STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: NARRAGANSETT ELECTRIC COMPANY	:	
STANDARD OFFER SERVICE, TRANSMISSION	:	DOCKET NO. 3243
ADJUSTMENT FACTOR, AND TRANSITION	:	
CHARGE	:	

REPORT AND ORDER

I. NARRAGANSETT

On December 1, 2000, Narragansett Electric Company ("Narragansett") filed three proposed rate changes with the Public Utilities Commission ("Commission") for effect on January 1, 2001. The first proposed rate change is an increase in the retail Standard Offer Service ("SOS") rate to 5.905 cents per kWh, constituting an increase of .504 cents per kilowatt-hour ("kWh") over the present retail SOS rate of 5.401 cents, which had been implemented October 1, 2000 in Docket No. 3138. Also, Narragansett proposed a decrease in the transition charge to 0.988 cents per kWh for all its retail delivery customers in its three zones: Blackstone Valley Electric ("BVE"), Newport Electric ("Newport"), and Narragansett. Lastly, Narragansett proposed an increase in the transmission adjustment factor to 0.173 cents per kWh, and the elimination of transmission zonal credits. This would result in a total Transmission Energy Charge of 0.847 cents per kWh.

In support of this filing, Narragansett presented the pre-filed testimony of Jeanne A. Lloyd, a Principal Financial Analyst from National Grid USA Service Company; Pamela A. Viapiano, the Manager of

Transmission Regulation and Policy for New England Power Company; and Michael J. Hager, the Manager of Distribution Energy Services for National Grid USA Service Company. In her pre-filed testimony, Ms. Lloyd testified as to the basis for the changes in the SOS rate, transition charges and transmission rates.

SOS RATE

Ms. Lloyd explained due to escalating fuel prices since the last increase in the SOS rate, an under-recovery for SOS of $10.2 million would occur in the first quarter of 2001 unless the SOS rate was increased on January 1, 2001.[1] Ms. Lloyd noted that Narragansett is proposing the rate increase for SOS at this time because the Commission requested Narragansett report back to the Commission by December 1, 2000 whether the six month rate for SOS, approved for effect on October 1, 2000, was fully recovering costs.[2] Furthermore, Ms. Lloyd stated there was an over-recovery of approximately $2.3 million for SOS through December 31, 2000, and that Narragansett recommended the crediting of the total fuel index payments for January 2001 through March 2001 with the projected over recovery of $2.3 million.[3] With the application of the over-recovery, the SOS rate would be 5.905 cents per kWh, but

[1] Narragansett Exhibit 1A; Lloyd pre-filed testimony, pp. 2-3, 6.
[2] Id., p. 6.
[3] Id., p. 7.

without the credit of the over-recovery the SOS rate would be 6.047 cents per kWh.[4]

TRANSITION CHARGE

In regards to the transition charge, Ms. Lloyd explained that this charge is intended to recover from all retail delivery service customers the Contract Termination Charges ("CTC") billed to Narragansett by the New England Power Company ("NEP").[5] These transition charges include amounts formerly billed by Montaup Electric Company to BVE and Newport, as in 2000 Montaup was merged into NEP, and BVE and Newport were merged into the Narragansett distribution company. The CTC is collected pursuant to the Utility Restructuring Act of 1996 and it represents standard costs incurred on the divestiture of power purchase contracts, generating plants, and equipment previously dedicated to service Narragansett, BVE and Newport as wholesale customers of NEP and Montaup.

Ms. Lloyd noted that the transition charge is currently set at 1.150 cents per kWh for all three zones in 2000, with the customers in the BVE and Newport zones being billed an additional zonal transition charge.[6] The incremental zonal charges are 0.89 cents per kWh for the BVE zone and 0.91 cents per kWh for the Newport zone.[7]

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[4] Id., pp. 7-8.
[5] Id., p. 81.
[6] Id.
[7] Id.

