COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Request for Comments Re: Procurement of Default Service	)	D.T.E. 04-115

INITIAL COMMENTS OF NSTAR ELECTRIC

Date: January 10, 2005

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I. INTRODUCTION

Boston Edison Company, Cambridge Electric Light Company and Commonwealth Electric Company, d/b/a NSTAR Electric ("NSTAR Electric" or the "Company") hereby submit initial comments in response to the issues raised by the Department of Telecommunications and Energy (the "Department") in its Request for Comments issued on December 6, 2004, regarding the procurement of default service ("Default Service") power supply for residential and small commercial and industrial ("C&I") customers.

The Department's Request for Comments was issued in anticipation of the end of the seven-year transition period established by the Electric Restructuring Act of 1997 (the "Restructuring Act"). During the transition period, customers receiving electric service from a distribution company as of March 1, 1998, could choose to take service under "standard offer" rates regulated by the Department or to purchase electricity from a competitive market supplier at unregulated rates. As of March 1, 2005, customers currently taking Standard Offer service will become Default Service customers (unless they become customers of a competitive supplier), and thereafter, will receive service from their electric company at rates established through the company's semi-annual

procurement of supply from the competitive wholesale market. As acknowledged by the Department, the competitive retail market for smaller customers, i.e., residential and small C&I customers, has developed at a relatively modest pace, and therefore, the vast majority of residential and small C&I customers will be purchasing electricity on and after March 1, 2005 as Default Service customers (Request for Comments at 1-2). Accordingly, the Department states that the purpose of its Request for Comments is to obtain feedback on how existing Default Service procurement policies could be further modified to ensure that the benefits of the competitive market continue to accrue to all Massachusetts customers on and after March 1, 2005.

As discussed in these comments, the central objectives of legislative and regulatory policy to date regarding the provision of Default Service for residential and small C&I customers have been: (1) to establish a structure for Default Service that is compatible with the development of an efficient market structure for retail generation services so that there is an opportunity for the benefits of increased competition to flow to smaller customers; and (2) to ensure the availability of electric service at a reasonable and relatively stable price. In the past year, the Department's established procurement practices have also enabled the Company to structure a seamless transition for Standard Offer customers who will become Default Service customers on March 1, 2005.

Therefore, from the Company's perspective, the Department's existing Default Service procurement practices achieve the appropriate balance for customers in terms of meeting these important public-policy objectives and in terms of ensuring that prices are market-driven without exposing customers to the full extent of price volatility on the market. As a result, benefits resulting from the creation of a competitive electric

generation market will flow to Default Service customers (including those transitioning from Standard Offer service on March 1, 2005) through the Company's competitive solicitations for Default Service supply, even if no changes are made to the Department's procurement policies.

At the same time, the Company recognizes that the Department may deem it appropriate, on a going forward basis, to make some modifications to its Default Service procurement practices to achieve a higher level of price stability for residential and small C&I customers, while enabling the continued development of the competitive market for electric supply. Therefore, in responding to the Department's questions, these comments discuss how existing procurement practices could be modified to provide a further level of price stability for customers. As NSTAR Electric has advocated in the past, these and any other proposed changes to Default Service procurement practices should be reviewed by the Department in the context of an analytical framework that ensures that any resulting changes are consistent with basic public-policy goals previously enunciated by the Department.

Accordingly, these comments are organized as follows: Section II describes NSTAR Electric's current procurement status, which includes the status of supplies procured for Standard Offer customers transitioning to Default Service on March 1, 2005. Section III discusses the policy framework that the Department should apply in evaluating potential changes to Default Service pricing and procurement and Section IV provides the Company's specific answers to questions set forth by the Department in its Request for Comments.

II. NSTAR ELECTRIC'S CURRENT PROCUREMENT STATUS

On March 1, 2005, customers currently taking Standard Offer service will become Default Service customers and will thereafter receive service from NSTAR Electric at rates established through the Company's semi-annual procurement of supply from the competitive wholesale market. In anticipation of this transition, the Department has taken steps over the past year to plan for the expiration of Standard Offer and to ensure that the transition to Default Service will be seamless for Standard Offer customers. For example, the Department instructed the Company to incorporate the load for Standard Offer customers who will transition to Default Service in the Default Service supply solicitations conducted by the Company in April and October 2004. See, e.g., NSTAR Electric, Default Service Tariff at 2 (May 21, 2004).

In light of the Department's efforts to provide for a smooth transition, the status of Default Service procurement on the NSTAR Electric system is as follows: Approximately 50 percent of total customer load is currently taking Standard Offer service from the Company. The remaining 50 percent of NSTAR Electric customer load is split almost equally between Default Service and competitive supply. Under existing procurement practices, the Company purchases supply for its Default Service customers in two semi-annual solicitations (i.e., once every six months), each resulting in a contract for 50 percent of the needed supply for a term of one year.

Consistent with the Department's instructions regarding the procurement of supplies for transitioning Standard Offer customers, NSTAR Electric locked in the supply necessary to serve all customers who will be on Default Service as of March 1, 2005, as part of its two most recent solicitations: (1) the first in April 2004 for 50 percent of the existing Default Service load for the term July 1, 2004 through June 30, 2005; and (2) the

second in October 2004 for the remaining 50 percent of existing Default Service load for the term January 1, 2005 through December 31, 2005. As part of the April 2004 solicitation, the Company procured supply for 50 percent of the total Standard Offer load expected to transition to Default Service on March 1, 2005, for the period March 1, 2005 through June 30, 2005. As part of the October 2004 solicitation, the Company procured supply for the remaining 50 percent of the Standard Offer load expected to transition to Default Service on March 1, 2005, for the period March 1, 2005 through December 31, 2005.

Consequently, at this point in time, the Company has the supply locked in to serve all Default Service customers on March 1, 2005, which will ensure a seamless transition for Standard Offer customers who will begin taking Default Service on that date.[1] Because the Department has already provided for the consolidation of Default Service loads, the Department's attention can now be turned to an evaluation of whether additional price stability for smaller Default Service customers is desirable, and if so, to the identification of changes to achieve that objective.

