COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Petition of Cambridge Electric Light Company and Commonwealth Electric Company for Approvals Relating to the Termination of Purchase Power Agreements with Pittsfield Generating Company, L.P.	)	D.T.E. 04-60

INITIAL BRIEF OF
PITTSFIELD GENERATING COMPANY, L.P.

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August 12, 2004

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INITIAL BRIEF OF PITTSFIELD GENERATING COMPANY

I. INTRODUCTION

On June 29, 2004, Cambridge Electric Light Company ("Cambridge") and Commonwealth Electric Company ("Commonwealth") (collectively, the "Companies") filed a petition with the Department of Telecommunications and Energy (the "Department" or "DTE"), pursuant to G.L. c. 164, §§ 1A, 1G, 76, 94, and 94A, for approval of: (a) the Termination Agreements between: (1) Cambridge and Pittsfield Generating Company, L.P. (formerly known as Altresco Pittsfield, L.P.) ("Pittsfield"); and (2) Commonwealth and Pittsfield (collectively, the "Termination Agreements"); and (b) the inclusion of certain Termination Agreement Payments and associated transaction costs in the variable component of Cambridge's and Commonwealth's respective transition charge (the "Petition").

As demonstrated by record evidence presented in this proceeding, the Termination Agreements will result in approximately $7 million in savings for the Companies' customers. In calculating these savings, the Companies have assumed a unit capacity factor of 37%. The Attorney General appears to question whether the Companies' use of a 37% capacity factor assumption is appropriate for purposes of calculating savings to customers associated with the

Termination Agreements. Stated simply, the Attorney General seems to argue that in estimating the value of the current contracts, the Companies should be assuming a higher capacity factor and, if they do so, customer savings would diminish. In support of this argument, the Attorney General appears to assert that if the Pittsfield facility continues to operate under the current contracts, the facility will average a capacity factor higher than 37% because (1) the provisions contained in the current contracts so require; or (2) the Companies could somehow modify or terminate the current contracts and by doing so, could obtain more favorable contractual provisions which require a higher capacity factor. This, in turn, under this argument, makes the current contracts more valuable to the Companies and the Termination Agreements less valuable, resulting in less savings for the Companies' customers if the Department approves the Termination Agreements.

It is the Attorney General's assumptions, however, that are incorrect. The current contracts do not require the Pittsfield facility to achieve a higher capacity factor, and instead, require it to be bid and operated in accordance with current market conditions and rules. The Companies have no rights under the current contracts to "require" Pittsfield to dispatch the facility in a certain manner. Indeed, the Attorney General appears to confuse contracted capacity with energy delivery, failing to recognize that regardless of how often the Unit is dispatched, the Companies retain their PSAs capacity rights. Any attempt by the Companies to cease payment or unilaterally terminate or amend the current contracts would constitute a material breach of those agreements by the Companies, subjecting the Companies to potential litigation and damages.

Moreover, if the Companies themselves sought to litigate this issue, they would be met with resistance, would not succeed, and the time and costs incurred in pursuing such an endeavor would only serve to reduce customer savings. Finally, the evidence demonstrates that the use of a 37% capacity factor is a conservative and appropriate assumption given that the facility is currently achieving an average 27% capacity factor, and even if the Companies assume a higher capacity factor consistent with what appears to be the Attorney General's flawed interpretation of the current contracts, the evidence demonstrates that the Companies' customers will still receive savings from the approval of the Termination Agreements.

II. PROCEDURAL HISTORY

On June 29, 2004, Cambridge and Commonwealth filed the Petition with the Department pursuant to G.L. c. 164, §§ 1A, 1G, 76, 94 and 94A seeking approval of the Termination Agreements and the ratemaking treatment relating thereto. In support of the Petition, the Companies presented the testimony of (1) Geoffrey O. Lubbock (with accompanying exhibits), Vice President, Financial Strategic Planning & Policy, regarding the Termination Agreements and related customer savings (the "Lubbock Testimony") (Exh. NSTAR-GOB); and Robert B. Hevert (with accompanying exhibits), President of Concentric Energy Advisors, Inc. ("CEA"), regarding the specifics of the 2003 Auction (the "Hevert Testimony") (Exh. NSTAR-RBH). On July 2, 2004, the Department issued a Notice of Public Hearing and Procedural Conference with respect to the Petition. On July 21, 2004, the Department conducted a Public Hearing followed by a procedural conference during which the Department granted Pittsfield's Petition to Intervene and noted the receipt of a Notice of Intervention by the Attorney General. Also, on July 21, 2004, the Hearing Officer issued a memorandum setting a procedural schedule and

ground rules for the case. The Department held evidentiary hearings in this proceeding on August 5, 2004.

III. BACKGROUND

A. THE EXISTING PSAS

Pittsfield operates an electric cogeneration facility, consisting of a gas-fired, combined-cycle generation plant, together with housings and other integral equipment, located in Pittsfield, Massachusetts (the "Facility"). Cambridge and Pittsfield are parties to a Power Purchase Sale dated February 20, 1992, as amended on November 7, 1994 and November 21, 1996, pursuant to which Pittsfield sells to Cambridge, and Cambridge purchases from Pittsfield, electricity produced by the Facility (the "Cambridge/Pittsfield PPA"). Exh. NSTAR-CAM-GOL-1. The term of the Cambridge/Pittsfield PPA runs through December 31, 2011.

Commonwealth and Pittsfield are parties to a Power Sale Agreement dated February 20, 1992, as amended on November 7, 1994 and November 21, 1996, pursuant to which Pittsfield sells to Commonwealth, and Commonwealth purchases from Pittsfield electricity produced by the Facility (the "Commonwealth/Pittsfield PSA"). Exh. NSTAR-COM-GOL-1. The term of the Commonwealth/Pittsfield PPA runs through December 31, 2011.[1]

The Existing PSAs require each Company to purchase and take delivery of 17.2 percent of the electric capacity and related energy produced by the Unit through December 31, 2011.

[1] Together, the Cambridge/Pittsfield PPA and the Commonwealth/Pittsfield PPA are referred to herein as "the Existing PSAs" or "the 1992 PSAs." The Existing PSAs are in the record as Exhs. NSTAR-COM-GOL-1 and NSTAR-CAM-GOL-1. For purposes of this brief, the record citations will not be repeated, but will cite to "the Existing PSAs" or "the 1992 PSAs."

