

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

**PUBLIC UTILITIES COMMISSION**

IN RE: NARRAGANSETT ELECTRIC COMPANY:

LAST RESORT SERVICE RATES : DOCKET NO. 3117

LAST RESORT SUPPLY CONTRACT : DOCKET NO. 3005

**REPORT AND ORDER**

On April 14, 2000, Narragansett Electric Company (“Narragansett” or the “Company”) made two filings with the Commission relating to the Company’s provision of Last Resort Service (“LRS”)<sup>1</sup>. The first filing requests approval of the Company’s selection of the LRS power supplier<sup>2</sup> as required by the Utility Restructuring Act of 1996, as amended (“URA”)<sup>3</sup>. The second filing requests approval of a change in the LRS rate for non-residential customers, commencing with bills rendered on and after June 1, 2000.<sup>4</sup>

**I. TRAVEL OF THE CASE**

On April 14, 2000, the Company filed the testimony of Peter T. Zschokke and Michael J. Hager in support of the proposed LRS rate change and the selection of the LRS power supplier. A prehearing conference was held on April 24, 2000 at 10:00 a.m. at the offices of the Commission, 100 Orange Street, Providence, R.I. Notice of the rate filing and the selection of the LRS power supplier was duly published on May 9, 2000.

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<sup>1</sup> Filing letter dated April, 14, 2000, p. 1.

<sup>2</sup> Under the URA, the LRS power supplier must be a non-regulated power producer (“NPP”) as defined in R.I.G.L. §39-1-2(13).

<sup>3</sup> R.I.G.L. §39-1-27.3(f).

<sup>4</sup> Filing letter, supra, p. 1.

On May 12, 2000, the Division of Public Utilities and Carriers (“Division”) filed the testimony of Dr. John Stutz in opposition to various aspects of the Company’s LRS rate proposal. On that same day, The Energy Council of Rhode Island (“TEC-RI”)<sup>5</sup> filed the testimony of Roger Buck, Executive Director of TEC-RI, and James O’Donahue, Utility Manager of Toray Plastics (America), Inc., in opposition to various elements of the Company’s LRS rate proposal.

Public hearings were held on May 19 and 22, 2000 at the Commission’s offices.

The following appearances were entered in this proceeding:

FOR THE COMPANY	Ronald T. Gerwatowski, Esq.
FOR THE DIVISION	Paul J. Roberti, Esq. Chief, Utilities Regulatory Unit
FOR TEC-RI	Andrew J. Newman, Esq. Rubin and Rudman, LLP
FOR THE COMMISSION	Lindsay Johnson, Esq. Special Counsel

All parties made oral arguments on May 22, 2000.

On May 24, 2000, TEC-RI submitted a letter to the Commission outlining its position on issues and presenting one or more new proposals to deal with the LRS rate issues (“Letter of TEC-RI”). The other Parties were then given until May 31, 2000 to respond to the Letter of TEC-RI and all Parties were given the opportunity to comment on any of the record requests received after May 22, 2000. On May 26, 2000,

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<sup>5</sup> TEC-RI is a membership organization comprised of large industrial, commercial and institutional electric customers.

Narragansett submitted a letter in response to the Letter of TEC-RI. On May 31, 2000, the Division submitted a letter in response to the Letter of TEC-RI.

At an open meeting on May 31, 2000, the Commission decided the issues presented and issued an abbreviated order establishing LRS rates for the months of June, July and August 2000. On June 2, 2000, TEC-RI filed a letter requesting the rehearing, reconsideration and retraction of the Commission's May 31, 2000 Order. On June 5, 2000, Narragansett filed a letter responding to TEC-RI's motion. On June 5, 2000, TEC-RI filed a Motion to Stay the Commission's Order. On June 12, 2000, the Division filed a letter responding to TEC-RI'S Motion for rehearing, reconsideration and retraction of the Commission's May 31, 2000 Order and TEC-RI's Motion for a Stay filed on June 5, 2000.

At an open meeting on June 13, 2000, the Commission denied (in part) TEC-RI's Motion for rehearing and reconsideration. The Commission allowed the motion in part by setting a LRS rate for September 2000 and beyond at a rate equal to the greater of (i) 4.5¢ per kWh<sup>6</sup> or (ii) the estimated market price for the service month. The Commission also denied TEC-RI's Motion for a Stay.

## **II. INTRODUCTION**

The intent of the URA is to promote a competitive market for electricity. During the transition from regulated rates to competition, the URA requires each electric distribution company to arrange with a wholesale power supplier for a standard power

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<sup>6</sup> In this Report and Order, all unit prices, costs or rates that are expressed in terms of cents (¢) represent the price, cost or rate per kilowatt hour ("kWh").

supply offer (“Standard Offer”) to sell electricity to all customers at a stipulated rate.

