

Massachusetts Electric Company
Nantucket Electric Company
d/b/a National Grid
Docket No. D.P.U. 10-54
Witness: Garrett

PRE-FILED DIRECT TESTIMONY OF
MARK E. GARRETT
ON BEHALF OF
ASSOCIATED INDUSTRIES OF MASSACHUSETTS

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Exhibit MG-1 Qualifications of Mark E. GarrettAttached

SECTION I. WITNESS IDENTIFICATION AND PURPOSE OF TESTIMONY

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

2 A: My name is Mark Garrett. My business address is First National Center, Suite 1400
3 West, 120 North Robinson, Oklahoma City, Oklahoma 73102.

4

5 **Q: What is your current address and occupation?**

6 A: I am the President of Garrett Group, LLC, a firm specializing in public utility regulation,
7 litigation and consulting services.

8

9 **Q: Would you please describe your educational background and your professional
10 experience related to utility regulation?**

11 A: I am an attorney and a certified public accountant. I work as a consultant in the area of
12 public utility regulation. I received my bachelor's degree from the University of
13 Oklahoma and completed post graduate hours at Stephen F. Austin State University and
14 at the University of Texas at Arlington and Pan American. I received my juris doctorate
15 degree from Oklahoma City University Law School and was admitted to the Oklahoma
16 Bar in 1997. I am a Certified Public Accountant licensed in the States of Texas and
17 Oklahoma with a background in public accounting, private industry, and utility
18 regulation. In public accounting, as a staff auditor for a firm in Dallas, I primarily

1 audited financial institutions in the State of Texas. In private industry, as controller for a
2 mid-sized (\$300 million) corporation in Dallas, I managed the Company's accounting
3 function, including general ledger, accounts payable, financial reporting, audits, tax
4 returns, budgets, projections, and supervision of accounting personnel. In utility
5 regulation, I served as an auditor in the Public Utility Division of the Oklahoma
6 Corporation Commission from 1991 to 1995. In that position, I managed the audits of
7 major gas and electric utility companies in Oklahoma. Since leaving the Commission, I
8 have worked on various rate cases and other regulatory proceedings on behalf of
9 industrial interveners, gas pipelines and the Attorney General of Oklahoma.

10
11 **Q: Have your qualifications been accepted in proceedings dealing with cost-of-service
12 and other ratemaking issues?**

13 A: Yes, they have. A more complete description of my qualifications and a list of the
14 proceedings in which I have been involved are included at the end of my testimony as
15 Exhibit MG-1.

16
17 **Q: On whose behalf are you appearing in these proceedings?**

18 A: I am appearing on behalf of Associated Industries of Massachusetts ("AIM").
19

1 **Q: What is the purpose of your testimony in this proceeding?**

2 A: The purpose of my testimony is to address the cost allocation methods in the proposed
3 long term Power Purchase Agreements between Massachusetts Electric Company and
4 Nantucket Electric Company d/b/a/ National Grid (“the Company”) and Cape Wind
5 Associates, LLC (“Cape Wind”).
6

7 **SECTION II. DESCRIPTION OF COMPANY’S COST ALLOCATION PROPOSAL**

8
9 **Q: Please summarize the Company’s proposed plan for cost allocation.**

10 A: In this proceeding, the Company seeks approval of two long-term contracts to purchase
11 wind power and associated renewable energy certificates (“RECs”) from Cape Wind.
12 Under the first contract, the Company will purchase 50 percent of the total output of the
13 Cape Wind project, or about 760,497,500 kWh of electric power, along with the
14 associated RECs for a term of 15 years at a price beginning at \$207.00/MWH in 2013
15 and escalating 3.5% per year thereafter.¹ This price assumes that Cape Wind will
16 receive both the investment tax credit (“ITC”) and the production tax credit (“PTC”) to
17 offset the costs of the project. The Company would also collect an additional 4%
18 remuneration as prescribed in the Act, in the amount of \$6,296,847 in 2013, to
19 compensate the Company for accepting the financial obligations of this contract, which

1 See Rapp Direct Testimony at page 9.

1 would also be collected from ratepayers. With respect to the second contract for the
2 remaining 50 percent of the Cape Wind output, the Company expects to assign this
3 contract to other buyers and does not seek to recover the costs of this contract in this
4 proceeding.