III. POLICY GUIDELINES TO EVALUATE CHANGES IN DEFAULT SERVICE PRICING AND PROCUREMENT

There are several factors that bear on the Department's consideration of changes in its existing Default Service pricing and procurement policies. First, the Department's Default Service procurement policy for smaller customers must be consistent with the statutory provisions set forth in the Restructuring Act governing Default Service. In that

[1] The first solicitation for the "consolidated" Default Service load will occur in April 2005 for the term July 1, 2005 through June 30, 2006. This solicitation will be for 50 percent of the consolidated load, unless the Department makes a determination in this proceeding, and prior to the April solicitation, to change the existing procurement schedule.

regard, the Restructuring Act establishes the following parameters for utility-provided Default Service:

- Each distribution company shall provide its customers with Default Service;
- The distribution company shall procure its Default Service supply through a competitive bidding process;
- The Default Service price shall not exceed the average monthly market price of electricity;
- All bids shall include payment options with rates that remain uniform for periods of up to six months.

G.L. c. 164, § 1B(d). In combination, these four basic requirements convey a policy directive that requires the Department to establish procurement practices designed to strike a balance between market-based rates and rate stability for customers.

Based on the policy directives embodied in the Restructuring Act, the Department has defined its policy mission to encompass "two equally important principles that serve as guidelines for the design and implementation of default service." Default Service, D.T.E. 02-40-B at 30. These principles are that: (1) Default Service should be provided in a manner that is compatible with the present development and future sustenance of an efficient market structure for retail generation service; and (2) for those customer classes for whom an efficient competitive retail market may not be available, Default Service should be provided in a manner that ensures that electric service will be available at a reasonable price. Id.

Consistent with these guiding principles, the Department has developed Default Service procurement practices for smaller customers that are designed to maintain the balance between a reliance on competitive market forces and a level of rate stability for customers. In that regard, the Department currently requires distribution companies to

procure 50 percent of their residential and small C&I supply requirements semi-annually for twelve-month terms, producing Default Service prices for six-month terms based on a portfolio of resources from a company's two most recent supply solicitations. D.T.E. 02-40-B at 44-45; Request for Comments at 3. As stated by the Department, this type of approach is designed to balance "price certainty and price efficiency." Id. The Department has also recognized the importance of minimizing customer confusion and dissatisfaction during the transition stage of restructuring because these factors have the potential to undermine the industry's efforts to transition to a competitive market. D.T.E. 02-40-B at 30.

Lastly, to fulfill its policy mandate, the Department should also consider more specific policy parameters such as the following:

- In evaluating proposals for structuring default service, the Department should apply a standard that will result in measurable benefits to customers;
- Opportunities for direct access to retail markets should be allowed to develop at a different pace for different customer groups;
- Default Service prices should reflect no more and no less than the costs incurred to procure default service from the competitive market; and
- The concept of retail choice should be maintained and customers should not be involuntarily assigned to retail suppliers.

See, D.T.E. 02-40-B, Initial Comments of NSTAR Electric, August 9, 2002, at 3.

As the Company has advocated in the past, these parameters help to frame an analytical approach for the consideration of potential changes to existing Default Service procurement practices. Using an analytical approach to evaluate potential changes will enable the Department to further its stated goals of maximizing consumer welfare, minimizing customer confusion and ensuring the availability of electric service at a

reasonable price, while promoting the continued development of the competitive retail market.

IV. RESPONSES TO DEPARTMENT QUESTIONS

The Company's responses to the Department's questions as set forth in the Request for Comments are detailed below:

(1) Would smaller customers be better served if power supply for Default Service is procured using a portfolio of more than two solicitations? Please discuss the advantages and disadvantages of increasing the number of solicitations used to procure Default Service supply.

One consideration that the Department has long recognized regarding the procurement of Default Service supply from the competitive market is that prices in a deregulated market have the potential to fluctuate significantly in short time periods based on the forces of supply and demand, which may create an undesirable level of price volatility for residential and small C&I customers. At the same time, the Department has demonstrated a desire to have Standard Offer and Default Service prices "track" market prices to a degree so that customer consumption is guided by accurate price signals and so that the competitive market can function appropriately. Therefore, the Department's existing procurement practices for this customer group are designed to mitigate price volatility, without creating impediments to the development of the competitive market.

In terms of mitigating price volatility, the Department has recognized that customer rates are not as vulnerable to short-term fluctuations in market price when: (1) supply is purchased in segments, so that only a portion of the load is subject to price fluctuations in the market at any given time; and (2) supply is purchased for a period of time rather than being purchased on a daily or monthly basis, so that load is shielded from the brunt of short-term market price swings. Thus, the Department has established a

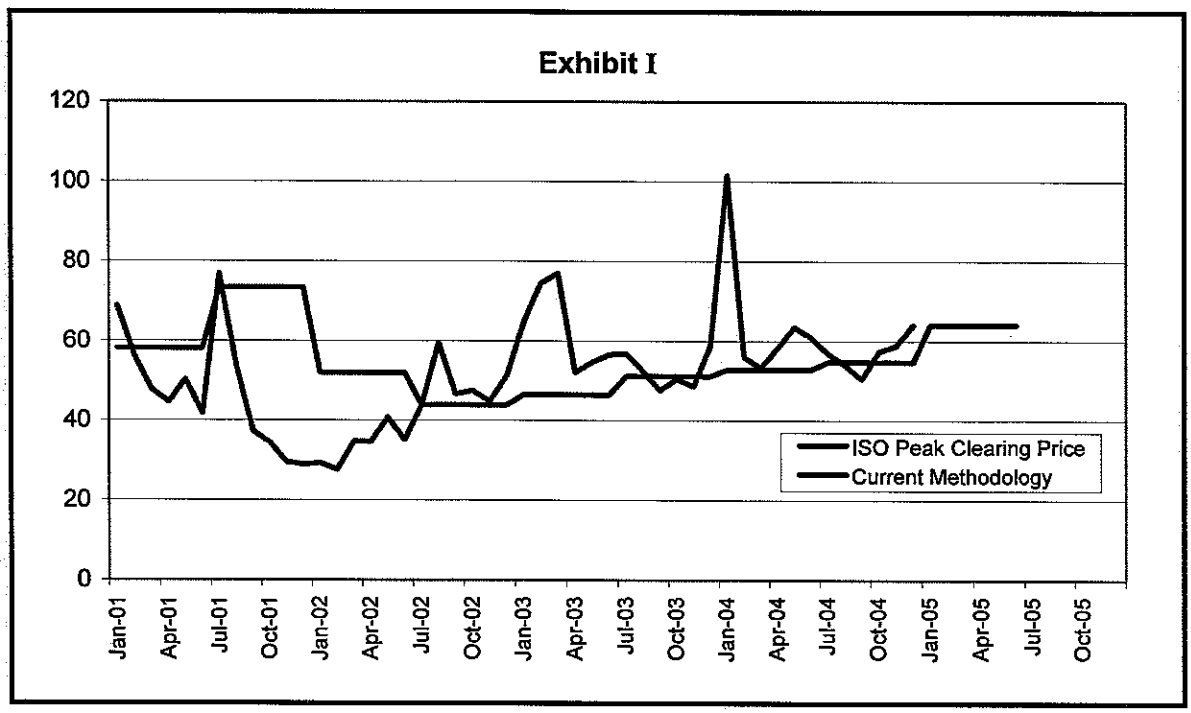
procurement schedule that provides for two semi-annual procurements, each for 50 percent of the Default Service load and each for a one-year term. The Company's experience to date has been that this procurement schedule has achieved a significant level of price stability for customers, while allowing prices to also "track" the market and establish accurate price signals for customers. Moreover, the process is feasible and efficient from an administrative perspective.