In section 15 of the Merger Agreement between BVE, Newport and Narragansett, the transition charge for the Narragansett zone is set at 1.05 cents per kWh for 2001.[8] The transition charge in the BVE and Newport zones is determined by calculating the balance of Narragansett's total CTC expense during each of the five years subsequent to the merger, also known as the Rate Freeze Period, less the estimated transition charge revenues collected from customers in the Narragansett zone and dividing the remaining balance of CTC expenses by estimated kWh deliveries and in the BVE and Newport zones.[9] If this calculation results in transition charge in the BVE and Newport zones being less than that in the Narragansett zone, then the Merger Agreement provides that the transition charges shall be equalized and all customers in Narragansett's service territory will be charged one transition charge.[10]

From the total CTC costs expected to be billed Narragansett in 2001 approximately $54.4 million will be collected from customers in the Narragansett zone, leaving approximately $15.5 million to be recovered from customers in the BVE and Newport zones.[11] As a result, customers in the BVE and Newport zones would have had a transition charge of 0.821 cents per kWh while customers in the Narragansett zone would have had a transition charge of 1.050 cents per kWh.[12] Since the transition charge for the BVE and Newport zones would be less than the

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[8] Id., p. 9.
[9] Id., pp. 9-10.
[10] Id., p. 10.

Narragansett zone, the transition charges must be equalized in accordance with the terms of the Merger Agreement.[13] Consequently, the transition charge for 2001 is based on a weighted average CTC rate and results in an equalized transition charge of 0.988 cents per kWh for all retail delivery customers in the three zones.[14]

TRANSMISSION CHARGE

As for the transmission charge, under the Merger Agreement a uniform transmission rate for all customers in the three zones was to be set on January 1, 2001, so as to coincide with the expected decrease in transition charges in the BVE and Newport zones.[15] BVE and Newport customers have been paying lower transmission rates than Narragansett customers, but the proposed increase in transmission rates to customers in the BVE and Newport zones will be offset by a decrease in their transition charges.[16]

Narragansett forecasted a total transmission cost for 2001 of approximately $46.2 million, resulting in a unit cost of 0.651 cents per kWh for 2001.[17] Also, Ms. Lloyd estimated that the under-collection from the transmission reconciliation would be approximately $5.2 million by December 31, 2000, and proposed increasing the transmission adjustment factor by 0.076 cents per kWh on January 1, 2001, so as to

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[11] Id., pp. 10-11.
[12] Id., p.11
[13] Id.
[14] Id.
[15] Id., pp. 12-13.
[16] Id., pp. 12-13.

recover the under-collection plus interest over the next 12 months.[18] Ms. Lloyd noted that Narragansett's current transmission rates recover 0.554 cents per kWh, which is compromised of a base rate averaging 0.386 cents per kWh and a transmission adjustment factor of 0.168 cents per kWh. Therefore, Ms. Lloyd proposed increasing Narragansett's transmission factor on January 1, 2001 by 0.173 cents per kWh in order to recover projected transmission costs in 2001 and to recover the estimated under-collection from the transmission reconciliation.[19] Lastly, Ms. Lloyd noted Narragansett's proposal eliminates transmission zonal credits currently in effect for the BVE and Newport zones because the Merger Agreement allowed Narragansett to eliminate those credits beginning in 2001.[20] This results in an increase in the share of transmission costs that are paid by customers in the BVE and Newport zones and a decrease in the share paid by customers in the Narragansett zone.[21]

In conclusion, Ms. Lloyd analyzed the impact of Narragansett's proposed changes to customers in the Narragansett, BVE and Newport zones. For a typical 500 kWh residential customer in the Narragansett zone, the monthly bill would increase by $2.69 from $61.65 to $64.34 or 4.4%.[22] This increase is due to: an increase in the SOS rate from 5.401

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[17] Id., p. 14.
[18] Id., pp. 15-16.
[19] Id., p. 16.
[20] Id., p.17
[21] Id.
[22] Id., p. 18.

