

DE 05-064

UNITIL ENERGY SYSTEMS, INC.

**Petition for Approval of a Default Service Supply Proposal for G1 and Non-G1 Customers
and Approval of Solicitation Process**

Order Approving Settlement Agreement

ORDER NO. 24,511

September 9, 2005

Appearances: Gary M. Epler, Esq., for Unitil Energy Systems, Inc.; Michael S Giamo, Esq., for the Business & Industry Association; McLane, Graf, Raulerson & Middleton by Steven V. Camerino, Esq. for Constellation NewEnergy, Inc.; F. Anne Ross, Esq. for the Office of Consumer Advocate; and Suzanne Amidon, Esq. for Commission Staff

I. PROCEDURAL HISTORY

On April 1, 2005, Unitil Energy Systems, Inc. (Unitil) filed with the New Hampshire Public Utilities Commission (Commission) a Petition for Approval of Default Service Supply Proposal for G1 and Non-G1 Customers, and Approval of Solicitation Process. In support of its Petition, Unitil submitted testimony of Robert Furino and Karen Asbury and sample forms of the proposed power supply agreement (PSA), the proposed request for proposal (RFP), a proposed solicitation schedule, a proposed form of tariffs, a sample rate calculation, and provisional terms to address the uncertainty around the locational installed capacity (LICAP) market.

On April 11, 2005, the Office of Consumer Advocate (OCA) notified the Commission of its intent to participate. On April 22, 2005, both Constellation NewEnergy, Inc. (Constellation) and the Business & Industry Association of New Hampshire (BIA) petitioned to intervene in this docket.

The prehearing conference was held as scheduled on April 26, 2005. Following the prehearing conference, the Parties and Staff met in technical session to establish a procedural schedule for the docket. On May 2, 2005, Staff filed a proposed procedural schedule with the Commission and on May 13, 2005, the Commission issued Order No. 24,427, which adopted the proposed procedural schedule. Order No. 24,427 also granted Constellation's and BIA's petitions to intervene.

Pursuant to the procedural schedule, Staff submitted the pre-filed testimony of George R. McCluskey on July 8, 2005. On July 21, 2005, Unitil filed a Motion for Confidential Treatment in connection with its response to certain data requests submitted by the OCA. Also on July 21, 2005, Unitil, the OCA and Staff met in a settlement conference, which led to a Settlement Agreement among Staff, Unitil and the OCA. On August 9, 2005, Staff filed a letter with the Executive Director requesting a waiver of rule N.H. Admin. Rule Puc 203.09, which requires a settlement agreement to be filed no less than 5 days before the date of the hearing in the matter. The Staff filed the Settlement Agreement with the Commission on August 11, 2005.

The Commission held a hearing in this matter as scheduled on August 16, 2005. Staff, OCA and Unitil presented the Settlement Agreement to the Commission at the August 16, 2005 hearing. At the hearing, Unitil also introduced a revised PSA and RFP and related bid documents, reflecting the terms of the Settlement Agreement and the change in the solicitation schedule made by Unitil as a result of the procedural schedule and concerns about the potential

implementation of LICAP¹. Constellation presented public comment in support of the Settlement Agreement and the BIA filed a letter with the Commission on August 16, 2005 expressing the BIA's support for Unitil's petition as modified by the Settlement Agreement.

II. POSITIONS OF THE PARTIES AND STAFF

A. Unitil

Pursuant to terms of the Settlement Agreement in Docket No. DE 01-247, Order No. 24,046 (August 28, 2002), Unitil solicited for and is currently providing Transition Service (TS) and Default Service (DS) for two customer groups: G1 customers, Unitil's large commercial and industrial customers; and Non-G1 customers. The term originally established for TS and DS was three years for the Non-G1 customers (May 1, 2003 through April 30, 2006) and 2 years for the G1 customers (May 1, 2003 through April 30, 2005).