However, if the Department's objective were to achieve a higher level of price stability for residential and small C&I customers, there are a couple of modifications to the procurement schedule that the Department could consider. In particular, there are two interrelated components of the procurement process that bear on the level of price stability achieved for smaller customers. These two components are: (1) the number of "tranches" or segments to be procured (i.e., the number of solicitations); and (2) the duration of the supply term.

These two components are interrelated because the intent is to procure tranches on a staggered basis so that only a portion of supply is subject to the market at any given time. However, if the Default Service load is divided into smaller tranches, and Default Service rates change each time there is a solicitation, then customers will experience a greater frequency of price changes unless the duration of the contract terms are extended. Accordingly, any change to the existing procurement schedule to achieve a higher level of mitigation will need to deal with both of these components, as well as taking into consideration issues of rate continuity for customers, administrative feasibility and efficiency for the Company and the Department.

With the total load for residential and small C&I customers currently divided into

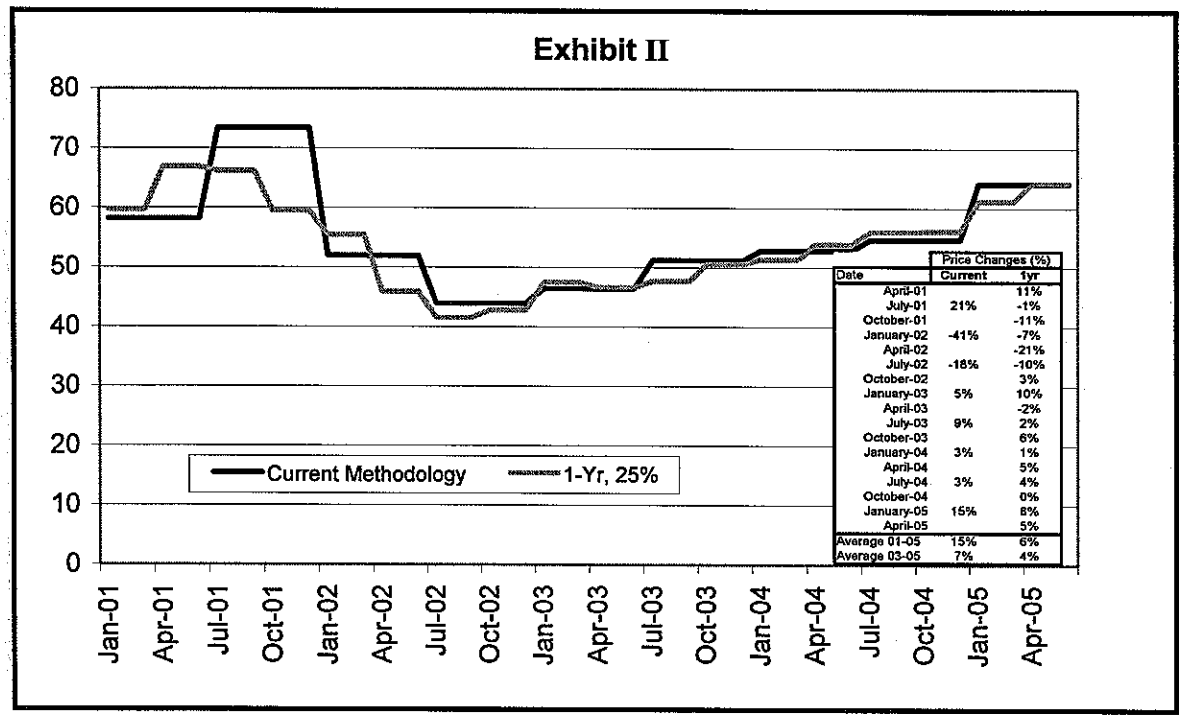
two tranches, and supply being procured for a one-year term, the Company is conducting a bid solicitation every six months, or two times a year. Under this schedule, Default Service rates change twice a year and the price charged is a composite of two solicitations. Exhibit I compares the ISO Peak Clearing Price with the price charged to customers had the Department's existing procurement practice been in place since 2001, which illustrates the level of price stability achieved through the 50 percent/one-year term solicitations.



As shown on Exhibit I, the Department's existing procurement practice tracked market prices reasonably well, while protecting customers from the largest swings in spot market prices.

If the Department were to modify procurement practice and divide the procurement of Default Service load into a greater number of tranches, the Department would also need to make a determination regarding contract term. For example, if the

total Default Service load was divided into four tranches, each solicitation would be for 25 percent of the load. If one-year contracts were used, the Company would be conducting quarterly solicitations, the Default Service rate would change four times a year, and the rate charged to customers at any given time would be the composite of four solicitations. Exhibit II compares the current methodology to a procurement protocol involving tranches equal to 25 percent of the Default Service load with a one-year contract term.