Specifically, the URA provides:

Each electric distribution company shall arrange for a standard power supply offer (“Standard Offer”) to customers that have not elected to enter into power supply arrangements with other nonregulated power suppliers.<sup>7</sup>

The URA also requires electric distribution companies to provide last resort service (“LRS”) *“for customers who are no longer eligible to receive service under the standard offer and are not adequately supplied by the market because they are unable to obtain or retain electric service from nonregulated power producers.”*<sup>8</sup> The URA stipulates that the power supply required to serve last resort customers is to be periodically purchased at market prices.<sup>9</sup> The URA also requires that “[a]cceptance of bids by the electric distribution company and the terms and conditions for such last resort service shall be subject to approval by the Commission.”<sup>10</sup>

### **III. THE COMPANY’S CASE**

#### **A. HAGER TESTIMONY**

The Company presented the testimony of Michael J. Hager, Standard Offer Portfolio Manager for New England Power Service Company,<sup>11</sup> on the selection of a new LRS power supplier.<sup>12</sup> Mr. Hager testified that a request for proposals (“RFP”)<sup>13</sup> to

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<sup>7</sup> R.I.G.L. §39-1-27.3(d)

<sup>8</sup> R.I.G.L. §39-1-27.3(f)

<sup>9</sup> Id.

<sup>10</sup> Id.

<sup>11</sup> Now National Grid USA Service Corp.

<sup>12</sup> Narr. Ex. 1, Testimony of M.J. Hager.

<sup>13</sup> The Company participated in a joint RFP with affiliated distribution companies. Id., p. 3.

provide the LRS power supply at fixed rates for the six-month period May through October 2000 was issued on February 15, 2000.<sup>14</sup>

Mr. Hager testified that the bids received “for the six-month period were, on average, substantially higher than Narragansett’s historical cost for such supply.”<sup>15</sup> He was of the opinion that the higher bids were a result of “uncertainties in the ICAP (installed capacity)<sup>16</sup> market and uncertainties associated with the imposition of a NEPOOL Congestion Management System”<sup>17</sup> to address regional transmission capacity shortages.

Narragansett was not satisfied with any of the bids received pursuant to the February 15, 2000 RFP and subsequently issued a second RFP for the LRS power supply. The new RFP requested bids with (i) fixed-prices for the months of May, June, September and October 2000 and (ii) market prices for the months of July and August 2000, together with a supplier fee representing the administrative cost [and profit] for July and August.<sup>18</sup> Bids were to exclude the cost of ICAP which would be allowed to float with the spot market for the entire six-month period “because the ICAP market is currently in an unpredictable state of flux.”<sup>19</sup>

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<sup>14</sup> Id., p. 4.

<sup>15</sup> Id., p. 5.

<sup>16</sup> ICAP costs are the costs of the NEPOOL installed capacity requirements which have typically traded in the bilateral market at 50 ¢ to \$1.00 per kilowatt month, but have recently traded at prices in excess of \$5 per kilowatt month. Id., p. 7, Tr. 5/19/00, a.m., p. 103. Any ICAP costs incurred by the supplier would be recoverable over and above the quoted prices. Narr. Ex.1, Testimony of M.J. Hager, p. 9.

<sup>17</sup> Id., p. 6. The Congestion Management System would be designed to minimize congestion costs. Congestion costs are incurred when lower cost energy cannot be transmitted to or through an area due to transmission capacity shortages, and higher cost “out of merit” local generation is called upon to generate and deliver the energy. Under the current NEPOOL Agreement these incremental “congestion” costs are allocated to all transmission customers throughout New England. See Order No.16275, dated June 1, 2000, p. 4.

<sup>18</sup> Narr. Ex.1, Testimony of M.J. Hager, p. 9.

<sup>19</sup> Id.

Southern Company Energy Marketing, L.P. was the low bidder under the second RFP, and a contract to supply LRS power to Narragansett for the six-month period May through October 2000 was executed on April 4, 2000 at the following monthly prices:<sup>20</sup>

May 2000	3.8¢
June	6.5¢
July	Market (estimated at 8-10¢)
August	Market (estimated at 8-10¢)
September	4.0¢
October	3.6¢

Mr. Hager stated that Narragansett intends to enter into financial arrangements (futures contracts) with third parties to secure fixed prices for July and August.<sup>21</sup>

## **B. ZSCHOKKE TESTIMONY**

The Company also presented the testimony of Peter T. Zschokke, Vice-President and Director of Distribution Financial Analysis for National Grid USA Service Corp.<sup>22</sup> Mr. Zschokke testified that LRS customers are currently receiving service at the current Standard Offer Service rate of 3.8¢, which is less than the historical and ongoing cost of the LRS power supply.<sup>23</sup> He stated that the Company is proposing to increase the non-residential LRS rate because “725 commercial and industrial customers have dropped their suppliers to take Last Resort Service since January of 2000.”<sup>24</sup> In just four months, the LRS load has skyrocketed from 370,365 kWh in December 1999 to

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<sup>20</sup> *Id.*, pp. 10-11. These prices exclude the cost of ICAP. The price per kWh over the contract period, excluding the cost of ICAP, is expected to average approximately 6¢. Narr. Ex.1, Ex. PTZ-2, p. 1 of 5, col. (c) / col. (a).

<sup>21</sup> Narr. Ex.1, Testimony of M.J. Hager, pp. 9-10.

<sup>22</sup> Narr. Ex.1, Testimony of P.T. Zschokke.

<sup>23</sup> *Id.*, pp. 3, 5; Ex. PTZ-1, Ex. PTZ-2.

