

STATE OF NEW HAMPSHIRE
BEFORE THE
NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION

PETITION OF THE PUBLIC)
SERVICE COMPANY OF NEW)
HAMPSHIRE TO ESTABLISH AN) DOCKET NO. DE-11-216
ALTERNATE DEFAULT ENERGY)
SERVICE RATE)

DIRECT TESTIMONY
OF
STEVEN L. ESTOMIN, PH. D.

ON BEHALF OF THE
OFFICE OF THE CONSUMER ADVOCATE

AUGUST 24, 2012

EXETER

ASSOCIATES, INC.
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DIRECT TESTIMONY OF STEVEN L. ESTOMIN

I. INTRODUCTION

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Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

A. My name is Steven L. Estomin. I am a Senior Economist and principal with Exeter Associates, Inc. Our offices are located at 10480 Little Patuxent Parkway, Suite 300, Columbia, Maryland 21044.

Q. PLEASE DESCRIBE YOUR QUALIFICATIONS AND BACKGROUND.

A. I received a Bachelor of Arts degree with a major in economics in 1975, a Master of Arts degree in economics in 1978, and a Ph.D. in economics in 1986, all from the University of Maryland. My areas of specialization in graduate school were industrial organization, econometrics, and environmental economics.

I joined Exeter Associates, Inc. in 1981 as an economist and have been involved with economic analysis related to regulated industry since that time. A detailed statement of my qualifications is included as an appendix to this testimony.

Q. HAVE YOU TESTIFIED AS AN EXPERT WITNESS IN OTHER REGULATORY PROCEEDINGS?

A. Yes, I have provided expert witness testimony in more than 35 regulatory proceedings. I have testified before the utility commissions in Maine, Maryland, Pennsylvania, Vermont, New Mexico, New Jersey, Illinois, Rhode Island, Kentucky, and the District of Columbia on issues related to load forecasting, weather normalization, production planning, statistical analysis, electric utility industry restructuring, default service supply procurement, and other issues. I have also testified in U.S. District Court and before the Federal Energy Regulatory Commission on issues related to statistical estimation.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. No, I have not.

1 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

2 A. My testimony addresses Public Service Company of New Hampshire's ("PSNH")
3 proposed alternative default energy service rate -- Rate ADE. Additionally, I address the
4 broader issue of the sustainability of PSNH's recovery of generation costs within a
5 restructured industry framework.

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7 **II. PSNH'S ALTERNATE DEFAULT SERVICE ENERGY RATE PROPOSAL**

8 Q. HAVE YOU REVIEWED PSNH'S PROPOSAL TO ESTABLISH AN
9 ALTERNATE DEFAULT SERVICE ENERGY RATE?

10 A. Yes. I have reviewed the April 27, 2012 Direct Testimony of Stephen R. Hall and
11 Frederick B. White, witnesses for PSNH addressing the proposed Rate ADE.

12 Q. CAN YOU PLEASE SUMMARIZE THE NEW RATE BEING PROPOSED BY
13 PSNH?

14 A. Yes. Rate ADE would be available to customers who are returning to PSNH for energy
15 service after taking service from a competitive supplier. The pricing for Rate ADE would
16 be based on the Company's marginal cost to serve the returning customers plus an adder
17 of approximately one cent per kWh. The marginal price-based rate would be fixed for a
18 period of one year, at which time it would be adjusted to reflect new, forward looking
19 marginal costs for the subsequent one-year period. If, however, the marginal prices
20 increase to a level to absorb 75 percent of the adder over a six-month period, the
21 Company would file a request for an increase in the ADE rate.

22 Q. WHAT IS THE PURPOSE OF THIS RATE?

23 A. The purpose of this rate is to attract migrated customers back to PSNH at a price that still
24 provides a contribution to the Company's fixed costs. The returning customers,

1 therefore, would be covering the marginal rate of service and helping to defray fixed
2 costs for the default service customers that have continued to be served by PSNH.

3 Q. WOULD THIS RATE BE AVAILABLE TO ALL SHOPPING CUSTOMERS?

4 A. Initially, the rate would be available only to larger customers. After an initial 9-month
5 period, the rate would also be available to smaller customers, including residential
6 customers who have selected competitive energy supply.

7 Q. WOULD CUSTOMERS HAVE THE ABILITY TO MOVE TO AND FROM
8 THE NEW RATE WITHOUT PENALTY?

9 A. The Company has proposed certain restrictions to migration to and from the rate which
10 are designed to minimize the potential for gaming the rate to the potential detriment of
11 PSNH's non-shopping customers.

12 Q. WHAT WOULD BE THE IMPLICATIONS FOR DEFAULT SERVICE
13 CUSTOMERS IF MARGINAL COSTS INCREASED BY AN AMOUNT
14 MORE THAN THE ADDER OVER THE SIX-MONTH PERIOD?

15 A. In that circumstance, the ADE rate would be insufficient to cover the marginal costs of
16 the returning customers, no contribution to fixed costs would be available, and additional
17 costs would be incurred by the default service customers, including residential customers.

18 Q. DOES THE OCA SUPPORT THE APPROVAL OF THE PROPOSED RATE
19 ADE?

20 A. Yes. The approval and implementation of this rate should serve to reduce costs that
21 would otherwise be borne by residential customers, though OCA recognizes that there is
22 some risk that residential customers could be exposed to higher rates for some short
23 period of time if marginal costs increase substantially within a compressed time frame.
24 We believe, however, that the risks associated with this potential are small relative to the
25 potential benefit.

