STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DE 12-003

UNITIL ENERGY SYSTEMS, INC.

Petition for Approval of Revisions to Default Service Solicitation Process for G1 and Non-G1 Customers

Order Following Hearing

ORDER NO. 25,397

July 31, 2012

APPEARANCES: Gary Epler, Esq. on behalf of Unitil Energy Systems, Inc.; the Office of Consumer Advocate by Rorie E.P. Hollenberg, Esq. on behalf of residential customers; and Suzanne Amidon, Esq. on behalf of Commission Staff.

I. PROCEDURAL BACKGROUND

This docket was opened on January 6, 2012 for the consideration of Unitil Energy System's (UES or Company) default service filings for calendar year 2012. On June 5, 2012, UES filed a petition, with supporting testimony and related exhibits, for approval of revisions to the processes it uses to procure default service power supply for its large commercial and industrial (G1) and its residential and small commercial (Non-G1) customers. With its petition, UES filed the supporting testimony and related exhibits of Robert S. Furino, the Director of the Energy Contracts department for Unitil Service Corp., an affiliate that provides management and administrative services to UES. UES proposed that these changes become effective with the solicitation of default service power supplies for November 1, 2012.

The Office of Consumer Advocate (OCA) previously entered an appearance at the March 14, 2012 hearing in this docket. The Commission issued a Supplemental Order of Notice on

June 29, 2012 scheduling a hearing for July 17, 2012 to specifically address the issues raised in UES's June 5 filing. The hearing was held as scheduled.

II. POSITIONS OF THE PARTIES

A. Unitil Energy Systems, Inc.

UES testified that it currently solicits default service pursuant to the terms of a settlement agreement approved by the Commission in Order No. 24,511 (September 9, 2005) as modified by Order No. 24,897 (September 19, 2008). Pursuant to the settlement, UES solicits 100% of default service load requirements for a three-month period for its G1 customers and establishes fixed monthly prices which vary from month to month. For Non-G1 customers, UES uses a portfolio of contracts and solicits blocks of 25% of load requirements every six months for either 12-month or 24-month periods. UES sets prices for Non-G1 customers for a six-month period based on the average cost of power in the portfolio of contracts. Non-G1 customers include residential customers, regular general (G2) customers and outdoor lighting (OL) customers.

UES's proposal would make the following changes to the current default service procurement structure: (1) move the effective date for default service supply contracts, and thus the request for proposals (RFP) issuance dates, forward by one month; (2) for Non-G1 customers, change the duration and percentage of Non-G1 load requirements to be purchased and split the Non-G1 load into small and medium customer groups, each of which would be contracted for separately; and (3) change the pricing structure for G1 customers from fixed pricing to variable pricing and change the duration of the supply purchases.

UES said that the solicitation process itself would remain the same. Under that process, the Company issues a separate RFP for the G1 and Non-G1 customers groups. Bidders respond by providing bids and UES conducts an analysis to determine which bidder provides the greatest value for the service sought. UES then notifies bidders, executes contracts and prepares its regulatory filing for the Commission to review and approve. UES testified that it would continue to issue RFPs for default service power supplies and would provide a similar filing following each solicitation seeking Commission approval of the recovery of the costs from the resulting contracts. The RFPs would remain the same except for conforming changes to reflect that proposed changes approved by the Commission, such as frequency of issuance, customer group composition and G1 pricing structure. UES stated that the Company would continue to recover the administrative and other costs it incurs in providing default service from customers, including costs to comply with New Hampshire's renewable portfolio standards statute (RSA 362-F).

UES testified that it is proposing to move its procurement cycle forward by one month to coordinate the solicitation for New Hampshire default service supply with that of UES's Massachusetts affiliate, Fitchburg Gas and Electric Light Company (FG&E). According to UES, the combination of the New Hampshire and Massachusetts solicitations will bring a larger load to market at one point in time and thereby attract more potential bidders. In addition, the Company stated that moving the procurement period forward by one month avoids conflicts with other solicitations occurring in the New England market, such as the default service solicitation of National Grid.