27,154,126 kWh through March 2000,<sup>25</sup> producing a correspondingly dramatic increase in the actual and projected LRS cost under-recoveries:

<u>MONTH</u>	<u>LRS CUMULATIVE UNDER-RECOVERY</u> <sup>26</sup>
January 1999	\$ 217
February	\$ 529
March	\$ 1,146
April	\$ 1,980
May	\$ 2,350
June	\$ 8,809
July	\$ 15,471
August	\$ 16,587
September	\$ 15,483
October	\$ 13,445
November	\$ 12,637
December	\$ 140,626
January 2000	\$ 879,139
February	\$ 557,984
March	\$ 720,909
April	\$ 956,665,
May	\$ 956,665
June	\$2,201,753
July	\$4,607,768
August	\$6,940,990
September	\$7,044,226
October	\$7,042,554

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<sup>24</sup> Id.; Testimony of P.T. Zschokke, p. 4.

<sup>25</sup> Id.

<sup>26</sup> The unrecovered LRS balances, actual and estimated, through April 2000 are from Narr. Ex.1, Ex. PTZ-1. The estimated balances for May through October 2000 were derived by adding the projected LRS under-recoveries from Narr. Ex.1, Ex. PTZ-2 to the April 2000 balance from Ex. PTZ-1.

In short, Mr. Zschokke indicated that if the LRS rate is not increased, the cumulative LRS under-recovery would increase from \$956,665 to approximately \$7,042,544 during the current six-month contract supply period.<sup>27</sup> Absent an LRS rate increase, recovery of these LRS under-collections will be deferred for recovery from (some or all of) the Company's customers next year under the terms of the Standard Offer Adjustment Provision of the Company's tariff.<sup>28</sup>

Narragansett is proposing to phase-in higher LRS rates for non-residential customers to bring these rates more in line with LRS power costs and to reduce the amount of the ongoing LRS under-recovery.<sup>29</sup> The Company's rate proposal is shaped by two concerns.

First, the Company is proposing to exempt residential customers from the LRS rate increase because it does not "believe that any suppliers would offer power supply service to residential customers, given our price proposals for non-residential customers in this filing."<sup>30</sup> Mr. Zschokke testified that, to his knowledge, no suppliers are currently offering service to residential customers.<sup>31</sup>

The second concern is that the immediate implementation of cost-based (or market)<sup>32</sup> pricing "would be unfair to many customers who might have been relying upon

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<sup>27</sup> Id.

<sup>28</sup> The Standard Offer Adjustment Provision provides that LRS under-collection balances may be recovered from (i) all customers, (ii) only Standard Offer and/or LRS customers, or (iii) through any other reasonable method.

<sup>29</sup> Id., pp. 3, 5.

<sup>30</sup> Id., p. 4.

<sup>31</sup> Tr. 5/19/00, a.m., p. 68..

<sup>32</sup> The Division's witness, Dr. Stutz, refers to cost-based rates as rates "priced at market" (see Section IV, infra.). This difference in terminology appears to be largely one of perspective and not substance. Under the LRS power supply contract, power purchased at market price becomes the Company's cost and, as of that point in time, the market price and the cost are the same.

the lower Last Resort Service price as a ‘safe harbor’ for summer months.”<sup>33</sup> For that reason the Company has proposed that higher LRS rates be phased-in to give customers “some time to shop for and negotiate a reasonable supply contract.”<sup>34</sup> The Company proposes to phase in higher LRS rates as follows:<sup>35</sup>

May 2000	3.8¢
June	4.1¢
July	4.2¢
August	4.3¢
September	4.4¢
October	4.5¢ (or market price, if higher) <sup>36</sup>

It should be noted that the LRS rates proposed for September and October are higher than the contracted LRS supply costs presented by Mr. Hager.<sup>37</sup> Mr. Zschokke testified that the higher rates in the months of September and October would provide the Company with an opportunity to recover some of the LRS under-recovery.<sup>38</sup> In addition, the higher autumn prices would encourage “customers to leave Last Resort Service and purchase power in the market.”<sup>39</sup> If the Company’s LRS rate proposal is approved, Mr. Zschokke estimated that the incremental LRS under-recovery from May through October 2000 would be reduced to approximately \$4.9 million.<sup>40</sup>

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<sup>33</sup> Narr. Ex. 1. Testimony of P.T Zschokke, p. 5.

<sup>34</sup> Id.

<sup>35</sup> Id., Ex. PTZ 4.

<sup>36</sup> Mr. Zschokke proposes that the October price be set at 4.5¢ or the average estimated cost of power for that month, if the cost is higher. Id., p. 6. However, the proposed tariff simply provides that the October 2000 LRS rate of 4.5¢ will remain in effect until changed by order of the Commission. Id., Ex. PTZ 4.

<sup>37</sup> See Section III.A, supra.

<sup>38</sup> Narr. Ex. 1, Testimony of P.T. Zschokke, p. 6.

<sup>39</sup> Id.

<sup>40</sup> Id., p. 8.