Under the Existing PSAs, the Companies are required to make certain fixed payments every month and a payment based on the amount of energy produced by the Facility. *See* Existing PSAs at Appendix B. The Cambridge/Pittsfield PSA includes a separate transmission charge. Exh. NSTAR-CAM-GOL-1.

B. THE 2003 AUCTION

As part of their divestiture plans, the Companies offered to sell their entitlements to the Existing PSAs in a public auction. As demonstrated by the evidence presented in this proceeding, the 2003 Auction was conducted in an open and competitive manner and was otherwise equitable and maximized the value of the assets that were subject to the auction, pursuant to G.L. c. 164, § 1A(b)(1). The Companies selected CEA, a nationally prominent economics consulting firm, to help conduct the 2003 Auction. In conducting the auction, the Companies and CEA used a fair, unbiased, confidential and competitive process, whereby bidders had the ability and opportunity to maximize the value of their respective bids through complete, uninhibited and non-discriminatory access to all data.

From October through December 2003, the Companies through CEA marketed the Existing PSAs to a broad group of potential bidders, and provided selected, qualified bidders with substantial information in due diligence support regarding all aspects of the Existing PSAs. On December 3, 2003, the Companies received twelve bids for various combinations of the 1992 PPA entitlements, including three bids for the complete portfolio. All three bids were subject to internal approval, further due diligence or other such conditions. Exh. NSTAR-RBH at 23.

The Termination Agreements were negotiated by the Companies and Pittsfield as a result of the 2003 Auction and, therefore, are the results of an extensive and carefully implemented

auction process in which bidders were given substantial amount of data to analyze the contracts, and were provided many opportunities to revise and enhance their bids. Exh. NSTAR-RBH at 25.

C. THE TERMINATION AGREEMENTS

Under the Termination Agreements, the Existing PSAs terminate upon the date that certain conditions have been satisfied (the "Effective Date"). Thereafter, the Companies are relieved of any obligations to purchase or accept electricity produced by the Facility, and Pittsfield has no obligation to sell electricity to the Companies. In consideration for termination of the Existing PSAs, the Companies are required to pay Pittsfield $1.67 million per month from the Effective Date through and including December 1, 2008 (the "Termination Payments"). Exh. NSTAR-GOL at 12-13.

Compared to the Existing PSAs, the Termination Agreements will result in approximately $7 million of customer savings, on a net present value ("NPV") basis. Exhs. NSTAR-GOL at 13, NSTAR-CAM-GOL-2, NSTAR-COM-GOL-2, DTE-2-1 (ERRATA), DTE-1-2; Tr. 13. In his prefiled testimony, the Company's witness, Mr. Lubbock, indicates that the Companies determined the savings by comparing: (a) the NPV of Transition-Cost payments by customers that would have been made if the Existing PSAs were to remain in effect to (b) the NPV of Transition-Cost payments by customers that will be made if the Termination Agreements are approved by the Department. Exh. NSTAR-GOL at 13. These savings then will be passed on to the Companies' customers through the respective Transition Charges of Cambridge and Commonwealth.

IV. STANDARD OF REVIEW

A. ASSET DIVESTITURE

Asset divestitures and power-purchase agreement buyouts are subject to the Department's jurisdiction pursuant to G.L. c. 164, §§ 1A, 1G, 76, 94, 94A and 94B. In reviewing a company's proposal to divest its generating units, the Department considers the consistency of the proposed transaction with the company's restructuring plan and the Restructuring Act.

A divestiture transaction will be determined to be consistent with a company's restructuring plan and the Act if the company demonstrates to the Department that the sale process is equitable and maximizes the value of the existing generation facilities being sold. D.T.E. 98-78/83, at 3-4 (1998); G.L. c. 164, § 1A(b)(1). A sale process will be deemed both equitable and structured to maximize the value of the existing generating facilities being sold if the company establishes that it used a competitive auction or sale that ensured complete, uninhibited, non-discriminatory access to all data and information by all interested parties seeking to participate in such sale or auction. *Id.*; G.L. c. 164, § 1A(b)(2). In D.P.U./D.T.E. 97-111, at 90 (1998), the Department found that the Companies' Restructuring Plan, which provided for the buyout and buydown of above-market purchase-power obligations, was consistent with or substantially complied with the Act.

B. BUYOUTS

G.L. c. 164, §§ 1A and 1G require electric companies to seek to mitigate transition costs, including, as one mitigation method, the buyout of above-market power purchase contracts. G.L. c. 164, § 1G(d)(1) and (2). In reviewing power contract buyouts, buydowns and renegotiations, the Department has applied a standard of reasonableness. *Commonwealth Electric Company*

(Lowell Cogen Buyout), D.T.E. 99-69, at 7 (1999); *Boston Edison Company* (L'Energia Buyout), D.T.E. 99-16, at 5-6 (1999); *Western Massachusetts Electric Company* (Springfield Resource Contract Restructuring), D.T.E. 99-56, at 7-8 (1999). In assessing the reasonableness of a power purchase contract renegotiation, buyout or buydown, the Department reviews available information to ensure that the agreement is consistent with the public interest. *Western Massachusetts Electric Company*, D.T.E. 99-101, at 5-6 (2000) (MASSPOWER Buyout); *Commonwealth Electric Company*, D.P.U. 91-200, at 5 (1993); *Boston Edison Company*, D.P.U. 92-183 (1992) (Department approval of a termination agreement of a purchase-power contract with Down East Peat, L.P.).

The Termination Agreements should be approved by the Department because they are consistent with the public interest as they will cost the Companies' customers less than the Existing PSAs, thereby mitigating transition costs, consistent with the Act and the Companies' Restructuring Plan. The Pittsfield Termination Agreements are consistent with the Companies' obligation under the Act to mitigate their transition costs to the maximum extent possible because they minimize the overall transition costs that the Companies would otherwise be required to collect from their customers by approximately $7 million NPV.[2] Because terminating the PSAs will achieve savings for ratepayers as well as other benefits, and because the savings mitigate the Companies' transition costs, the Department should find that the

[2] As noted below, the Companies have demonstrated that the Termination Agreements will result in customer savings under various scenarios, including the use of a higher capacity factor in determining the value of the Existing PSAs. Even with a higher capacity factor, the Termination Agreements result in customer savings. *See* Exhs. AG-2-3, Attachment AG-2-3(a) ERRATA, Attachment AG-2-3(b) ERRATA, and AG-3-5.

