

DE 05-126

GRANITE STATE ELECTRIC COMPANY

Petition for Approval of Post-Transition Default Service Proposal

Order Approving Petition as Modified by Settlement Agreement

ORDER NO. 24,577

January 13, 2006

Appearances: Colin Owyang, Esq. on behalf of Granite State Electric Company; F. Anne Ross, Esq. on behalf of the Office of Consumer Advocate; and Suzanne Amidon, Esq. on behalf of Commission Staff.

I. PROCEDURAL BACKGROUND

On August 1, 2005, Granite State Electric Company (Granite State) filed with the New Hampshire Public Utilities Commission (Commission) two Default Service plans for effect May 1, 2006, one for residential and small commercial customers and the other for medium and large commercial and industrial customers. Pursuant to RSA 374-F:2, Default Service is electricity supply for retail customers who are otherwise without an electricity supplier and are ineligible for Transition Service.

With its Petition, Granite State filed the testimony of Michael J. Hager, Vice President for Energy Supply for National Grid USA Service Company, the parent company of Granite State. Attached to Mr. Hager's testimony were the Proposed Form of Request for Proposals, the Proposed Form of Power Purchase Agreement (PPA), and the Proposed Procurement Schedule.

On August 8, 2005, the Office of Consumer Advocate (OCA) notified the Commission that it would be participating in the docket on behalf of residential ratepayers. The Commission issued an Order of Notice on August 19, 2005, scheduling a prehearing conference

for August 30, 2005. The following entities filed petitions to intervene, none of which were opposed: Until Energy Systems, Inc. (Unitil), Direct Energy Services LLP (Direct Energy), Select Energy, Inc. (Select Energy), Mirant Americas Energy Marketing, LP, the Retail Energy Supply Association, Freedom Partners LLC, Dominion Retail, Inc., the Business & Industry Association of New Hampshire, Constellation Energy Commodities Group, Inc., Constellation New Energy, Inc. and Public Service Company of New Hampshire.

The Commission held the prehearing conference as scheduled and granted all motions to intervene. Following the prehearing conference, the Parties and Commission Staff (Staff) met in technical session to commence discovery and to establish a proposed procedural schedule for the docket. Staff submitted the proposed schedule to the Commission on September 1, 2005, which was approved by Secretarial Letter on September 9, 2005.

In addition to the technical session held on August 30, 2005, following the prehearing conference, Staff and Parties met in technical sessions October 13 and November 3, 2005, and Staff engaged in three rounds of data requests. On November 18, 2005, Staff submitted a Settlement Agreement signed by Granite State, Staff and the OCA. On November 23, 2005, the Commission issued a Secretarial Letter rescheduling the hearing from November 29 to December 12, 2005.

II. POSITION OF THE PARTIES AND STAFF

A. Granite State Electric Company

Granite State is currently authorized to provide Transition Service (TS) and Default Service (DS) to its customers through April 30, 2006, pursuant to the requirements of RSA 374-F:3,V(b). Granite State proposed that upon the statutory expiration of TS on April 30, 2006, it reassign each customer receiving TS or DS to one of two DS plans to take effect May 1, 2006.

Granite State averred that it currently procures DS power supply as a load-following supply where the supplier is responsible for meeting all actual DS requirements. Accordingly, Granite State only procures power that is consumed by its DS customers and is not obligated to procure a minimum amount of supply nor is the supply capped. Granite State testified that the DS rate currently charged to customers consists of a fixed price that is uniform across all rate classes and can vary by calendar month. Granite State noted that although RSA 374-F:3 allows administrative costs to be reflected in DS rates, its administrative costs are not considered significant and therefore these costs have been recovered through the DS reconciliation mechanism and subsequently through its DS Adjustment Factor as approved by the Commission. Finally, Granite State asserted that it has historically billed DS customers on a bills-rendered basis, but that it is proposing to switch to a service-rendered basis to eliminate the delay between cost incurrence and cost responsibility when the DS rate varies from month to month. This proposal is consistent with the Commission's approval of service-rendered billing for Granite State DS in Order No. 24,539 in Docket No. 05-163.

In order to supply DS customers as of May 1, 2006, Granite State testified that it developed a proposal to solicit full requirements power contracts on a quarterly basis for the medium/large industrial and commercial customers (Large Customer Group), and semi-annually for the residential and small commercial customers (Small Customer Group). Granite State explained that each group comprises customer classes with comparable load shapes. Hence, the costs imposed on Granite State by each customer class within a group are likely to be similar.

