DE 03-175

PUBLIC SERVICE COMPANY OF NEW HAMPSHIRE

Transition Service Rate Proceeding

Order Following Mid-Year Hearing

O R D E R N O. 24,358

August 2, 2004

APPEARANCES: Gerald M. Eaton, Esq. for Public Service Company of New Hampshire; McLane, Graf, Raulerson & Middleton, P.A. by Steven V. Camerino, Esq. for Constellation New Energy, Inc. and Constellation Power Source, Inc.; Office of Consumer Advocate by F. Anne Ross, Esq. on behalf of residential ratepayers; and Donald M. Kreis, Esq. of the Staff of the New Hampshire Public Utilities Commission

I. BACKGROUND AND PROCEDURAL HISTORY

In Order No. 24,252, entered in this docket on December 19, 2003, the New Hampshire Public Utilities Commission (Commission) established a Transition Service rate of 5.36 cents per kilowatt-hour for customers of Public Service Company of New Hampshire (PSNH) for the one-year period beginning on February 1, 2004. The Commission explicitly left open the possibility of adjusting the PSNH Transition Service rate effective on August 1, 2004 at the request of any party or the Commission Staff, but specified that any such adjustment would not vary the methodology approved in Order No. 24,252. Order No. 24,252, slip op. at 28-30. PSNH filed an adjustment request on July 1, 2004, proposing a new Transition Service rate of 5.94 cents per kilowatt-hour.

Transition Service is "electricity supply that is available to existing retail customers prior to each customer's first choice of a competitive electricity supplier, and to others, as deemed appropriate by the commission." RSA 374-F:2, V. The other two major charges appearing on the bills of PSNH customers are also currently under review by the

Commission. In Docket No. DE 03-200, the Commission is considering proposed changes in PSNH's Delivery Service charge. In Docket No. DE 04-071, the Commission is conducting a reconciliation of PSNH's Stranded Cost Recovery Charge (SCRC). Hearings in the former proceeding are scheduled for August 3-6, 2004. Hearings in the latter case are scheduled for early October.

PSNH made a second filing in this docket on July 1, 2004. The additional filing was a consented-to motion to amend Order No. 24,252 with respect to the requirement stated therein for PSNH to maintain certain coal inventory at its two coal-fired generation facilities, Schiller Station in Portsmouth and Merrimack Station in Bow.

The Commission entered Order No. 24,344 on July 6, 2004, establishing a procedural schedule for consideration of both the PSNH request to revise the Transition Service Rate and its motion to amend Order No. 24,252. In Order No. 24,344, the Commission scheduled a technical session for July 15, 2004, a deadline of July 21, 2004 for the filing of responsive testimony with respect to either filing and a hearing date of July 26, 2004.

The technical session took place as scheduled. On the same date, the Commission received via electronic mail a request from Executive Councilor Raymond Burton for an additional public hearing, to be conducted in his district, with respect to the rate increases contemplated in this docket and Docket No. DE 03-200. Accordingly, the Commission scheduled such a hearing for July 28, 2004 at the Twin Mountain Town Hall.

Staff submitted responsive testimony on July 21, 2004. The hearings established for July 26 and 28, at the Commission's offices and in Twin Mountain respectively, took place as scheduled. Concerns expressed at the July 28, 2004 public hearing focused on the paper industry and the negative impacts of increased rates.

On July 26, 2004, subsequent to the hearing conducted on that date, the Commission received a letter from Senator Theodore Gatsas expressing concern about the proposed upward revision to the Transition Service rate. Senator Gatsas expressed the concern that what PSNH describes as an under-collection might, in fact, reflect costs that should really be borne by PSNH's shareholders because they were not actual, prudent and reasonable as required by RSA 369-B:3, IV(b)(1)(C). In particular, Senator Gatsas referenced costs associated with PSNH's coal supply as well as costs billed to PSNH by the independent system operator, ISO-New England.