Termination Agreements are in the public interest and consistent with the requirements of G.L. c. 164, § 1G(d)(2)(ii).

V. ARGUMENT

The Companies have estimated that the Termination Agreements will result in $7 million in savings for the Companies' customers. In calculating these savings, the Companies appropriately have assumed a Unit capacity factor of 37%. The Attorney General appears to question whether the Companies' assumption of a 37% capacity factor is appropriate for purposes of calculating savings. The Attorney General appears to argue that in estimating the value of the current PSAs, the Companies should be assuming a higher capacity factor than 37%, and, if they do so, customer savings associated with the Termination Agreements would diminish.

In support of this argument, the Attorney General appears to assert that if the Project continues to operate under the existing PSAs in a manner consistent with the Attorney General's interpretation of the contracts, the Facility will achieve a capacity factor significantly higher than 37%. The Attorney General seems base to this assumption on another assumption -- that the PSAs require the Unit to operate at a higher capacity factor, or the Companies can somehow make it so. Under the Attorney General's view, the 1992 PSAs are more valuable to the Companies and, as such, termination of the contracts yields less savings to the Companies' customers.

As addressed further below, it is the Attorney General's assumptions and interpretations that are incorrect. First, the 1992 PSAs simply do not require the Project to achieve a higher capacity factor, and instead, require the Unit to be bid and operated in accordance with current

market conditions and rules. Moreover, the Companies have no rights under the Existing PSAs to "require" Pittsfield to dispatch the Unit in a certain way and any attempt by the Companies to cease payment or unilaterally terminate or amend the 1992 PSAs would constitute a material breach of the agreements subjecting the Companies to litigation and damages.

Second, if the Companies had chosen to litigate this issue rather than resolve it consistent with their mitigation obligation under the Restructuring Act, any such litigation would be met with resistance, would not succeed, and the time and costs incurred in pursuing such an endeavor would only serve to reduce customer savings. Third, the Companies' use of a 37% capacity factor is a conservative and appropriate assumption given that Unit is currently achieving an average 27% capacity factor. Finally, even if the Companies were to assume a higher capacity factor consistent with a flawed interpretation of the 1992 PSAs, the evidence demonstrates that the Companies' customers would still receive savings as a result of Termination Agreements.

A. THE CURRENT PSAS DO NOT REQUIRE THAT THE UNITS MEET ANY SPECIFIC CAPACITY FACTOR AND INSTEAD REQUIRE BIDS AND OPERATION IN COMPLIANCE WITH CURRENT NEPOOL RULES AND PROCEDURES

(1) NO PROVISION OF THE 1992 PSAS REQUIRES THAT THE UNIT BE DISPATCHED AT A SPECIFIC LEVEL

The Attorney General's apparent argument regarding capacity factor hinges on the following faulty assumption: the 1992 PSAs require the Unit to be dispatched in a way that achieves a capacity factor above 37% and Pittsfield's failure to do so constitutes a breach of the 1992 PSAs. However, a plain reading of the unambiguous provisions of the 1992 PSAs reveals quite the opposite. *Schwanbeck v. Federal-Mogul Corp.*, 412 Mass. 703 (1992) (where the wording of a contract is unambiguous, the contract must be enforced according to its terms). No provision in the 1992 PSAs requires the Unit to be dispatched at any specific level or to achieve

any specific capacity factor. Instead, the 1992 PSAs only require the Unit to be "available" or "capable" of operating. Numerous contractual provisions in the 1992 PSAs make it clear that the parties' obligations under the 1992 PSAs are measured by whether and/or how often the Unit is *available* or *capable* of operating and not on whether a pre-determined amount of electricity has been produced. *De Freitas v. Cote*, 342 Mass. 474 (1961); *Massachusetts Municipal Wholesale Electric Co. v. Danvers*, 411 Mass. 39 (1991) (a contract must be construed according to the parties' intent; to ascertain intent, a court considers the words used by the parties in their contract taken as a whole).

The Companies' obligations under the Existing PSAs are essentially twofold: first, to take a certain percentage of the Facility's electricity and capacity, and, second, to pay for the right to do so. Both of these obligations are dependent upon Unit availability and capability, not upon a specific production of electricity.

With respect to the Companies' obligation to take delivery, the parties agreed that the Companies would be required to take a percentage of the electricity that is produced, *whatever that amount may be*. Specifically, pursuant to Section 2.1 of the 1992 PSAs, each Company agrees to purchase and take delivery of the "Company's Entitlement" of electric capacity and related energy "*produced* by the Unit during the term of the Agreement." Under the 1992 PSAs, each Company's Entitlement is 17.2 percent. *See* 1992 PSAs, Article I. Similarly, the introduction section of the 1992 PSAs describes the purpose of the contract as "the Seller wishes to sell and deliver and the Company wishes to purchase and take delivery of a percentage of the electric capacity and related energy *produced* by the unit . . . ." *See* 1992 PSAs, Introduction.

The Companies' payment obligations also are dependent on the status of Unit availability or capability and not on whether the Unit produces a certain requisite amount of electricity every month. In Appendix B of the 1992 PSAs, which outlines the pricing mechanism under the agreements, all of the charges the Companies pay, except the Monthly Energy Charge, are based on the Unit's "availability" or "capability." For instance, the "Monthly Gas Transportation Demand Cost" and the "Monthly Capital Cost" are equal to the product of "Company's Available kilowatt hours during the applicable Billing Period"[3] and certain fixed payments. 1992 PSAs, Appendix B, ¶¶ 4, 5.[4] Similarly, the Monthly Capacity Charge contains an adjustment based on the Unit's "availability." 1992 PSAs Appendix B, ¶ 2. As stated by Mr. Lubbock and Mr. Hervert, less than 30% of the contract price is based on the kilowatthours produced. Tr. 114. Instead, for the most part, the Companies are "paying for kilowatthours that are available but not necessarily produced." *See* Tr. 169.

Pittsfield's obligations under the 1992 PSAs also center around ensuring that the Unit is capable of producing electricity. For instance, in Section 2.1, Pittsfield "agrees to sell and deliver . . . [17%] of the electric capacity and related energy *produced* by the Unit during the term of this Agreement," and Section 2.3 requires Pittsfield, if the Companies request, to undergo audits to ensure that the Unit is capable of producing the Companies' capacity requirements.