UES testified that the RFP for New Hampshire default service load requirements, while issued at the same time as the RFP for Massachusetts default service load requirements, would be solely for the New Hampshire customer groups. According to UES, the Company would separately evaluate bids by customer group block and would not award a bid to provide default service supply for New Hampshire that was contingent on the provision of any other service.

The Company opined that phasing out the laddered portfolio mechanism and soliciting for 100% of load requirements for a six-month period would benefit Non-G1 customers because suppliers view longer-term obligations as more risky than shorter-term obligations. According to UES, substituting a six-month supply for the current 12-month and 24-month contract terms would present less risk for suppliers, increase supplier participation in the solicitation, and result in improved pricing for customers.

UES testified that its proposal would split the Non-G1 group into two subgroups—a small (residential) customer group and a medium (outdoor lighting and small commercial and industrial) customer group. UES explained the division of the Non-G1 customers into two subgroups reflects the differences in load factors and in the rate of migration to third party supply experienced by the customers in each subgroup. According to UES, the current rate of migration of residential customers is roughly 1.0% of total energy sales for that group, while the current rate of migration for the medium customer group exceeds 30%; and the load factor for the residential customer group is 56%, while the load factor for the medium customer group is 63%. UES said that splitting the Non-G1 customer group would avoid the cross-subsidization that occurs as a result of the differing migration rates and load factors and should result in more bids and more efficient prices for each group. The Company said it already processes separate paperwork at the Independent System Operator-New England (ISO-NE) for the Non-G1 customer class for the two subgroups proposed in its filing. UES's proposal would make two changes to G1 default service procurement. First, UES proposes to change the G1 default service pricing from fixed monthly prices to variable prices with a fixed monthly adder. Second, UES would change the term from a contract period of three months to a contract period of six months. UES testified that the Company has used this process to procure power for FG&E's large customers since 2006.

In its prefiled testimony, UES stated that the Company intended to propose to also increase the contract term from three months to six months for FG&E's large customer group to conform with the proposed change for UES's customers in New Hampshire. At hearing, UES provided an update on that proposal. According to UES, the Company no longer issues RFPs for its power requirements for large customers of FG&E based on a June 13, 2012 decision of the Massachusetts Department of Public Utilities (DPU) (Docket D.P.U. 11-16). The June 13, 2012 decision allows FG&E to begin to self-supply the remaining large customers from its load serving entity account at the ISO-NE. UES said that the Massachusetts DPU's decision did not impact its proposal to modify the solicitation process for its New Hampshire customers.

Under UES's proposal, the Company would solicit variable prices at the locational marginal price (LMP) for its G1 customers for a period of six months, and the RFP would further ask suppliers to submit bids for fixed monthly adders in addition to the variable energy cost. UES said that the adders would include capacity costs and ancillary costs as well as a margin of profit for the supplier. If the change is approved, UES would solicit adders which would be fixed by each month, but which may vary by month for G1 customers for a six-month period. The resulting monthly contract price would be determined by adding the fixed monthly adder to the real-time LMP for the New Hampshire load zone weighted by the hourly loads of all G1 customers who take default service from UES. UES said that, based on its experience with

FG&E, it expects increased supplier interest in bidding to serve G1 customer loads as a result of this change and that the increased supplier interest would likely off-set any increased risk associated with a six-month versus three-month contract. In addition, the Company said that variable pricing would discourage a customer from moving between competitive supply and fixed-rate default service supply, thus discouraging "gaming" behavior. Finally, the Company stated that the proposal would eliminate the cost of hedges that suppliers add to their bid to defray the risk associated with a fixed price product.

UES said that the change in procurement and the associated filing with the Commission twice a year would result in administrative efficiency and associated savings and that those savings would be passed along to customers. According to the Company, the modifications to its default service procurement process, if approved, would also result in appropriate price signals for all customers.

B. Office of Consumer Advocate

The OCA did not oppose the changes proposed by UES in its proposal. The OCA said that there appear to be some benefits to it that would inure to residential customers.

C. Commission Staff

Staff stated that it had reviewed the petition and that UES's proposal conformed to the electric industry restructuring principles. Staff noted that, based on UES's experience in Massachusetts, the proposed changes to the procurement and pricing for G1 customers may also lead to less long-term reliance on default service. Staff concluded by recommending that the Commission approve the petition but instruct the Company to conduct outreach and education of its G1 customer group to familiarize those customers with the change from a fixed price to a variable price in energy.

III. COMMISSION ANALYSIS

The Commission approved the current process by which UES procures default service supply in Docket DE 05-064. In that earlier proceeding, UES sought to establish the method by which it would procure default service supply for all customers following the end of transition service as provided in the electric utility restructuring statute, RSA 374-F:3, V. RSA 374-F:3, V sets forth the principles by which we should evaluate the changes UES now proposes to its default service procurement process. Pursuant to RSA 374-F:3, V(c), default service should be procured through the competitive market and the costs of administering default service should be borne by the customers in a manner approved by the Commission. In addition, RSA 374-F:3, V (c) authorizes the Commission to implement measures to discourage misuse or long-term use of default service. The Commission is authorized to established default service "appropriate to the particular circumstances of each jurisdictional utility." RSA 374-F:3, V (d). Finally, 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, V (e).

We have reviewed the filing and have determined that UES's proposal to modify its default service procurement process is consistent with the principles in the electric utility restructuring law and is in the public interest. We find that it is appropriate to split the Non-G1 customer group into two subgroups because of their separate migration rates and load factors.

With the proposed division, we expect that solicitations will attract bids that reflect the characteristics of each group, resulting in more efficient rates. In addition, we approve of UES phasing out the laddered portfolio approach to acquiring power for the Non-G1 group. In Order No. 24,511, we observed that "one disadvantage with the portfolio approach is that the aggregation of several long-term contracts with different start dates and terms could widen the gap between [default service] prices and market prices, consequently slowing the development of a competitive retail market to serve small customers." Order No. 24,511 at 13. Phasing out the laddered portfolio and soliciting for 100% of supply for a six month period will result in rates that are more reflective of market rates and will thus provide more efficient price signals for Non-G1 customers. This development could lead to greater competitive options for small customers, which is consistent with the restructuring principles. We also find an additional benefit to customers as the Company has testified that any savings resulting from the anticipated administrative efficiencies will be passed along to customers.

We also determine that the proposed changes to the default service procurement process for G1 customers are consistent with restructuring principles and should result in more efficient, market-based prices for the large customers who have not elected to be served by competitive supply. We find that the price structure and supplier contract based on the LMP with an adder for capacity and ancillary costs will provide an appropriate price signal to the G1 customers taking default service; would likely off-set any increased risk associated with a six-month versus three-month contract; may discourage "gaming" behavior thus eliminating the cost of suppliers' hedges; and, may prompt some of those customers to seek supply from the competitive market.

Finally, we agree with the Company that the change from four regulatory filings per year to two per year will result in administrative efficiencies for the Company and for the Commission. Based on the foregoing analysis, we approve UES's proposal as filed and direct the Company to begin to phase in the changes effective with its August 7, 2012 default service solicitation as proposed in its filing.

We agree with Staff that appropriate outreach to G1 customers is necessary to inform them of the new pricing structure prior to the next G1 default service term, which begins November 1, 2012. Therefore, we direct UES to commence such outreach and education as soon as practicable and to file a report with the Company's next default service filing describing the Company's actions in that regard. .

Based upon the foregoing, it is hereby

ORDERED, the petition of Unitil Energy Systems, Inc. to revise its default service procurement process is hereby APPROVED for effect with its next G1 default service solicitation; and it is

FURTHER ORDERED, that UES, with its next default service filing, provide the Commission with a detailed description of the outreach it conducted with G1 customers regarding the change in default service pricing.

By order of the Public Utilities Commission of New Hampshire this thirty-first day of July, 2012.

Amy L. Ignatius
Chairman

Michael D. Harrington
Commissioner

Robert R. Scott
Commissioner

Attested by:

Lori A. Davis
Assistant Secretary