least through 2004, all customers would receive a uniform "Settlement Credit" of $0.00038 per kWh[62] in order to generate an additional $2.7 million of savings.[63] Fifth, credits totaling $400,000 would be applied to Newport and BVE customers' bills through the end of 2004 to ensure that no customers receive rate increases. Sixth, a $700,000 annual reduction in the contract termination charge expenses to BVE and Newport customers

III. COMMISSION FINDINGS.

At an open meeting of the Commission on March 14, 2000, the Third Amended Stipulation and Settlement dated March 14, 2000 was unanimously approved based upon the Commission's finding that the parties presented substantial evidence that the Settlement is in the public interest because it: (i) is the product of serious bargaining among capable, knowledgeable parties; (ii) benefits ratepayers and the public interest; and (iii) does not violate any important regulatory principle or practice. In approving the Settlement, however, the Commission will not give up any authority the Legislature has delegated to the Commission to protect the public against improper and unreasonable rates.

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[59] Id.
[60] Id..
[61] Ibid., p. 5 (lower right).
[62] Joint Ex. 3, Ex. 2, Rate Cover Sheets.
[63] Settlement, p. 5 (lower right).

Generally, ratemaking constitutes the exercise of legislative powers delegated to the Commission by the Legislature and the Commission's findings are not binding on future Commissions. The Commission approves the Settlement subject to its own, as well as every future Commission's, ongoing obligation and right to review and, where required, modify rates to protect the public against improper and unreasonable rates. The Commission's obligation arises from the Legislative mandate that the Commission periodically review and hold public hearings respecting public utility rates.[64] This review is required of all proposed rate changes and also in the absence of any proposed rate changes.[65] It is the Commission's view that this Legislative mandate gives the Commission an indefeasible[66] right to modify rates as required to protect the public in accordance with the intent of the statute. Accordingly, the Commission's approval of this Settlement and the agreed-upon rates is not binding upon a future Commission in any future investigation of Narragansett's rates, to the extent modifications of this Settlement are consistent with the Commission's ongoing obligation to protect the public against improper and unreasonable rates.

There is one rate matter that is not included in the Settlement. This matter arises from the fact that Narragansett, BVE and Newport each has a similar tariff that allows for the refund or recovery, as appropriate, of any over- or under-collection of the cost of wholesale Standard Offer service.[67] Narragansett proposes that, following the merger, all customers would be billed under the provisions of its Standard Offer Adjustment

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[64] R.I.G.L. §39-1-1(c).
[65] R.I.G.L. §39-3-11; see also In re Island Hi-Speed Ferry, LLC, RI Sup. Ct. slip op. at p.6 (issued Feb. 21, 2000).
[66] The rule-making power of any administrative body may not abrogate state law dealing with the same subject. Reback et al. v. Rhode Island Board of Regents, 560 A.2d 357, 358.
[67] See Order No. 15521, Docket No. 2651, dated July 10, 1998, p.18.

Provision. There is, however, one significant provision in the BVE and Newport tariffs that is not contained in the Narragansett tariff:

> Notwithstanding the foregoing, the Company may not recover, without full disclosure and the express approval of the Commission, any cost of Standard Offer Service in excess of the costs billable under the Settlement Agreement dated October 17, 1997.[68]

This provision arose out of the Commission's ongoing concern with the terms of BVE and Newport's Standard Offer supplier contracts. In essence, the Commission's concern was that BVE and Newport had not, consistent with prior representations, required Standard Offer wholesale suppliers to "deliver a performance surety securing the suppliers full responsibility."[69] The Commission found that the security provisions did not "meet reasonable commercial standards because the quality and reliability of service may be compromised, and/or additional costs could be incurred in the event of a supplier default."[70] BVE and Newport represented to the Commission, however, that any costs arising from the default of a supplier would not be recoverable from ratepayers:

> The financial consequences to ratepayers arising from these issues . . . will be mitigated by the fact that the Companies have represented to the Commission that costs arising from the default of a supplier are not recoverable from ratepayers and that negotiated cost increases . . . are recoverable only with the Commission's express approval. The Commission believes that these facts should be made clear in the Companies' tariffs. In addition, the Commission finds that the tariff language should specify the rights of all parties to examine the facts surrounding the acquisition of power supply and to contest the Companies' rights to recover any resulting costs.[71]

The merger of BVE, Newport and Narragansett does not change the extent to which costs incurred under BVE and Newport's Standard Offer power contracts are

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[68] Order No. 15756, Docket No. 2834, dated December 31, 1998, at p. 14.
[69] Ibid. p. 11.

recoverable. Narragansett is simply stepping into the shoes of BVE and Newport with respect thereto.[72] Consequently, the Commission finds that the following modified tariff language should be inserted in Narragansett's Standard Offer Adjustment Provision:[73]

> Notwithstanding the foregoing, the Company may not recover, without full disclosure and the express approval of the Commission, any cost of Standard Offer Service in excess of the costs billable under the applicable Wholesale Settlement agreements from 1997 that established prices for wholesale standard offer supply.[74]

Accordingly, it is:

(16200) ORDERED:

1. That the rate plan filing filed on May 20, 1999 relating to the consolidation of Narragansett, BVE and Newport is hereby denied and dismissed.

2. That Third Amended Stipulation and Settlement dated March 14, 2000 is hereby approved.

3. That Narragansett's proposed Standard Offer Adjustment Provision shall be modified to include the following at the end of the proposed Provision:

> Notwithstanding the foregoing, the Company may not recover, without full disclosure and the express approval of the Commission, any cost of Standard Offer Service in excess of the costs billable under the applicable Wholesale Settlement

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[70] Ibid., p. 13.
[71] Ibid., pp. 13-14.
[72] It should be noted that Mr. Jesanis stated that any commitment made by BVE and Newport would be honored by Narragansett. Tr. 2/15/00, p. 110.
[73] The addition of this provision was agreed to by Narragansett's Counsel by letter dated March 6, 2000.
[74] Order No. 15756, Docket No. 2834, dated December 31, 1998, at p. 14, as revised per letter from Narragansett's Counsel dated March 6, 2000.

agreements from 1997 that established prices for wholesale standard offer supply.

4. That the Company shall file compliance tariffs consistent with the terms of the Third Amended Stipulation and Settlement to become effective on the later of: (i) the first day of the month following the closing of the merger, or (ii) the first day of the month following the completion of all modifications to the customer billing and metering systems necessary for the consolidation of rates.

5. That the Company shall act in accordance with all other terms and conditions imposed by the Third Amended Stipulation and Settlement and this Report and Order.

EFFECTIVE AT PROVIDENCE, RHODE ISLAND PURSUANT TO AN OPEN MEETING DECISION ON MARCH 14, 2000. WRITTEN ORDER ISSUED MARCH 24 , 2000.

PUBLIC UTILITIES COMMISSION

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Kate F. Racine, Commissioner

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Brenda K. Gaynor, Commissioner