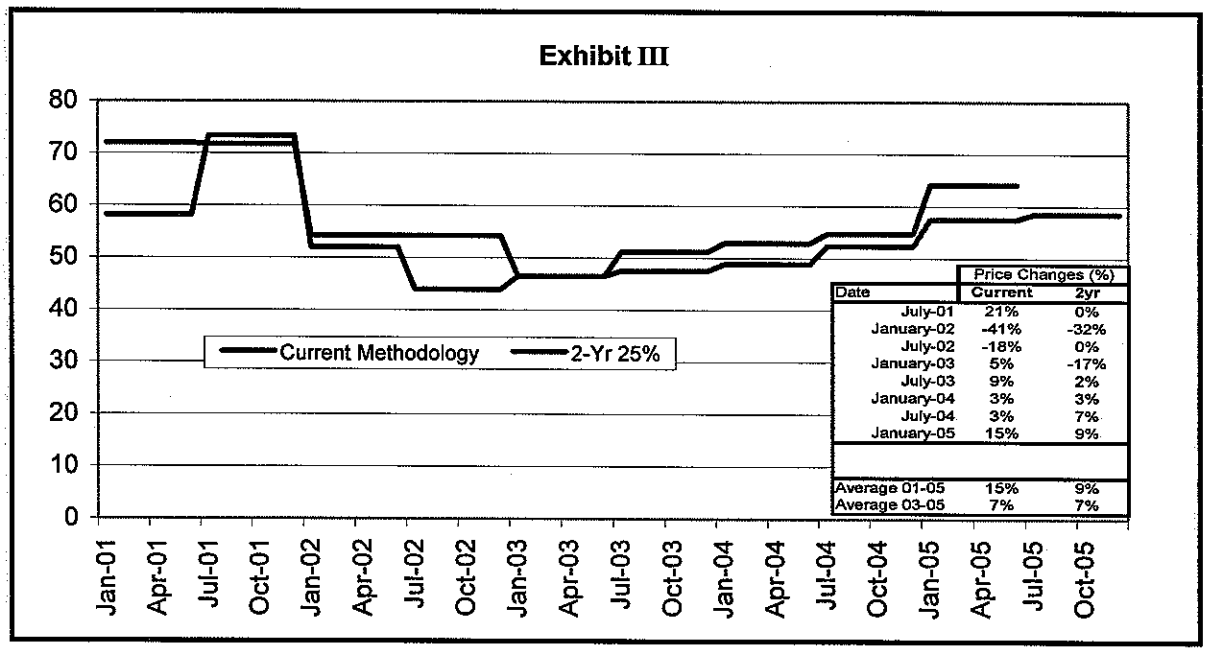


Date	Price Changes (%) Current	1yr
April-01		11%
July-01	21%	-1%
October-01		-11%
January-02	-41%	-7%
April-02		-21%
July-02	-18%	-10%
October-02		3%
January-03	5%	10%
April-03		-2%
July-03	9%	2%
October-03		6%
January-04	3%	1%
April-04		5%
July-04	3%	4%
October-04		0%
January-05	15%	8%
April-05		5%
Average 01-05	15%	6%
Average 03-05	7%	4%

As shown in Exhibit II, a procurement protocol involving tranches of 25 percent for a one-year term would provide a greater level of price stability in terms of lessening the magnitude of price changes, but customers would experience rate changes four times a year. Specifically, the magnitude of price changes since January 2001 averaged approximately 15 percent under the current methodology and would have averaged

approximately 6 percent under a 25%/1-year methodology.[2] Thus, price stability (in terms of the size of incremental price changes) is enhanced, but it comes at a cost of rate continuity for customers.[3] In addition, although feasible, quarterly solicitations would increase the administrative burden for the Company.

If the Department were to divide the solicitations into four tranches (25 percent each) and to extend the contract term to two years, then a higher level of price stability could be achieved without increasing the frequency of price changes for customers and without increasing administrative burdens for the Company. Exhibit III compares the current procurement methodology to a procurement protocol involving tranches equal to 25 percent of the Default Service load and two-year contract terms.



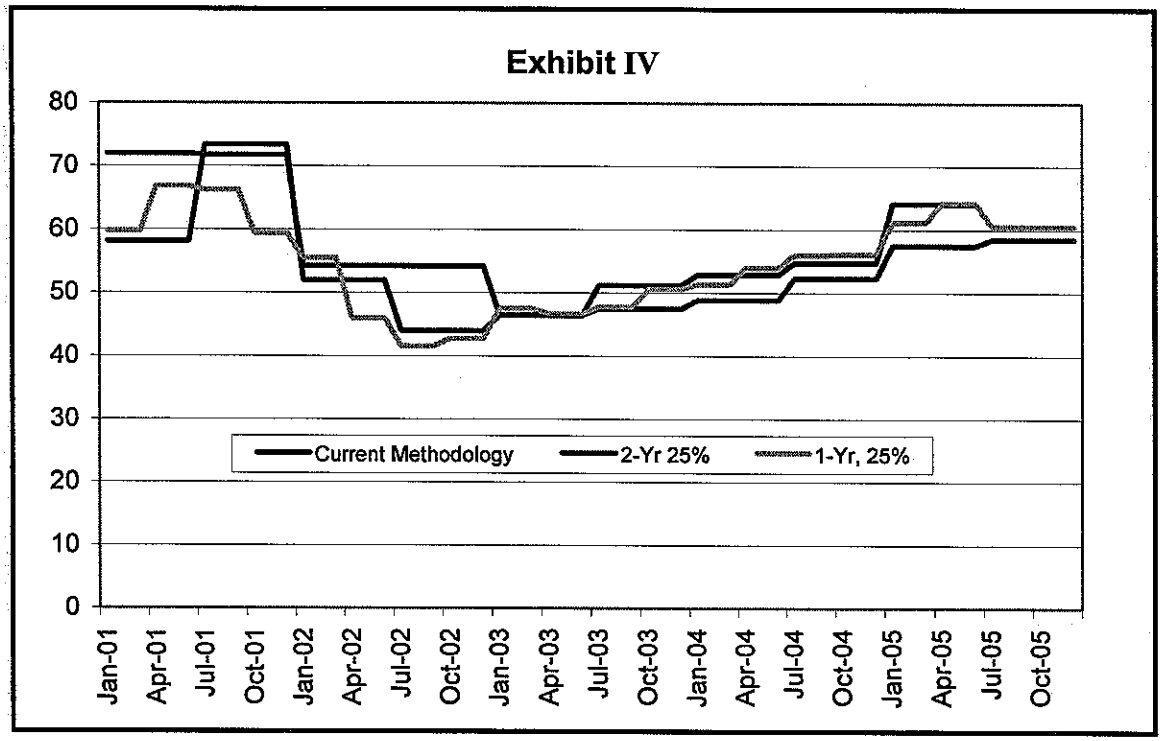
Date	Price Changes (%) Current	2yr
July-01	21%	0%
January-02	-41%	-32%
July-02	-18%	0%
January-03	5%	-17%
July-03	9%	2%
January-04	3%	3%
July-04	3%	7%
January-05	15%	9%
Average 01-05	15%	9%
Average 03-05	7%	7%

2 There has been less price volatility in the electric markets in the years 2003 through 2005. Taking that period alone, the current methodology yielded price changes of a magnitude of approximately 7 percent, versus a magnitude of 4 percent under a 25%/1-year methodology.