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[3] Further recognizing that there may be months where no electricity is produced, the definition of "Billing Period" is any calendar month in which the Unit "produces" electricity pursuant to the Agreement and for which the Company is obligated to pay for such electricity "produced" for such month pursuant to the Agreement. 1992 PSAs, Article I.

[4] In each of the 1992 PSAs, the Company's Available Kilowatthours are the product of the Unit availability as reported to NEPOOL; multiplied by the Company's Capacity Entitlement; multiplied by the number of hours in the applicable Billing Period. The "Company's Capacity Entitlement" is the product of 17.2% and the audited Capacity during a season. PSAs, Article I and Appendix B.

The Attorney General seems to argue that Section 6.1 of the 1992 PSAs requires Pittsfield to produce a certain amount of electricity. Again, however, the parties did not make the production of a specific amount of electricity a requirement of the contract. To argue otherwise, ignores the fundamental difference in the PSAs between contracted capacity and delivered energy. Instead, Section 6.1 of the 1992 PSAs requires Pittsfield to "exert all reasonable efforts consistent with Good Utility Practice to cause the Unit *to be capable of* operating and producing electric energy at or near the Design Capacity on a continuous twenty-four (24) basis for the full term of this Agreement" (emphasis added). No party disputes that the Unit has been "capable of operating and producing electric energy at or near the Design Capacity on a continuous twenty-four (24) hour basis." There is no evidence in the record that NEPOOL, ISO-NE or the Companies have alleged that the Unit is incapable of operating or producing electric energy at any capacity level.

In drafting the 1992 PSAs, the parties were not bound to enter into a contract where the Companies are only obligated to purchase a percentage of what the Unit produces. The parties could have required the Unit to produce a specific amount of electricity every month and/or required the Companies to purchase a specific amount of electricity every month. The parties also could have provided for penalties in the event of a failure by the Facility to produce a specific amount of electricity. But the parties here chose not to do so, and it is not for the Department or the Attorney General to change the terms of the parties' agreement.

(2) THE 1992 PSAS CONTEMPLATE THAT THE UNIT WILL BE DISPATCHED IN ACCORDANCE WITH CURRENT NEPOOL RULES AND REGULATIONS

The parties' clear intent under the 1992 PSAs was that dispatch of the Unit would be governed by NEPOOL rules, standards and procedures.[5] Section 2.2 requires Pittsfield to "make the Unit available for NEPOOL dispatch in accordance with the provisions of Section 12.2 of the NEPOOL Agreement." Section 12.2 of the 1992 NEPOOL Agreement required NEPOOL participants to subject their generating facilities to central dispatch through the appropriate satellite dispatch center and NEPEX in accordance with the directions of the Operations Committee "provided, however, that each Participant shall at all times be the sole judge as to whether or not and to what extent safety requires that at any time any of such facilities will be operated at less than full capacity or not at all." *See* New England Power Pool, *Restated New England Power Power Agreement*, 1992 as amended.

Similarly, the 1992 PSAs define "Good Utility Practice" ("GUP") as, among other matters, taking reasonable steps to ensure "that the Unit is operated in conformance with

[5] The 1992 PSAs define "NEPOOL" as the New England Power Pool and specifically state that the term "NEPOOL" includes NEPEX, the central dispatching agency, as defined in Section 15.22 of the NEPOOL Agreement, operating through such satellite dispatching centers as the NEPOOL Management Committee may determine to be appropriate. Section 15.22 of the NEPOOL Agreement has been deleted because NEPEX is no longer the control dispatching agency and dispatching functions are now performed by ISO-NE. *See* www.iso-ne.com/FERC/filings/Index_NEPOOLagree.html.

NEPOOL CRS's and Operating Procedures, and NEPEX dispatch instructions."[6] Moreover, Section 4.1 of the 1992 PSAs provides that the Unit shall be subject to economic dispatch at the sole direction of NEPOOL so long as the dispatch is in accordance with the other provisions of Article 4.[7]

In drafting the 1992 PSAs, the parties recognized, however, that market rules and procedures could and would change during the term of their 20-year agreement. Thus, they made it clear in numerous PSA provisions that the parties' performance would be governed by the *current* market rules, regulations and procedures, *i.e.*, as they were amended or replaced or that "may be in effect from time to time." For instance, as noted above, Section 2.2 of the 1992 PSAs requires that Pittsfield "make the Unit available for NEPOOL dispatch in accordance with the provisions of Section 12.2 of the NEPOOL Agreement." The parties defined, the "NEPOOL

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[6] The other examples of GUP listed in the 1992 PSAs include:

> (1) That adequate materials, resources, and supplies, including fuel, are available to meet the Unit's needs;
>
> (2) That sufficient operating personnel are available and are adequately experienced, trained, and licensed as necessary to operate the Unit properly and efficiently, and who are capable of responding to emergency conditions whether caused by events on or off the Site;
>
> (3) That preventative, routine, and non-routine maintenance and repairs are performed on a basis that ensures reliable long-term and safe operation, and are performed by knowledgeable, trained, and experienced personnel utilizing proper equipment and tools;
>
> (4) The appropriate monitoring and testing are performed to ensure that equipment is functioning as designed;
>
> (5) That equipment is not operated recklessly, or in a manner that is unsafe to workers, the general public, or the environment, or without regard to defined limitations such as steam pressure, temperature, and moisture content, chemical content of make-up water, flood conditions, safety inspection requirements, operating voltage, current, frequency, rotational speed, polarity, synchronization, or control system limits;
>
> (6) That equipment will function properly under both normal and emergency conditions.

[7] *See* Section V.A. 5 below for further discussion regarding Section 4.1 of the 1992 PSAs.

Agreement", however, as "the New England Power Pool Agreement, dated September 1, 1971, *as amended*." Emphasis added. At the time the 1992 PSAs were executed, the 1971 version of the NEPOOL Agreement had been amended 28 times.[8] Clearly, the parties were aware that the NEPOOL Agreement was subject to and indeed, would change. Thus, the parties specifically incorporated any amendments to the NEPOOL Agreement into the 1992 PSAs' definition of "NEPOOL Agreement."

