

BEFORE THE
RHODE ISLAND PUBLIC UTILITY COMMISSION

DOCKET NO. 4041

SURREBUTTAL TESTIMONY

OF

RICHARD S. HAHN

IN THE MATTER OF NATIONAL GRID'S STANDARD
OFFER SUPPLY PROCUREMENT PLAN FOR 2010

ON BEHALF OF THE

RHODE ISLAND DIVISION OF PUBLIC UTILITIES AND CARRIERS

August 25, 2009

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1 **INTRODUCTION**

2 **Q. Please identify yourself for the record.**

3 A. My name is Richard S. Hahn. I am a Principal Consultant for La Capra
4 Associates. My business address is One Washington Mall, Boston, Massachusetts
5 02108.

6 **Q. Have you previously prepared testimony in this proceeding?**

7 A. Yes. On July 22, 2009, I submitted direct testimony on behalf of the Rhode
8 Island Division of Public Utilities and Carriers (“Division”) in this proceeding.

9 **Q. What is the purpose of your surrebuttal testimony in this proceeding?**

10 A. The purpose of this surrebuttal testimony is to respond to the rebuttal testimony of
11 witnesses Daniels and Allegretti on behalf of Constellation NewEnergy, Inc. and
12 Constellation Energy Commodities Group, Inc. (“Constellation”). I also respond
13 briefly to the rebuttal testimony of Mr. Smithling on behalf of National Grid
14 (“NGRID”).

15

16 **SUMMARY**

17 **Q. Can you summarize your response to the rebuttal testimony of Mr. Daniels
18 and Mr. Allegretti on behalf of Constellation?**

19 A. Constellation submits lengthy rebuttal testimony criticizing my proposal for a
20 managed portfolio approach to procuring Standard Offer Service (“SOS”) power
21 supplies. Constellation claims that my testimony is unsupported and incorrectly
22 portrays the benefits of a managed portfolio approach.

1 **Q. How do you respond to this testimony?**

2 A. At a high level, Constellation’s testimony claims that my testimony is
3 unsupported, and it makes numerous arguments as to why that is the case.
4 Unfortunately, the Constellation rebuttal testimony is just that – arguments. As
5 Constellation notes on page 3, “Through our arguments herein, we maintain and
6 provide addition support for Constellation’s position that a Full Requirements
7 Service structure will best meet the needs of National Grid’s SOS customers.”
8 These arguments are simply Constellation’s point of view. Despite its criticism of
9 my testimony, Constellation has offered no evidence to prove or even suggest that
10 100% reliance on Full Requirements Service (“FRS”) is a better model to use to
11 procure SOS power supplies. Furthermore, Constellation makes erroneous
12 statements that mis-characterize a managed portfolio in an attempt to discredit it.
13 In the remainder of this testimony, I shall attempt to respond to as many of the
14 points raised by Constellation as I can, given the time schedule allowed for the
15 submittal of surrebuttal testimony. If I do not respond to a particular point raised
16 by Constellation, that lack of a response should not be interpreted as agreeing
17 with Constellation.

18 **Q. Can you offer any additional evidence that a managed portfolio approach**
19 **produces superior results?**

20 A. I provide two comparisons that compare the power supply costs from a managed
21 portfolio approach to power supply costs based upon FRS transactions. The first
22 is a benchmark comparison filed on July 13, 2009 in Pennsylvania on behalf of

1 Citizens Electric and Wellsboro Electric¹, both of whom use a managed portfolio
2 approach. The second is a comparison of power supply costs for Massachusetts
3 municipal electric systems, which also use a managed portfolio approach, and
4 Massachusetts investor-owned utilities, which rely on FRS contracts. Both of
5 these comparisons demonstrate that a managed portfolio approach produces better
6 results for customers.

7 **Q. In light of the positions taken by you and Constellation during the testimony**
8 **phase of this proceeding, what should the Commission do to decide which**
9 **procurement model to adopt?**

10 A. I have made a strong case for a managed portfolio approach, and have provided
11 direct comparisons that demonstrate the desirability of this procurement method.
12 The multitude of unsupported arguments offered by Constellation have possibly
13 left confusion in the record. I recommend that the Commission consider the case
14 I have made, including the additional evidence provided in this surrebuttal
15 testimony, and also speak with entities that have actually implemented a managed
16 portfolio approach. The Commission should contact organizations such as the
17 Pennsylvania Office of Consumer Advocate, the utilities of Wellsboro Electric
18 and Citizens Electric, the Illinois Power Authority, and the general managers of
19 municipal electric systems in Massachusetts, all of whom have implemented a
20 managed portfolio approach. The Commission can learn first hand that a
21 managed portfolio approach such as I recommend can be done with utility