II. POSITIONS OF THE PARTIES AND STAFF

A. Public Service Company of New Hampshire

PSNH proposes revising the Transition Service rate upward from its present level of 5.36 cents per kilowatt-hour to 5.94 cents. According to the technical statement appended to the PSNH request, such a change would provide approximately $23.54 million in additional Transition Service revenue between August 1, 2004 and January 31, 2005. According to PSNH, this revision is justified because of additional forecasted costs of $28.5 million, offset by a forecast net $5 million of higher-than-estimated Transition Service revenues. The $28.5 million of additional forecasted costs is comprised of an estimated $12.5 million in forward prices for wholesale energy on the regional market, $9 million in higher coal costs due to supply constraints, $4 million in higher expenses associated with ISO-New England (operator of the regional electricity grid), $2 million in higher costs associated with emissions allowances and $1 million in higher-than anticipated oil consumption costs at Schiller Station.

According to PSNH, both on-peak and off-peak energy for forward purchase was trading higher at the time of its July 1 filing than it was in December of 2003 when the current

Transition Service price was established. PSNH avers that energy costs have also risen as the result of transmission congestion as well as losses reflected in the region's newly implemented Locational Marginal Price (LMP) system with respect to wholesale energy.

PSNH blames its increased coal cost on the loss of certain shipments from Venezuela as the result of *force majeure* – specifically, heavy rains that caused flooding at a coal mine of PSNH's Venezuelan supplier of low-sulphur coal. According to PSNH, replacement prices on the spot market were approximately double the contract price.

The PSNH technical statement further reported that the $4 million in additional ISO-New England expenses arises out of the omission of certain expenses from the estimates reflected in the current rate. In addition, PSNH points to increased ISO-New England costs in connection with revised estimates of regulation and operating reserve charges as well as the introduction by ISO-New England of a mandatory forward reserve market. The higher emissions costs, according to PSNH, reflect costs associated with unanticipated load. Finally, PSNH stated that the increased oil costs for Schiller Station reflect the cost of using oil at the facility to maximize the full capacity of the facility while keeping it economic to dispatch Schiller Station.

At hearing, PSNH introduced an exhibit that updated its Transition Service pricing calculations to reflect more recent data. *See* Exh. 10. Although there were some changes from the calculations in the original filing, they offset each other such that PSNH's requested rate remained 5.94 cents. PSNH also noted at hearing that although its proposal differs from Staff's recommendation in one respect, discussed *infra*, it would not object if the Commission were to adopt Staff's view.

PSNH's assented-to motion concerns the requirements in Order No. 24,252 that PSNH (1) maintain an average coal inventory of 45 to 60 days' supply at Schiller Station based on an average minimum inventory level that takes into account inventory spikes resulting from large seaborne shipments, (2) maintain a minimum coal inventory at Schiller Station of 30 days' supply, with the supply of coal at Schiller and the amount of coal at Merrimack in excess of that facility's required inventory used to satisfy this requirement. *See* Order No. 24,252, slip op. at 33. The latter requirement takes into account PSNH's ability to truck coal between the two facilities with relative ease given their proximity to one another.

According to PSNH, it has been meeting the Schiller Station inventory requirement by storing from 30,000 to 50,000 tons of coal in the upper coal storage yard at the Portsmouth facility. PSNH notes that the Commission recently approved the Company's request in Docket No. DE 03-166 to modify the Unit No. 5 boiler at Schiller Station to allow the unit to burn wood as well as coal and oil. PSNH reports that the construction associated with the project will render the upper coal storage yard unusable. PSNH further reports that the remaining storage capacity at Schiller, i.e., the lower storage yard immediately adjacent to the plant, does not have sufficient capacity to (1) hold at least 45 days of supply for all three boilers at Schiller, (2) transship low-sulfur coal to Merrimack Station and (3) accept new shipments from oceangoing vessels. Accordingly, PSNH requests authority to modify the inventory requirement so as to allow the Company to maintain the average minimum inventory of 45 to 60 days with both inventory at Schiller and excess inventory at Merrimack. PSNH requests this change only on a temporary basis, during the construction approved in Docket No. DE 03-166.

B. Staff

The pre-filed testimony submitted by Staff adopted PSNH's recommendations with one significant exception. Staff urged the Commission not to adjust the Transition Service rate for the remainder of the period to include the approximately $6.2 million in undercollections arising out of the February-June period. According to Staff, excluding this undercollection would yield a Transition Service rate of 5.79 cents per kilowatt-hour.

In Staff's view, including the undercollection in the adjusted Transition Service rate would be at variance with the principle that the rate charged during a particular period should reflect PSNH's cost of providing Transition Service during the same period. Staff noted that, had a similar rate adjustment been made a year ago, including the relevant undercollection in the adjusted rate would have involved a revenue deficiency of $40.8 million, as opposed to the $6.2 million at issue here.

Staff conceded that if a goal of this midyear review is to minimize deferrals, one could make the argument that undercollections should be added to the midyear rate calculations because they result in deferrals whereas overcollections should not be treated in this manner because they do not cause deferrals. However, Staff expressed the view that such treatment would be "unbalanced" and would "continue to blur the line regarding PSNH's actual prudent and reasonable costs," the statutory standard by which the Transition Service rate is calculated. Exh. 11 at 6.

Staff noted that minimizing deferrals is a stated objective in Order No. 24,252 for conducting a midyear review of the Transition Service rate. However, according to Staff, this objective is advanced under Staff's alternative because the new Transition Service rate will result in smaller deferrals as compared to the situation that would arise out of not changing the Transition Service rate at midyear. Staff also argued that its approach would further the objective of rate stability. In Staff's view, this is an appropriate outcome given the likelihood of Delivery Service rate increases in October 2004 and June 2005 as contemplated by the settlement agreement on file in Docket No. DE 03-200 and presently before the Commission.

C. Constellation New Energy, Inc. and Constellation Power Source, Inc.

Intervenors Constellation New Energy, Inc. and Constellation Power Source, Inc. (collectively, "Constellation") did not sponsor testimony. However, Constellation indicated at hearing that it supports PSNH's proposed inclusion of the accumulated undercollection in the Transition Service rate for the remainder of the rate year. In the view of Constellation, revising the Transition Service rate now to account for the undercollection is particularly appropriate given that, unlike in similar rate adjustment proceedings applicable to other utilities, PSNH does not simply collect interest on any deferral balances but earns the stipulated rate of return on such amounts as specified in the Agreement to Settle PSNH Restructuring (Restructuring Agreement) approved by the Commission in Docket No. DE 99-099.

Constellation further urged the Commission to limit its ruling to the question of how to treat Transition Service undercollections, as opposed to overcollections. According to Constellation, there are policy reasons for treating overcollections in a different manner, because they do not trigger deferrals. But, in any event, it is not a question the Commission presently confronts and Constellation therefore urged the Commission not to decide it here.

D. Office of Consumer Advocate

The OCA did not present any witnesses but urged the Commission to adopt the PSNH proposal. The OCA stressed the objective of minimizing deferrals as adopted by the Commission in Order No. 24,252. The OCA further stressed PSNH's testimony at hearing to the effect that the prudence of any Transition Service costs incurred by PSNH is not at issue in this docket and will be resolved in a future SCRC reconciliation proceeding.

III. COMMISSION ANALYSIS

As noted in Order No. 24,252, PSNH's Transition Service rate is no longer legislatively determined but, rather, is set by the Commission to reflect the Company's "actual, prudent and reasonable" cost of providing the service. *See* Order No. 24,252, slip op. at 22 (citing RSA 369-B:3, IV(b)(1)(B)(ii)). Order No. 24,252 makes clear that such a determination takes place against the backdrop of the policy principles set forth in the Electric Industry Restructuring Act, see RSA 374-F:3, including the objective of maintaining the option of "stable and predictable ceiling electricity prices" during the transition to retail competition, see RSA 374-F:3, V(b) and Order No. 24,252, slip op. at 27.

Additionally, the legislatively approved objective of minimizing deferrals, see RSA 369-B:3, IV(b)(1)(E), was central to the determination that PSNH's Transition Service rate could be reviewed at the midpoint of the rate year on request of a party or Staff. See Order No. 24,252, slip op. at 28-29. The Commission was careful to note both that an adjustment was not inevitable even if requested and that review would be "limited to a consideration of whether it is in the public interest to adjust the transition service rate using the methodology" approved at the beginning of the rate year. *Id.* at 29-30.

In light of the legal and policy framework set forth in Order No. 24,252, the parties and Staff are in agreement that a midyear adjustment to the PSNH Transition Service rate is appropriate. Setting aside the question of whether the expenses of PSNH in connection with providing Transition Service thus far in the rate year have been incurred prudently, there is agreement that PSNH's costs during the first half of the rate year were greater than predicted at the time Order No. 24,252 was issued and that prices in the forward market for wholesale electricity justify a determination that costs will be increasing further from now through the end of January 2005. We agree that in these circumstances, the objective of setting Transition Service prices based on PSNH's actual, prudent and reasonable costs is well-served by an upward adjustment in the Transition Service rate at this time. We note in passing our agreement with OCA and Staff that such a determination, as made here, does not foreclose the possibility of some Transition Service expenses being disallowed as imprudent when PSNH's SCRC is reconciled for the relevant period next year.

Thus, the only disputed question here is whether the $6.2 million in undercollections accumulated by PSNH so far in the Transition Service rate year should be included in the rate adjustment and, thus recovered from customers during the remainder of the rate year. Pursuant to the Restructuring Agreement, opting for the latter course would have the effect of leaving the $6.2 million to be recovered, via the SCRC, as a so-called Part 3 stranded cost.

The challenge before us is how best to balance competing policy objectives, which include, avoiding deferrals, providing rate stability and rate continuity, mitigating rate impacts, and providing for recovery of reasonable and prudent costs. The parties appear to be generally agreed that we are neither prescribed to adopt nor proscribed from adopting either of the two recommendations presented to us, and we agree that the Commission has broad discretion in setting the appropriate rate level here.

A significant aspect of the challenge in setting the appropriate rate level results from the attendant difficulty of accurately forecasting energy costs. The provision in Order No. 24,252, establishing the possibility of an update recognized that difficulty and, in fact, although we have more recent data, the potential volatility in forward market prices is generally acknowledged.

In light of the inherent difficulty of forecasting energy costs, and the fact that the underlying reasonableness and prudence of the Company's actions with respect to those costs will not be addressed until a subsequent hearing in another proceeding, we find that a balancing of the objectives of avoiding deferrals and providing rate stability requires a pass-through of an amount less than that proposed by PSNH. Given the record before us, we will allow an increase in the Transition Service Rate in the amount recommended by Staff, but this action should not be interpreted as an adoption of the principle that under- recoveries in the early months of a Transition Service period should be deferred for recovery as a stranded cost. Rather, this action should be interpreted as an application of the Commission's responsibility to balance various interests.

Finally, we grant PSNH's assented-to motion with respect to modifying the Company's obligation to maintain a coal inventory. RSA 365:28 authorizes us to amend a previous order of the Commission after notice and hearing. We exercise that authority here, noting that the imperative remains to assure that PSNH has an adequate supply on hand to meet the needs of its two coal-burning facilities. As noted in Order No. 24,252, the two facilities are sufficiently near each other to permit the shifting of fuel inventory between them, even on short notice if necessary. In these circumstances, and given the logistical considerations occasioned by the boiler conversion project we approved in Docket No. DE 03-166, the modification requested by PSNH is reasonable and consistent with the public good.

Based upon the foregoing, it is hereby

ORDERED, that the request of Public Service Company of New Hampshire for modification of its Transition Service rate applicable through January 31, 2005 is **GRANTED**

IN PART and, accordingly, the Transition Service rate shall be 5.79 cents per kilowatt-hour effective on August 1, 2004; and it is

FURTHER ORDERED, that the motion of Public Service Company of New Hampshire to modify the requirements of Order No. 24,252 with respect to coal inventory is GRANTED; and it is

FURTHER ORDERED, that Public Service Company of New Hampshire file a compliance tariff within three business days of the entry of this order.

By order of the Public Utilities Commission of New Hampshire this second day of August, 2004.

Thomas B. Getz Chairman	Graham J. Morrison Commissioner

Attested by:

Debra A. Howland
Executive Director and Secretary