On January 7, 2005, the Commission issued Order No. 24,420 in Docket No. DE 01-247, which approved Unitil's petition for a one-year extension from May 1, 2005 through April 30, 2006, of TS and DS for G1 customers, and Unitil's proposal to solicit TS and DS supplies for G1 customers through two semi-annual solicitations for a six-month supply periods commencing May 1, 2005 and November 1, 2005. Order No. 24,420 also approved Unitil's proposal to subdivide, for retail pricing purposes only, the G1 class into two subgroups as follows: Large G1, comprising those customers experiencing an average metered monthly 15 minute peak kVA demand of equal to or greater than 1,000 kVA; and Small G1, comprising those customers experiencing an average metered monthly peak kVA demand for the same

¹ The Independent System Operator-New England (ISO-NE) intended to implement LICAP January 1, 2006. ISO-NE's LICAP plan was heard before an Administrative Law Judge who issued an Initial Decision on June 15, 2005. FERC had expected to release its decision by September 15, 2005. As a result, Unitil changed its release date of the RFP to September 20, 2005. On August 10, 2005, FERC issued a decision that granted oral argument on the Initial Decision and announced that it would delay implementation of LICAP at least until October 1, 2006.

period of less than 1,000 kVA. The Order also granted Unitil the right to price TS and DS supply for Large G1 customers at monthly variable prices and to price supply for Small G1 customers at fixed prices for a six-month term, with an option for Small G1 customers to elect monthly variable pricing.

Unitil notes that these arrangements expire on April 30, 2006 when, pursuant to requirements of RSA 374-F:3,V(b), TS power supply arrangements end for all electric customers. Unitil therefore petitions the Commission for approval of its Default Service Supply Proposal (Proposal) for its G1 and Non-G1 customers beginning on May 1, 2006.

In its petition, Unitil proposes to supply DS by soliciting full requirements wholesale power supply on a quarterly basis by issuing RFPs. Unitil states that it will follow the solicitation process approved by the Commission in Order No. 24,420 (January 7, 2005) including the procedures for market notification of the RFP, distribution of the RFP, providing potential bidders with appropriate and accessible information as well as flexibility with regard to contracting options, provision of historic and projected load information, regular telephonic and electronic communication to promote bidder interest, a request for indicative bids, a review of the proposals to establish and evaluate bidders' creditworthiness, ensuring extension of adequate credit to Unitil to facilitate the transaction, ensuring bidder capability of performing the terms of the RFP in a reliable manner, ensuring bidder willingness to enter into contractual terms acceptable to Unitil, basing the selection of a winning bidder on both quantitative and qualitative criteria, and notifying all bidders once a winning bid has been selected.

For G1 customers, Unitil proposes to continue to issue RFPs on a quarterly basis to solicit three-month DS power supply contracts. Unitil asserts that the resulting power supply

contracts would have fixed monthly prices for a three-month term. Unitil states that it intends to continue, for retail pricing purposes only, the subdivision of the G1 rate class into Large G1 and Small G1 as approved by the Commission in Order No. 24,420. As a result, Unitil proposes that Large G1 customers automatically receive DS at the “G1 Variable Default Service Charge” (G1 Variable Charge) which will vary from month to month reflecting the monthly variable wholesale price. Unitil states that, unlike the Large G1 customers, Small G1 customers would receive supply at a fixed rate calculated on the basis of weighted average monthly bid prices across the three-month period. In the event that a Small G1 customer leaves Unitil’s DS before the three-month period is over, that customer’s bill will be recalculated using the G1 Variable Charge. Unitil further plans to offer Small G1 customers the option to receive supply at the G1 Variable Charge.