#### IV. THE DIVISION'S CASE

On May 12, 2000, the Division filed the testimony of its rate consultant, Dr. John Stutz.<sup>41</sup> Dr. Stutz summarized the content of his testimony as follows:

1. The Company's selection of a supplier of power for Last Resort Service is reasonable and consistent with the URA requirements. The Company's selection should be approved.
2. At this time, the Commission should only address Last Resort Service Pricing for the period through October 2000. For residential customers, the price of Last Resort Service should remain at the Standard Offer price. Last Resort Service for non-residential customers should be priced monthly based on the cost of power. Customers taking Last Resort Service on or before May 1, 2000 should receive a credit of up to 2¢ per kWh during June, July, and August.
3. The Commission should provide an opportunity for a thorough discussion of future supply and pricing arrangements for LRS.<sup>42</sup>

In Dr. Stutz's opinion, the Company's selection of the winning bidder has satisfied the requirements of the URA which stipulate how the power supply for LRS is to be acquired and priced.<sup>43</sup>

Dr. Stutz then presented his view of the basic conflict presented by the LRS rate issue. "If the price of Last Resort Service does not cover the cost of power for Last Resort Service, the difference is deferred for recovery later with interest."<sup>44</sup> He recognized,

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<sup>41</sup> Div. Ex.1.

<sup>42</sup> Id., p. 3.

<sup>43</sup> R.I.G.L. §39-1-27.3(f).

<sup>44</sup> Div. Ex.1, p. 7.

however, that “the desire to limit deferrals [by adopting cost-based rates] must be balanced against the need to protect Last Resort Service customers from high prices.”<sup>45</sup>

In Dr. Stutz’s opinion, a reasonable balance would be created if service to non-residential LRS customers is “priced at market”<sup>46</sup> (or cost)<sup>47</sup> with a credit of up to 2¢ per kWh.<sup>48</sup> He described his proposal as follows:

For prices up to 3.8¢ per kWh, the credit should be zero.  
For prices over 3.8¢ per kWh, the credit should be the difference between the market price and 3.8¢, up to a maximum of 2¢ per kWh.

Stated differently, under the Division’s proposal LRS customers would pay 3.8¢ plus the excess, if any, of the market price over 5.8¢. For market prices between 3.8¢ and 5.8¢, the LRS rate would be 3.8¢. For market prices in excess of 5.8¢, the LRS rate would be equal to the market price less 2¢.<sup>49</sup>

Dr. Stutz’s proposal would phase-in higher market (or cost)-based LRS rates more quickly than the Company’s rate proposal:<sup>50</sup>

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<sup>45</sup> Id.

<sup>46</sup> Id., p. 8.

<sup>47</sup> See Section III.B, supra.

<sup>48</sup> Id. Under Dr. Stutz’s original proposal the credit was available only to those customers taking LRS service on or before May 1, 2000. Id. The proposal was modified by letter from the Division dated May 31, 2000 proposing to make the credit available to all LRS customers.

<sup>49</sup> For example, if the estimated market price for a given month is 5.8¢, the rate would be 3.8¢.

Alternatively, if the market rate were 8¢ the rate would be 6¢, the sum of 2.2¢ (8¢ - 5.8¢) plus 3.8¢.

<sup>50</sup> Div. Ex.1, Ex. JS-1.

## COMPARATIVE RATES

<u>MONTH</u>	<u>AVERAGE COST OF POWER<sup>51</sup></u>	<u>PROPOSED RATES</u>	
		<u>COMPANY</u>	<u>DIVISION</u>
May 2000	3.8¢	3.8¢	3.8¢
June	6.5¢	4.1¢	4.5¢
July	9.2¢ (est.)	4.2¢	7.2¢ (est.)
August	8.9¢ (est.)	4.3¢	6.9¢ (est.)
September	4.0¢	4.4¢	4.0¢
October	3.6¢	4.5¢	3.6¢

Dr. Stutz takes the position that “the rapid changes in prices associated with the credit approach make it inappropriate for residential customers.”<sup>52</sup> He notes that “keeping the price of Last Resort Service for residential customers at the Standard Offer price will have a minimal impact on the deferral -- \$128 thousand increase for the May to October period.”<sup>53</sup> Accordingly, Dr. Stutz recommends that the LRS rate for residential customers be kept at the Standard Offer rate through the term of the current LRS supply contract.<sup>54</sup>

### V. TEC-RI’s CASE

TEC-RI presented two witnesses in support of its LRS rate proposal to keep the LRS rate tied to the Standard Offer rate.

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<sup>51</sup> Narr. Ex.1, Testimony of M.J. Hager, p. 10.

<sup>52</sup> Div. Ex.1, p. 9.

<sup>53</sup> Id.

<sup>54</sup> Id.

## A. BUCK TESTIMONY

Roger Buck presented prefiled testimony on three points.<sup>55</sup> First, he described the efforts of TEC-RI to obtain power for its members from competitive suppliers.<sup>56</sup> TEC-RI's efforts resulted in members signing power purchase contracts with an independent supplier during 1999.<sup>57</sup> Second, Mr. Buck testified that despite TEC-RI's recent efforts, it has been unable to locate an alternative supplier willing to provide power at a price equal to the current Standard Offer rate of 3.8¢.<sup>58</sup> Consequently, Mr. Buck contended, TEC-RI members have no better economic alternative than the current of LRS rate of 3.8¢ and that they, like residential customers, should not receive a rate increase for LRS.<sup>59</sup> He proposed that rates for "Last Resort Service should remain tied with Standard Offer Service until at least October 1, 2000."<sup>60</sup>

Mr. Buck also proposed that the Company's request for power supply bids should be in the form of "a fixed supplier fee plus an hourly market-based price for power."<sup>61</sup> Customers with hourly time-of-use meters would be billed based on their hourly loads. Customers without hourly time-of-use meters would be billed based on their hourly loads determined by rate class load profiles similar to those used in the power supply agreement, to establish the load servicing responsibility of the LRS supplier.<sup>62</sup>

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<sup>55</sup> Ex. TEC-RI-20.