According to Granite State's proposal, the resulting power supply contracts for the Large Customer Group will have three-month terms and fixed energy prices that will vary monthly. Granite State testified that it will supply the Small Customer Group with six-month contracts at rates based upon the weighted average of the monthly contract prices. Granite State attested that it was appropriate to provide price stability to customers in the Small Customer Group because of the lack of competitive supply options for such customers.

Due to the current uncertainty surrounding the future market rules for locational installed capacity (LICAP), Granite State initially proposed to pay suppliers for LICAP based on the spot prices for capacity set by the Independent System Operator - New England (ISO-NE). However, Granite State testified that it agreed to seek separate energy-only and energy-and-capacity bids to permit it to evaluate which approach offered the best value to retail customers. Granite State testified that this change is contained in the Settlement Agreement.

Granite State attested that it would distribute the RFP to all interested wholesale power suppliers. Granite State averred that it will continue to procure power supply for DS customers in conjunction with its Massachusetts affiliate's Request for Proposals (RFPs) issued for basic service in Massachusetts.

According to Granite State, the RFP and the Purchase Power Agreement will be substantially similar in form as those filed as attachments to Mr. Hager's testimony. Granite State averred that it will continue to procure DS power supply as a load-following supply where the supplier is responsible for meeting all actual DS requirements. It will only procure power that is consumed by its DS customers and will have no obligation to procure a minimum amount; there will be no cap on supply.

Granite State testified that it would select a winning supplier from those bidders that: 1) have demonstrated an ability to provide DS during the applicable delivery period; 2) have acceptable financial strength or provide required financial security; and 3) execute a power supply contract that is acceptable to Granite State. Of this pool of bidders, Granite State stated that the winning supplier will be the bidder that offers the lowest price for DS. In addition, Granite State attested that it would perform a qualitative review of each bidder's ability to provide services based on the following: past experience in providing similar services to Granite State or its affiliates or to other companies in New England; demonstrated understanding of the market rules related to the provision of DS; demonstrated understanding of its obligations under the proposed PPA; and, whether there are any past or present events that may adversely affect the bidder's ability to provide DS.

In its petition, Granite State proposed to recover administrative costs associated with the implementation of delivery of DS through the Default Service Adjustment Factor. However, based on settlement discussions with Staff and the OCA, Granite State agreed to recover administrative costs associated with the implementation of DS, including supply-related

working capital and supply-related bad debt costs, through the DS rates as set forth in the Settlement Agreement.

Granite State testified that it made two additional changes to its proposal based on discussions with Staff and OCA, both of which are part of the Settlement Agreement. The first change requires Granite State to investigate the costs of acquiring the capability to price DS for Large Customer Group customers with average annual billing demands in excess of 1 MW 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. Granite State affirmed its agreement to report the results of this investigation to the Commission no later than November 1, 2006. The second change requires Granite State to submit to the Commission for its approval the proposed retail rates, the proposed PPA, and a summary of the bids and the associated bid evaluation report no later than three days after conditionally executing the power supply agreement. Granite State affirmed its agreement to this provision and indicated that the Settlement Agreement also provides the Commission five days to consider the merits of the filing.

Granite State affirmed its agreement with all provisions of the Settlement Agreement and asked the Commission to approve the Settlement Agreement.

B. Direct Energy Services, LLP

At the hearing, Direct Energy stated its general support for the Settlement Agreement but expressed its concern with two provisions. First, Direct Energy noted that the language in the agreement requiring Granite State to seek bids for energy-only and energy-and-capacity provides that the requirement would remain in effect until such time as “final, non-appealable” capacity market rules were in place. Direct Energy requested that the word “non-

appealable” be eliminated in order to limit the time the requirement remains in effect. Direct Energy also questioned whether Granite State should be required to revise its RFP during periods when there are uncertainties related to changing market rules. Direct Energy suggested that Granite State be given the freedom to decide whether a change in the RFP is needed. Finally, Direct Energy recommended that, in the event Granite State did change its RFP, copies should be provided not only to the Commission but to intervenors as well.

C. Select Energy

Select Energy testified that it supported the Settlement Agreement but also shared the concerns expressed by Direct Energy.