With respect to Non-G1 customers, Unitil proposes to implement a “portfolio” approach to secure supply. Unitil explains that bids would be solicited in four blocks, each representing 25 percent of Non-G1 requirements. Unitil indicates that two blocks will be purchased for three-year terms, and two blocks for one-year terms. Unitil states that retail pricing would be based upon a simple average of the wholesale pricing for each of the four blocks, and would be reset every six months as the composition of the contracts for the four blocks changes. Unitil proposes to ladder the contract blocks such that a new one-year block would be purchased every six months, and a new three-year block would be purchased every 18 months. Consequently, Unitil states, at least one contract term, representing 25 percent of Non-G1 requirements, would begin on May 1 and November 1 of each year. As Unitil proposes,

Non-G1 customers would automatically receive a single fixed price for six months of service beginning on May 1 and November 1 of each year.

Unitil states that capacity supplied by winning bidders would be priced separately based on ISO-NE's monthly LICAP market. Under this proposal, Unitil indicates that it would bill capacity costs on a pass-through basis, rather than as a fixed price per unit. For rate-setting purposes, Unitil proposes to use estimates of capacity costs, which would be reconciled with actual costs each time the DS rate would normally be subject to change (semi-annually for Non-G1 customers and quarterly for G1 customers).

Unitil also requests the Commission to clarify that, subject to the Commission's ongoing duty to act in the future according to law, and the obligation of Unitil to act according to law, including Unitil's duty to act prudently, the approval of such rates will mean that the payments for the supply of DS set forth in the PSA to be paid by Unitil to the supplier in exchange for the performance of its obligations under the PSA will be fully recoverable in Unitil's retail rates, provided that the supplier in fact performs its obligations under the PSA.

B. Business & Industry Association

Although the BIA did not participate in the settlement discussions and is not a party to the Settlement Agreement, BIA filed a letter on August 16, 2005 with the Commission indicating its support for the Settlement Agreement. The BIA based its support on several characteristics of Unitil's proposal, as amended by the Settlement Agreement. Specifically, BIA stated that the DS service proposal: (i) will not result in stranded costs; (ii) will enhance market transparency; (iii) will reduce customer migration price premiums; (iv) recognizes the value in

investigating hourly prices for large customers; and (v) balances competition with consumer protection.

C. Constellation NewEnergy, Inc.

At the August 16, 2005 hearing, Constellation expressed support for the Settlement Agreement, particularly the proposal to solicit power for G1 customers on a quarterly basis. Constellation contended that this feature will enable suppliers to match or beat the DS price and also offer customers the type of products they desire. In addition, Constellation stated its support for the proposal to recover the costs to administer DS through the DS rate. Constellation opined that Unitil's combined procurement and cost recovery plan would help promote the development of a competitive market.

D. OCA

OCA participated in the settlement discussions and agreed with Commission Staff regarding the recovery of administrative costs through the DS rate. OCA also supported Unitil's plan for the Non-G1 class, which OCA expects will result in more stable prices for residential customers. OCA is a signatory to the Settlement Agreement.

E. Commission Staff

Staff contends that the language in RSA 374-F suggests that DS should be backup or last resort service and that it should be priced so as to not compete with competitive market offerings. To avoid competing with the market, it states that DS prices should be reasonably reflective of current market prices. In order to balance the tensions in RSA 374-F:3, V between the desire to promote retail competition and the desire to minimize customer risk, Staff argues that the Commission should recognize and reflect in its decisions the fact that some customers

are more capable of responding to market price signals and have more competitive options than other customers.

In order to promote retail competition for G1 customers, Staff witness McCluskey states that, among other things, DS prices must reflect wholesale market prices and recover the administrative costs of providing the service. Mr. McCluskey also contends that DS providers must refrain from offering products that compete with offerings from competitive suppliers. With respect to Unitil's proposed DS service, Mr. McCluskey concludes that Unitil had proposed reasonable plans to provide DS to customers beginning May 1, 2006, but did not agree with all elements of that proposal. Mr. McCluskey recommends four changes as follows:

- The administrative costs relating to the design and implementation of DS be recovered from DS customers only;
- The power supply solicitation process be revised to require bidders to submit both energy-and-capacity and energy-only fixed priced bids so Unitil could determine whether the implicit price of capacity in the winning energy-and-capacity bid produces more value for customers than expected market capacity prices;
- DS prices to Small G1 customers reflect the same monthly fixed prices that Unitil proposed to charge Large G1 customers; and
- Unitil investigate the costs and benefits of obtaining the capability to price DS for Large G1 customers based on hourly wholesale market prices.