3 Also, it would be necessary to maintain a six-month pricing option for customers to avoid contravening the Restructuring Act's requirement that Default Service prices for smaller customers be for terms of up to six months, which the Department has interpreted as requiring prices to be set for six-month periods. Default Service, D.T.E. 99-60-B at 7, n.8.

As shown in Exhibit III, a procurement protocol involving tranches of 25 percent for a two-year term would provide about the same level of price stability as the current methodology in periods where prices are relatively stable, but would provide a greater level of price stability in periods where there is a high degree of price volatility. Moreover, this greater level of price stability would not involve more frequent rate changes for customers, as would the 25%/1-year protocol. Specifically, the magnitude of price changes since January 2001 averaged approximately 15 percent under the current methodology and would have averaged approximately 9 percent under a 25%/2-year methodology. However, there was a high degree of price volatility in the years 2001 through 2003, and the 25%/2-year would have worked better to mitigate that volatility because price changes (up or down) are incorporated more slowly under a two-year regime. Taking the period 2003-2005 alone, both the current methodology and a 25%/2-year methodology would yield price changes of a magnitude of approximately 7 percent because prices were relatively stable in that time period. Accordingly, this option would provide a higher level of price stability than the current methodology in times of high price volatility without requiring more frequent Default Service price changes and without imposing an increased administrative burden.

Exhibit IV shows a comparison of the current methodology to both the 25%/1-year and 25%/2-year methodologies.



As discussed above, the 25%/1-year methodology produces price changes of lesser magnitudes, but involves more frequent price changes (and more administrative burden). The 25%/2-year methodology stabilizes prices to a greater degree than the current practice in times of high volatility, but with the use of longer-term contracts reflects changes in market price (up or down) on a more gradual basis than the use of one-year contracts. In fact, the existing procurement practice (50%/1-year term) provides a good balance between price stability, rate continuity and the desire to track market prices, without imposing an administrative burden.

In that regard, it should be noted that NSTAR Electric does not advocate for procurement solicitations more frequently than a quarterly basis. First, as discussed by NSTAR Electric in its Initial Comments in the D.T.E. 02-40-B proceeding, the procurement process for Default Service supply involves several procedures that are

necessary regardless of the frequency of solicitations.[4] The solicitation, review and approval process currently takes approximately 45 business days (two months) to complete and the customer notification period adds an additional 30 calendar days. Although this process could be compressed to some extent, if required, fitting the process into a timeframe more frequent than quarterly poses risks to customers because of the importance of these procedures in securing the best proposals from suppliers and in facilitating the development of a comprehensive supply contract with clear and accurate terms.

Moreover, the most important procedure involved in developing a final Default Service supply contract is the negotiation process between the distribution companies and winning bidders. Currently, the negotiation of appropriate contracts to deal with the wide variety of issues that arise is a critical component of the procurement process. In addition to negotiating price terms during this process, liability issues, financial security provisions, and allocation of duties between the parties are each negotiated before a final contract is signed. Agreements on these and other issues ensure the orderly and efficient

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[4] NSTAR Electric's procedures and typical time line for: (1) procuring Default Service supply on a semi-annual basis; and (2) notifying customers of forthcoming Default Service price changes is, as follows:

(1) update request for proposals ("RFP") and proposed contract (10 business days);

(2) issuance of the RFP and the bidding period (10 business days);

(3) receipt of bids, bid review and management approval (5 business days);

(4) contract negotiations with the winning bidder or bidders (10 business days);

(5) preparation of Default Service supply contract filing to the Department (3-5 business days);

(6) Department review and approval (5 business days); and

(7) customer notification of change in Default Service price (30 days).

provision of Default Service between distribution companies and suppliers, as well as inevitably producing lower prices for customers. Therefore, an adequate amount of time must be available to both distribution companies and suppliers to properly negotiate the terms of supply contracts.

Ideally, a "standard contract" could be negotiated up front so that the only point at issue would be the price negotiated in response to the Request for Proposals. However, because of wholesale market rule changes and the entry of new players with a desire to conform the "standard contract" to fit their business objectives, negotiation of these contracts remains necessary. Although time consuming, this process increases the number of participants in the Request for Proposals, and therefore, has a positive impact on the level of competition in the process. In the future, it may be possible for wholesale markets to move toward a standard contract and to compress the time frame for contract execution.

Accordingly, in responding to the Department's questions, NSTAR Electric has concluded that the existing procurement methodology is working reasonably well to achieve a significant level of price stability for customers, while allowing prices to also track the market and establish accurate price signals for customers. Moreover, the process is feasible and efficient from an administrative perspective. The Company suggests that, if the Department's objective is to achieve a greater level of price stability for customers, the Department should provide for solicitations involving 25 percent of the Default Service load for terms of two years. This approach provides the best result in terms of (1) achieving a greater level of price stability; (2) maintaining rate continuity for

customers; (3) creating administrative efficiency; and (4) ensuring that the Default Service price continues to track market prices over the long term.

(2) Would smaller customers be better served if power supply for Default Service was procured for a term longer than twelve months? Please discuss the advantages and disadvantages of using supply terms greater than twelve months. In particular, please discuss:

(a) whether longer contract terms are likely to produce lower prices;

(b) how such an approach would affect price certainty and market efficiency, and

(c) how such an approach could be tailored to accommodate customer migration to competitive supply.

The Department has recognized in the past that lengthening the procurement term would likely result in more price stability for smaller customers. D.T.E. 02-40-B at 44-45. NSTAR Electric agrees with this general proposition. However, NSTAR Electric does not believe that longer term contracts "are likely" to produce lower prices.

As a fundamental matter, there is no general rule of thumb that would lead to the conclusion that longer term contracts "are likely" to produce lower prices. For example, if a longer-term contract is executed during a period of relatively low electricity prices, that contract will generally reflect those "lower" prices over the life of the contract, where price changes occurring during that period would be captured in any solicitation for a shorter term. However, the Company generally does not have the flexibility to "time" its procurements to adjust to prevailing market conditions. Thus, it is equally likely that a longer-term contract will lock in relatively high prices. It is also possible that market prices at the end of a longer-term contract may not be any different from the contract price. Therefore, the only conclusion that can be drawn regarding the relationship between contract term and price is that a longer-term contract has a greater

potential to establish a price that is different from market over the course of the contract.