D. The Office of Consumer Advocate

The OCA testified in support of the Settlement Agreement. The OCA stated its approval of the Company’s proposal to secure a six-month PPA for the Small Customer Group and to develop a fixed six-month rate for those customers. The OCA opined that the rate design would afford these customers price stability and indicated that was appropriate considering the paucity of competitive energy supply available to such customers. The OCA testified that, while Granite State’s proposal to solicit energy supply for the Small Customer Group every six months is different from the laddered portfolio approach developed by Unitil¹ for its small DS customers, the Commission should approve the Settlement Agreement. The OCA opined that the Granite State proposal provided the Commission the ability to investigate the results of the two approaches and to determine whether one was superior to the other.

The OCA did not object to Direct Energy’s request to eliminate from the Settlement Agreement the term “non-appealable” as it relates to market rules. OCA did not

comment on Direct Energy's suggestion to provide Granite State flexibility in deciding whether to revise the RFP when there are uncertainties related to changing market rules. Finally, the OCA stated its continued interest in promoting the development of a DS product based on the use of renewable resources.

E. Commission Staff

George McCluskey testified on behalf of Staff in support of the Settlement Agreement. Mr. McCluskey stated that, pursuant to RSA 374-F:3,V, DS service rates must be reasonably reflective of the competitive market. In addition, to balance the tensions in RSA 374-F:3,V, Mr. McCluskey acknowledged 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 others. Mr. McCluskey reviewed Granite State's proposal using these principles as guidelines. Based on his review, and his previous analysis of the Unitil DS RFP process in Docket No. DE 05-064, Mr. McCluskey recommended four fundamental changes to Granite State's proposal and noted that these recommendations are incorporated in the Settlement Agreement.

Mr. McCluskey recommended that the following changes be made to Granite State's proposal:

- The administrative costs relating to the design and implementation of DS be recovered from DS customers through the DS rate;
- The RFP process be revised to require bidders to submit both energy-and-capacity and energy-only fixed priced bids so that Granite State could determine whether the implicit price of capacity in the winning energy-and-capacity bid produces more value for customers than expected if capacity was obtained in the future at spot market prices;

¹ See Docket No. 05-064, Order No. 24,511 (September 9, 2005).

- Granite State submit a copy of the PPA and, on a confidential basis, its bid evaluation report, along with the resulting rates for review and approval by the Commission within three days of executing the PPA. The Commission would have five days to respond to such a request; and
- Granite State investigate the costs and benefits of obtaining the capability to price DS for Large G1 customers based on hourly wholesale market prices.

Mr. McCluskey concurred with Granite State's proposal to separate customers into two groups and to price service to each group differently. Mr. McCluskey noted that because customers in the Small Customer Group presently have few competitive alternatives, the use of a fixed rate for the six-month service term affords these customers increased price stability yet reasonably reflects prices in the competitive market.

Mr. McCluskey also opined that the use of energy-only and energy-and-capacity fixed price bids until such time as there are final LICAP rules will allow Granite State to determine whether the implicit price of capacity in the winning energy-and-capacity bids creates more value for customers than passing through to customers the monthly spot price of capacity.

Mr. McCluskey testified that requiring Granite State to file the PPA and, on a confidential basis, its bid evaluation report is necessary for the Commission to make an informed determination as to whether the bid process and the resulting selection of the supplier is in the customer's interest. Mr. McCluskey pointed out that Granite State currently enters into a binding PPA and subsequently informs the Commission of the resulting retail rates. Unitil, following a Commission-approved process, conditions the PPA on a Commission finding that the retail rates are reasonable and affords the Commission five days to make that determination. Mr. McCluskey contended that Granite State should use the same process as Unitil not for the sake of

uniformity but to provide the Commission an opportunity to evaluate the bid process and the resulting retail rates.

With respect to Direct Energy's suggestions, Staff agreed that when Granite State files a revised RFP with the Commission, it should also provide copies to the intervenors in this docket. However, with respect to Direct Energy's proposal to allow Granite State discretion as to whether to file any revisions to the RFP, Staff asserted that, for as long as uncertainty remained regarding the capacity market rules, Granite State must file with the Commission any revisions to subsequent RFPs, Staff did not comment on Direct Energy's suggestion that the word "non-appealable" be stricken from the Settlement Agreement. Finally, Staff affirmed its support for the Settlement Agreement and requested the Commission's approval.