5 The Company is proposing to allocate or “stream” the energy from this contract
6 to its Basic Service customers and use the RECs from this contract to meet the RPS
7 obligations for Basic Service. However, the Company seeks to impose the above-market
8 costs of this contract not only on Basic Service customers but also on distribution
9 customers purchasing generation service from competitive suppliers.² Under this
10 scheme, Basic Service customers would receive 100% of the benefits of the contract,
11 including 100% of the renewable power and 100% of the associated RECS, but would
12 pay only about 50% of the higher costs required to obtain these benefits.³ Distribution
13 customers taking generation service from competitive suppliers, on the other hand,
14 would receive none of the renewable power and none of the associated RECs under this
15 contract but would be expected to pay about 50% of the higher costs required to obtain
16 these benefits. In other words, about half of the higher costs required to obtain the

2 Milhous at page 31, lines 9-14.

3 Response to AG 3-1 states that Basic Service represents about 50% of the National Grid load.

1 power and RECs under this contract for Basic Service customers would be paid for by
2 other customers who receive none of these benefits.⁴

3

4 **Q: How is the “above-market” price calculated?**

5 A: In very general terms, the Company describes the “above-market” price as the difference
6 between the contract price paid for this power and the average price paid for all other
7 electric power purchased for Basic Service customers.⁵

8

9 **Q: How does the Company justify allocating the above-market costs of the Cape Wind
10 contract to customers who do not receive any of the power or RECs from the
11 contract?**

12 A: The Company uses the following justifications for allocating the above-market costs of
13 the Cape Wind contract to customers who purchase power from competitive sources:

14 (1) an interpretation of Chapter 164 Section 1B,⁶

15 (2) an interpretation of Section 83 of the Green Communities Act,⁷ and

16 (3) a belief that Cape Wind prices would drive away Basic Service customers.⁸

4 The benefits discussed here are the benefits associated with the electric power and RECs purchased through this contract and do not include the societal benefits discussed by Dr. Tierney. The societal benefits associated with renewables are enjoyed by all members of society – and not solely by the customers of this company – and are paid for by society through income tax schemes that subsidize these projects.

5 Milhous at page 31, line 22 through page 32, line 3.

6 Id. at page 2-4.

7 See Company’s response to AG 3-1 at page 2.

8 Id. at page 4.

1 **SECTION III. CONCERNS WITH COMPANY'S COST ALLOCATION PROPOSAL**

2

3 **Q: Do you agree with the Company's justification for spreading the costs of the Cape**
4 **Wind contract to all distribution customers, even to those customers who do not**
5 **receive any of the electric power or RECs from the contract?**

6 A: No. The Company's proposed allocation of the Cape Wind costs is objectionable from
7 *statutory, ratemaking* and *public policy* perspectives. First, the proposed allocation is
8 not supported by the statutory provisions cited by the Company in Chapter 164, Section
9 1B(d) and Section 83 of the Green Communities Act ("GCA"). Although the Company
10 makes reference to these statutes as the basis for its proposed allocation, the Company's
11 position misstates the intent and misinterprets the application of these statutory
12 provisions. Second, the Company's proposed allocation violates longstanding
13 ratemaking principles that the costs of utility service should be borne by those customers
14 who receive the benefits of that service. And third, the proposed allocation is contrary to
15 public policy in that the cost allocation would create a discriminatory and anti-
16 competitive rate. In the remaining sections of this testimony, I will address the statutory,
17 ratemaking and public policy problems with the Company's proposed allocation of the
18 Cape Wind costs. In the final section of my testimony I will offer my recommendation.

1 **III. A. Statutory Interpretation Concerns**

2 **Q: How does the Company rely on Chapter 164, section 1B(d), to support its proposed**
3 **allocation?**

4 A: The Company contends that Chapter 164, Section 1B supports its proposition that Basic
5 Service customers can only be charged the *market price* for electricity and that the Cape
6 Wind costs that are *above-market* must be charged to all distribution customers.⁹
7 Specifically, the Company states in response to AG 3-1:

8 In setting rates for Basic Service, the Company believes it is essential to
9 take into account the governing rules associated with Basic Service.
10 Specifically, the original statutory provision governing Basic Service
11 (referred to as “default service” in the law) requires that it be priced in
12 such a way that it is designed “not to exceed the average monthly market
13 price of electricity.” (Chapter 164, Section 1B(d)).

14 **Q: Do you agree with the Company’s interpretation of this statutory provision?**

15 A: No. The statute actually provides, “The distribution company shall procure such service
16 through competitive bidding; provided, however, that the default service rate so procured
17 shall not exceed the average monthly market price of electricity.” In effect, the statute
18 requires that the distribution company procure default service through competitive
19 bidding, and that the aggregate cost of those services acquired through competitive
20 bidding not exceed the average monthly market price of electricity. Here, the Company
21 did not competitively bid the Cape Wind contract. Moreover, the statute clearly

1 contemplates that the aggregate default rate (acquired through competitive bidding) will
2 be no higher than the market price for electricity. Here, the Company is comparing a
3 single contract price to the average price of its own existing contracts, which is not the
4 comparison contemplated by the language of the statute.