cents to 5.905 cents per kWh; an increase in the transmission charge from 0.674 cents to 0.847 cents per kWh, which includes an increase in the transmission adjustment factor of 0.238 cents to 0.411 cents per kWh; and a decrease in the transition charge from 1.15 cents to 0.988 cents per kWh.[23] For a typical 500 kWh residential customer in the BVE zone, the monthly bill would decrease by $0.84 or 1.3% from $65.18 to $64.34; in the Newport zone, the monthly bill would decrease by $0.83 or 1.3% from $65.17 to $64.34.[24] This decrease is due to: the increase in the SOS rate from 5.401 cents to 5.905 cents per kWh; an increase in the transmission charge from 0.462 cents to 0.847 cents per kWh for BVE customers, and 0.440 cent for Newport customers to 0.847 cents per kWh; and a decrease in the transition charge from 2.04 cents for BVE and 2.06 cents for Newport, to 0.988 cents per kWh.[25]

In her pre-filed testimony, Ms. Viapiano discussed Narragansett's estimated transmission and ISO-NE expenses for 2001.[26] Ms. Viapiano explained that since January 1, 1998, Narragansett has been taking transmission services on behalf of its entire customer base under two open access transmission tariffs approved by FERC.[27] Under ISO-NE's FERC Electric Tariff No. 1, ISO-NE provides Scheduling System Control and Dispatch, Energy Administration Service, and Reliability

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[23] Id., Exhibit JAL-10, p. 1.
[24] Id., p. 18.
[25] Id., Exhibit JAL-11, p. 1, and JAL-12, p. 1.
[26] Narragansett Exhibit 1B; Viapiano pre-filed testimony, p. 2.
[27] Id.

Administration Service.[28] In addition to these charges, Narragansett is charged certain energy uplift charges which are currently under dispute between Narragansett and its Standard Offer power suppliers and, therefore, are being deferred through the Transmission Adjustment Clause.[29] Ms. Viapiano estimated Narragansett's total transmission and ISO-NE expenses for 2001 to be approximately $46.2 million.[30] This estimate includes a projected 40% increase in congestion costs, which are incurred when energy from in-merit generation cannot be dispatched and transmitted to and through an area due to transmission constraints, with the result that higher cost, out-of-merit local generation is required to generate and deliver energy.[31] These incremental congestion costs are currently allocated to all transmission customers throughout New England regardless of the location of the congestion.[32] Ms. Viapiano explained that congestion costs have risen dramatically from $2 million for the first three months following the opening of the new wholesale market in 1999 to $33 million for the corresponding three months in 2000.[33] In conclusion, Ms. Viapiano determined that the 18% increase in the transmission adjustment factor is required due to increased congestion costs, which accounts for 90% of the increase, as well as

[28] Id., p. 3.
[29] Id., p. 6.
[30] Id., p. 7.
[31] Id., p. 8.
[32] Id.
[33] Id., pp. 8-9.

anticipated new charges associated with Reactive Power and Black Start service.[34]

In his pre-filed testimony, Mr. Hager provided an estimate of the additional costs expected to be incurred by Narragansett as a result of the fuel index adjustment provision contained in Narragansett's Standard Offer contracts.[35] In the prior Standard Offer filing, Docket No. 3138, Narragansett utilized a projection of fuel index payments for the six-month period ending March 2001 based upon the average price of gas and oil at the end of August 2000.[36] Mr. Hager explained that a review of gas and oil prices at the end of November resulted in a higher fuel index adjustment amount than previously estimated, and that he expected that fuel index-related payments would continue at least through December 2001.[37]

II. DIVISION

On December 11, 2000, in response to Narragansett's filing, the Division of Public Utilities and Carriers ("Division") submitted the pre-filed testimony of Dr. John Stutz, and David J. Effron, consultants retained by the Division, and of Stephen Scialabba, Chief Accountant of the Division.