III. SETTLEMENT AGREEMENT

In the Settlement Agreement, Granite State, the OCA 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. The Settlement Agreement provides that administrative costs associated with DS be recovered in DS rates through a "transfer" of such costs from the TS and DS reconciliation mechanisms and base distribution rates to DS rates beginning May 1, 2006. The Settlement Agreement further provides that the transferred costs be collected in DS rates.

The Settlement Agreement includes Granite State'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. Until the capacity market has stabilized, the Settlement Agreement provides that the OCA, Granite State

and Staff will meet during the one-week period between Granite State's receipt of indicative bids and the due date for final bids in order to review the implied cost of the capacity product embedded in the indicative bids received, and to solicit input on the expected spot market value of the capacity product.

The Settlement Agreement further provides that Granite State shall obtain approval from the Commission of the inclusion in retail rates of the amounts payable to the supplier. Accordingly, Granite State agrees to submit to the Commission for its approval the retail rates, the power supply agreement, a summary of the bids, and the bid evaluation report no later than three days after execution of the power supply agreement. The Commission is asked to issue a decision no later than five days after Granite State's submission.

Finally, the Settlement Agreement incorporates Staff's recommendation that Granite State 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, Granite State shall report the results of this investigation to the Commission no later than November 1, 2006.

IV. COMMISSION ANALYSIS

The statutory transition service period expires April 30, 2006 for all customers in the state. Granite State has proposed to transfer all customers taking TS at that time to DS, which will be available to new customers and customers that desire to return to utility service. The restructuring statute, in particular RSA 374-F:3(c), sets forth the elements we should consider 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 Granite State’s petition, as modified by the Settlement Agreement, meets the requirements of the law and is in the public interest.

Granite State’s proposal to provide DS service to customers in the Small Customer Group based on a six-month supply contract and at a fixed rate protects these customers by mitigating price volatility. This is important because, as noted in Granite State’s petition, small customers are unlikely to receive as much attention from competitive suppliers and therefore products that protect against price volatility will not likely be available. Although we approved a laddered portfolio approach for Unitil’s service to small DS customers, we recognize that there are different approaches to achieving price stability and that some may be better than others at promoting retail competition for small customers. For this reason, we will approve Granite State’s small customer rate design. We also remain open to proposals to offer DS using renewable energy sources as suggested by the OCA.

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 create a more level playing field and, as a result, help promote the development of retail competition.

The Settlement Agreement also requires that the solicitation process 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 Granite State the ability to procure LICAP at the lowest cost. 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 Granite State to compare the implicit fixed capacity prices bid by potential suppliers with expected future spot prices in the LICAP market.

The last issue in the Settlement Agreement is the proposal to require Granite State 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 to the Settlement Agreement are not requesting authorization to implement hourly pricing at this time, we will approve the proposal.

Finally, we approve the provision in the Settlement Agreement which requires Granite State to present the PPA, the accompanying rates, and the bid evaluation (on a confidential basis) for us to review pursuant to RSA 363:17-a. As part of our approval of the Settlement Agreement, we will require submission of redlined copies of Granite State's PPA, highlighting any changes made to the version submitted with this Petition.

We have considered the comments made at the hearing by Direct Energy and determined that, when Granite State files a revised RFP with the Commission, it shall also provide a copy to intervenors in this docket. However, we do not approve Direct Energy's

proposal to strike the word “non-appealable” with respect to the condition regarding bids for energy-and-capacity and energy-only bids. As a result, Granite State will be required to solicit energy-only and energy-and-capacity fixed-price products until such time as the Federal Energy Regulatory Commission issues a non-appealable rule.

Based upon the foregoing, it is hereby

ORDERED, that the Settlement Agreement among Granite State Electric Company, the Office of Consumer Advocate and the Commission Staff is hereby APPROVED; and it is

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

FURTHER ORDERED, that the solicitation schedule set forth in Granite State’s Petition, as amended, is APPROVED; and it is

FURTHER ORDERED, that the recommendations for changes presented by Direct Energy are REJECTED; and it is

FURTHER ORDERED, that the process for review and approval of the results of the solicitation process is APPROVED as amended by the Settlement Agreement.

By order of the Public Utilities Commission of New Hampshire this thirteenth day of January, 2006.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Clifton C. Below
Commissioner

Attested by:

ChristiAne G. Mason
Assistant Executive Director & Secretary