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March 7, 2012

PUBLIC VERSION

David J. Collins, Executive Secretary
Maryland Public Service Commission
6 St. Paul Street, 16th Floor
Baltimore, Maryland 21202

Re: Case No. 9149

Dear Mr. Collins:

Enclosed for filing, please find an original and seventeen (17) **Public** copies of the Direct Testimony of Jonathan Wallach on behalf of the Office of People's Counsel in the above-referenced case.

If there are any questions regarding this filing, please do not hesitate to contact me.

Respectfully submitted

A handwritten signature in black ink, appearing to read 'W. F. Fields'.

William F. Fields
Senior Assistant People's Counsel

WFF/eom

STATE OF MARYLAND
BEFORE THE PUBLIC SERVICE COMMISSION

**In the Matter of the Investigation of the)
Process and Criteria for Use in Development of)
Request for Proposal by the Maryland Investor-)
Owned Utilities for New Generation to Alleviate)
Potential Short-Term Reliability Problems in the)
State of Maryland)**

Case No. 9149

DIRECT TESTIMONY OF
JONATHAN WALLACH
ON BEHALF OF
THE OFFICE OF PEOPLE'S COUNSEL
PUBLIC

Resource Insight, Inc.

MARCH 7, 2012

1 **I. Introduction and Summary**

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

3 A: My name is Jonathan F. Wallach. I am Vice President of Resource Insight, Inc.,
4 5 Water Street, Arlington, Massachusetts.

5 **Q: Please summarize your professional experience.**

6 A: I have worked as a consultant to the electric-power industry since 1981. From
7 1981 to 1986, I was a research associate at Energy Systems Research Group. In
8 1987 and 1988, I was an independent consultant. From 1989 to 1990, I was a
9 senior analyst at Komanoff Energy Associates. I have been in my current
10 position at Resource Insight since September of 1990.

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

19 My resume is attached as Exhibit JFW-1.

20 **Q: Please describe your involvement in Case No. 9149.**

21 A: I have assisted the Office of People's Counsel throughout the course of this
22 proceeding. As part of my work in this case, I have assessed the need for new
23 capacity, estimated the market value of demand response resources, evaluated
24 responses to a Request for Proposals for demand response resources ("Gap

1 RFP”), analyzed filings by various parties, and assisted in settlement
2 negotiations.

3 **Q: Have you testified previously in utility regulatory proceedings?**

4 A: Yes. I have sponsored expert testimony in more than fifty state, provincial, or
5 federal proceedings in the U.S. and Canada. Exhibit JFW-1 includes a detailed
6 list of my previous testimony.

7 **Q: On whose behalf are you testifying?**

8 A: I am testifying on behalf of the Office of People’s Counsel.

9 **Q: What is the purpose of your testimony?**

10 A: On July 13, 2011, Energy Curtailment Specialists, Inc. (“ECS”) filed a motion
11 seeking approval of proposed amendments to two contracts for the sale of
12 demand response capacity to Delmarva Power and Light Company
13 (“Delmarva”) and Potomac Electric Light Company (“PEPCO”), respectively.
14 This motion indicates that ECS failed to meet its obligations under the two
15 contracts to deliver specified megawatts of demand response capacity during the
16 2011-2012 Delivery Year, and seeks to remedy that failure to perform with
17 amendments to the two contracts that would retroactively reduce ECS’ capacity
18 obligations for the 2011-2012 Delivery Year.

19 On January 4, 2012, ECS filed a second motion proposing an additional
20 modification to the Delmarva and PEPCO contract prices for the 2011-2012
21 Delivery Year, and seeking to amend its contract with Delmarva in order to
22 reduce its capacity obligation for the remaining term of the contract. Finally, on
23 February 1, 2012, ECS filed direct testimony by William Chen in support of the
24 two motions.

25 The purpose of this testimony is to respond to Mr. Chen’s testimony. In
26 particular, this testimony addresses ECS’ proposal to compensate ratepayers for

1 the harm from its failure to perform by modifying contract prices for the 2011-
2 2012 Delivery Year.

3 **Q: Please summarize your findings and conclusions.**

4 A: Pursuant to the provisions of its contracts with Delmarva and PEPCO, ECS is
5 obligated to provide a fixed and certain amount of demand response capacity
6 over the four-year terms of those contracts. In exchange for the guarantee of
7 delivery of a certain amount of capacity over all four years of the contract, ECS
8 is paid a contract price that exceeds the market price for that capacity. The
9 Commission approved these contract prices, even though such prices were
10 expected to exceed market prices, in order to secure the guaranteed delivery of
11 capacity over the four-year term of the contracts.

12 ECS' failure to meet its 2011-2012 delivery obligations constitutes a
13 material breach of the terms of its contracts with Delmarva and PEPCO and
14 causes substantial direct harm to ratepayers. Contrary to ECS' assertion, the
15 economic damage from this failure is not limited to the 2011-2012 Delivery
16 Year. In approving these contracts, the Commission imposed an obligation on
17 ratepayers to pay more for delivered capacity over the four years of the contracts
18 than it would have cost to purchase that capacity through the RPM markets.
19 According to the Commission, the payment of that premium over market was
20 reasonable in order to ensure guaranteed delivery of a fixed and certain amount
21 of capacity in all four years of the contracts. By its own admission, ECS is
22 unable to guarantee delivery of contractual capacity throughout the term of the
23 contract. Absent such a guarantee, it would be contrary to the public interest for
24 ratepayers to pay an insurance premium that was intended to compensate ECS
25 for providing that guarantee.