In addition to market timing, other factors may cause relatively long-term contracts (i.e. greater than two to three years) to result in higher, not lower, prices for smaller customers. First, as noted previously, long-term contracts may result in the payment of premiums over the spot market price for electricity because suppliers must shoulder increased risks related to variable loads and price volatility. In addition, the current lack of stability in wholesale market rules makes contracts of over two years relatively unattractive to many bidders, and may result in more expensive electricity because suppliers must factor in the risk of uncertainty with longer term contracts.[5] Moreover, suppliers have less ability to hedge their positions when contract terms are relatively longer because there are fewer counterparties willing to take a position in the market. Lastly, the lack of bidders on Default Service contracts, in and of itself, may result in higher prices for small customers to the extent that fewer bidders produces less favorable prices than would likely occur with a more vibrant bid pool.

Even if a longer-term contract results in relatively lower prices over the period of the contract, there is the potential for customers to experience "sticker shock" at the end of a longer-term contract. For example, the State of Maine is currently nearing the end of a state-procured, three-year electricity contract for standard offer customers. Because electricity prices are dramatically higher in Maine than they were three years ago,

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5 This may be mitigated if the Department continues to allow cost flow-through for unresolved market costs, such as costs associated with ISO-NE's Locational Installed Capacity policy.

customers in Maine are likely to experience up to a 30 percent increase in prices once their current contract ends.[6]

Conversely, contracts of relatively shorter duration tend to remain reflective of market prices. D.T.E. 02-40-B at 44-45. Moreover, because electricity prices do not tend to fluctuate dramatically over periods of one or two years or less, there is less risk of market shock for customers being served under shorter-term contracts (as compared to customers in the State of Maine, for example). As a result, the dynamic that occurs in considering short versus long-term contracts is that the use of longer contracts helps to mitigate price volatility, but if the contract is too long, will involve the payment of a risk premium. Shorter contracts more closely track market prices, and therefore, do not involve a high risk premium, but are consequently not as effective in mitigating price volatility.

Shorter-term contracts are also less attractive than longer-term contracts in terms of contract administration. For example, procuring Default Service for a large number of customers pursuant to shorter term contracts requires more RFPs to be issued, more credit reviews of potential suppliers and more time reviewing draft contracts than if Default Service supply were procured pursuant to longer-term contracts. Moreover, procuring Default Service supply through shorter-term contracts would result in additional Department filings, with their commensurate demands on both Company and Department resources, and potentially more rate changes for customers in a given 12-month period.

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6 Please see http://www.state.me.us/mpuc/News%20Releases/prStdOfferRes0305.htm for more information. Because the Department's current Default Service procurement policy is based on staggered or "laddered" procurements, price jumps similar to the one facing Maine customers are avoided to the extent that procurements are based on less than 100 percent of a distribution company's load for a particular customer class and the rates from such staggered procurements are blended.

Accordingly, if the determination is made to solicit supply with a greater number of tranches (i.e., four tranches of 25 percent each), NSTAR Electric would like the Department to consider allowing distribution companies to procure Default Service supply for smaller customers for a period of up to two years, as described in response to Question 1, infra. With a two-year contract, any increased risk of a "premium" over spot market prices will be smaller and will be mitigated by blending the rates with other solicitations. Moreover, the Company's proposal to allow distribution companies to procure Default Service supply in 25 percent increments for periods up to two years will mitigate the potential for large changes in price for any one solicitation and will maintain rate continuity for customers because prices will continue to change every six months.

If two-year contracts are used, the requirements of G.L. c. 164, §94A ("Section 94A") will apply. Section 94A requires approval by the Department of contracts for the purchase of gas or electricity with contract terms in excess of one year. However, Section 94 does not dictate the process that must be used by the Department to approve contracts for electric supply. In fact, Section 94A explicitly allows the Department to establish a review and approval process that is in the public interest. Id.

In that regard, the Department has previously recognized that its responsiveness in reviewing Default Service solicitations is essential to ensuring that markets work to produce the lowest prices for customers, and instituted a 5-day review period for reviewing Default Service solicitations. Default Service, D.T.E. 99-60-C at 8. Moreover, in approving gas supply contracts, the Department has applied a two-part standard requiring a demonstration that (1) the supply is needed; and (2) that the supply to be procured compares favorably to other alternatives reasonably available to the

company. This type of analysis is not needed in relation to Default Service supply in light of the RFP process that the Company conducts.

In addition, the Default Service price would likely reflect a premium if the Company were to seek a regulatory approval clause in the contract and hold the contract pending a review and approval process by the Department. This is because competitive wholesale suppliers are generally uncomfortable entering into a contract for a fixed price that contains a regulatory approval clause. In that situation, suppliers perceive a risk in that, if regulatory approval is not granted, the supplier will have to liquidate its supply and losses not covered by an executed contract will be incurred.

In approving the price for Default Service, the Department is effectively determining that the supply is needed and that the RFP process has established that the supply compares favorably to other reasonably available alternatives. In addition, the establishment of a formal review and approval process will increase costs and create delay, which will have a negative effect on price. Therefore, for purposes of Section 94A, the Department should find that it is in the public interest to continue the existing process for Department review of Default Service prices, and that contracts entered into by the companies to service Default Service load as a result of the RFP process, are deemed approved when the price is approved by the Department.

(3) Would small customers be better served if power supply for Default Service was procured on a statewide basis? Please discuss the advantages and disadvantages of using a statewide approach to Default Service procurement.

NSTAR Electric does not believe that smaller customers would be better served if power were procured on a statewide basis for Default Service. In short, there are no benefits to be gained through the establishment of a statewide process. For example, if

the purpose of the "statewide" process is to have a single entity managing the RFP process, there could actually be a loss of customer benefits that result from the current structure. The current structure promotes competition given that there are multiple companies, with multiple solicitations to the market, thereby increasing the number of transactions and the numbers of buyers and sellers in the market. If the purpose of a "statewide" process is to have a single entity manage the entire procurement process through contract administration, there will be significant obstacles to overcome in terms of contract negotiation, contract administration, credit, title issues, liability and other details.

As noted by the Department in its Request for Comments, two states, Maine and New Jersey, currently procure supply Default Service supply on a "statewide" level. Maine procures its Standard Offer Service supply through an RFP process administered by the MPUC staff. See 35-A M.R.S.A. § 3212.(2); see also Order Designating Standard Offer Service Providers, [Maine Public Utilities Commission] Docket No. 2004-342, at 1-2 (July 20, 2004). New Jersey procures Basic Generation Service through a statewide auction process administered by consultants for the utilities and the NJBPU.[7] Significantly, the statewide procurement models established in Maine and New Jersey were intended to address specific circumstances present in those markets, which are not concerns in the Massachusetts competitive generation market. As a result, this construct does not appear to offer any advantages over the current system of Default Service procurement by distribution companies either in terms of promoting the competitive market or to provide customer benefits.