Through numerous other 1992 PPA provisions, the parties signaled their clear intent to ensure that any changes in market rules, operations or procedures would be incorporated into the 1992 PSAs. For instance,

- In defining "Capability Audit" the 1992 PSAs states that the tests should be conducted pursuant to Section 8.13 of the NEPOOL Agreement "or any properly issued replacement thereof created from time to time during the term of this Agreement."
- "Economic Dispatch" is defined as "the operation of the Unit in accordance with such procedures as may be established by NEPOOL from time to time to foster the objective of satisfying the energy requirements of the participants of NEPOOL at the lowest practicable cost."
- "Good Utility Practice" is defined as the "practice, methods, and acts (including but not limited to the practices, methods, and acts engaged in or approved by a significant portion of the electric utility industry) that, at a particular time, in the exercise of reasonable judgment in light of the facts known or that should have been known at the time a decision was made, would have been expected to accomplish the desired result in a manner consistent with law, regulation, reliability, safety, environmental protection, economy, and expediency.
- Pursuant to Section 2.2 of the 1992 PSAs, Pittsfield is required to staff, test, operate and maintain the Unit in accordance with GUP and in a manner consistent with "the standards applicable to generating facilities owned and operated by

[8] Today, the Agreement "as amended" contains 106 amendments to the original agreement. *See* www.iso-ne.com/FERC/filings/Index_NEPOOLagree.html for a copy of the NEPOOL Agreement.

participants in NEPOOL, as such standards *may be in effect from time to time* during the term of this Agreement."

- Under the 1992 PSAs, Section 9.2, each party is responsible "for taking all necessary actions to satisfy any regulatory requirements that may be imposed by any federal, state or municipal statute, rule, regulation or ordinance that *may be in effect from time to time* relevant to the performance of such party hereunder."[9]

(Emphasis added in each excerpt.)

(3) CURRENT NEPOOL RULES AND ISO-NE BIDDING REQUIREMENTS AUTHORIZE AND ENCOURAGE THE INCLUSION OF THE FULL OPPORTUNITY COST OF GAS IN BIDS TO THE ISO-NE

As fully expected and contractually provided for by the parties, since the execution of the 1992 PSAs, the market rules and procedures have been modified and amended. The economic dispatch requirements and other NEPOOL rules in effect in 1992 have been amended and revised to reflect NEPOOL and ISO-NE bidding rules and requirements adopted consistent with the restructuring of the electric industry. Tr. 158; RR-AG-2. In accordance with NEPOOL Operating Procedure No. 1,[10] economic dispatch of the bulk power system is now the responsibility of ISO-NE, which accomplishes the "economical allocation of energy resources" primarily through the application of NEPOOL Market Rule 1[11] and the system of bidding rules

[9] Other provisions of the 1992 PSAs authorize the Companies to impose reasonable substitutes for NEPOOL rules, standards or publications should they cease to be established. *See* 1992 PSAs, definition of "Capability," Section 17.3, Appendix B, para. 7. These provisions are further evidence that the parties anticipated potential changes in the market rules and procedures. They are not implicated here, however, because the procedures and rules of NEPOOL cited in the 1992 PSAs have not "ceased to exist," but have been revised or amended. For instance, the 1992 PSAs definition of "Capability Audit" references Section 8.13 of the NEPOOL Agreement, which Section is now cited as Section 10.4 of the NEPOOL Agreement.

[10] NEPOOL Operating Proceeding No. 1 is located at www.iso-ne.com/smd/operating_procedures/.

[11] NEPOOL Market Rule 1 is located at www.iso-ne.com/smd/market_rule_1_and_NEPOOL_manuals/Market_Rule1/.

and requirements contained therein, including a market monitoring function carried out by ISO NE pursuant to Market Rule 1, Appendix A.[12]

Consistent with the restructuring of the electric industry in Massachusetts and elsewhere, there also is now an active daily market in fuel trading in New England. ISO-NE, FERC and state regulators all recognize that today's generation companies can either burn their fuel to produce power or sell their fuel. It is now accepted practice in the electricity market to sell fuel if it is priced higher than electricity (a behavior generally called arbitrage). *See Interim Report on Electricity Supply Conditions in New England during the January 14-16 "Cold Snap"*, ISO-New England, Inc., May 10, 2004, at 72-73 ("*ISO-NE Interim Report*").[13] Of course, if a generator sells fuel rather than using it to produce electricity, there will be an effect on its unit's capacity factor.

The ISO-NE/NEPOOL bidding rules recognize and encourage this practice and it is specifically codified in the applicable market rules. *See e.g.*, Market Rule 1, Appendix B, § 3.2.6 *Certain Economic Decisions Excused* ("Participants may make decisions affecting the

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[12] The Attorney General appears to argue that because the 1992 PSAs state that the Unit will be dispatched by NEPOOL, the PSAs, therefore, do not allow for the Unit to be dispatched by ISO-NE. In presenting such an argument, the Attorney General essentially would be asking the Department to ignore critical changes to market rules and practices – changes which are fully accepted and understood by the industry and have been authorized by the FERC. In 1996, the FERC deregulated portions of the electric industry, which changed NEPOOL's role and led to the creation of an ISO-NE in 1997. Under an agreement reached between the ISO-NE and NEPOOL on July 1, 1997 ("ISO Agreement"), ISO-NE became responsible for the day-to-day reliable operation of New England's bulk power generation and transmission system. ISO-NE is responsible for the continued operation of the NEPOOL Control Area from the NEPOOL control center and the administration of the Tariff, subject to regulation by FERC. Tr. 48; *see also* NEPOOL Agreement, § 1.58. ISO-NE is required to perform its duties consistent with the terms of the NEPOOL Agreement and the Tariff, the NEPOOL System Rules and Procedures, Good Utility Practice, applicable law and regulations and the ISO Agreement. *See* ISO Agreement at 10. (This ISO Agreement is located at www.iso-ne.com/FERC/filings/Interim_ISO_Agreement/.)