5 The provisions of Section 1B(d) were intended to protect default customers
6 against the risk that the distribution company would enter into above-market contracts
7 and charge the costs of those contracts to the default service customers. Nothing in the
8 statute, however, allows the distribution company to comply with the provisions of
9 Section 1B by merely shifting the costs of above-market contracts to the other
10 customers, as the Company proposes here.

11
12 **Q: How does the Company rely on Section 83 of the GCA to support its proposed**
13 **allocation?**

14 In response to AG 3-1, the Company states that, along with Chapter 164, Section 1B
15 requirements, the Company needed to take into account Section 83 of the GCA.
16 Specifically, the Company states:

17 That section permits the distribution company to retain the energy and
18 RECs for Basic Service and reflects the intent that all of the above-market
19 costs for long-term contracts entered into under section 83 be allocated to
20 all distribution customers. This avoids the potential for customers
21 attempting to bypass this cost and ensures that the incremental costs

9 This interpretation does not really explain why it is appropriate to charge Basic Service customers with 50% of the above-market costs, which is what happens under the Company's proposal.

1 resulting from implementation of the GCA be equitably shared by all.
2 (Underlines added).

3 In my opinion, this statement contains two material errors, both are underlined above.
4 First, with respect to the assertion that the GCA reflects the “intent” that above-market
5 costs be allocated to distribution customers, my reading of Section 83 as discussed
6 below, indicates no express or implied intent that above-market costs be allocated to all
7 distribution customers, particularly when the “above-market” costs are calculated in the
8 manner prescribed by the Company. Second, with respect to the Company’s assertion
9 regarding equitably sharing the incremental costs of the GCA, the Company’s approach
10 actually ensures an *inequitable* result – that is, Basic Service customers are allowed to
11 retain 100% of the Cape Wind energy and RECs while the competitive service customers
12 pay 50% of their above-market costs.

13
14 **Q: Is there any portion of Section 83 that could be construed as intent to allocate**
15 ***above-market* costs to all distribution customers as the Company claims?**

16 A: No. The words *above-market* do not appear in the statute. The relevant paragraphs of
17 the Act provide the following:

18 An electric distribution company may elect to use any energy purchased
19 under such contracts for resale to its customers, and may elect to retain
20 RECs for the purpose of meeting the applicable annual RPS requirements
21 set forth in said section 11F of said chapter 25A. If the energy and RECs
22 are not so used, such companies shall sell such purchased energy into the
23 wholesale spot market and shall sell such purchased RECs through a

1 competitive bid process. Notwithstanding the foregoing, the department
2 of energy resources shall conduct periodic reviews to determine the
3 impact on the energy and REC markets of the disposition of energy and
4 RECs hereunder, and may issue reports recommending legislative
5 changes if it determines that actions are being taken that will adversely
6 affect the energy and REC markets.

7 If the distribution company sells the purchased energy into the wholesale
8 spot market and auctions the RECs as described in the fifth paragraph, the
9 distribution company shall net the cost of payments made to projects
10 under the long-term contracts against the proceeds obtained from the sale
11 of energy and RECs, and the difference shall be credited or charged to all
12 distribution customers through a uniform fully reconciling annual factor
13 in distribution rates, subject to review and approval of the department of
14 public utilities. The reconciliation process shall be designed so that the
15 distribution company recovers all costs incurred under such contracts.
16 (Emphasis added).

17 The statute is very clear. The distribution company is allowed to either (1) use the
18 energy and RECs purchased under the contract for its own customers or (2) sell the
19 energy and RECs in the competitive markets. If the distribution company sells the
20 energy and RECs in the competitive markets, the company then allocates the difference
21 in the contact price and the sales price to all customers. The allocation of above-market
22 cost (or below-market savings) to all distribution customers, however, is expressly
23 reserved for situations where the electric power and RECs are sold in the competitive
24 markets. No such rate treatment is contemplated under the statute when the energy and
25 RECs are retained and used by the company. Under general statutory construction, the
26 express mention of the one excludes the other. Further, as discussed below, the financial

1 impact of spreading the excess or shortfall in proceeds when the power and RECs are
2 sold is vastly different than the approach proposed by the Company.