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[7] As noted by the Department in its Request for Comments at 4, n. 4, Maine Standard Offer Service and New Jersey Basic Generation Service are equivalent to Massachusetts' Default Service.

For example, one important distinction between New Jersey and Massachusetts that factored into the New Jersey proceedings is that, in New Jersey, generation assets continue to be utility-owned. Accordingly, where utility affiliates that own generation are bidding on supplying utility customers, an independent solicitation process better ensures that no self-dealing is occurring in the context of supply procurement. This concern is not applicable in Massachusetts because the utilities do not participate in the generation market and have no vested interest in the awarding of supply contracts to individual competitive suppliers.

In Massachusetts, the Department has already established a uniform set of rules under which the distribution companies solicit for Default Service and these rules ensure that consumer benefit is maximized. Under the current system, distribution companies solicit Default Service supply from the wholesale market semi-annually through RFPs. The semi-annual solicitation periods are staggered among the distribution companies and, therefore, the distribution companies are not simultaneously soliciting bids for supply. This diversity of solicitation periods benefits smaller customers because it lowers costs for suppliers to bid on their load. Where multiple distribution companies are procuring supply from multiple sellers, the diversity of buyers and sellers contributes to a more vibrant competitive solicitation than would likely occur if a single-state purchaser is conducting the solicitation. Thus, in Massachusetts, customer benefit is maximized through the existing procurement process and the creation of a statewide process, of any scope, would only add cost.

If the purpose of the statewide process is to create a single procurement process through contract administration or to obtain a single price for all customers, there will be

significant obstacles to overcome. For example, each utility's customers are located in different load zones, some of which are constrained and have different loss factors. This results in different prices for different customers, some of whom benefit from ample supplies of capacity and energy. Others customers pay a premium for capacity and energy in constrained zones. Thus, under a statewide procurement to obtain a single price for all customers, some customers would be subsidizing others. In addition, this construct would eliminate the price signal for investment in infrastructure in constrained zones because customers in those zones would not see the benefit of those investments.

Statewide procurement also has inherent drawbacks to distribution company procurement that would be more difficult to address. For example, the current system of distribution company solicitation and Department oversight of the process allows for the Department to provide a beneficial "checks and balances" role, ensuring that the distribution companies' RFP process is sufficiently competitive to ensure that smaller customers receive the lowest prices for Default Service. To the extent that the Department was to undertake both roles, as solicitor of supply and overseer of the process, customers would lose the benefit of having independent oversight over the process, i.e., ensuring that the process is efficient and sufficiently competitive to produce the lowest-possible prices for Default Service. To the extent that statewide solicitations are performed by governmental authorities, an administrative body or consultants separate from the Department would perform the solicitations and the Department would oversee the process. However, in either instance, a change in the law would be necessary and a significant increase in state resources would be required to accomplish this change in the solicitation process. The Department should not create a procurement regime that

adds the burden of another layer of administration because this will only increase costs for customers.

It should also be noted that, under the current system, distribution companies ensure that the suppliers with whom they contract for Default Service have sufficient credit worthiness to perform their obligations under the contract. Any state governmental procurement process would have to ensure that the suppliers bidding on a statewide Default Service solicitation have similar *bona fides* to ensure performance under a Default Service supply contract.

In addition, a related issue (and one potentially more difficult to address) is how a statewide procurement process would incorporate the credit facilities of distribution companies into the procurement process. For example, similar to the reliance by distribution companies on a supplier's credit-worthiness, suppliers count on the credit worthiness of distribution companies when executing Default Service contracts as a means of ensuring that they will be paid pursuant to the contracts' terms. Distribution companies must, in turn, manage their credit facilities to ensure payment. However, to the extent that an entity conducting a statewide procurement process attempts to utilize the credit of the distribution companies without the companies' involvement, serious credit risks to the distribution companies may accrue.

In New Jersey, the distribution companies sign the supply contracts with the competitive suppliers and are heavily involved in the process through designing the process and the hiring of the consultant to oversee the process; therefore it is difficult to identify what would be gained by the implementation of this type of process in Massachusetts. In Maine, the distribution companies sign the contract with the suppliers

following a PUC-administered solicitation. However, the Maine utilities apparently do not take title to the energy under the agreement and the procedure is conducted pursuant to restructuring legislation. At a minimum, changes in the law would be required to implement an arrangement in Massachusetts that is similar to Maine.

Accordingly, for the reasons stated above, a statewide procurement process poses potential risks and costs to both the companies and their customers that are unnecessary to incur given the benefits of the current system of distribution company-procured Default Service.

(4) Would smaller customers be better served if power supply for Default Service was procured using an auction process (e.g., descending clock) rather than through requests for proposals? Please discuss the advantages and disadvantages of using an auction process to procure Default Service. In particular, please discuss whether using an auction is likely to produce lower Default Service prices.

As noted above, the State of New Jersey procures its Basic Generation Service through a "descending clock" auction process. In this process, the New Jersey Board of Public Utilities (the "Board") and a Board Advisor are responsible for initially approving the auction process, auction rules and "Supplier Master Agreements." See New Jersey Board of Public Utilities Docket No. EO04040288 (July 1, 2004 Proposal for Basic Generation Service Requirements to be Procured Effective June 1, 2005, at 7). The Board Advisor oversees the conduct of the auction and the Board ultimately renders a decision on the final auction results at the end of the auction (id.).[8]

The "clock auction" itself consists of several rounds of bids, whereby bidders indicate in each round how much of the load of each distribution company they want to

[8] Technically, two auctions are performed, one for fixed-priced supply for smaller customers and one for hourly-priced service for large C&I customers.

serve at prices offered by an Auction Manager (NERA Economic Consulting Project Profile at 1). The load for each distribution company is offered in approximately 100 megawatt "tranches" or "slices," representing a fixed percentage of the distribution company's total fixed-price obligation to serve load (http://www.bgs-auction.com/bgs.auction.overview.asp). The price for a distribution company's load is then lowered or "ticked down" in a subsequent round where bidders can bid to provide additional load at the lower price, until sufficient bids have been received to serve the entire load of a distribution company (NERA Economic Consulting Project Profile at 1). Bidders may revise their auction offerings as the auction progresses, or switch offerings from one distribution company to another (id.). In 2003 and 2004, each distribution company procured approximately one-third of its fixed-price load for a three-year term (http://www.bgs-auction.com/bgs.auction.overview.asp). The remaining tranches, representing approximately one-third of the fixed-price load for each distribution company, will be procured in a 2005 auction and will also cover a three-year period (id.).