1 Based on RPM market prices, I estimate that the economic harm to
2 ratepayers from ECS' failure to perform to be about **BEGIN CONFIDENTIAL**
3 **\$** **END CONFIDENTIAL** million. Delmarva and PEPCO offer a reasonable
4 approach for mitigating the harm to ratepayers from ECS' breach of
5 performance.¹ However, ECS rejects this approach and offers a woefully
6 inadequate remedy in its place.

7 **Q: What action should the Commission take to remedy ECS' failure to meet its**
8 **obligation to guarantee delivery?**

9 A: Given the material harm to ratepayers from ECS' breach of contract, and given
10 ECS' unwillingness to provide reasonable remedy for such harm, the
11 Commission should direct Delmarva and PEPCO to terminate their contracts
12 with ECS pursuant to the default provisions of those contracts.

13 **II. The Gap RFP Process**

14 **Q: Please describe the process that led to the execution of the ECS contracts.**

15 A: Delmarva and PEPCO each entered into contracts with ECS pursuant to
16 Commission orders in this proceeding. In its November 6, 2008 order, the
17 Commission directed the four investor-owned utilities to issue Requests for
18 Proposals for demand response resources for the period June 1, 2011 to May 31,
19 2016. The Commission ordered the procurement of demand response capacity in
20 order to address a potential capacity shortfall in the Mid-Atlantic region of PJM
21 and, in particular, to "serve as insurance against the possibility that the in-

¹ In its recently issued Order No. 84715, the Commission found that this approach provides a reasonable remedy for the economic harm from EnerNOC's failure to meet its capacity obligations in the 2011-2012 Delivery Year.

1 service dates of the TrAIL and PATH transmission projects are delayed past
2 June 2011 and June 2013, respectively.”²

3 In Order No. 82511, the Commission approved the selection of ECS to
4 provide demand response capacity to Delmarva and PEPCO.³ In approving
5 these contracts, the Commission determined that the contract prices, while
6 greater than expected market prices, were reasonable on the basis that:

7 ... the demand response resources bid into the Gap RFPs offer an
8 opportunity to obtain low-cost insurance against highly disruptive
9 reliability events, however unlikely they might be.... The Commission
10 finds that procurement of modest demand response resources now
11 represents a reasonable, low-cost hedge against demand growth and
12 potential reliability shortfalls.⁴

13 **Q: Please describe the terms and conditions of the two ECS contracts.**

14 A: Except for the megawatt amount of the capacity obligation, the terms and
15 conditions of the two contracts are substantially the same. The contracts have
16 four-year terms that extend from June 1, 2011 through May 31, 2015. In
17 addition, both contracts require a constant amount of delivered megawatts for all
18 four years of the contract term.⁵ Such deliveries must be from capacity resources
19 located in the contracting utility’s Maryland service territory.

² Letter Order, Case No. 9149, November 6, 2008, p. 7.

³ The Commission also approved the selection of a number of other winning bidders for contracts with all four investor-owned utilities.

⁴ Order No. 82511, Case No. 9149, March 11, 2009, p. 8.

⁵ “Delivered” quantities are not delivered in the sense that the purchasing utility takes title to the demand response capacity for the purposes of meeting PJM capacity obligations. Instead, the supplier is obligated to enroll a certain amount of capacity in PJM’s Emergency Load Response program, to bid that amount into the Base Residual Auction, and to pay the purchasing utility all revenues received from bidding that amount into the Base Residual Auction. In return, the purchasing utility is obligated to pay the supplier the product of the contract price and the “delivered” quantity.

1 For the 2011-2012 Delivery Year, demand response capacity must be
2 certified as Interruptible Load for Reliability (“ILR”) capacity, and must not
3 have been bid into the Base Residual Auction (“BRA”) for the 2011-2012
4 Delivery Year. For the remaining three years of the contracts, demand response
5 capacity must be certified and bid into the BRA for each year as Demand
6 Resource (“DR”) capacity. In all years, the full amount of the ILR or DR
7 capacity must be enrolled in PJM’s Emergency Load Response (“ELR”)
8 program.

9 Finally, contract payments in each delivery year are set at the product of
10 the capacity obligation and the difference between the contract price and the
11 RPM clearing price for demand response resources for that delivery year.⁶ No
12 payments will be made for 2011-2012 capacity, since the contract price for the
13 2011-2012 Delivery Year in both contracts is set at the 2011-2012 RPM clearing
14 price for ILR resources of \$110.04/MW-day.

15 **III. Proposed Contract Amendments**

16 **Q: Why is ECS seeking to amend its contracts with Delmarva and PEPCO?**

17 **A:** ECS seeks to amend its contracts in order to remedy a breach in its obligation
18 under those contracts. According to its two motions and Mr. Chen’s direct
19 testimony, ECS was unable to meet its contractual obligations under either
20 contract for capacity deliveries for the 2011-2012 Delivery Year. Specifically,
21 ECS failed to enroll sufficient ILR capacity in the ELR program to fulfill its
22 2011-2012 capacity obligations in either the Delmarva Maryland or PEPCO

⁶ Under this settlement mechanism, the supplier would pay the buyer in any delivery year where the RPM clearing price exceeds the contract price.