Mr. McCluskey observes that the Unitil proposal to use a portfolio of supply contracts to provide DS to Non-G1 customers has some advantages and disadvantages. The advantages are that small customers would receive the benefits of increased price certainty and term diversity. Mr. McCluskey notes that mixing together contracts with different start dates and terms tends to suppress price changes that result when long-term contracts terminate at the same time and are replaced by new contracts that reflect different market conditions. The disadvantages are that price certainty usually requires the purchaser to pay a premium.

Combining long-term contracts with different start dates and terms could also result in a widening of the gap between DS and market prices, which could delay the development of competitive retail markets to serve small customers. Mr. McCluskey concludes that because Non-G1 customers presently have few competitive alternatives, the increased price certainty and term diversity that results from the portfolio approach likely outweighs the disadvantages of this approach. For this reason, Mr. McCluskey recommends that Unitil's proposal be approved.

As noted above, Mr. McCluskey recommends that Unitil revise its power supply solicitation to require bidders to submit both energy-and-capacity and energy-only fixed price bids until such time as there are final LICAP rules and the capacity market has stabilized. Unitil had proposed to exclude the cost of LICAP from the fixed price bids because of the risk that potential wholesale suppliers would bid artificially high capacity prices. In Mr. McCluskey's opinion, with separate energy-only and energy-and-capacity bids, Unitil could make a professional determination as to whether the implicit price of capacity in the winning energy-and-capacity bid creates more value for customers than passing through to customers the monthly spot price of capacity.

At the Hearing held on August 16, 2005, Staff testified that the Settlement Agreement modified Unitil's petition by incorporating all four of Staff's recommendations. Staff also noted that the provision in the Settlement Agreement requiring bidders to provide energy-only and energy-and-capacity bids would apply once the LICAP rules are implemented.

III. SETTLEMENT AGREEMENT

In the Settlement Agreement, the Parties and Staff agreed that all administrative costs associated with the design and implementation of DS, including supply-related working

capital costs and supply-related bad debt costs, should be recovered from DS customers through DS rates. To effect this provision, the Settlement Agreement provides that, effective May 1, 2006, external company administrative costs included in the External Delivery Charge shall be transferred to DS rates. With respect to internal company administrative costs and supply-related working capital costs, the Parties and Staff agree that such costs shall be removed from distribution rates in conjunction with Unitil's next base distribution rate case. Effective at the time new distribution rates are implemented, internal company administrative costs shall be recovered through DS rates on a reconciling basis, beginning with the effective date for the new permanent distribution rates. The amount collected through DS rates shall equal the test year internal company administrative costs as adjusted annually based on changes to labor costs and associated overheads as compared to the test year amounts. In addition, the Parties and Staff agreed to meet prior to May 1, 2006 to discuss potential alternative mechanisms to address the risk that significant decreases in DS load might result in unacceptable bill impacts.

The Settlement Agreement includes Unitil's agreement to require bidders to submit both energy-and-capacity and energy-only fixed price bids until such time as there are final, non-appealable LICAP market rules and the capacity market has stabilized. As noted in Staff testimony, this provision resulted from the concern that the lack of final rules could result in suppliers bidding artificially high fixed capacity prices. Until the capacity market has stabilized, the Parties have agreed to meet during the two-week period between Unitil's receipt of indicative bids and the due date for final bids to review the implicit cost of capacity embedded in the bids received. Under the Settlement Agreement, if at such meeting the Parties and Staff

determine that the fixed price is too high, Unitil would procure capacity at the ISO-NE monthly market price and pass the associated costs through to customers.