1 Q. ARE THERE ANY SAFEGUARDS IN PLACE TO HELP MINIMIZE THE
2 POTENTIAL ADVERSE IMPACT ASSOCIATED WITH AN INCREASE IN
3 MARGINAL COSTS DURING A SIX-MONTH PERIOD WHEN THE RATE
4 ADE WOULD BE FIXED?

5 A. Yes. The adder of approximately one cent per kWh provides a significant buffer to
6 marginal cost increases. Additionally, PSNH employs a variety of hedging strategies to
7 manage price risk that would be employed in the context of Rate ADE. These have been
8 addressed in general terms in the Company's response to interrogatory OCA-3-003,
9 attached as OCA Exhibit SLE-1.

10 Q. DO YOU BELIEVE THAT THE ONE-CENT ADDER TO MARGINAL COSTS
11 PROPOSED BY PSNH IS OPTIMAL?

12 A. That is not clear. The adder needs to be small enough that shopping customers in
13 meaningful numbers would be attracted to Rate ADE and return to PSNH for the supply
14 of energy. The adder, however, needs to be sufficiently high so as to provide a
15 significant contribution to fixed costs. Additionally, the adder needs to be high enough to
16 provide protection to existing PSNH customers from unanticipated short-term increases
17 in marginal costs. While the one-cent adder appears to represent a reasonable balance
18 among these goals, an alternative adder may be preferred as circumstances evolve, for
19 example, changes in wholesale power markets. The OCA, therefore, is not willing to
20 agree that the one-cent adder proposed by PSNH should be adopted to the exclusion of
21 consideration of alternatives that might be proposed.

22 Q. DO YOU VIEW THE IMPLEMENTATION OF RATE ADE AS A LONG-
23 TERM SOLUTION TO THE ISSUE OF FIXED GENERATION COSTS BEING
24 ALLOCATED TO A DECLINING LOAD OVER TIME?

25 A. No, I do not. This issue is discussed in the following section of my Direct Testimony.

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III. LONG-TERM COST COVERAGE ISSUES

Q. WHAT ARE THE IMPLICATIONS OF CUSTOMERS SWITCHING TO COMPETITIVE ELECTRIC POWER SUPPLY FOR THOSE CUSTOMERS WHO CONTINUE TO BE SERVED BY PSNH?

A. The implication of customers switching to competitive service is that "...the fixed costs of PSNH's generation assets must be spread over a smaller group of customers and lower sales volume. The customers that [do] not switch to a third party supplier, predominantly residential and small commercial and industrial customers, are now paying a larger proportion of these fixed costs."¹ As the proportion of the fixed costs increase for non-shopping customers, shopping becomes more attractive and additional customers will migrate to competitive supply, thereby worsening the problem for remaining customers. The problem is further exacerbated by declining market prices for energy, which have generally been the case over the past several years. Clearly, PSNH's existing structure is not viable in the long term.

Q. WOULD INCREASING MARKET POWER PRICES RELATIVE TO PSNH RATES AMELIORATE THIS PROBLEM?

A. Yes, but that would generate another problem affecting competitive suppliers. If market prices increase and exceed PSNH costs, shopping customers will migrate back to PSNH and competitive suppliers operating in the New Hampshire market may find it uneconomic to continue marketing and operating in a boom/bust environment. Increasing market power prices, therefore, are not conducive to development of a competitive market, which is a cornerstone of industry restructuring.

¹ Northeast Utilities, *2010 Annual Report*, p. 6.

1 Q. DOES THE IMPLEMENTATION OF RATE ADE HAVE THE SAME IMPACT
2 AS A RISE IN THE MARKET PRICE OF POWER?

3 A. Fundamentally, yes. The purpose of the rate is to lure customers back to PSNH as a way
4 of reducing per-kWh fixed costs to PSNH generation customers. The notion of enacting
5 programs to reduce the amount of load being served by the competitive market, which the
6 OCA supports as an interim measure to protect residential default service customers, is
7 antithetical to the basic premise of industry restructuring.

8 Q. ARE THERE SOLUTIONS TO THIS SITUATION?

9 A. There is a wide range of potential solutions including, but not necessarily limited to,
10 eliminating retail open access, having PSNH transfer its generation assets to an
11 unregulated generation affiliate, or having PSNH sell its generation assets and become a
12 transmission and distribution company. Under the second and third options, it would be
13 anticipated that PSNH would continue to provide energy service on a default basis for
14 customers that either cannot shop or choose not to shop. These types of arrangements
15 have been employed by other states that have implemented industry restructuring, with
16 varying degrees of success.

17 Q. IS THE OCA PROPOSING A SPECIFIC SOLUTION OR COURSE OF
18 ACTION IN THIS REGARD?

19 A. Not at this time. The OCA, however, urges the Commission to move expeditiously
20 towards development of an approach to eliminate the tension between PSNH's current
21 rate setting arrangements and promotion of retail electric competition.

22 Q. DOES THIS COMPLETE YOUR TESTIMONY?

23 A. Yes, it does.

Appendix
Summary of Qualifications
for
Steven L. Estomin