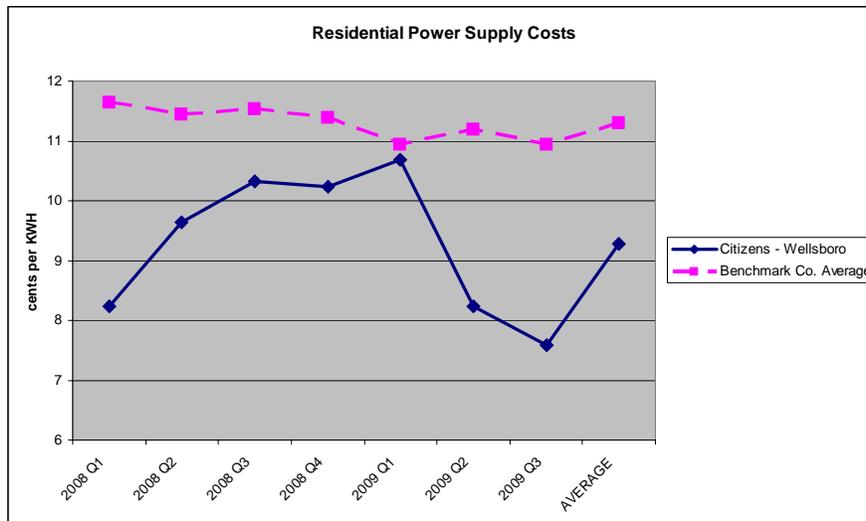
¹ See testimony of Charles Barnes in PA PUC Dockets P-2009-2110798 and P-2009-2110780.

1 resources, is not burdensome or onerous to the Commission or the Company, does
2 not present excess risk, promotes competition, and results in lower, more stable
3 SOS prices over time for the benefit of customers.

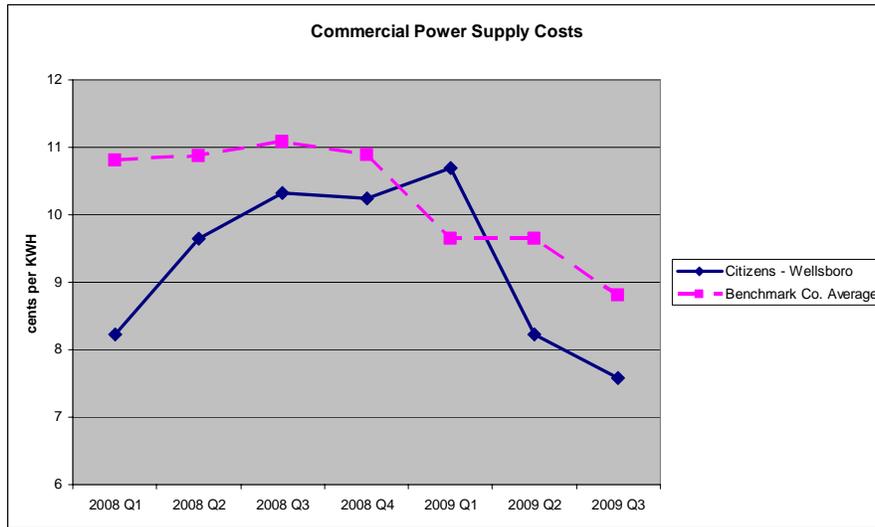
4 **BENCHMARK COMPARISONS**

5 **Q. In your summary, you mentioned a benchmarking comparison performed by**
6 **Citizens Electric and Wellsboro Electric companies. Can you describe this**
7 **comparison?**

8 A. Citizens-Wellsboro uses a managed portfolio approach to arrange for their power
9 supplies. They retain Aces Power Marketing to fulfill the role of portfolio
10 manager. On July 13, 2009, Citizens-Wellsboro filed a comparison of their power
11 supply costs to other utilities in New Jersey and Pennsylvania that rely on FRS
12 contracts for the last seven calendar quarters. The following graphs summarize
13 the comparison.



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The managed portfolio rates for Citizens-Wellsboro are lower than the rates of the utilities that rely upon FRS contracts. It is important to note that the rates for Wellsboro include the congestion costs that Constellation cites as an example of why Constellation opposes a managed portfolio approach. I will address these congestion costs later in my detailed response to Constellation, and explain why this incident is not applicable to Narragansett Electric. If these congestion costs were excluded from the above comparison, the managed portfolio rates for Citizens-Wellsboro would be even more favorable. It should also be noted that the above comparison covers a time period where energy prices were extremely volatile. Even with this extreme volatility, the managed portfolio approach fared better.