<sup>56</sup> Id., pp. 3-4.

<sup>57</sup> Id., p. 4.

<sup>58</sup> Id.

<sup>59</sup> Id., pp. 4-5.

<sup>60</sup> Id., p. 6.

<sup>61</sup> Id., p. 7.

<sup>62</sup> Id.

## **B. TORAY'S TESTIMONY**

James O'Donahue, Utility Manager for Toray Plastics (America), Inc. ("Toray"), a TEC-RI member now on LRS, presented testimony on Toray's efforts to obtain power from competitive suppliers and the potential impact of the LRS rate increase proposals on Toray.<sup>63</sup> He testified that Toray has been unable to find a supplier to provide power at a fixed rate of 3.8¢ through the summer of 2000.<sup>64</sup> For the five month period June through October 2000, he estimated that the LRS rates proposed by the Company would increase Toray's electricity costs by \$323,643.<sup>65</sup> He estimated that during this same period, the LRS rates proposed by the Division would increase Toray's electricity costs by approximately \$1,000,000.<sup>66</sup>

## **VI. COMMISSION FINDINGS ON RATE ISSUES**

### **A. LAST RESORT SERVICE RATE**

Both the Company and the Division take the position that the LRS rate for residential customers should continue to be tied to the Standard Offer rate and that a market (or cost)-based LRS rate should be phased-in for non-residential LRS customers.<sup>67</sup> The Company supports its position based upon its understanding that alternative suppliers are not available to provide residential service and that it would be unfair to impose rate increases on residential customers when there is no competition for

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<sup>63</sup> Ex. TEC-RI-21.

<sup>64</sup> Id., p. 2.

<sup>65</sup> Plus any increase in the future from the Standard Offer/Last Resort Adjustment balance. Id., p. 3.

<sup>66</sup> Tr. 5/19/00, p.m., p. 106.

<sup>67</sup> Narr. Ex.1, Testimony of P.T. Zschokke, p. 4.; Div. Ex.1, p. 9.

providing their service.<sup>68</sup> The Division supports its position with the logic that “the rapid changes in prices associated with [market (cost)-based pricing] make it inappropriate for residential customers.”<sup>69</sup> The Division also emphasizes the fact that “keeping the price of Last Resort Service for residential customers at the Standard Offer price will have a minimal impact on the deferral -- \$128 thousand increase for the May to October period.”<sup>70</sup>

TEC-RI contends that non-residential customers currently on LRS also have no power supply alternative and should, consistent with the position the Company has taken on residential customers, continue to receive LRS at the Standard Offer rate.<sup>71</sup>

The Commission is not persuaded by TEC-RI’S argument. TEC-RI testified that it was unable to find an alternative supplier that would provide power for TEC-RI members at prices equal to or less than the current LRS rate of 3.8¢,<sup>72</sup> and that suppliers were available but unwilling to supply power for a contract term acceptable to TEC-RI.<sup>73</sup> This is quite different from having no supplier available.

These customers previously made the decision to leave Standard Offer Service to purchase power from an alternative supplier, presumably at cost savings. The result is that, consistent with the requirements of the URA,<sup>74</sup> they no longer qualify for Standard Offer service under the terms of the Company’s tariffs and consequently, must purchase

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<sup>68</sup> Narr. Ex.1, Testimony of P.T. Zschokke, p. 4.; Tr. 5/19/00, a.m., p. 68.

<sup>69</sup> Div. Ex.1, p. 9.

<sup>70</sup> Id. \$128,000 represents approximately 2% of the projected \$6,000,000 LRS under-recovery.

<sup>71</sup> Ex. TEC-RI-20, pp. 4-5.

<sup>72</sup> Ex. TEC-RI-20, p. 4.

<sup>73</sup> Tr. 5/22/00, pp. 34, 36-37.

power either from an alternative supplier at market rates or from Narragansett at the LRS rate. While there may be extenuating circumstances that warrant affording customers some protection from unusually high market prices, TEC-RI has not convinced the Commission that non-residential customers should be shielded entirely from market prices. Holding the LRS rate below the prevailing market prices simply frustrates the intent of the URA by preventing the development of a competitive power market.

## **B. THE PHASE-IN ISSUE**

The basic problem presented in this proceeding is that the current LRS rate of 3.8¢ will recover only 63% of the estimated costs under the current LRS power supply agreement.<sup>75</sup> Conversely, the immediate adoption of cost-based LRS rates would require a rate increase for LRS customers of 59%.<sup>76</sup> All of the Parties agree that the LRS rate should not immediately be increased to recover the full cost of the LRS power supply but rather, that the LRS rate increase should be phased-in over time.<sup>77</sup> The basic issue is: how quickly should the LRS rate be increased to reflect the full cost of the LRS power supply?