Unlike Massachusetts, the New Jersey wholesale electricity market is relatively liquid and is far less congested than portions of the Massachusetts market. These factors result in ample supply and multiple bidders, which better facilitate an auction process. Conversely, in Massachusetts (and New England generally), the wholesale market is insufficiently liquid to operate a vibrant Default Service auction statewide. For example, in Massachusetts, the ownership of generation resources and transmission constraints provide barriers to some suppliers that wish to bid into particular load zones, e.g. NEMA, where 80 percent of the generation is owned by two entities and 90 percent is owned by three entities with none of these entities competing to provide Default Service. The

FERC's proposed LICAP policy, if implemented, will further exacerbate these load zone differences and market concentrations by mandating the purchase of capacity within constrained load zones such as NEMA by load-serving entities such as Default Service suppliers. An RFP process allows distribution companies and suppliers more flexibility than an auction would to negotiate favorable contracts that address New England's complex wholesale market rules and infrastructure.

(5) Although the term "default service" is statutory, G.L. c. 164, §, it has confused some customers because of its unintended suggestion of nonfeasance in performing a legal or contractual obligation. Is there some better or more descriptive term that ought to be used by the distribution companies on and after March 2005?

The Company agrees that the term "Default Service" carries negative connotations for some customers. Since customers began receiving Default Service in 1998, NSTAR Electric has received many calls from customers who were confused and/or upset about the term, believing that the Company viewed them as having defaulted on some obligation to the Company. Accordingly, the Company suggests that the Department allow distribution companies to refer to Default Service on customers bills under a less negatively-charged term, such as "Basic Service."[9]

Neither the Act nor Department regulations restrict distribution companies from describing Default Service on customer bills by another term. The statutory requirements governing the provision of default service are reflected in G.L. c. 164, §1 ("Section 1") and § 1B(d) ("Section 1B(d)"). Section 1 defines the term "Default Service" and Section 1B(d) governs distribution company requirements to providing a "default service rate" to

[9] Although the Company believes that the term "Basic Service" is preferable to "Default Service" as a moniker on customer bills, the Company is willing to discuss other possible terms to describe the service. However, for ease of implementation, the Company recommends that any term be 16 characters or less in order to maximize compatibility with the Company's billing system.

retail customers. However, neither section requires distribution companies to refer to the default service rate as "Default Service," or any other name, on customers' bills. Moreover, in an order governing the provision of Default Service, the Department has acknowledged that Section 1B(d) "requires each distribution company to provide a default service *option* (emphasis added) to its customers." Order Instituting a Notice of Inquiry/Generic Proceeding into the Pricing and Procurement of Default Service, D.T.E. 99-60, at 2 (1999). Accordingly, the Department has recognized that Chapter 164 uses the term "default service" generically to refer to the type of service being provided to the customer.

The Department's regulations governing default service do not address the issue. 220 C.M.R. § 11.04 (9)(c).[10] Since the advent of Default Service on March 1, 1998, the Department has approved tariffs submitted by the distribution companies that refer to the service as "Default Service." However, the Department's regulations do not require that the tariffs be referenced as such.

The Department's billing requirements also do not require that generation service be specified by a particular name on customer bills. G.L. c. 164, § 1D ("Section 1D") and Department regulations address the type of information required to be reflected on the bills of retail customers. In relevant part, Section 1D requires that:

> Beginning January 1, 1998, all electric and gas bills sent to a retail customer shall be unbundled to separately reflect the rates charged for generation, transmission, and distribution services, as well as any other charges, as added pursuant to any provision of law, contained in the total retail price.

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[10] In fact, the Department's regulations refer to the service as "Default Generation Service."

However, although Chapter 164 includes references to different types of generation service rates, i.e., default service rates (G.L. c. 164, § 1B(d)) and standard service transition rates (id. at § 1B(b)), Section 1D does not specify that the generation service rate on which a customer is being served must be referenced by a specific name on a customer's bill.[11]

Moreover, the Department's regulations governing billing and payment requirements do not specify that a generation service rate must be referenced by a specific name. 220 C.M.R. §11.04(10). Rather, similar to Section 1D, the Department's regulations governing the type of information that must be reflected on customers' bills require only that distribution company bills be unbundled.

The implementation of Section 1D by gas companies ("LDCs") is illustrative of how companies that are subject to Section 1D have interpreted its provisions. As noted above, LDCs are required by Section 1D to provide unbundled bills to their retail customers. However, many LDCs use the term "basic service" on their bills to describe the service that is referred to in their tariffs as "default service."

Similarly, although G.L. c. 164, § 1B(b) requires distribution companies to offer customers a "standard service transition rate," the Department has approved tariffs submitted by the distribution companies referring to the rate as "Standard Offer Service." Accordingly, neither Section 1D nor Department regulations requires that retail

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[11] Some distribution companies have interpreted the bill unbundling requirement by naming the energy service on customer bills as "generation service." Although to date the term "generation service" has been further specified as either "standard offer service" or "default service" on customer bills, there is no statutory language or regulation requiring distribution companies to use those terms in describing the services.

customers' bills include a specific name for the type of generation service being provided to the customer by the distribution company.[12]

Accordingly, the term "Default Service" on customer bills has caused confusion because of the term carries with it negative connotations of being in "default" on some obligation or in terms of it being a lower quality of service. Accordingly, the Department should allow distribution companies to use a less negatively-charged term on customer bills to refer to Default Service, such as "Basic Service."[13] No change to the Act or Department regulations is necessary to effect this change and it would benefit customers by clarifying the nature of the service being provided to them through a distribution company's Default Service tariffs.

V. CONCLUSION

NSTAR Electric appreciates the opportunity to submit comments in this proceeding and looks forward to participating in the Department's consideration of Default Service issues.

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12 However, the Department's Consumer Division regularly reviews correspondence between distribution companies and their residential customers in order to ensure that such communications are neither confusing nor misleading. Accordingly, any change to a customer's bill governing the naming of generation service should be discussed with the Consumer Division prior to implementation.

13 Optimally, the Company would like to implement a name change for Default Service as of March 1, 2005, when Standard Offer Service customers electing to take service from the Company will become Default Service customers. This will require a determination by the Department prior to March 1, 2005, so that the Company can implement the change as of that date.