3

4 **Q: At page 32 of his testimony, Mr. Milhous states that the recommended treatment of**
5 **the Company is the same treatment that would occur if the Company sold the Cape**
6 **Wind energy and RECs in the market. Do you agree?**

7 A: No. There are several material differences. First, the calculation of the above-market
8 portion of the contract price would be very different in a situation where the power and
9 RECs are sold. Under the Company's proposed treatment, the calculation of the *above-*
10 *market* price is the contract price minus the average cost of energy purchased by the
11 Company for the Basic Service customers – in other words, the cost of renewable power
12 plus RECs compared with the cost of mostly non-renewable power without RECs. If the
13 Cape Wind power and RECs were sold, however, the calculation of the *above-market*
14 price would be the contract price minus the price third party purchasers would pay in the
15 market for renewable power and RECs, which would be a far higher price than the
16 Company's average cost of power for Basic Service customers. Thus, under a scenario
17 where the power and RECs are sold, the costs allocated to the distribution customers
18 would be far less than the costs allocated under the Company's proposed treatment.

19 Also, under the Company's proposed treatment, the Company would retain the
20 Cape Wind RECs for the benefit of its Basic Service customers and charge half of the

1 additional costs of procuring these RECs to the other distribution customers on the
2 system. If the Cape Wind power and RECs were sold, however, the Company would
3 have to procure other RECs in the market for its Basic Service customers at a cost that
4 would be charged solely to them and not subsidized by the other customers.

5
6 **Q: Are there other instances when the over or under collection of costs are assessed to**
7 **all distribution customers?**

8 A: Yes. My understanding is that the Basic Service Adjustment Mechanism (“BSAM”)
9 reconciles basic service costs and revenues on a periodic basis. This reconciliation is
10 needed because the precise level of basic service revenues may not equal basic service
11 costs since some level of estimation is involved in determining the price.¹⁰ Currently,
12 the over- and under-collections that result from these reconciliations are spread to all
13 customers, based on (1) an understanding that basic service acts as a safety net for all
14 customers, and (2) a belief that the potential effects of the differences is not expected to
15 be significant in the near term.

16
17 **Q: Do the cost reconciliations performed under the BSAM justify a similar allocation**
18 **treatment with respect to the Cape Wind costs as the Company has proposed?**

10 D.P.U. 09-26.

1 A: No. The Basic Service Adjustment Mechanism is used to collect the differences
2 between actual and estimated costs not the differences between the price paid for
3 renewable contracts and the average cost of power on the Basic Service system as the
4 Company proposes here. I cannot see that any of the reasons used to justify spreading
5 the reconciliation costs (the differences between actual and estimated costs of energy and
6 RECs of basic service) to all customers would apply in this situation.

7

8 **III. B Ratemaking Concerns**

9 **Q: From a ratemaking perspective, why is the Company's proposed treatment of the**
10 **Cape Wind costs inappropriate?**

11 A: One of the more fundamental ratemaking tenets, observed in virtually every jurisdiction,
12 is that costs should follow benefits; in other words, costs should be assigned to those
13 customers who receive the benefits brought about by those particular costs. In the case
14 of the Cape Wind contract, Basic Service customers are receiving all of the benefits from
15 the project, yet a large portion of the costs are being assigned to other customers under
16 the Company's plan. Specifically, all of the energy purchased under the contract is
17 being used by Basic Service customers and all of the contract RECs are being used to
18 meet Basic Service RPS requirements, yet other customers are being asked to bear the
19 costs to acquire these benefits.

20

1 **Q: Are there other ratemaking concerns with the Company's proposed treatment?**

2 A: Yes. In general, utility rates must be *just, reasonable* and *nondiscriminatory*. Rates are
3 generally considered *just* and *reasonable* if they are based on the cost of providing
4 service and are *nondiscriminatory* if they do not favor some customers over others.
5 Here, the Company's proposed treatment discriminates against the competitive service
6 customers by allocating these customers a significant portion of the Cape Wind costs
7 with none of the associated benefits. In essence, the competitive service customers will
8 still have to procure all of their own renewable energy requirements plus pay for a
9 portion of the Basic Service customers' renewables.

10

11 **Q: How could the proposed allocation of the Cape Wind costs be corrected to conform**
12 **with sound ratemaking principles?**

13 A: So long as all the benefits of the Cape Wind project are assigned to the Basic Service
14 customers – as they are here – then all of the costs of the project should be assigned to
15 these customers as well.

