COMMONWEALTH OF MASSACHUSETTS

BEFORE THE DEPARTMENT OF PUBLIC UTILITIES

NSTAR Electric Company,	**)**	D.P.U. 11-05
Groton Wind, LLC Contract	**)**	
	)	
NSTAR Electric Company,	**)**	D.P.U. 11-06
New England Wind, LLC Contract	**)**	
	)	
NSTAR Electric Company,	**)**	D.P.U. 11-07
Blue Sky East, LLC Contract	**)**	

DIRECT TESTIMONY OF

JONATHAN WALLACH

ON BEHALF OF

THE CAPE LIGHT COMPACT

Resource Insight, Inc.

MAY 27, 2011

Q: Please state your name, occupation, and business address.

A: My name is Jonathan F. Wallach. I am Vice President of Resource Insight, Inc., 5 Water Street, Arlington, Massachusetts.

Q: Please summarize your professional experience.

A: I have worked as a consultant to the electric-power industry since 1981. From 1981 to 1986, I was a research associate at Energy Systems Research Group. In 1987 and 1988, I was an independent consultant. From 1989 to 1990, I was a senior analyst at Komanoff Energy Associates. I have been in my current position at Resource Insight since September of 1990.

Over the past twenty-nine years, I have advised clients on a wide range of economic, planning, and policy issues relating to the regulation of electric utilities, including: electric-utility restructuring; wholesale-power market design and operations; transmission pricing and policy; market-price forecasting; market valuation of generating assets and purchase contracts; power-procurement strategies; risk assessment and mitigation; integrated resource planning; mergers and acquisitions; cost allocation and rate design; and energy-efficiency program design and planning.

My resume is attached as Exhibit CLC-JFW-2.

Q: Please describe your experience with competitive retail electricity markets in Massachusetts and in other jurisdictions.

A: Over the last seven years, I have assisted the Cape Light Compact ("Compact") on numerous occasions in the solicitation and procurement of retail power supply to serve the Compact's aggregated load. My services to the Compact for these procurements included assistance in drafting of Requests for Proposals and contracts for the purchase of all-requirements power supply, evaluation of bidders' price offers, and assistance in negotiations with prospective suppliers. In addition, I have assisted the Compact in the economic evaluation of proposals for wholesale power supply, and advised the Compact on matters relating to the procurement and pricing of Basic Service power supply.

I have also served for many years as a consultant to the Maryland Office of People's Counsel, the Connecticut Office of Consumer Counsel, and the Office of the Ohio Consumers' Counsel, providing technical assistance, strategic advice, and expert testimony on a wide range of issues relating to the design and implementation of wholesale and retail power markets and the procurement and pricing of retail default service.

Q: Have you testified previously in utility regulatory proceedings?

A: Yes. I have sponsored expert testimony in fifty state, provincial, or federal proceedings in the U.S. and Canada. Exhibit CLC-JFW-2 includes a detailed list of my previous testimony.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of the Cape Light Compact.

Q: Please briefly describe the Compact's role as an aggregator.

A: The Compact, among other things, implements a plan to aggregate its electric consumers ("Aggregation Plan"). The primary purpose of the Aggregation Plan is to provide the Compact with the ability to negotiate the best rates for the supply of electricity to its consumers.

Q: What is the goal of the Compact's power-supply program?

A: The power-supply program is designed to provide competitive electricity prices for consumers and to gain other favorable economic and non-economic terms on service contracts. Under the power-supply program, the Compact is responsible for developing, through a competitive bid and negotiation process, a contract with a power supplier to provide firm, all-requirements service to participating customers on Cape Cod and Martha's Vineyard.

Q: What is the purpose of your testimony?

A: On February 18, 2011, NSTAR Electric Company ("NSTAR"; "the Company") filed with the Department of Public Utilities ("DPU") three petitions for approval of power-purchase agreements with Groton Wind, LLC, New England Wind, LLC, and Blue Sky East, LLC. In support of its petitions, NSTAR filed testimony by James G. Daly and Henry C. La Montagne.

In accordance with Section 83 of the Green Communities Act and DPU regulations, the Company's petitions propose mechanisms for: (1) retaining or disposing of the energy, capacity, and Renewable Energy Credits ("REC") purchased under the three contracts; and (2) recovering contract costs from distribution customers. The Compact is concerned that these proposed mechanisms may lead to anti-competitive subsidization of Basic Service customers. This testimony discusses the Compact's concerns with regard to these proposed mechanisms and recommends modifications to the Company's proposals to ensure that contract costs are recovered in a competitively neutral fashion.

Q: Please describe the three proposed contracts.

A: The contract with Groton Wind, a subsidiary of Iberdrola, S.A., provides for the purchase of energy and RECs from a 48 megawatt ("MW") wind project located in Groton, New Hampshire. Contract prices for both energy and REC purchases are fixed over the ten-year term of the contract.