1 Maryland service territory. ECS notes that it was able to enroll an additional
2 amount of DR capacity in the ELR program for 2011-2012, although such
3 capacity does not qualify under the provisions of the contracts to meet the
4 capacity obligation for the 2011-2012 Delivery Year. Nonetheless, even if the
5 additional DR capacity were qualified to meet 2011-2012 capacity obligations,
6 ECS would still have fallen short of its obligations for the 2011-2012 Delivery
7 Year under the contracts with Delmarva and PEPCO.

8 In addition, with respect to its contract with Delmarva, ECS seeks to
9 reduce its capacity obligation for the remaining three years of the contract term,
10 because it does not believe that it will be able to enroll sufficient additional
11 capacity in the ELR program to meet the current obligation.

12 **Q: To what extent did ECS fall short of its capacity obligations for the 2011-**
13 **2012 Delivery Year?**

14 **A:** According to the first motion of July 13, 2011, ECS was able to meet only about
15 **BEGIN CONFIDENTIAL** ■ **END CONFIDENTIAL** of its obligations
16 under the Delmarva and PEPCO contracts, when counting both the ILR and DR
17 that it enrolled in the ELR program. Specifically, ECS secured **BEGIN**
18 **CONFIDENTIAL** ■ **END CONFIDENTIAL** MW of ILR and DR capacity,
19 or **BEGIN CONFIDENTIAL** ■ **% END CONFIDENTIAL** of its **BEGIN**
20 **CONFIDENTIAL** ■ **END CONFIDENTIAL** MW obligation, in Delmarva's
21 Maryland service territory. In PEPCO's Maryland service territory, ECS secured
22 **BEGIN CONFIDENTIAL** ■ **END CONFIDENTIAL** MW of ILR and DR
23 capacity, or **BEGIN CONFIDENTIAL** ■ **% END CONFIDENTIAL** of its
24 **BEGIN CONFIDENTIAL** ■ **END CONFIDENTIAL** MW obligation.

25 **Q: What is ECS' explanation for this failure to perform?**

26 **A:** According to Mr. Chen:

1 This disappointing performance was not for lack of trying, but rather
2 because of fierce competition for these MWs, and in the case of DPL,
3 simply may not be available in sufficient quantity to be delivered.⁷

4 Mr. Chen also notes that ECS enrolled capacity outside of the Maryland
5 service territories for Delmarva and PEPCO, but within the RPM zones for
6 Delmarva and PEPCO, “under the assumption that such MWs would count
7 toward its requirement under the contracts.”⁸

8 **Q: How might ECS have overcome the “fierce competition” for customers in
9 order to meet its obligation?**

10 A: ECS might have been able to enhance the competitiveness of its offers by
11 increasing payments for customers’ load reductions or by offering other energy-
12 related services to eligible customers.⁹

13 **Q: Are there provisions of the contracts with Delmarva and PEPCO that
14 might have led ECS to believe that it could rely on DR outside of Maryland
15 to meet its capacity obligations?**

16 A: To the contrary, Section 3.1.1 of those contracts explicitly requires that the
17 capacity obligation be met with DR located in Maryland:

18 During the Term, Supplier shall provide the Committed Capacity Amount
19 to PJM from *Capacity Resources located in Company’s Maryland service*
20 *territory....* [Emphasis added.]

21 **Q: How does ECS propose to amend its contracts with Delmarva and PEPCO
22 to address the shortfall in the 2011-2012 Delivery Year?**

⁷ *Direct Testimony and Exhibits of William Chen*, Case No. 9149, February 1, 2012, p. 3.

⁸ *Id.*

⁹ However, doing so might have reduced ECS’ profits from meeting its capacity obligations under its contracts with Delmarva and PEPCO.

1 A: In order to address this shortfall, ECS proposes to amend certain provisions of
2 its contracts with Delmarva and PEPCO, so that: (1) DR capacity would be
3 allowed to count toward ECS' capacity obligations for the 2011-2012 Delivery
4 Year; and (2) the capacity obligations for the 2011-2012 Delivery Year would
5 be reduced to the amounts of ILR and DR capacity that ECS was able to enroll
6 in the ELR program for the 2011-2012 Delivery Year. In other words, ECS
7 proposes to eliminate its 2011-2012 capacity shortfalls by retroactively restating
8 contractual obligations to amounts actually enrolled in the ELR program.

9 **Q: How does ECS want to change its capacity obligation for the remainder of**
10 **its contract with Delmarva?**

11 A: ECS proposes to reduce its current capacity obligation by **BEGIN**
12 **CONFIDENTIAL** ██████████ **END CONFIDENTIAL**, from **BEGIN**
13 **CONFIDENTIAL** ██████████ **END CONFIDENTIAL** MW to **BEGIN**
14 **CONFIDENTIAL** ██████████ **END CONFIDENTIAL** MW, for the 2012-2013, 2013-
15 2014, and 2014-2015 Delivery Years.