The Settlement Agreement also incorporates Staff's recommendation that Unitil charge Small G1 customers the same monthly DS price that it charges Large G1 customers. Finally, Unitil agreed to investigate the costs of acquiring the capability to price DS for Large G1 customers based upon hourly wholesale market prices, as well as the potential impact on the development of the competitive retail market of offering such hourly pricing. Under the terms of the Settlement Agreement, Unitil shall report the results of this investigation to the Commission no later than November 1, 2006.

IV. COMMISSION ANALYSIS

At the outset, we address Unitil's Motion for Confidentiality and Protective Order (Motion). In its Motion, Unitil stated that, as part of its discovery responses, Unitil provided as Attachment OCA-UES 1-1 a copy of selected pages from its affiliate Fitchburg Gas and Electric Light Company's (FG&E) Default Service Bid Evaluation Report filed with the Massachusetts Department of Telecommunications and Energy (MDTE) on April 22, 2005. Unitil seeks protection of OCA-UES 1-1 from public disclosure because it presents a confidential and proprietary presentation of FG&E's analysis of the bids it received in response to its default service solicitation for its customers in Massachusetts. Unitil states that FG&E considers this to be confidential and proprietary commercial information and has not publicly disclosed this information in any other forum. Unitil argues that the disclosure of this information could compromise FG&E's ability to conduct successful default service solicitation in the future, harming its interests as well as the interests of its customers. Unitil further proffers that the

information it seeks to protect is exempt from public disclosure under the New Hampshire Right to Know statute, RSA 91-A. No one opposed the Motion.

We note that N. H. Code Admin. Rules Puc 204.06(c) provides for the confidential treatment of utility information when the utility provides evidence that the information is commercially or financially sensitive in nature. Puc 204.06(c)(2). We find that the information relating to the evaluation of bids by FG&E qualifies as commercially or financially sensitive to Unitil and note that it is exempt from disclosure pursuant to RSA 91-A:5(IV). Therefore, we will grant Unitil's Motion for Confidentiality and Protective Order.

In addition, we grant Staff's August 8, 2005 request for a waiver to Puc 203.09, which requires a settlement agreement to be filed 5 days before a hearing. Puc 203.09 would require that any settlement agreement in this docket be filed no later than August 8, 2005. Staff filed the Settlement Agreement on August 11, 2005. We find that waiver of Puc 203.09 in this instance serves the public interest and has not disrupted the orderly process of the proceedings.

As Staff noted in its testimony, the statutory transition service period expires April 30, 2006 for all customers in the state. Unitil has proposed to transfer all customers taking TS at that time to DS, which will also be available to customers that desire to return to utility service. The restructuring statute, in particular RSA 374-F:3(c), sets forth the elements we should look at to determine whether a DS proposal is in the public interest. According to the statute, DS must be designed to assure universal access and system integrity; it should be procured through the competitive market; and the administrative costs should be borne by the customers in a manner approved by the Commission. The statute further permits us to approve "alternative means of providing transition or default service which are designed to minimize

customer risk, not unduly harm the development of competitive markets, and mitigate against price volatility without creating new deferred costs” as the competitive market develops. RSA 374-F:3(e). We find that Unitil’s petition, as modified by the Settlement Agreement, meets the requirements of the law and is in the public interest.

Unitil’s proposal to provide DS service to Non-G1 customers using a laddered portfolio of long term contracts is one way to provide residential and small commercial customers some protection against price volatility. This is important because, as noted in Unitil’s petition, Non-G1 customers do not receive much attention from competitive suppliers, and therefore products that protect against price volatility are typically not available. However, one disadvantage of the portfolio approach is that the aggregation of several long-term contracts with different start dates and terms could widen the gap between DS prices and market prices, consequently slowing the development of a competitive retail market to serve small customers. While this is a concern, until there is more evidence of the market providing small customers with the products they need, we believe Unitil’s proposal for Non-G1 customers meets the requirements of the restructuring legislation. We remain open, however, to suggestions to create greater competitive opportunities for small customers.