The New England Wind contract calls for the purchase of energy and RECs from a 28.5 MW wind facility located in northwestern Massachusetts. As with the Groton Wind contract, prices for both energy and REC purchases are fixed over the ten-year term of the contract. New England Wind is also a subsidiary of Iberdrola.

The contract with Blue Sky East, a subsidiary of First Wind Holdings, LLC, provides for the purchase at fixed prices of energy, capacity, and RECs from a 32.4 MW wind facility located in Eastbrook, Maine. The proposed contract has a 15-year term.

Q: How does NSTAR propose to use or dispose of the various products purchased through these three contracts?

A: The Company proposes to sell the energy purchased under these three contracts into the wholesale spot market. Likewise, the capacity purchased under the Blue Sky East contract would be sold into the wholesale capacity market.[1]

In contrast, NSTAR proposes to retain all RECs purchased under the three contracts for the purposes of meeting the Renewable Portfolio Standard ("RPS") requirements for its Basic Service load. The Company argues that it is reasonable to retain the purchased RECs, since by doing so the Company avoids transaction costs associated with the sale of such RECs into the wholesale

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[1] More precisely, Blue Sky East will bid the qualified capacity from the project into the Forward Capacity Market and the proceeds from the cleared qualified capacity will be transferred to NSTAR. See D.P.U. 11-07, Company's response to CLC 1-7.

market and since the Company would have to repurchase an equivalent amount of RECs to meet the RPS obligation for its Basic Service load.[2]

Q: Under the Company's proposal, what price would Basic Service customers pay for the RECs supplied by the three contracts?

A: The Company proposes to charge Basic Service customers the fixed contract price for RECs purchased under the three contracts.

Q: What price would Basic Service customers pay for RECs if they were purchased from the market, rather than supplied by the proposed contracts?

A: According to the Company's response to CLC 2-4 in D.P.U. 11-05, 11-06 and 11-07, the Company typically purchases RECs to meet Basic Service RPS obligations through quarterly competitive solicitations. As a result, Basic Service customers would pay the market price demanded by winning bidders in the quarterly procurements.

Q: How does NSTAR propose to recover contract costs?

A: The Company proposes to charge or credit to all distribution customers the net difference between: (i) contract payments for the purchase of energy, capacity, and RECs; and (ii) revenues received from the sale or retention of the purchased energy, capacity, and RECs.

For energy or capacity, the difference between payments and revenues would be determined by the difference between contract price for the purchase of project energy or capacity and market price for the sale of project energy or

[2] Unlike with RECs, the Company would not have to repurchase the energy and capacity sold into the market, since Basic Service energy requirements and capacity obligations are already satisfied through Basic Service supply contracts with wholesale suppliers.

capacity. Thus, there would either be a net cost or credit to distribution customers for the energy or capacity purchased under the proposed contracts, depending on the relationship between contract prices and market prices for energy and capacity.

In contrast, for RECs the difference between payments and revenues would be determined by the difference between contract price for purchased RECs and the rate charged to Basic Service customers for use of those RECs. In this case, there would never be a difference between contract payments and revenues, since the Company proposes to set the rate charged to Basic Service customers for the use of the RECs at the same contract price paid for the purchase of those RECs.

Q: Is the Company's proposal for recovery of contract costs reasonable?

A: The Company's proposal to sell the energy and capacity purchased under the contracts into the wholesale markets, and to charge or credit the difference between contract payments and market revenues to distribution customers, is reasonable. This proposal to sell energy and capacity into the wholesale markets ensures that distribution customers would receive fair market value for the energy and capacity purchased under these contracts. Moreover, the Company's proposal to charge contract payments and credit market revenues to distribution customers would reasonably allocate contract costs commensurately with contract benefits. Finally, the Company's proposal for energy and capacity would recover contract costs in a competitively neutral fashion, without any distortion to Basic Service rates that would be detrimental to the competitive retail power market.

The Company's proposal to retain RECs purchased under the three contracts is also reasonable, since NSTAR would need to purchase an equivalent amount of RECs from the market if it were to sell the contract RECs into the market. Thus, the Company's proposal to retain contract RECs offers a pragmatic and cost-efficient alternative to the market sale and subsequent repurchase of those RECs

On the other hand, the Company's proposal to charge Basic Service customers the contract price for those retained RECs would unreasonably subsidize Basic Service customers and could adversely affect the competitive retail electricity market. In contrast with the treatment of energy and capacity, the proposed pricing for RECs may grossly understate the fair market value of those RECs and, hence, unreasonably overstate net contract costs charged to distribution customers. Furthermore, below-market pricing of retained RECs would distort Basic Service prices and could undermine retail suppliers' ability to offer market-priced alternatives at competitive rates.

Q: To what extent are REC contract prices expected to fall short of market value?

A: Contract prices for RECs are fixed at $[redacted]/MWh for the ten-year terms of the contracts with Groton Wind and New England Wind and at $[redacted]/MWh for the fifteen-year term of the contract with Blue Sky East.[3] In contrast, the Company forecasts that annual market prices for RECs will range between about $[redacted]/MWh and $[redacted]/MWh over the terms of these three contracts.[4] In other words, RECs purchased from Groton Wind or New England Wind are expected to be priced anywhere from [redacted]% to [redacted]% below market, while RECs purchased from Blue Sky East are expected to be priced from [redacted]% to [redacted]% below market.

[3] D.P.U. 11-05, 11-06 and 11-07, Exhibit NSTAR-JGD-4 (confidential).

[4] *Id.*

Q: To what extent might distribution customers be overcharged for net contract costs under the Company's proposal?

A: Based on the Company's forecast of REC market prices, I estimate that distribution customers would overpay for net contract costs by about $[redacted] million (nominal) in total for all three proposed contracts over the terms of those contracts.[5] In other words, under the Company's proposal, distribution customers would pay $[redacted] million more in net contract costs than if they were to receive fair market value for the contract RECs.

As noted above, distribution customers would overpay for contract costs under the Company's proposal because Basic Service customers would pay less than market price for the contract RECs applied to Basic Service. Under the Company's proposal, distribution customers would therefore subsidize Basic Service customers' payments for the contract RECs applied to Basic Service RPS requirements.[6]

According to Mr. Daley, the three contracts in total are expected to yield about $111 million in net benefits (i.e., market value in excess of contract payments for energy, capacity, and RECs) over the lives of those contracts.

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[5] This amount is calculated based on data provided in the confidential version of Exhibit NSTAR-JGD-4 in D.P.U. 11-05, 11-06 and 11-07. I calculate the overpayment in each year of a contract as the difference between the forecasted annual market value of contract RECs and the annual contract payment for contract RECs. The total overpayment is simply the sum across the three contracts and across all years of the contracts of the annual overpayments for each contract.

[6] Basic Service customers represent about 48% of the Company's distribution sales. These distribution customers would therefore overpay through distribution rates, but be more than compensated through the subsidy to Basic Service rates. In contrast, distribution customers taking competitive supply, at about 52% of NSTAR distribution sales, would bear about 52% of the total overpayment without any offsetting benefit. In other words, customers taking competitive service would subsidize customers taking Basic Service by about $[redacted] million.

Under the Company's proposal for charging Basic Service customers the contract price for retained RECs, Basic Service customers would capture about [redacted]% of the forecasted $111 million in net benefits.

Q: How might this subsidy to Basic Service customers affect the Compact's ability to provide competitively priced service?

A: Charging Basic Service customers the contract price rather than the market price for retained RECs could result in Basic Service rates that are lower than market price. Setting NSTAR Basic Service rates below market, in turn, would adversely affect the Compact (and the broader competitive retail market.) The Compact procures retail power supply to serve aggregated customers at prevailing market prices. If NSTAR were to offer Basic Service at below-market prices, the Compact would not be able to offer a competitively priced alternative to Basic Service at a rate that is attractive to customers and allows the Compact to recover its costs. Consequently, below-market pricing of Basic Service would seriously threaten the Compact's viability as a competitive retail supplier.

Q: How can this subsidy be eliminated?

A: The Company can eliminate this subsidy by adopting the approach for pricing retained RECs that was proposed by National Grid and approved by the DPU in D.P.U. 10-54. Specifically, NSTAR should charge Basic Service customers the market price, rather than the contract price, for the contract RECs assigned to Basic Service.

As recognized by the DPU in D.P.U. 10-54, charging Basic Service customers the market price for RECs would eliminate any distortion to the Basic Service rate associated with pricing of RECs at below-market contract prices.[7]

[7] *Order*, D.P.U. 10-54, November 22, 2010, p. 335.

In addition, charging Basic Service customers for contract RECs at the market price would ensure that distribution customers receive the full market value for the RECs assigned to Basic Service customers. In other words, charging Basic Service customers the market price for RECs would be equivalent to selling the contract RECs into the wholesale market, in terms of both the effect on retail rates charged to Basic Service customers and the amount of contract-related revenues credited to distribution customers.

Q: How should NSTAR derive the market price for retained RECs?

A: The Company should adopt the approach approved in D.P.U. 10-54. Under this approach, NSTAR would charge Basic Service customers for the retained RECs at the same price as paid for RECs purchased through the Company’s quarterly solicitations.

Q: Does this conclude your testimony?

A: Yes.