In his pre-filed testimony, Dr. Stutz discussed Narragansett's proposed increase in the transmission adjustment factor from 0.238

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[34] Id., pp. 9-10.
[35] Narragansett Exhibit 1C: Hager pre-filed testimony, pp. 2, 5.
[36] Id., p. 3.

cents to 0.411 cents per kWh and elimination of the transmission credits in the BVE and Newport zones.[38] Dr. Stutz explained that Narragansett's proposed increase in the transmission adjustment factor was necessary to recover the expected under-collection of $5.2 million in 2000 and to recover higher anticipated transmission costs in 2001.[39] Also, Dr. Stutz noted that these factors also caused the increase in the transmission adjustment factor in Docket No. 3031.[40] Although Dr. Stutz approved of Narragansett's proposal to increase the transmission adjustment factor, he expressed concern that Narragansett did not explain why congestion costs have increased or what can be done to limit and control future transmission cost increases.[41]

In his pre-filed testimony, Mr. Stephen Scialabba discussed Narragansett's proposal to increase the SOS rate.[42] Initially, Mr. Scialabba summarized the percentage increases in Narragansett's SOS rate from 3.8 cents per kWh prior to July 1, 2000 to 5.401 cents per kWh on October 1, 2000, due to higher gas and oil prices, and the implementation of a standard offer adjustment factor of 0.232 cents per kWh to recover the under-collection in SOS.[43] Mr. Scialabba emphasized that due to even higher gas and oil prices Narragansett is continuing to experience increases in its SOS costs as a result of the fuel-index

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[37] Id., pp. 3-4.
[38] Division Exhibit 1: Stutz pre-filed testimony, pp. 2, 5.
[39] Id., p. 6.
[40] Id.
[41] Id., p. 7.
[42] Division Exhibit 2: Scialabba pre-filed testimony, p. 1.

adjustment provisions of Narragansett's SOS contracts with its suppliers.[44] In order to prevent an under-collection in SOS revenues from materializing, Mr. Scialabba agreed with Narragansett's proposal to increase the SOS rate from 5.401 cents per kWh to 5.905 cents per kWh.[45]

Mr. Scialabba also suggested that a number of options are available which could lessen dependence on Narragansett's existing SOS supply contracts.[46] First, Narragansett could put out to bid the load obligation currently supplied by NEP, which is approximately 12 % of Narragansett's retail standard offer load.[47] Second, Narragansett could attempt to manage SOS supply costs under existing contracts by engaging in the purchase of hedging instruments.[48] Third, Narragansett could obtain a long-term and price-stable Last Resort Service supply contract and have that service be available for SOS customers.[49] Lastly, Mr. Scialabba mentioned the possibility of creating a new power supply service with new supply contracts if Narragansett put the entire retail standard offer load out to bid.[50] However, Mr. Scialabba emphasized that Narragansett's current SOS supply contracts are a "relatively safe harbor" because wholesale suppliers of electricity are not offering any

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[43] Id., p. 2.
[44] Id., pp. 2, 4.
[45] Id., p. 4.
[46] Id., p. 5.
[47] Id., pp. 5-6.
[48] Id., p.6.
[49] Id.
[50] Id., p. 7.

prices below Narragansett's 5.905 cents per kWh.[51] Mr. Scialabba also approved of Narragansett's proposal to eliminate the zonal transmission credit for BVE and Newport customers in 2001 in accordance with the Merger Agreement.[52]

In his pre-filed testimony, Mr. Effron addressed Narragansett's proposed transition charge for 2001 and discussed the expected transition charge for 2002.[53] Mr. Effron recommended approval of Narragansett's proposed transition charge of $0.988 cents per kWh for Narragansett's entire service to territory in 2001, but took issue with Narragansett's expectation that the CTC from NEP, including the Montaup Electric Company, will increase in 2002.[54] He noted that Narragansett's forecasted CTC from NEP and Montaup actually occurs, and the equalization of the transition charge is merely a one-year phenomenon, in 2002 the transition charge in the Narragansett zone will be $0.0105, as provided in the Merger Agreement, and the transition charge in the BVE and Newport zones will be $0.0177.[55] Alternatively, Mr. Effron suggested that the Merger Agreement could be interpreted to require that the transition charges converged, in which case the transition charge would be $0.0124 in 2002.[56] However, Mr. Effron projected that the 2002 NEP and Montaup CTC will be approximately

[51] Id., p. 5.
[52] Id., p. 8.
[53] Division Exhibit 3: Effron pre-filed testimony, p. 3.
[54] Id., pp. 3-4.
[55] Id., p. 6.
[56] Id., p. 7.