16 **Q: Why is ECS seeking to reduce its capacity obligation for the remainder of**
17 **the Delmarva contract?**

18 A: According to Mr. Chen, ECS currently has **BEGIN CONFIDENTIAL** ██████████
19 **END CONFIDENTIAL** MW of DR capacity under contract, or more than
20 enough capacity to meet its proposed capacity obligation of **BEGIN**
21 **CONFIDENTIAL** ██████████ **END CONFIDENTIAL** MW. In addition, ECS estimates
22 that there are about 15 MW more of available DR in Delmarva's Maryland
23 service territory that has not yet been enrolled in the ELR program. Thus, by
24 ECS' own estimate, there appears to be adequate available DR to meet its
25 current capacity obligation of **BEGIN CONFIDENTIAL** ██████████ **END**
26 **CONFIDENTIAL** MW. In fact, of that 15 MW, ECS appears to be in

1 negotiations to secure an additional **BEGIN CONFIDENTIAL** **END**
2 **CONFIDENTIAL** MW of DR capacity, which when added to the **BEGIN**
3 **CONFIDENTIAL** **END CONFIDENTIAL** MW currently under contract
4 would be sufficient to meet its current **BEGIN CONFIDENTIAL** **END**
5 **CONFIDENTIAL** MW obligation. Nevertheless, ECS apparently has little
6 confidence that it will be able to secure all of the capacity currently under
7 negotiation or any of the remainder of the 15 MW of available DR capacity. As
8 a result, ECS proposes to reduce its capacity obligation to a level slightly below
9 the amount currently under contract.

10 **Q: Has ECS provided a reasonable basis for approving a permanent reduction**
11 **in its capacity obligation under the Delmarva contract?**

12 A: No. ECS has failed to provide a reasonable basis for its estimate that there is
13 only 15 MW of DR potential remaining in Delmarva's Maryland service
14 territory. This estimate of *remaining* potential appears to be based on a rule of
15 thumb used by ECS to determine the *total* potential in a service territory.
16 However, this rule of thumb apparently substantially understates total potential
17 in Delmarva's service territory, since it indicates a total potential (25 MW) that
18 is half the amount of DR capacity that has already been enrolled (50 MW).¹⁰

19 Moreover, ECS has not explained why it is unable to procure the additional
20 **BEGIN CONFIDENTIAL** **END CONFIDENTIAL** MW of DR capacity it
21 would need to meet its current **BEGIN CONFIDENTIAL** **END**
22 **CONFIDENTIAL** MW obligation. In particular, ECS has not explained why it

¹⁰ In contrast, in testimony filed in this proceeding, EnerNOC estimates a total achievable potential of about 70 MW in Delmarva's Maryland service territory. Netting out the 50 MW that is already enrolled in the ELR program, EnerNOC estimates that there is about 20 MW of remaining DR potential, or 33% more than the 15 MW remaining potential estimated by ECS. See *Testimony of Herb Healy in Support of Settlement Agreement*, Case No. 9149, January 4, 2012, pp. 16-17.

1 believes that it is unlikely to secure the **BEGIN CONFIDENTIAL** **END**
2 **CONFIDENTIAL** MW of capacity currently under negotiation and whether
3 these negotiations are stalling over the price ECS is willing to pay for
4 customers' load reductions. It would not be reasonable to reduce ECS' capacity
5 obligation simply because it improves ECS' bottom line.

6 **Q: Would ratepayers benefit economically from a permanent reduction in**
7 **ECS' capacity obligation?**

8 A: Ratepayers would benefit in the sense that a reduction in ECS' capacity
9 obligation would reduce above-market contract payments by ratepayers. From
10 this perspective, ratepayer benefits would be greatest if the contract were
11 terminated.

12 **IV. Economic Damage from ECS' Breach of Contract**

13 **Q: Does ECS believe that ratepayers have been harmed by its failure to meet**
14 **its capacity obligations for the 2011-2012 Delivery Year?**

15 A: No. According to Mr. Chen, ratepayers have not been directly harmed, because:

16 ... with the benefit of hindsight the MWs were not needed in 2011-12 for
17 reliability purposes, and the first year pricing mechanism was set so that
18 ratepayers neither paid nor received payment for the contracted MWs. The
19 ILR price was already known to be \$110.04 prior to execution of the
20 agreements and the contract price was set to match. So effectively the first
21 year was a wash for both parties.¹¹

22 **Q: Do you agree that the capacity amount that ECS failed to deliver was not**
23 **needed for reliability purposes?**

¹¹ Chen Direct, pp. 5-6.

1 A: Yes. For that matter, the capacity amount that ECS did deliver for the 2011-
2 2012 Delivery Year was also not needed. In fact, *none* of the DR capacity that
3 ECS is contracted to deliver over the remaining three years of its contracts with
4 Delmarva and PEPCO may be needed for reliability purposes, since PJM has
5 already acquired much more capacity than needed to meet minimum reliability
6 requirements in the RPM auctions for the 2012-2013, 2013-2014, and 2014-
7 2015 Delivery Years.¹²

8 Nevertheless, none of this is relevant to the matter at hand. The
9 Commission judged the reasonableness of the ECS contract prices based on an
10 expectation of guaranteed delivery of a certain amount of capacity in the 2011-
11 2012 Delivery Year (and thereafter.) In approving the ECS contracts, the
12 Commission imposed an obligation on ratepayers to pay such prices regardless
13 of whether the contracted capacity is eventually needed for system reliability.
14 ECS is likewise obligated to provide the contracted capacity regardless of
15 whether such capacity is needed to serve load. By its own admission, ECS has
16 failed to meet this obligation.