[13] This report can be found at www.iso-ne.com/special_studies/Interim_Report_on_January_14_-16_2004_Cold_Snap/Interim_Report_on_Electricity_Supply_Conditions_in_New_England_during_the_January_14_-16_2004_Cold_Snap.pdf.

availability for a Resource for reasons relating to the economics of operating that Resource . . . . It is not the intent of [the NEPOOL market rule] to require a Participant to provide services from all or a portion of a Resource where the Resource-specific NEPOOL market revenues derived from the provision of such service do not justify the associated operating costs or Opportunity Cost . . . of providing such service from such Resource"). ISO-NE has stated that generators reflecting the full opportunity cost of gas (*i.e.*, the spot market price) in their bids to ISO-NE are bidding in a manner that is "appropriate" and "efficient." *ISO-NE Interim Report* at 73 ("Arbitrage allocates resources more efficiently and is appropriate market behavior") and Appendix C. As described by ISO-NE,

> Even generators that do not sell available gas may appropriately reflect the foregone revenue opportunity in their supply offers. The foregone revenues from the sale of the gas are a cost (known to economists as an opportunity cost) of a decision to generate electricity. Opportunity costs are included in the calculation of submitted offers just like any other costs, and help ensure that the electricity price reflects the true value of the resources used in the production of electricity . . . . A rational owner of long-term gas will reflect any opportunity costs in its supply offers to reflect the mark-to-market value of natural gas in the regional marketplace.

See ISO-NE Interim Report at 73-74.

Thus, Pittsfield's bidding and offering practices are not only consistent with current market rules and procedures, they are specifically encouraged by NEPOOL and ISO-NE. In today's world, it simply would not be "reasonable" to bid and operate the Unit in manner inconsistent with the bidding practices of other generating companies under current market rules or to employ outdated practices which are inconsistent with the generator's business interest. Moreover, there is also no evidence in the record of either NEPOOL or ISO-NE ever notifying Pittsfield or any other party of wrongful bidding or dispatch practices. In fact, neither NEPOOL

nor ISO-NE has notified any party of an instance where Pittsfield has violated any rule or requirement of NEPOOL or ISO-NE.

(4) THE 1996 AMENDMENT TO THE PSAS DOES NOT REQUIRE PITTSFIELD TO OBTAIN APPROVAL FROM THE COMPANIES BEFORE SELLING FUEL

The Second Amendment to the Power Purchase Agreement dated February 2, 1996 amends Sections 6 of the PSAs to add a provision (Section 6.4) on "short-term power purchases." That provision provides as follows:

> Seller and Company agree that, from time to time, they may agree to allow and accommodate the short-term purchase by Company of electricity from other market sources in replacement of the purchase of electricity that would otherwise occur pursuant to the Agreement, and that the terms and conditions of such arrangements shall be negotiated on a case by case basis and agreed to in writing, but that the Agreement shall otherwise remain in full force and effect.

There have been no agreements entered into between the parties pursuant to Section 6.4. Exh. AG-3-15. Despite the Attorney General's attempt to characterize this amendment as one "designed to allow Pittsfield to sell its natural gas rather than use it to generate electricity and require Pittsfield to compensate the companies and amount in excess of replacement power costs," such characterization was expressly rejected by the Companies' witness. *See* Tr. 165.

Instead, the plain terms of Section 6.4 allow the *Companies* to purchase electricity. Not only is the name of the section "Short-term power purchases," the provision itself specifically states that the Seller and Company "may agree to allow and accommodate the short-term purchase by *Company* of electricity." Second Amendment to 1992 PSAs, at 2. There is no language whatsoever in the Amendment regarding Pittsfield's purchase or sale of fuel. Rather, it is clear from the plain language of the Amendment that this provision was designed to allow the

Companies, under certain circumstances, to use "replacement" electricity – a right that would otherwise be prohibited by the 1992 PSAs.

(5) NO PROVISION OF THE 1992 PSAS ALLOWS THE COMPANIES TO DICTATE HOW OR WHEN THE UNIT WILL BE DISPATCHED

The Attorney General also seems to assert that the Companies could somehow "require" Pittsfield to dispatch the plant at the levels experienced prior to September 2003. Yet, no contractual provision gives the Companies that right. Instead, as noted above, Section 4.1 of the 1992 PSAs provides that the Unit shall be subject to economic dispatch at the *sole direction* of NEPOOL so long as the dispatch is in accordance with the other provisions of Article 4.[14] There is no evidence in the record that the Unit is being dispatched in any way but in accordance with the other provisions of Article 4 or that the Companies have ever made such an assertion.

That the parties intended the Unit's dispatch to be controlled by NEPOOL and not the Companies is confirmed in an attachment to the 1992 PSAs that outlines the changes the parties made in the 1992 PSAs when compared to the Long-Run Standard Contract at the time. This attachment specifically states that Article 4 of the 1992 PSAs and, specifically, the provisions governing dispatchability of the Unit "have been modified to provide that NEPOOL, and *not the Company*, will ordinarily control Unit dispatch."[15] (Emphasis added.)

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[14] Section 4.1 provides:

"The Unit shall be subject to Economic Dispatch at the direction of the Company or NEPOOL; provided, however, that the Unit shall be subject to Economic Dispatch at the sole direction of NEPOOL if, and only if, such dispatch is fully in accordance with the provision of this Article 4. The Company or NEPOOL, as appropriate, may call for up to three hundred (300) stops . . . and up to three hundred (300) restarts of the Unit per year. The Unit shall be subject to changes in the level of its output at the direction of the Company or NEPOOL, as appropriate, provided that such changes are within the Unit's reasonable design limitations."

[15] See February 20, 1992 PSAs filed with Department (and approved by the Department in a March 18, 1992 letter).

(6) THE 1992 PSAS ARE VALID CONTRACTS THAT CANNOT BE AMENDED OR TERMINATED ABSENT AN AGREEMENT OF THE PARTIES

No party disputes that the 1992 PSAs are valid, binding contracts. The parties entered into them freely and obtained approval for them from the Department. Tr. 158. The 1992 PSAs have a term of twenty years and therefore, the parties are required to perform under those agreements until December 2011 unless they agree otherwise or a court or arbitration allows early termination. *See* PSAs, Section 3.1 (the 1992 PSAs "remain in full force and effect until December 31, 2011.")

Nonetheless, the Attorney General seems to suggest that the Companies could simply amend or stop payment under the 1992 PSAs or perhaps, unilaterally terminate them. However, there is no provision in the 1992 PSAs allowing for early, unilateral termination. Moreover, under Massachusetts law, a party may not cease payment under a contract and must continue to perform under that contract until the end of the term unless and until a court or arbitration panel finds that the other party has materially breached that agreement.[16] A unilateral cessation of payments under the 1992 PSAs by the Companies would constitute a breach of those agreements and would subject the Companies to potential litigation and damages. Indeed, when asked whether the Companies had ever considered stopping payments under the 1992 PSAs, Mr.