Two competing objectives must be considered in resolving this phase-in issue. The first objective is to increase the LRS rate to reflect the full cost of providing LRS and to eliminate the subsidization of LRS by other customer classes. The second objective is

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<sup>74</sup> The URA provides that “once a customer has elected to enter into a power supply arrangement with a nonregulated power producer, the electric distribution company shall not be required to arrange for the standard offer to such customer.” R.I.G.L. §39-1-27.3(d).

<sup>75</sup> Narr. Ex.1, PTZ-3, p. 1 of 5, col. (b) / col. (c).

<sup>76</sup> 1 / .63

<sup>77</sup> Narr. Ex. 2, Ex. PTZ-4; Div. Ex.1, p. 8. TEC-RI’s position can be inferred from the fact that it has taken the position that the LRS rate should not presently be increased (Ex. TEC-RI-20, p. 6) but that, as a general matter, ratepayers should pay for the cost of service without subsidization. Tr. 5/22/00, pp. 16, 19.

to avoid sudden and sharp rate increases that produce “rate shock.” The Commission’s goal is to balance these competing objectives.

## 1. ANALYSIS

The Company’s proposal is to phase-in a LRS rate of 4.5¢ over a five-month period. The problem with the Company’s proposal is that it does not go far enough soon enough. Under the Company’s proposal, the average LRS power cost under the Company’s current supply contract will increase by 2.2¢ over the contract period; however, the Company’s rate proposal would increase the average LRS rate by only .4¢ over the same period.<sup>78</sup> Based upon the LRS sales and power supply costs estimated by the Company, approximately 83% of the anticipated LRS cost increases would be under-recovered during the contract period.<sup>79</sup>

Alternatively, under the Division’s proposal, the LRS rate would be equal to the power cost under the current LRS supply contract with a credit not to exceed 2¢.<sup>80</sup> LRS customers would pay a monthly rate equal to 3.8¢ plus the cost of the LRS supply in excess of 5.8¢.<sup>81</sup> The advantage of this proposal is that the LRS rates would be tied, albeit somewhat indirectly, to the cost of the LRS power supply. Based upon the LRS sales and power supply costs estimated by the Company, the average LRS rate for the contract period would increase by 1.2¢ and recover 55% of the increase in anticipated LRS power supply costs for the same period.<sup>82</sup> However, the disadvantage of the

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<sup>78</sup> Div.Ex.1, Ex. JS-1.

<sup>79</sup> *Id.*, p. 10. Note that this percentage applies to LRS cost increases over and above 3.8¢, while the percentages on the previous page apply to total LRS supply costs and revenues.

<sup>80</sup> *Id.*, pp. 8-9.

<sup>81</sup> *Id.*

<sup>82</sup> Div. Ex.1, Ex. JS-1.

Division's proposal is that its impact on customers will vary greatly with the level of LRS costs incurred. As long as the cost of the LRS power supply does not exceed 5.8¢, LRS customers will not receive any rate increase.<sup>83</sup> Thus, the flaw in the Division's proposal is that non-residential LRS customers will not be required to pay for any portion of LRS cost increases between 3.8¢ and 5.8¢.

Finally, the TEC-RI proposal to tie the LRS rate to the Standard Offer rate "until at least October 1, 2000"<sup>84</sup> simply does not address the ongoing LRS under-recovery problem. Under TEC-RI's proposal, LRS customers would not receive any rate increases during the current supply contract period. However, based upon the Company's estimates of LRS sales and power supply costs over the current contract period, the TEC-RI proposal would result in the under-recovery of approximately \$6,000,000 of LRS power supply costs.<sup>85</sup>

In striking a balance between achieving cost-based LRS rates and avoiding rate shock, consideration must be given to the intent of the URA to create competition in the electric industry.<sup>86</sup> If the LRS rate is set at only 63%<sup>87</sup> of the prevailing market price for power, in the short-term it will frustrate, and in the long-term perhaps destroy, the emerging competitive market for electricity. This consideration also highlights the need to act now to correct the problem and bring LRS rates in line with LRS costs as soon as possible.

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<sup>83</sup> Tr. 5/19/00, pp. 22-24.

<sup>84</sup> Ex. TEC-RI-20, p. 6.

<sup>85</sup> Narr. Ex.1, Testimony of P.T. Zschokke, p. 8.

<sup>86</sup> R.I.G.L. §39-1-1(d).

<sup>87</sup> See Section VI.B, infra.

## 2. FINDINGS

The unit cost under the current LRS supply contract is 6.5¢ for the month of June 2000. The Company has proposed a LRS rate of 4.1¢ and the Division has proposed a LRS rate of 4.5¢ for the month of June.<sup>88</sup> Based upon the foregoing analysis, the Commission finds that the LRS rate for non-residential LRS customers of 4.5¢ proposed by the Division is just and reasonable. It represents a rate increase of 18%,<sup>89</sup> but is also 30% below the 6.5¢ unit supply cost for the month of June.