16

17 **III. C. Policy Concerns**

18 **Q. Is the Company's allocation method appropriate from a policy perspective?**

19 A. No. One of the more serious flaws with the Company's proposed allocation is that it
20 artificially lowers the cost of providing renewable power to its Basic Service customers.

1 As Mr. Milhous explains it, the ratemaking mechanism the Company proposes is
2 designed so that the Basic Service customers will be billed the same rates they would
3 have been billed absent the high-cost Cape Wind power and RECs.¹¹ This means that
4 actual pricing effects of the Cape Wind contract will not be allocated to the customers
5 that receive the benefits of the Cape Wind power and RECs. Instead, under the
6 Company's proposed mechanism, roughly 50% of the above-market costs are transferred
7 to customers who would not receive any of the power or RECs under the contract.

8

9 **Q: Why is this inappropriate from a policy perspective?**

10 A: The Company's recommended approach is inconsistent with this Department's stated
11 policy on default service pricing. In D.T.E. 99-60-C, the Department makes it clear that
12 default service pricing must derive from and be governed by the same market forces as
13 the competitive market. Specifically, the Section III of the order states:

14 Default service cannot artificially undercut the competitive market, but
15 must, if that competitive market is to function well for the benefit of all
16 consumers, derive from and be governed by those same market forces.
17 The sooner default service finds its proper role sending an efficient price
18 signal, the smoother and sounder the remaining party to competitive
19 wholesale and retail markets will be.

20 Here, the Company's proposed cost allocation is contrary to the provisions of D.T.E. 99-
21 60-C. By artificially shifting a substantial portion of the costs away from customers

11 See Milhous Direct Testimony, at p. 32, lines 16-18.

1 actually receiving the benefits under the contract, and by imposing those costs on
2 distribution customers that receive neither the power nor the RECs under the contract,
3 the allocation method undercuts the competitive market and fails to send efficient price
4 signals as to the actual cost of the contract.

5
6 **Q: Are the distribution customers that take service from third party suppliers**
7 **attempting to avoid paying for the renewable power and RECs associated with the**
8 **power they receive?**

9 A: No. Customers taking service from third party suppliers already pay for the renewable
10 power contracts and RECs acquired by their suppliers. Since all electric generation
11 providers must meet the RPS standards, the Company's distribution customers are
12 required to pay for the costs of their renewable power and/or RECs separate and apart
13 from the Company's Cape Wind contract. Thus, if the Department were to approve the
14 Company's allocation method, it would cause National Grid's distribution customers to
15 pay the increased costs associated with renewable power twice -- once for the renewable
16 power and RECs they actually acquire and use from their third-party suppliers, and a
17 second time to pay for renewable power and RECs used by the National Grid's Basic
18 Service customers. This is a fundamentally unfair and anti-competitive pricing
19 mechanism that is directly contrary to the policy objectives articulated by the
20 Department. As is explained in D.T.E. 99-60-C, "an underlying goal of the Department's

1 default service pricing policy is to ensure that, to the extent possible, default service
2 customers pay the full costs of providing that service."

3

4 **Q: How does the Company's proposed treatment of the Cape Wind costs interfere with**
5 **these important policies?**

6 A: The problems associated with the Company's proposed treatment are threefold. First, by
7 charging Basic Service customers an artificially low price to receive RECs associated
8 with the Cape Wind contract, the Basic Service customers do not receive accurate price
9 signals. Under the Company's scheme, its Basic Service customers remain shielded from
10 the impact of the Company's decision to enter this extremely high-priced contract.
11 Second, as discussed above, the Company's approach violates fundamental ratemaking
12 principles by allowing the Basic Service customers to receive REC benefits they have
13 not paid for. Finally, shifting the cost of the renewable power and RECs costs unfairly
14 burdens National Grid's distribution customers, who must pay artificially inflated prices
15 for renewable power and RECs they do not actually receive. In my opinion, it is
16 fundamentally unfair and contrary to public policy to advocate the misallocation of costs
17 -- that is, assigning the benefits of the Cape Wind energy and RECs to Basic Service
18 customers while transferring the high costs associated with these benefits to a different
19 set of customers.

1 **SECTION IV. RECOMMENDATIONS AND CONCLUSION**

2

3 **Q: What is your recommendation with respect to the Company's proposed allocation**
4 **of the Cape Wind costs?**

5 A: I recommend that, in light of the fact that Basic Service customers receive all of the
6 tangible benefits from the Cape Wind project – in effect, all of the electricity and RECs
7 generated by the project – all of the costs associated with these benefits should be
8 allocated to the Basic Service customers.

9

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

11 A: Yes. It does.