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[16] As stated above, there is no provision in the PSAs which precludes the current operation of the Facility. Under Massachusetts law, the Companies must continue to perform under the PSAs unless they can demonstrate that Pittsfield has materially breached the parties' agreement. Not all breaches of contract by one party will excuse performance by the other. In evaluating a breach of contract, a Massachusetts court must determine "whether the Defendant's breach entitled the Plaintiff merely to recover for that breach while continuing to abide by the Contract or was so material in all circumstances as to justify the Plaintiff in throwing the Contract over and suing for the total breach." *See Dunkin Donuts, Inc. v. Gav-Stra Donuts, Inc.*, 139 F.Supp. 2d 147, 155 (D.Mass. 2001). A material breach of an agreement occurs when there is a breach of an essential and inducing feature of the contract. *See Lease-It, Inc. v. Massachusetts Port Authority*, 33 Mass.App.Ct. 391 (1992). As demonstrated above, Pittsfield's actions do not constitute a breach of the PSAs, let alone a material breach. It is clear, however, that if the Companies fail to pay Pittsfield under the parties' agreement, that would constitute a material breach.

Lubbock surmised that while the Companies might have considered it, he was sure that "after discussion with [the Companies'] legal department [a Company employee] felt that that was not the appropriate action to take." Tr. 178. In the end, the Companies have not unilaterally terminated the 1992 PSAs. *See* RR-AG-4, Tr. 179 ("If we could have walked away, we would have").

Similarly, the Attorney General seems to assert that when the market rules changed, the Companies should have acted to amend the 1992 PSAs. Again, there is no provision in the 1992 PSAs which would allow the Companies to amend the agreements without Pittsfield's consent. Indeed, Mr. Lubbock testified that he knew of no power contracts that had been amended to reflect the changes in the market. Tr. 160. Citing Section 17.6 of the 1992 PSAs, the Attorney General also seems to imply that an administrative committee should have taken it upon itself to amend or revise the contract. Yet, as Mr. Lubbock testified, such committees have "no ability to affect the operation of the plant in just about any way." They are "powerless" committees. Tr. 173-74. This is confirmed by Section 17.6 which specifically states that the administrative committee "shall serve informational functions only."

Any argument that the Companies should be excused from continued performance under the PSAs because of the change in the market rules would also fail because (1) the changes in governmental regulation of the electric industry were foreseeable at the time the parties executed the 1992 PSAs; (2) the parties specifically foresaw and allocated the risk of governmental changes to the Companies; and (3) the changes have not destroyed the principal purpose of the contract. *Chase Precast Corp. v. John J. Paonessa Co., Inc.*, 409 Mass. 371, 374 (1991); Restatement of Contract (Second) Section 265. Moreover, even if the PSAs did not specifically

allocate the risk of such changes to the Companies, the Companies could have protected themselves from the risk of such change and therefore, were tacitly allocated the risk. For instance, they could have purchased a fixed amount of electricity (rather than a percentage of the amount *produced*) or specifically required the Unit to be dispatched at a fixed percentage. They also could have covered a change in market conditions in the PSAs' force majeure clause, which they did not.

In numerous cases involving contracts executed prior to the changes in the electric and gas industry courts have declined to terminate or modify those agreements and instead, have found that the remedy in such a situation is to allow utilities to buy-out or buy-down contracts, not to invalidate them. For instance, in *Town of Norwood v. New England Power Company*, 202 F.3d 408 (1st Cir. 2000), the Town argued that New England Power Company's sale of its non-nuclear generation plants constituted a repudiation of the parties' power contract. Among other matters, Norwood argued that such a transaction frustrated the purpose of the power contract and made it impossible for Norwood to perform. The First Circuit noted that Norwood failed to sufficiently develop its frustration of purpose argument, but went on to specifically note the "decidedly difficult path" facing Norwood:

> The argument will probably be uphill in any event since [NEP] has continued to offer Norwood the gist of what it was promised: a cost-based long-term supply of electricity, subject to FERC regulation.

In *MMWEC v. Town of Danvers*, 411 Mass. 39 (1991), the Supreme Judicial Court addressed a power sales agreement for the Seabrook Nuclear Power Plant (Project 6) in which some municipal light plants were required to pay much more for a project than the envisioned at the beginning of the contract. The Court stated:

> These unfortunate events have undoubtedly imposed some measure of hardship on the defendants. If they had known in 1980 what they know now, they might not have participated in Project 6.
>
> These unanticipated hardships, however, did not alter the fact that Project 6 seemed like a good arrangement when the parties entered into it. The Project 6 [power sales agreements] were premised on a rational evaluation of the risks and benefits associated with a joint financing project such as this one. To interfere with this allocation of risks and benefits because of unforeseen hardships, or based on the mechanical and irrational extension of a legal fiction, would introduce elements of uncertainty and arbitrariness into municipal financing arrangements. While the risks assumed by the defendants under the agreements are greater than they anticipated in this case, adherence to the intent of the parties will ultimately work to the benefit of public entities seeking financing in the future as they may be assured that their arrangements will be enforced as they intended.

MMWEC, 411 Mass. at 61-62.

See also e.g., Sabine Corp. v. ONG Western, Inc., 725 F.Supp. 1157 (W.D.Okla. 1989) (to the extent an increase in cost of performance was due to governmental regulation, it is foreseeable as a matter of law); *Resource Investment Corp. v. Enron Corp.*, 669 F.Supp. 1038 (D.Colo. 1987) (denying request to rescind contract claimed to be impracticable due to changes in the marketplace); *RJB Gas Pipeline Company v. Colorado Interstate Gas Company*, 813 P.2d 1 (1990) (refusing to excuse a contracting party from gas contract due to restructuring of the gas industry); *Northern Illinois Gas Co. v. Energy Corporation, Inc.*, 122 Ill.App.3d 940 (1984).