The months of July and August present a different problem because the contract supply costs for these months will be pegged to prevailing market prices and corresponding cost-based LRS rates cannot now be determined. The Company has recommended rates of 4.2¢ for July and 4.3¢ for August, but there is no way of predicting whether these rates will approximate the actual power supply costs. For this reason (which is consistent with the Division's testimony), the Commission finds that for July and August, the LRS rates for non-residential LRS customers should be tied to the estimated market prices for these two months, with some adjustment to mitigate rate shock. The Commission also finds that a reasonable limit must be placed upon the amount of the adjustment to control the amount of the potential LRS cost under-recoveries.

The Commission rejects the credit proposed by the Division, however, because it would result in LRS customers paying only for LRS cost increases over and above 5.8¢.

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<sup>88</sup> Narr. Ex.1, Ex. PTZ-4; Div. Ex.1, Ex. JS-2.

<sup>89</sup>  $4.5¢ - 3.8¢ = .7¢$  increase;  $.7¢ / 3.8¢ = 18\%$ .

Instead, the Commission finds that a credit equal to one-half (50%) of any unit supply cost increases over the Standard Offer rate (currently 3.8¢), but not to exceed 3¢, is just and reasonable. The maximum credit has been increased from 2¢ to 3¢ to further reduce the LRS rate for non-residential LRS customers during the highest cost summer months. The result is that, under the approved LRS rates for July and August, non-residential LRS customers will pay 50% of LRS cost increases over the Standard Offer rate (currently 3.8¢) up to 9.8¢ and all LRS cost increases above 9.8¢.

Establishing appropriate LRS rates for the months of September and October presents yet another set of issues. The contracted LRS supply costs for September and October drop to 4.0¢ and 3.6¢, respectively. Under the Division's market (cost)-based pricing proposal, LRS rates for non-residential customers would similarly be 4.0¢ and 3.6¢, respectively.

Under the Company's proposal, the September and October LRS rates for non-residential customers would be set above cost at 4.4¢ and 4.5¢, respectively. The Company justifies this pricing on the grounds that:

The Company has already under-recovered its costs for Last Resort Service. To the extent that the costs continue to exceed the price during the transition period, the deferral of cost recovery would grow. As a result, pricing the Last Resort Service at 4.5¢ would permit some of the under-recovery to be made up to the extent any customers are remaining on the rate. In addition, it would have the effect of encouraging customers to leave Last Resort Service and purchase power in the market. Last Resort Service was not designed as an alternative to the market. Rather, it was designed to be a "last resort" for those customers who are unable to find a supplier.<sup>90</sup>

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<sup>90</sup> Narr. Ex.1, Testimony of P.T. Zschokke, p. 6.

The Commission agrees with the Company that a LRS rate of 4.5¢ (or the market price, if higher)<sup>91</sup> is more appropriate. To the extent that actual power costs decline in the autumn months below the LRS rate, there will be an opportunity to recoup some portion of the LRS under-recovery that is expected to accumulate over the summer months. It will also produce a uniform 4.5¢ LRS rate over the current LRS supply contract period, with the exception of the months of July and August which have costs tied to the prevailing market price. Accordingly, the Commission finds that a LRS rate of 4.5¢ (or market price, if higher) for usage on and after September 1, 2000 is just and reasonable.

Based upon the cost estimates provided by the Company for the current LRS supply contract period, the LRS rates approved by the Commission compare to the various LRS rate proposals as follows:

#### COMPARATIVE RATES

<u>MONTH</u>	<u>AVERAGE COST OF POWER</u>	<u>PROPOSED RATES COMPANY</u>	<u>DIVISION</u>	<u>COMMISSION FINDINGS<sup>92</sup></u>
June 2000	6.5¢	4.1¢	4.5¢	4.5¢
July	9.2¢ (est.)	4.2¢	7.2¢ (est.)	6.5¢ (est.)
August	8.9¢ (est.)	4.3¢	6.9¢ (est.)	6.4¢ (est.)
September	4.0¢	4.4¢	4.0¢	4.5¢
October	3.6¢	4.5¢	3.6¢	4.5¢

<sup>91</sup> The provision setting the LRS rate at the market price, if higher than 4.5¢, would not be triggered during the term of the current LRS supply contract because under this contract, the market prices (cost) for September and October are 4.0¢ and 3.6¢, respectively. This provision would be triggered only if the approved LRS rate continues in effect after a new LRS supply contract is executed and the new contract has market prices in excess of 4.5¢.

<sup>92</sup> On May 26, 2000, Narragansett filed a proposed rate change to increase the Standard Offer Service rate to 4.1¢ on July 1, 2000. Any change in the Standard Offer rate would result in a change in the LRS rate for the months of July and August 2000.

The LRS rates approved by the Commission are within the range of LRS rates proposed by the Company and the Division, with some advantages over each. In addition to the advantages mentioned above, the approved LRS rates are lower than the Division's proposed rates for July and August and higher than the Division's proposed rates for September and October. Thus, the approved LRS rates are more directly tied to LRS power supply costs and yet, are more stable than the rates proposed by the Division. Moreover, based upon the Company's projected LRS sales and current contract supply prices, the LRS under-recovery produced by the approved rates is expected to be within 5% of the LRS under-recovery produced by the Division's rate proposal.<sup>93</sup>

## **VII. CONTRACT ISSUES**

The URA requires each electric distribution company to provide LRS to its customers. The URA provides in relevant part:

The electric distribution company shall periodically solicit bids from nonregulated power producers for such service at market prices plus a fixed contribution from the electric distribution company. Acceptance of bids by the electric distribution company and the terms and conditions for such last resort service shall be subject to approval by the Commission. The bids requiring the lowest fixed contribution from the electric distribution company shall be accepted.<sup>94</sup>

While it appears that the purpose of this statutory provision is to assure selection of the lowest-cost LRS power supply available, cost cannot be the only consideration.

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<sup>93</sup> The LRS under-recovery is \$2,705,303, and is derived by multiplying the approved LRS rates times the sales volumes projected by the Company (Narr. Ex. 1, PTZ- 2, col. (a)) to arrive at total LRS revenues of \$13,774,447 less total supply costs of \$16,479,750 (Id., col. (c)).

<sup>94</sup> R.I.G.L. §39-1-27.3(f).

The Commission has emphasized that “the quality and reliability of service not be compromised. The bidding procedure must give consideration to the bidder’s resources and the bidder’s ability to provide a reliable supply of power. Lower prices that come at the cost of reliability and quality of service are unacceptable.”<sup>95</sup>

The Company’s RFP for the LRS power supply stated that the selection criteria would include both the bid price and the “financial and operational viability of the LRS power supply.”<sup>96</sup> This is consistent with the Commission’s statement on the selection of suppliers.<sup>97</sup> However, while the Commission finds that Narragansett has presented sufficient financial information to justify acceptance of the lowest bidder for the current LRS supply contract, it also finds that the Company lacks adequate procedures and standards to evaluate bidders on any basis other than price.<sup>98</sup> In this time of unstable markets,<sup>99</sup> when credit is a major risk,<sup>100</sup> a systematic review of the bidder’s “financial and operational viability” is essential. Therefore, all future filings for Commission approval of the Company’s acceptance of any LRS power supply bid shall contain a description of the procedures and standards that were followed to establish the financial and operational viability of the winning bidder<sup>101</sup>.

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<sup>95</sup> Order No. 521, (Docket Nos. 2651, 2657, 2514), dated July 10, 1998, at p. 14

<sup>96</sup> Narr. Ex.1, Ex. MJH-1, p. 10.

<sup>97</sup> Order No. 521, *supra*, p. 14.

<sup>98</sup> Tr. 5/19/00, p.m., pp. 78-86.

<sup>99</sup> Id., pp. 44, 47, 50.

<sup>100</sup> Id., p. 101.

<sup>101</sup> The filing should also contain a description of the procedures followed to select the parties invited to bid.

## VIII. UNRESOLVED MATTERS

Many issues involving the implementation of LRS service were not addressed in this proceeding and remain unresolved. In light of this, the Division has emphasized the need for a thorough discussion of future supply and pricing arrangements for LRS.<sup>102</sup> The URA authorizes the Commission to address these issues in a systematic manner by the promulgation of regulations to implement LRS.<sup>103</sup> The Commission intends to exercise this authority shortly by initiating a rulemaking on all aspects of LRS. The rulemaking will include but not be limited to the following issues:

1. What customers should be eligible to receive LRS?
2. Should there be different classes of LRS rates?
3. How often should supplier bids be obtained?
4. RFP standards and procedures.
5. What is the intent of the URA's requirement that electric distribution companies solicit bids to supply LRS power "at market prices plus a fixed contribution from the electric distribution company"?

Accordingly, it is

(16281) ORDERED:

1. That the Last Resort Service rate for the Company's non-residential customers for the month of June 2000 shall be 4.5¢ per kWh, effective for usage from June 1 through and including June 30, 2000.

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<sup>102</sup> Div. Ex.1, p. 3.

<sup>103</sup> R.I.G.L. §39-1-27.3(f).

2. That the Last Resort Service rates for the Company's non-residential customers for the months of July and August 2000 shall be equal to the estimated market price for Last Resort Service power supply for each month, as reported to the Commission no less than five (5) business days before the first day of such month, less a credit per kWh equal to the lesser of (i) one-half (50%) of the difference between the Standard Offer rate in effect for the applicable month and the estimated market price for Last Resort Service for such month, or (ii) 3¢ per kWh; such rates to be effective for usage on and after the first day of the applicable month.
  
3. That the Last Resort Service rates for the Company's non-residential customers for the months of September 2000 and beyond shall be the greater of (i) the estimated market price for the Last Resort Service power supply for the applicable month, as reported to the Commission no less than five (5) business days before the first day of such month, or (ii) 4.5¢ per kWh; such rates to be effective for usage on and after the first day of the applicable month.
  
4. That Last Resort Service for the Company's residential customers shall continue to be priced at the Standard Offer Service rate as in effect from time to time.

5. That the Company's acceptance of the bid of Southern Company Energy Marketing, L.P., to supply Last Resort Service power for the May through October 2000 contract period is hereby approved.
6. That the Company shall comply with all other findings and instructions contained in this Report and Order.

EFFECTIVE AT PROVIDENCE, RHODE ISLAND PURSUANT TO OPEN MEETING DECISIONS ON MAY 31 AND JUNE 13, 2000. WRITTEN ORDER ISSUED JUNE 16, 2000.

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