$14.3 million lower than forecasted by Narragansett as a result of lower than expected nuclear decommissioning costs.[57] Consequently, the CTC for 2002 would be reduced to $.0075, as compared to Narragansett's forecast of $.0102, and the transition charge for the entire Narragansett service territory would be equalized at $0.0105.[58]

A public hearing was held at the Commission's offices, 100 Orange Street, Providence, Rhode Island on December 13, 2000. The following appearances were entered:

FOR NARRAGANSETT:	Ronald Gerwatoski, Esq.
FOR THE DIVISION:	Paul J. Roberti, Esq. Assistant Attorney General
FOR TEC-RI:	Andrew Newman, Esq.
FOR COMMISSION:	Steven Frias, Esq. Senior Legal Counsel

At the hearing, Narragansett presented a panel of three witnesses: Ms. Lloyd, Ms. Viapiano, and Mr. Hager. Ms. Viapiano discussed the nature of congestion costs and stated that under the FERC approved tariffs, these congestion costs are "currently socialized to all customers throughout New England", regardless of where the congestion actually occurs.[59] Under cross-examination, Mr. Hager explained that the majority of congestion costs are attributed to transmission constraints in the Boston area and, in fact, there are minimal congestion costs

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[57] Id., pp. 7, 9-10.
[58] Id., pp.10-11.
[59] Id., p. 12.

attributable to Rhode Island.[60] Also, Ms. Viapiano explained that "congestion costs" are "occurring as a result of the new market," because there has been a change in dispatch from a cost-based system to a bidding system.[61] Ms. Viapiano noted that fortunately NEPOOL had filed and FERC has approved a Locational Congestion Management System, which will direct charges to the locations based on where the congestion is occurring, but she anticipated that this system will not be implemented until 2002.[62] Furthermore, Ms. Viapiano explained that generators are utilizing new bidding strategies in which low-cost generation located at a point of possible congestion is not bid in early in the bidding process, thereby causing prices to increase.[63] Consequently, she testified, as a distribution company, Narragansett has no control over congestion costs and National Grid, Narragansett's parent company, can only intervene at FERC, vote at NEPOOL and undertake efforts on its own transmission system to mitigate congestion costs.[64]

Ms. Viapiano underscored the need to alter the current NEPOOL governance structure so that transmission companies will have "significant" influence over regional transmission issues.[65] Mr. Hager added that market rules are needed that "encourage flexibility of generating units and don't allow units to bid very high minimum run

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[60] Id. p. 28.
[61] Id., pp. 11-12, 13.
[62] Id., p. 15.
[63] Id., pp.16-17.
[64] Id., pp. 18-19.
[65] Id., pp. 56-57.

points, long run times" so generators "collect uplift costs."[66] To alleviate congestion costs, Ms. Viapiano suggested that transmission companies receive a higher return on equity in order to incent these companies to build more transmission.[67] As for Mr. Scialabba's recommendation discussed in his pre-filed testimony, Mr. Hager stated that the bids received for the NEP portion of SOS were higher than present costs, but that Narragansett is continuing to explore ways to hedge the costs associated with its SOS supply contracts.[68]

At the hearing, the Division presented Dr. Stutz, Mr. Scialabba and Mr. Effron as witnesses. Dr. Stutz testified that the penalties and protections afforded by Market Rule 17 to mitigate market power are inadequate to prevent present or further increase in congestion costs.[69] To mitigate strategic bidding, Dr. Stutz approved of setting a "soft cap" and establishing "a presumption" that generators "who bid above certain levels have to explain themselves."[70]

In closing arguments, TEC-RI's counsel discussed the possibility of creating an incentive for Narragansett to reduce transmission costs by eliminating reconciling clauses.[71] Narragansett's counsel stated that Narragansett can do very little with respect to charges from ISO-NE.[72] As for the Division, counsel emphasized that state commissions are pre-

[66] Id., p. 58.
[67] Id., pp. 69-70.
[68] Id., pp. 103-104, 105.
[69] Id., pp. 121-122.
[70] Id., pp. 130-131,
[71] Id., pp. 160-161.

empted in this area of regulation by FERC, and these costs must be passed on to the ratepayers.[73]

COMMISSION FINDINGS

The deregulation of the electric industry occurred with the expectation that ratepayers would experience lower electricity prices. Unfortunately, since the creation of the wholesale electric market in 1999, transmission costs have risen dramatically as a result of congestion costs, especially attributable to transmission constraints in the Boston area. The high transmission costs billed to Narragansett are the result of FERC approved tariffs, which require the Commission to pass on these increases to the ratepayers. Furthermore, state commissions are limited in what actions they can take to mitigate transmission costs. Also, state commissions have no vote at NEPOOL, the body charged with setting the rules for the New England electric wholesale market. Consequently, state commissions can do little but express their concern to FERC regarding the status of the electric wholesale market. This Commission is disappointed with the increasing transmission costs and is frustrated that it can do little to stem the tide of these higher electric prices. However, this Commission has and will

[72] Id., pp. 163-164.
[73] Id., pp. 167-168.

continue to work through NECPUC to support proposals that mitigate transmission costs and the exercise of market power. Also, this Commission strongly urges the Division and Narragansett to exercise its best efforts before FERC and at NEPOOL to prevent higher transmission costs from being passed through to Rhode Island ratepayers. It is the hope of this Commission that a Locational Congestion Management System and other proposals limiting the exercise of market power through strategic bidding will some day ensure that the New England electric wholesale market will function in a manner that benefits the electric ratepayers of Rhode Island.

In regards to the SOS rate, this is the fourth proposed increase in approximately six months. All of the recent increases in the SOS rate are due to higher fuel costs such as the wholesale price of natural gas which is not regulated by this Commission. Narragansett's Standard Offer supply contracts contain provisions which require payments to be made by Narragansett when a fuel trigger point, based on the price of natural gas and oil, is exceeded. As previously ordered in Docket No. 3138 (Order No. 16634), the Commission reaffirms its position that these increases are necessary to avoid creating an under-collection in SOS revenues, in this instance projected to be $10.2 million by the first quarter of 2001.

At an open meeting held on December 15, 2000, the Commission considered the evidence presented in the case and found Narragansett's proposals to be just and reasonable and in the best interest of the ratepayers.

Accordingly, it is

(16636) ORDERED:

1. The Company's proposed retail Standard Offer Service Rate of 5.905 cents per kWh is approved to become effective for service on and after January 1, 2001.
2. The Company's proposed transition charge of 0.988 cents per kWh for the Company's entire service territory is approved to become effective for service on and after January 1, 2001.
3. The Company's proposed transmission charge of 0.847 cents per kWh, including a transmission adjustment factor of .441 cents per kWh, for the entire Narragansett service territory is approved to become effective for service on and after January 1, 2001.
4. The elimination of the zonal transmission credits for the former Blackstone Valley Electric and Newport Electric service territories is approved to become effective on and after January 1, 2001.

EFFECTIVE AT PROVIDENCE, RHODE ISLAND PURSUANT TO AN OPEN MEETING DECISION ON DECEMBER 15, 2000. WRITTEN ORDER ISSUED JUNE 13, 2001.

PUBLIC UTILITIES COMMISSION

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Elia Germani, Chairman

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Kate F. Racine, Commissioner

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Brenda K. Gaynor, Commissioner