The proposal to recover the costs to administer DS through the DS rate is also approved. The inclusion of administrative costs in the DS rate will result in the recovery of those costs from DS customers only, which is consistent with the restructuring statute and with the principle of cost causation. In addition, because competitive suppliers must recover their administrative costs through market prices, we believe the proposal will help promote the development of retail competition.

We also approve the proposal to price DS for Small G1 customers at the same monthly prices that Unitil will charge Large G1 customers. Exposing Small G1 customers to monthly rather than quarterly prices should encourage them to seek out suppliers that offer lower prices and greater price stability. This is appropriate because the record indicates that these customers are better able to make informed supply decisions and have more competitive options than Non-G1 customers.

The Settlement Agreement also provides for the solicitation process to be revised to require bidders to submit energy-and-capacity and energy-only fixed price bids. We understand the purpose of this provision is to give Unitil the option to procure LICAP at fixed or spot market prices. Given the uncertainty generated by the lack of final LICAP market rules and the associated risk of unreasonably high capacity price bids, we find it reasonable and prudent for Unitil to compare the fixed capacity prices bid by potential suppliers with expected future prices in the LICAP market.

The last issue in the Settlement Agreement is the proposal to require Unitil to investigate the costs and benefits of obtaining the capability to price DS for Large G1 customers based on hourly wholesale market prices. Given that the Parties are not requesting authorization to implement hourly pricing at this time, we will approve the proposal.

Finally, we address Unitil's request regarding a clarification concerning the recovery of payments for the supply of DS set forth in the PSA to be paid by Unitil to the supplier in exchange for the performance of its obligations under the PSA. We indicated in DE 01-247, Unitil's Restructuring Docket, and again in Docket No. DE 04-107, that it is possible that in the future certain costs incurred in connection with the Supply Agreement may not be

recoverable in retail rates, “depending on, among other things, our judgment about whether they would be required to be paid under the Agreement, or are prudently incurred by Unitil in performing the Agreement, or would have been avoidable by Unitil through prudent action.” *See* Order No. 24,139 (March 14, 2003) and Order No. 24,420 (January 7, 2005). Consequently, when Unitil presents its Supply Agreement and the accompanying rates, we will review the rates pursuant to RSA 363:17-a. As part of our approval of Unitil’s petition, we will require submission of redlined copies of Unitil’s Supply Agreement highlighting any changes made to the version submitted on August 16, 2005.

Based upon the foregoing, it is hereby

ORDERED, that Unitil’s Petition for Approval of a Default Service Supply Proposal for G1 and Non G1 Customers and Approval of Solicitation Process as amended by the Settlement Agreement filed with the Commission on August 11, 2005 is hereby GRANTED; and it is

FURTHER ORDERED, that Unitil’s Motion for Confidentiality and Protective Order is hereby GRANTED; and it is

FURTHER ORDERED, that the determination as to protective treatment made herein is subject to the ongoing authority of the Commission, on its own motion or on the motion of Staff, any party or any member of the public, to reconsider this Order in light of RSA 91-A should circumstances so warrant; and it is

FURTHER ORDERED, that the proposed tariff pages are suspended and that Unitil shall file revised tariff pages following the solicitation reflecting the rates resulting from the solicitation process; and it is

FURTHER ORDERED, that the solicitation process is APPROVED subject to the conditions of the Settlement Agreement; and it is

FURTHER ORDERED, that the solicitation schedules set forth in Unital's petition, as amended, are APPROVED; and it is

FURTHER ORDERED, that the process for review and approval of the results of the solicitation process is APPROVED subject to the qualifications discussed in this Order.

By order of the Public Utilities Commission of New Hampshire this ninth day of September, 2005.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Michael D. Harrington
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary