

**COMMONWEALTH OF MASSACHUSETTS
BEFORE THE DEPARTMENT OF PUBLIC UTILITIES**

Joint Petition for Approval of a Merger)
Between NSTAR and Northeast Utilities)

D.P.U. 10-170

**DIRECT TESTIMONY OF
JONATHAN WALLACH
ON BEHALF OF
THE CAPE LIGHT COMPACT**

Resource Insight, Inc.

MAY 20, 2011

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

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

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

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

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

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

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

21 A: Over the last seven years, I have assisted the Cape Light Compact (“Compact”)
22 on numerous occasions in the solicitation and procurement of retail power
23 supply to serve the Compact’s aggregated load. My services to the Compact for
24 these procurements have included assistance in drafting of Requests for
25 Proposals and contracts for the purchase of all-requirements power supply,

1 evaluation of bidders' price offers, and assistance in negotiations with
2 prospective suppliers. In addition, I have assisted the Compact in the economic
3 evaluation of proposals for wholesale power supply, and advised the Compact
4 on matters relating to the procurement and pricing of Basic Service power
5 supply.

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

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

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

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

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

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

19 A: On November 24, 2010, NSTAR and Northeast Utilities ("NU") jointly filed
20 with the Department of Public Utilities ("DPU") a request for approval of a
21 merger of the two holding companies and their utility subsidiaries. In support of
22 their petition, NSTAR and NU (collectively "Applicants") filed joint testimony
23 by James J. Judge and David R. McHale. On March 10, 2011, the DPU issued
24 an order revising its standard of review for merger petitions. In response,
25 Applicants filed supplemental testimony by Mr. Judge and Mr. McHale.

1 The Cape Light Compact is concerned that the proposed merger may
2 adversely affect the competitive retail electricity market in Massachusetts. This
3 testimony describes the potential harm to the competitive market from the
4 merger and discusses how the Compact's concerns can be addressed by the DPU
5 in the event that the DPU approves the merger petition.

6 **Q: Please describe the Compact's concerns regarding the impact of the**
7 **proposed merger on the retail market.**

8 A: The Compact is concerned that a merger of the two holding companies may
9 create opportunities for anti-competitive subsidization of Basic Service
10 customers in NSTAR's service territory. Such subsidization would be contrary
11 to the principles established in D.P.U. 95-30 that the retail electricity market
12 should:

- 13 1. Provide the broadest possible customer choice.
- 14 2. Provide all customers with an opportunity to share in the benefits of
15 increased competition.
- 16 3. Ensure full and fair competition in generation markets.¹

17 Specifically, the Compact is concerned that the merger may provide an
18 opportunity to consolidate the procurement and pricing of Basic Service power
19 supply for NSTAR and Western Massachusetts Electric Company ("WMECO").
20 As I discuss below, consolidation could lead to below-market prices for NSTAR
21 Basic Service supply. Such below-market pricing would seriously undermine
22 the Compact's ability to offer competitive pricing to its aggregated customers.

23 In addition, the Compact is concerned about the risk that prices for
24 NSTAR Basic Service supply would diverge from market prices in the event

¹ Massachusetts Department of Public Utilities, *Order*, D.P.U. 95-30, February 10, 1995, p. iv.

1 that the merged company is allowed to own renewable or non-renewable
2 generation for the purposes of serving Basic Service load.² As discussed below,
3 the cost of service for ratebased investments may be below prices in the
4 wholesale markets. In that event, the Compact would be at a competitive
5 disadvantage if Basic Service customers pay rates that reflect the below-market
6 costs for these long-term assets.

7 According to the supplemental filing, the proposed merger will enhance
8 Applicants' ability to finance investments in renewable generation. The
9 Compact supports utility investment in renewable resources, so long as the
10 costs for any such investments are recovered from ratepayers in a competitively
11 neutral fashion.