17 **Q: Do you agree that there was no economic harm because “the first year was**
18 **a wash for both parties”?**

19 A: No. There is no merit to ECS’ argument that there was no harm, as it fails to
20 recognize that the contract price for the three remaining delivery years reflects
21 the value to ratepayers of a guaranteed amount of demand response in all four

¹² Moreover, as indicated by the results reported in the *Long-Term Electricity Report for Maryland* by the Power Plant Research Program, there is little risk that this capacity would turn out to be needed before the end of the 2014-2015 Delivery Year because of unanticipated increases in customer load or other changes in system conditions that might reduce the expected capacity surplus.

1 years of the contract term.¹³ Since ECS failed to deliver that guaranteed amount
2 in the 2011-2012 Delivery Year, ratepayers will end up paying too high a
3 contract price in the remaining years of the contract for the value received.

4 In other words, as the Commission recognized in approving the selection
5 of winning bidders, ratepayers will pay an insurance premium – a premium on
6 expected market price – over the next three delivery years in order to guarantee
7 the delivery of a certain amount of demand response capacity in all four years of
8 the contract. Ratepayers will suffer economic harm from ECS' breach of
9 contract, because they will pay an insurance premium over the remaining term
10 of the Delmarva and PEPCO contracts for four years of guaranteed delivery,
11 even though ECS will have failed to deliver the guaranteed amount in all four
12 years.¹⁴

13 **Q: Would it be reasonable for ratepayers to pay a premium on market price**
14 **for delivery of uncertain amounts of capacity?**

15 **A:** No. If there is no more certainty in delivery via contract than through the RPM
16 market, then there is no additional value to ratepayers from procuring capacity
17 through contract rather than through RPM. Whether purchased through a non-
18 firm contract without guarantee of delivery or through the RPM market,
19 ratepayers should pay no more than RPM market price.

¹³ As Mr. Chen notes, per the terms of the Gap RFP, the contract price for the first delivery year was fixed at the RPM market price for ILR capacity. The additional value for guaranteed delivery in the first delivery year (and all other years) would therefore have been reflected in the contract price for the remaining three delivery years.

¹⁴ The fact that ratepayers are not paying a premium on the 2011-2012 market price does not imply that they are not paying for firm delivery in the 2011-2012 Delivery Year. As noted above, per the terms of the RFP, the 2011-2012 contract price was fixed at the RPM market price for ILR resources. Consequently, the insurance premium for all delivery years would have been reflected in the contract price for the remaining three delivery years.

1 **Q: Have you estimated the economic damage from ECS' failure to guarantee**
 2 **delivery of its capacity obligations?**

3 **A: Yes.** As indicated in Table 1, I estimate that the economic harm to ratepayers
 4 from ECS' breach of the Delmarva contract to be about **BEGIN**
 5 **CONFIDENTIAL \$ [REDACTED] END CONFIDENTIAL** million. As shown in Table
 6 2, I estimate that the damage from ECS' breach of the PEPCO contract amounts
 7 to about **BEGIN CONFIDENTIAL \$ [REDACTED] END CONFIDENTIAL** million. The
 8 total economic loss to ratepayers from ECS' failure to perform is thus about
 9 **BEGIN CONFIDENTIAL \$ [REDACTED] END CONFIDENTIAL** million.

10 **Table 1: Damage from Breach of Delmarva Contract (CONTAINS**
 11 **CONFIDENTIAL INFORMATION)**

Delivery Year	Committed Capacity Amount (Peak MW)	Delivered Capacity Amount (UCAP MW)	Contract Price (\$/UCAP MW-day)	RPM Price (\$/UCAP MW-day)	Economic Loss (\$000)
2012-2013	[REDACTED]	[REDACTED]	\$ [REDACTED]	\$139.73	\$ [REDACTED]
2013-2014	[REDACTED]	[REDACTED]	\$ [REDACTED]	\$245.00	\$ [REDACTED]
2014-2015	[REDACTED]	[REDACTED]	\$ [REDACTED]	\$125.47	\$ [REDACTED]
Total					\$ [REDACTED]

12

13 **Table 2: Damage from Breach of PEPCO Contract (CONTAINS**
 14 **CONFIDENTIAL INFORMATION)**

Delivery Year	Committed Capacity Amount (Peak MW)	Delivered Capacity Amount (UCAP MW)	Contract Price (\$/UCAP MW-day)	RPM Price (\$/UCAP MW-day)	Economic Loss (\$000)
2012-2013	[REDACTED]	[REDACTED]	\$ [REDACTED]	\$133.37	\$ [REDACTED]
2013-2014	[REDACTED]	[REDACTED]	\$ [REDACTED]	\$247.14	\$ [REDACTED]
2014-2015	[REDACTED]	[REDACTED]	\$ [REDACTED]	\$125.47	\$ [REDACTED]
Total					\$ [REDACTED]

1 **V. Remedy for ECS' Breach of Contract**

2 **Q: What would be a reasonable remedy for ECS' failure to guarantee delivery**
3 **of its capacity obligations under the Delmarva and PEPCO contracts?**

4 **A:** In comments filed in this proceeding on September 16, 2011, Delmarva and
5 PEPCO proposed a reasonable method for mitigating the harm from ECS'
6 breach of contract.¹⁵ As the Commission found in its Order No. 84715 regarding
7 the settlement agreement with EnerNOC, this proposed approach ("PHI
8 approach") appropriately and reasonably reflects the extent to which the
9 insurance premium has been devalued by ECS' failure to guarantee delivery of
10 its capacity obligation.