B. A Challenge By the Companies to the Current Pittsfield Operating Procedures Would Only Serve to Reduce Savings to Ratepayers

Of course, the Companies could have decided to challenge Pittsfield's current bidding and operating practices. Indeed, on January 26, 2004, the Companies sent a letter to Pittsfield in which they presented their interpretation of the 1992 PSAs and requested that Pittsfield return "to those bidding and operations practices previously utilized, where the Plant had achieved [higher

capacity factors]." Exh. AG-1-1(u). On February 13, 2004, Pittsfield responded to the Companies' January 26, 2004 letter and provided detailed support in the 1992 PSAs themselves for its position that the 1992 PSAs did not "mandate that [Pittsfield] apply any particular bid strategy," and that Pittsfield's bidding practices were appropriate. Exh. AG-1-1(v).

After receiving Pittsfield's February 13, 2004 response to the Companies' January 26, 2004 demand that Pittsfield return to previous bidding and operation practices, the record indicates that the Companies took no further steps to escalate their contract claims. In fact, the Companies moved forward to resolve this matter with Pittsfield even though the 1992 PSAs offered the Companies the opportunity to take their dispute to arbitration.

Specifically, Article 12.1 of the 1992 PSAs allows for arbitration in the event "of any dispute between the parties with respect to the interpretation of this Agreement or the performance of the same . . . ." Further, Article 12 sets forth detailed procedures for any party interested in pursuing a dispute through arbitration.

In Section V.A., above, Pittsfield has demonstrated that it consistently has employed bidding and operating practices for the Unit which are strictly in conformance with the 1992 PSAs. As such, if the Companies had chosen to pursue their dispute through the arbitration clause of the 1992 PSAs, at a minimum the Companies would have been required to address and counter the many contracts-related arguments raised in Section V.A. of this initial brief. It follows then that escalation of the Companies' dispute with Pittsfield through arbitration would have imposed significant costs on the Companies and their ratepayers.

While it is the case that no party can ever predict with certainty the outcome of arbitration or litigation, no party can reasonably contend that arbitration comes without cost. Here, the costs

associated with arbitration are twofold. First, any decision by the Companies to seek arbitration of their dispute would have required the Companies to incur legal and consulting fees. Second, because the 1992 PSAs would continue to run through the course of arbitration, the Companies would continue to pay Pittsfield pursuant to the PSAs.

When addressed from this perspective, it is clear that the Companies' decision to execute the Termination Agreements with Pittsfield rather than seek arbitration operated to protect the ratepayer savings captured by the Termination Agreements. And, while again it would be impossible to predict the outcome of any arbitration, if the Companies indeed had pursued arbitration, it is highly likely that the arbitrators would have sustained Pittsfield's interpretation of the 1992 PSAs. And, if any such decision by the arbitrators were followed by the execution of termination agreements similar to those submitted in this case, the savings associated with those termination agreements would have been reduced significantly by the potentially high costs associated with pursuit of the failed arbitration.

C. RECENT OPERATING HISTORY OF THE UNITS DEMONSTRATES THAT USE OF A 37% CAPACITY FACTOR IS A CONSERVATIVE ASSUMPTION

For almost the last year, the Project's capacity factor has averaged 27%. Exh. AG-1-10; Tr. 172. As demonstrated above, that is unlikely to change due to the provisions of 1992 PSAs and current bidding practices in New England. In addition, the Facility's heat rate is approximately 10,000 and, as Mr. Hevert testified "[i]t is highly unlikely that a plant with a 10,000 heat rate would be dispatched at a capacity anywhere near 90% . . . the capacity factor of 37% . . . is actually a fairly conservative estimate with respect to the capacity factor of a plant with such a high heat rate." Tr. 55; *see also* Tr. 148. Thus, the use of a 37% capacity factor is a conservative assumption. *See* Tr. at 55

D. EVEN ASSUMING A HIGHER CAPACITY FACTOR, THE TERMINATION AGREEMENTS RESULT IN SAVINGS FOR CUSTOMERS

Based on a capacity factor of 37% for the Unit, the savings associated with moving forward with the Termination Agreements, as opposed to continuation of the 1992 PSAs, are approximately 11.44%. Tr. at 8, *citing* Exhs. AG-2-13, AG-2-14, Tr. 10. Moreover, the Companies have stated that since capacity factors for the Unit have ranged from 27% to 37% over the last year, the use of a 37% capacity factor here results in a conservative analysis – one that tends to understate ratepayer savings. (Using a capacity factor of 27%, customer savings are expected to be 13.1%). Exhs. NSTAR-RBH at 26, DTE-1-32, Attachment DTE-1-32 ERRATA.[17]

In the course of this proceeding, the Companies presented a number of alternative calculations of ratepayer savings based on changes in certain variables. With respect to the capacity factor variable, the Companies calculated estimated savings based on both historical level capacity factors and higher than historical capacity factors. In response to an information request from the Attorney General, the Companies calculated that the Termination Agreements would yield savings of between 3.62% and 4.68% to customers if the Unit was achieving capacity factors between 80% and 86% (Exh. AG-2-3, Attachment AG-2-3(a) ERRATA, Attachment AG-2-3(b) ERRATA); and would yield savings of 2.90% assuming a 90% average annual capacity factor (Exh. AG-3-5).

And, while the Companies have stated clearly and repeatedly in this proceeding that they did not expect the Pittsfield Unit to operate in the future at capacity factors anywhere near

80-86% or above those levels based on current fuel prices, the Unit's heat rate, and Pittsfield's most recent bidding practices (Exh. AG-2-3; Tr. 55), it is important to note that even assuming unrealistic capacity factors for the Unit, the Termination Agreements still yield savings to the Companies' customers. It is because the termination of the 1992 PSAs in this case will achieve savings for ratepayers under the widest possible range of assumed capacity factors, the Department must find here that the Termination Agreements are in the public interest and are consistent with the requirements of G.L. c. 164, § 1G(d)(2)(ii).

VI. CONCLUSION

Based on the evidence presented during the proceedings and for the reasons set forth above, Pittsfield respectfully requests that the Department grant the Petition of Cambridge and Commonwealth and approve the Termination Agreements.

Respectfully submitted,

PITTSFIELD GENERATING COMPANY

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Dated: August 12, 2004

[17] In his pre-filed testimony, Mr. Hevert indicated that use of a 27% capacity factor resulted in savings to customers of 12.5%. This savings figure was confirmed by the Companies in Exh. DTE-1-32, Attachment 1-32. This calculation of savings was corrected to 13.1% in Exh. DTE-1-32, Attachment DTE-1-32 ERRATA.