12 **Q: How do NSTAR and WMECO currently procure and price Basic Service**
13 **wholesale supply?**

14 A: In accordance with DPU orders and regulations, each distribution company is
15 responsible for procuring wholesale supply to serve Basic Service load within
16 its service territory. Each distribution utility utilizes a competitive RFP process
17 to solicit either fixed- or variable-price offers from wholesale suppliers for
18 three-month (for medium and large commercial / industrial load) or one-year
19 contracts (for residential and small-commercial load) to supply full-
20 requirements power. Basic Service rates reflect the contract prices offered by
21 those bidders selected to provide Basic Service wholesale supply, along with the

² Although I discuss the Compact's concern with regard to generation ownership, this same concern applies to pricing for long-term bilateral contracts for the purchase of wholesale power, including long-term contracts for renewable generation pursuant to Section 83 of the Green Communities Act.

1 utilities' estimates of procurement-related administrative costs and Basic
2 Service bad-debt costs.

3 **Q: How do bidders reflect wholesale power costs in their price offers?**

4 A: There is little in the way of publicly available information regarding how
5 bidders incorporate wholesale-power costs into their price offers, since such
6 information is considered to be commercially sensitive and proprietary.
7 However, it is likely that such offers include bidders' estimates of:

- 8 • Uncongested energy cost;
- 9 • Zonal congestion cost (net of financial congestion hedge);
- 10 • Congestion hedge cost;
- 11 • Capacity cost;
- 12 • Zonal ancillary-service costs;
- 13 • Renewable Portfolio Standard compliance cost;
- 14 • Losses;
- 15 • Transaction costs; and
- 16 • Risk.

17 **Q: How have prices for NSTAR Fixed-Price Basic Service compared to those**
18 **for WMECO Fixed-Price Basic Service?**

19 A: As indicated in the following table, NSTAR residential prices have been
20 consistently higher than WMECO's over the last five years.³

³ It is difficult to compare commercial or industrial Basic Service rates across the two distribution companies, since each utility includes different customer classes in their commercial or industrial rate categories. For example, NSTAR's commercial Basic Service rate applies to streetlighting load, whereas WMECO charges a separate rate for streetlighting load.

1

	Residential Basic Service Rate (¢/kWh)		NSTAR – WMECO Difference	
	NSTAR	WMECO	¢/kWh	Percent
January-June, 2007	11.86	11.03	0.83	7.5%
July-December, 2007	10.84	10.18	0.66	6.5%
January-June, 2008	11.17	10.81	0.36	3.3%
July-December, 2008	12.55	12.11	0.44	3.6%
January-June, 2009	12.71	11.81	0.90	7.6%
July-December, 2009	9.22	8.55	0.67	7.8%
January-June, 2010	8.88	8.24	0.64	7.8%
July-December, 2010	7.98	7.65	0.33	4.3%
January-June, 2011	7.72	7.08	0.64	9.0%

2

3 **Q: What cost factors might explain this consistent difference in Basic Service**
4 **rates between the two distribution companies?**

5 A: I have not done a comprehensive assessment of the factors underlying these
6 price differences. However, the gap between NSTAR's and WMECO's
7 residential prices might be explained by differences in one or more of the
8 following wholesale or retail cost factors:

- 9
- 10 • Zonal energy congestion costs.
 - 11 • Zonal ancillary-service costs.
 - 12 • Residential load shape and load factor.
 - 13 • Procurement-related administrative costs.
 - 14 • Basic Service bad debt costs.

14 **Q: Are Applicants planning on consolidating the procurements for NSTAR**
15 **and WMECO Basic Service supply?**

16 A: Not at this time. According to the response to Discovery Request CLC 1-10:

1 The Joint Petitioners do not have any current plans to change the existing
2 processes for procuring Basic Service power supply, including
3 consolidation of the procurements for NSTAR and WMECO, as a result of
4 the merger.

5 However, according to the response to DR DPU-NU 4-04:

6 At the present time, the Joint Petitioners have not studied the possibilities
7 of coordinating purchases in Massachusetts, but if, post merger, it is
8 determined that opportunities exist that would be beneficial to customers,
9 the Joint Petitioners would make such a proposal to the Department.

10 **Q: How might consolidation of the NSTAR and WMECO procurements affect**
11 **NSTAR's Basic Service rates?**

12 **A:** The impact would depend in part on the extent to which the procurements were
13 consolidated. For example, the merged company could simply consolidate
14 administration and scheduling of the separate procurements. In this case, there
15 might be savings in procurement-related administrative costs and corresponding
16 reductions to Basic Service rates for both distribution companies.⁴

17 Alternatively, the merged company could combine the two procurements,
18 solicit wholesale supply for the combined Basic Service loads of the two
19 distribution companies, and establish a uniform price for the combined loads in
20 each customer class. In this case, charging the same price to customers in both
21 distribution companies would effectively spread the higher costs associated with
22 serving NSTAR load across both NSTAR and WMECO load.⁵ The net effect
23 would be to charge WMECO customers rates that exceed the market price to

⁴ In response to Discovery Request NRG 1-6, Applicants note the possibility for such reductions to administrative costs as a result of consolidation.

⁵ Consolidation might reduce capacity costs for the two companies, to the extent that there is diversity of peak loads across the two service territories.

1 serve their load, and to charge NSTAR customers rates that fall below market
2 prices.

3 **Q: How might this cost shifting affect the Compact's ability to provide**
4 **competitively priced service?**

5 A: Setting NSTAR Basic Service rates below market would adversely affect the
6 Compact (and the broader competitive retail market.) The Compact procures
7 retail power supply to serve aggregated customers at prevailing market prices
8 for NSTAR's service territory. If NSTAR were to offer Basic Service at below-
9 market prices, the Compact would not be able to offer a competitively priced
10 alternative to Basic Service at a rate that is attractive to customers and allows
11 the Compact to recover its costs. Consequently, below-market pricing of Basic
12 Service would seriously threaten the Compact's viability as a competitive retail
13 supplier.

14 **Q: How can the DPU mitigate the potential for subsidization of NSTAR Basic**
15 **Service customers?**

16 A: In the event that the merger is approved, the DPU should establish that the
17 current obligation to procure and price separately for Basic Service load in
18 NSTAR and WMECO will continue after the merger, absent a showing that
19 combined procurement would provide material reductions in wholesale supply
20 costs. Furthermore, the DPU should establish that this obligation will continue
21 after the merger, regardless of whether or the extent to which the merged
22 company consolidates the Basic Service procurements for its distribution
23 utilities.

1 **Q: What are the Compact’s concerns regarding potential utility ownership of**
2 **generation resources?⁶**

3 A: The Compact is concerned about the potential for Basic Service rates to diverge
4 from market prices in the event that the merged company is allowed to own
5 renewable or non-renewable generation for the purposes of serving Basic
6 Service load. If the merged company were to serve Basic Service load with a
7 portfolio of short-term full-requirements contracts and owned generation, Basic
8 Service rates would reflect a mix of short-term market prices and cost of service
9 for the ratebased investments. If, in turn, the cost of service for these ratebased
10 investments were less than market prices, Basic Service rates would also be
11 below market.

12 As noted above, the Compact’s ability to price its aggregated service
13 competitively would be seriously undermined if NSTAR Basic Service rates
14 were priced below market.⁷ Since the Compact pays prevailing market prices for
15 its power supply, it would have to price its service at a loss in order to match or
16 beat below-market Basic Service rates. It is therefore critical to the Compact’s
17 continued viability as an aggregator that the costs of any utility investments in
18 generation be recovered from ratepayers in a manner that does not distort Basic
19 Service rates.

⁶ Although I discuss the Compact’s concern with regard to generation ownership, this same concern applies to pricing for long-term bilateral contracts for the purchase of wholesale power, including long-term contracts for renewable generation pursuant to Section 83 of the Green Communities Act.

⁷ For that matter, it would not be in the Compact’s long-term interest for Basic Service rates to be sporadically above market, since this might increase customer “churn”, i.e., the rate that customers switch back and forth between Basic Service and Compact retail supply. An increase in churn would likely increase the Compact’s administrative costs.

1 **Q: Why is the Compact raising this particular concern in this proceeding?**

2 A: Although Applicants' are not proposing specific investments for approval in this
3 proceeding, the merger filing and responses to discovery indicate Applicants'
4 strong interest in investing in new renewable generation.