11 As described in the September 16, 2011 comments by Delmarva and
12 PEPCO, the PHI approach would reduce contract prices in the remaining three
13 years of the contracts by a percentage amount commensurate with the
14 percentage shortfall in ECS' capacity deliveries. In the case of the Delmarva
15 contract, ECS is obligated to deliver **BEGIN CONFIDENTIAL** **END**
16 **CONFIDENTIAL** MW of DR capacity per year, for a total of **BEGIN**
17 **CONFIDENTIAL** **END CONFIDENTIAL** MW over the four-year term of
18 the contract. As discussed above, ECS failed to deliver **BEGIN**
19 **CONFIDENTIAL** **END CONFIDENTIAL** MW in the first year of the
20 contract. Thus, under the PHI approach, Delmarva contract prices would be
21 reduced by the ratio of **BEGIN CONFIDENTIAL** **END**
22 **CONFIDENTIAL** MW to **BEGIN CONFIDENTIAL** **END**
23 **CONFIDENTIAL** MW, or **BEGIN CONFIDENTIAL** **END**
24 **CONFIDENTIAL**. Likewise, for the PEPCO contract, contract prices would be

¹⁵ This approach, with minor modifications, has been adopted in the EnerNOC settlement agreement in this proceeding.

1 reduced by the ratio of **BEGIN CONFIDENTIAL** **END CONFIDENTIAL**
 2 MW (the shortfall in the first year) to **BEGIN CONFIDENTIAL** **END**
 3 **CONFIDENTIAL** MW (the total obligation of four years), or **BEGIN**
 4 **CONFIDENTIAL** **END CONFIDENTIAL** % **END CONFIDENTIAL**.

5 The revised contract prices under the PHI approach are shown in Table 3.

6 **Table 3: Contract Prices under the PHI Approach (CONTAINS**
 7 **CONFIDENTIAL INFORMATION)**

Delivery Year	Delmarva		PEPCO	
	Original Contract Price	Revised Contract Price	Original Contract Price	Revised Contract Price
2012-2013	\$ CONFIDENTIAL	\$ CONFIDENTIAL	\$ CONFIDENTIAL	\$ CONFIDENTIAL
2013-2014	\$ CONFIDENTIAL	\$ CONFIDENTIAL	\$ CONFIDENTIAL	\$ CONFIDENTIAL
2014-2015	\$ CONFIDENTIAL	\$ CONFIDENTIAL	\$ CONFIDENTIAL	\$ CONFIDENTIAL

8
 9 **Q: To what extent would the PHI approach mitigate the harm from ECS’**
 10 **breach of contract?**

11 **A:** As indicated in Tables 4 and 5, I estimate that application of the PHI approach
 12 would reduce the economic loss for ratepayers to about **BEGIN**
 13 **CONFIDENTIAL** \$ **CONFIDENTIAL** **END CONFIDENTIAL** million in total for the two
 14 contracts. Relative to the **BEGIN CONFIDENTIAL** \$ **CONFIDENTIAL** **END**
 15 **CONFIDENTIAL** million damage under existing contract prices, application
 16 of the PHI approach would reduce ratepayer losses from ECS’ breach of
 17 contract by about **BEGIN CONFIDENTIAL** \$ **CONFIDENTIAL** **END CONFIDENTIAL**
 18 million, or about **BEGIN CONFIDENTIAL** **END CONFIDENTIAL** % **END CONFIDENTIAL**.

1
2

Table 4: Economic Losses with Revised Delmarva Prices (CONTAINS CONFIDENTIAL INFORMATION)

Delivery Year	Committed Capacity Amount (Peak MW)	Delivered Capacity Amount (UCAP MW)	Contract Price (\$/UCAP MW-day)	RPM Price (\$/UCAP MW-day)	Economic Loss (\$000)
2012-2013	█	█	\$█	\$139.73	\$█
2013-2014	█	█	\$█	\$245.00	\$█
2014-2015	█	█	\$█	\$125.47	\$█
Total					\$█

3
4

Table 5: Economic Losses with Revised PEPCO Prices (CONTAINS CONFIDENTIAL INFORMATION)

Delivery Year	Committed Capacity Amount (Peak MW)	Delivered Capacity Amount (UCAP MW)	Contract Price (\$/UCAP MW-day)	RPM Price (\$/UCAP MW-day)	Economic Loss (\$000)
2012-2013	█	█	\$█	\$133.37	\$█
2013-2014	█	█	\$█	\$247.14	\$█
2014-2015	█	█	\$█	\$125.47	\$█
Total					\$█

5

6 **Q: What is ECS' response to the remedy proposed by Delmarva and PEPCO?**

7 A: ECS rejects the PHI approach, but appears to be of two minds as to the basis for
8 its rejection.

9 According to Mr. Chen, no remedy is called for under the terms of the
10 contracts, because, as discussed above, ratepayers have not been harmed by
11 ECS' breach of contract.

12 In contrast, ECS' second motion of January 4, 2012 admits that ECS'
13 breach of contract harmed ratepayers: "The ratepayers are entitled to fair,
14 'direct, actual damages' for ECS' failure under the contracts."¹⁶ However, the

¹⁶ *Second Amended Motion of Energy Curtailment Specialists to Amend Agreements*, Case No. 9149, January 4, 2012, p. 7.

1 second motion argues that the PHI approach provides a remedy that exceeds the
2 direct damages caused by its breach:

3 Conversely, the PHI approach, as applied to ECS, fails this test by
4 providing damages over the remainder of the agreements of a magnitude
5 well in excess of the breach that occurred in 2011/12.¹⁷

6 ECS asserts that the PHI approach is punitive, since the revenue reduction
7 from application of the PHI approach is disproportionate to the shortfall:

8 As measured over the life of the contracts, ECS has failed to deliver to
9 Pepco and Delmarva **BEGIN CONFIDENTIAL** █% **END**
10 **CONFIDENTIAL** and **BEGIN CONFIDENTIAL** █% **END**
11 **CONFIDENTIAL**, respectively, of the MWs promised; however, the
12 PHI/EnerNOC approach would result in a penalty equivalent to a revenue
13 reduction of nearly **BEGIN CONFIDENTIAL** █% **END**
14 **CONFIDENTIAL**.¹⁸

15 **Q: Is there any merit to this proportionality argument?**

16 **A:** No. The PHI approach is not punitive, since the remedy does not exceed the
17 direct economic damage from ECS' breach of contract. In fact, the PHI remedy
18 would amount to only a fraction of the direct damage. As discussed above,
19 ratepayers will suffer an economic loss of about **BEGIN CONFIDENTIAL**
20 **\$** █ **END CONFIDENTIAL** million from ECS' shortfall in the first delivery
21 year. The PHI remedy would not exceed or even eliminate that loss, but only

¹⁷ *Id.*, p. 6.

¹⁸ *Id.*, p. 2. While the PHI approach would reduce contract revenues by about **BEGIN CONFIDENTIAL** █% **END CONFIDENTIAL**, it would reduce total revenues to ECS, including RPM revenues, by only **BEGIN CONFIDENTIAL** █% **END CONFIDENTIAL**. The percentage impact on total profits to ECS would be greater than this **BEGIN CONFIDENTIAL** █% **END CONFIDENTIAL** impact on total revenues to the extent that ECS incurs costs to enroll and administer customers in the ELR program, to manage the Delmarva and PEPCO contracts, or to interface with PJM.

1 reduce it by about **BEGIN CONFIDENTIAL \$** **END CONFIDENTIAL**
2 million, or about **BEGIN CONFIDENTIAL** **%** **END CONFIDENTIAL**.

3 **Q: What remedy has ECS offered for its breach of contract?**

4 A: According to ECS' second motion, ratepayers were directly harmed as a result
5 of the fact that they "did not receive MWs they were promised" for the 2011-
6 2012 Delivery Year.¹⁹ From ECS' perspective, ratepayers were harmed simply
7 because they paid for capacity they did not receive in that one year:

8 ECS did not deliver the contracted MWs in 2011/2012. Accordingly, the
9 proper methodology should be to credit the utilities (and thus ratepayers)
10 for the amount of overpayment received during that year.²⁰

11 If seller promised to sell 12 eggs for \$1 each and only delivered 6 eggs,
12 contract damages would obviously be \$6. The result should be no different
13 here.²¹

14 Consequently, ECS proposes to remedy its breach by applying the PHI
15 approach solely to contract prices for the 2011-2012 Delivery Year. ECS
16 estimates that this limited application of the PHI approach would provide a
17 credit to ratepayers of about **BEGIN CONFIDENTIAL \$** **END**
18 **CONFIDENTIAL** thousand.²²

19 **Q: Is ECS' proposal a reasonable remedy for the economic harm from its**
20 **breach of the Delmarva and PEPCO contracts?**

¹⁹ *Id.*, p. 5.

²⁰ *Id.*, p. 2.

²¹ *Id.*, footnote 2.

²² At a hearing before the Commission on December 14, 2011, Mr. Chen on behalf of ECS proposed a penalty of \$15,000 for its breach of contract, arguing that this amount was "equitable" based on the fact that "there was no money exchanged" for capacity in the 2011-2012 Delivery Year. (Transcript, Case No. 9149, December 14, 2011, p. 99.) Mr. Chen does not explain in his direct testimony why ECS no longer believes that its initial penalty proposal is appropriate.

1 A: No. As discussed above, the economic damage from ECS' breach of contract is
2 not limited to one delivery year. Instead, the economic loss extends over the life
3 of the contracts, because ratepayers are obligated to pay a premium on market
4 prices for a delivery guarantee that has been rendered essentially worthless by
5 ECS' failure to honor that guarantee.

6 Contrary to ECS' claim regarding its egg example, the economic harm is
7 not due to the fact that the buyer paid \$12 for 12 eggs, but only received 6
8 eggs.²³ Instead, the harm results from the fact that the buyer agreed to pay more
9 than market price for those eggs to guarantee delivery of 12 eggs and the seller
10 failed to honor that guarantee. In the instant case, it's as if a buyer agrees to
11 enter into a four-year contract for firm delivery of 12 eggs in every year. In
12 exchange for that guaranteed supply, the buyer agrees to pay the market price of
13 \$1 in the first year and \$1.25, or 25 cents more than market, in the remaining
14 three years. In total, the buyer would pay an insurance premium of \$9 over the
15 total market cost of \$48, reflecting the value to the buyer of firm supply of 48
16 eggs over four years. Absent that guarantee, it's unlikely that the buyer would
17 have agreed to pay more than market price for the contracted egg deliveries in
18 any year, since she would face comparable risk of being short on eggs whether
19 she purchased the eggs through a forward contract or on the spot market.²⁴

20 By failing to deliver 12 eggs in the first year, the seller has violated the
21 contract guarantee and thereby rendered it essentially worthless to the buyer. As
22 a result of seller's failure to honor the guarantee in the first year, the buyer is no

²³ To the contrary, there would be no harm in this case, since the buyer presumably would pay only \$6 for the 6 eggs delivered.