5 Applicants (at least NU) have apparently been interested in investing in
6 renewable generation for some time. WMECO has invested in a small amount
7 of solar capacity, pursuant to a settlement agreement in Docket No. D.P.U. 09-
8 05. Moreover, according to the response to DPU 4-7-SP1, NU discussed with
9 Massachusetts legislators a proposal to allow utility ownership of large-scale
10 wind projects. According to Applicants' filing in this proceeding, the proposed
11 merger would enhance the merged company's financial capability to pursue
12 such investments (or enter into long-term renewable contracts.)

13 **Q: Is there any indication that the cost of renewable investments might be less**
14 **than market prices for renewable generation?**

15 A: Yes. In Docket Nos. D.P.U. 11-05, 11-06, and 11-07, NSTAR has filed for
16 approval of three long-term contracts for the purchase of the output and
17 Renewable Energy Credits ("REC") from three new wind projects in New
18 England. According to the filings in all three proceedings, contract payments for
19 the purchase of project output and RECs are expected to be less than market
20 revenues associated with the sale of the output and RECs into the wholesale
21 markets. In other words, in all three cases, contract costs for the output and
22 RECs are expected to be lower than market prices for output and RECs over the
23 term of the contracts.⁸

⁸ Due to confidentiality restrictions, the only publicly available information is that the sum of annual contract costs over the term of the contract is less than the sum of annual market revenues over the term of the contract.

1 **Q: Are there ways to recover the costs of utility investments in generation that**
2 **don't distort Basic Service rates?**

3 A: Yes. One approach for recovering investment costs in a competitively neutral
4 fashion would be to not recover such costs through Basic Service rates. Instead,
5 the merged company would sell into wholesale markets the energy, ancillary
6 services, capacity, and renewable energy credits associated with the asset. The
7 revenues from such wholesale sales would be netted against cost of service, and
8 the difference would be recovered from or credited to all distribution customers.
9 Under this approach, all distribution customers, whether served by Basic Service
10 or competitive retail supply, would bear the costs and enjoy the benefits
11 associated with the investment.

12 Alternatively, Basic Service customers could be charged for these long-
13 term investments, not at cost of service, but at the market price for the output
14 and environmental attributes.⁹ The difference between revenues recovered from
15 Basic Service customers and the cost of service for these investments would
16 then be recovered from or credited to all distribution customers. As a result, as
17 with the sale alternative, all distribution customers would bear any net costs or
18 share in any net benefits.

19 **Q: Is there precedent in Massachusetts for the recovery of net costs or benefits**
20 **from all distribution customers?**

21 A: Yes. In Docket No. D.P.U. 09-05, the DPU approved a settlement agreement
22 that provided for the market sale of the output from WMECO's solar investment

⁹ For long-term contracts under this approach, Basic Service customers would be charged market price rather than contract price for the products purchased (e.g., energy, capacity, RECs.)

1 and that provided for the recovery of investment costs net of market revenues
2 from all distribution customers.

3 In addition, pursuant to Section 83 of the Green Communities Act and 220
4 C.M.R. 1700, NSTAR has proposed comparable treatment of contract costs and
5 market revenues for the three proposed long-term contracts in Docket Nos.
6 D.P.U. 11-05, 11-06, and 11-07.

7 Finally, in D.P.U. 10-54, the DPU approved National Grid's proposal to
8 assign the energy, capacity, and RECs from the Cape Wind contract to Basic
9 Service load at market prices and to recover the difference between market and
10 contract prices from all distribution customers.

11 **Q: How can the Compact's concerns with regard to generation ownership be**
12 **addressed?**

13 A: I recommend that the DPU find that it is reasonable, appropriate, and consistent
14 with the restructuring principles established in D.P.U. 95-30 to recover costs
15 associated with utility investments in generation assets or long-term bilateral
16 contracts in a competitively neutral fashion, such that all distribution customers
17 share equitably in both the costs and benefits associated with utility investments
18 or bilateral contracts.

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

20 A: Yes.

21

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