²⁴ In fact, the buyer might have required a discount to the market price as compensation for the obligation to take whatever amount of eggs were delivered by the supplier, regardless of need.

1 longer assured of a guaranteed supply in the remaining three years of the
2 contract. To the extent that the contract remains in force, the buyer will suffer an
3 economic loss of 25 cents per delivered egg, since she will pay an insurance
4 premium on all future deliveries even though she is no longer guaranteed
5 delivery of any of those eggs.

6 **Q: To what extent would ECS' proposed remedy mitigate the harm from its**
7 **breach of contract?**

8 A: I estimate that ECS' proposed remedy would reduce the total economic loss to
9 ratepayers from its failure to perform by a mere **BEGIN CONFIDENTIAL**
10 **█% END CONFIDENTIAL.**

11 **Q: What do you recommend with regard to ECS' proposed remedy?**

12 A: The Commission should reject ECS' proposal. Instead, the Commission should
13 find that: (1) ECS has failed to perform a material obligation under the
14 provisions of the Delmarva and PEPCO contracts; and (2) the failure to perform
15 constitutes an event of default. Accordingly, the Commission should direct
16 Delmarva and PEPCO to terminate their contracts with ECS pursuant to the
17 default provisions of those contracts.

18 **Q: Does this conclude your testimony?**

19 A: Yes.

Exhibit JFW-1

Qualifications of
JONATHAN F. WALLACH

Resource Insight, Inc.
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SUMMARY OF PROFESSIONAL EXPERIENCE

- 1990–Present** **Vice President, Resource Insight, Inc.** Provides research, technical assistance, and expert testimony on electric- and gas-utility planning, economics, regulation, and restructuring. Designs and assesses resource-planning strategies for regulated and competitive markets, including estimation of market prices and utility-plant stranded investment; negotiates restructuring strategies and implementation plans; assists in procurement of retail power supply.
- 1989–90** **Senior Analyst, Komanoff Energy Associates.** Conducted comprehensive cost-benefit assessments of electric-utility power-supply and demand-side conservation resources, economic and financial analyses of independent power facilities, and analyses of utility-system excess capacity and reliability. Provided expert testimony on statistical analysis of U.S. nuclear plant operating costs and performance. Co-wrote *The Power Analyst*, software developed under contract to the New York Energy Research and Development Authority for screening the economic and financial performance of non-utility power projects.
- 1987–88** **Independent Consultant.** Provided consulting services for Komanoff Energy Associates (New York, New York), Schlissel Engineering Associates (Belmont, Massachusetts), and Energy Systems Research Group (Boston, Massachusetts).
- 1981–86** **Research Associate, Energy Systems Research Group.** Performed analyses of electric utility power supply planning scenarios. Involved in analysis and design of electric and water utility conservation programs. Developed statistical analysis of U.S. nuclear plant operating costs and performance.

EDUCATION

BA, Political Science with honors and Phi Beta Kappa, University of California, Berkeley, 1980.

Massachusetts Institute of Technology, Cambridge, Massachusetts. Physics and Political Science, 1976–1979.

PUBLICATIONS

“The Future of Utility Resource Planning: Delivering Energy Efficiency through Distributed Utilities” (with Paul Chernick), *International Association for Energy Economics Seventeenth Annual North American Conference* (460–469). Cleveland, Ohio: USAEE 1996.

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“Reflecting Market Expectations in Estimates of Stranded Costs,” speaker, and workshop moderator of “Effectively Valuing Assets and Calculating Stranded Costs.” Conference sponsored by International Business Communications, Washington, D.C., June 1997.

EXPERT TESTIMONY

- 1989 **Mass. DPU** on behalf of the Massachusetts Executive Office of Energy Resources. Docket No. 89-100. Joint testimony with Paul Chernick relating to statistical analysis of U.S. nuclear-plant capacity factors, operation and maintenance costs, and capital additions; and to projections of capacity factor, O&M, and capital additions for the Pilgrim nuclear plant.
- 1994 **NY PSC** on behalf of the Pace Energy Project, Natural Resources Defense Council, and Citizen's Advisory Panel. Case No. 93-E-1123. Joint testimony with John Plunkett critiques proposed modifications to Long Island Lighting Company's DSM programs from the perspective of least-cost-planning principles.
- 1994 **Vt. PSB** on behalf of the Vermont Department of Public Service. Docket No. 5270-CV-1 and 5270-CV-3. Testimony and rebuttal testimony discusses rate and bill effects from DSM spending and sponsors load shapes for measure- and program-screening analyses.
- 1996 **New Orleans City Council** on behalf of the Alliance for Affordable Energy. Docket Nos. UD-92-2A, UD-92-2B, and UD-95-1. Rates, charges, and integrated resource planning for Louisiana Power & Lights and New Orleans Public Service, Inc.
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