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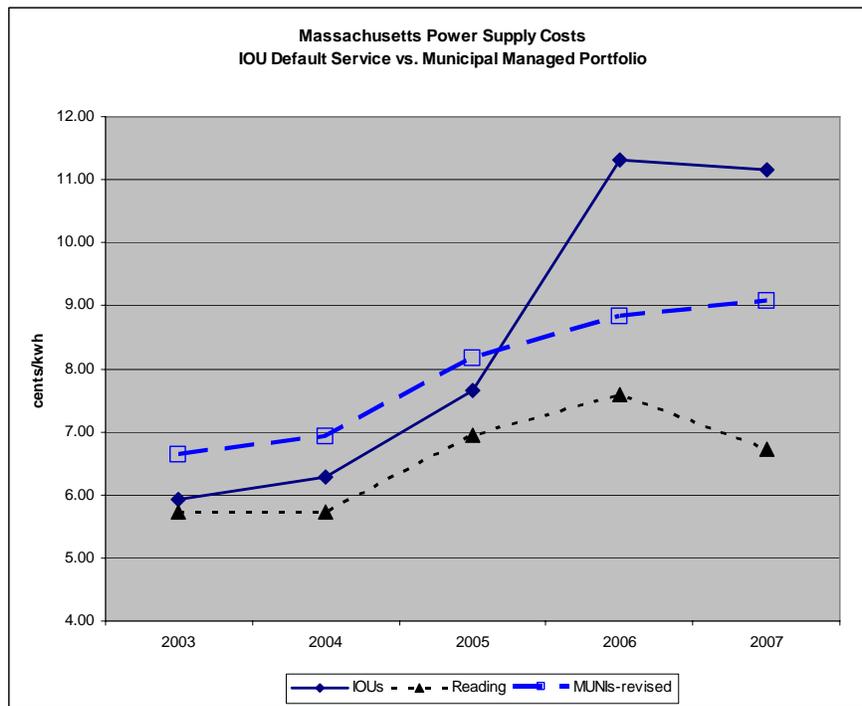
Q. Can you describe the second comparison that you mentioned?

14

A. The Pennsylvania Public Utilities Commission commenced hearings at the end of 2008 to establish default service power supply procurement plans for PECO

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1 Energy and PPL Utilities. In those proceedings, I filed testimony on behalf of the
2 Pennsylvania Office of Consumer Advocate. My testimony contained a
3 comparison of power supply costs for Massachusetts municipal electric systems,
4 which use a managed portfolio approach, to the power supply costs of
5 Massachusetts investor-owned utilities, which rely upon FRS contracts. Costs
6 were compared for the years 2003 to 2007, which represented the period after the
7 implementation of Standard Market Design in the ISO-NE markets. The
8 following graph demonstrates that the managed portfolio approach produced
9 superior results.



10

11 **Q. What do you recommend to the Commission?**

1 A. I recommend that the Commission rely upon the evidence provided here to
2 support the adoption of a managed portfolio approach for SOS power
3 procurement in Rhode Island.
4

5 **RESPONSE TO CONSTELLATION'S REBUTTAL TESTIMONY**

6 **Q. Are there some points of agreement between you and Constellation?**

7 A. Yes. Constellation seems to agree with me that laddering in staggered contracts,
8 regardless of the product purchased, can smooth out price fluctuations in the cost
9 of SOS.² To the extent that the Commission does approve an SOS procurement
10 plan that relies in some way on FRS, it should require the maximum amount of
11 laddering in staggered contracts as I recommend in my testimony.

12 **Q. Are there areas where you disagree with Constellation's rebuttal testimony?**
13 **For example, Constellation states that diversification is better achieved by**
14 **there being one product, namely FRS, rather than a diversified portfolio of**
15 **different products. (page 7) Do you agree?**

16 A. No. Constellation states that FRS suppliers assemble a portfolio of options as part
17 of their efforts to provide FRS, and that this method of diversification is
18 preferable to a managed portfolio approach. They offer no supporting evidence to
19 demonstrate that, even if the FRS supplier did have a diversified portfolio, the
20 benefits flow to SOS customers. The comparisons described earlier in my
21 surrebuttal testimony demonstrate that the managed portfolio approach is a

² See page 7 of the Constellation testimony.

1 superior method for creating a diversified portfolio that actually results in lower
2 costs to customers.

3 **Q. Constellation offers two reports by the Analysis Group that Constellation**
4 **claims demonstrate that FRS procurements are the preferred procurement**
5 **method. (page 8) Please respond.**

6 A. These same two reports were introduced on the Pennsylvania proceedings
7 referenced later in the Constellation rebuttal testimony. These reports actually
8 undercut the position that Constellation tries to use them to support. For example,
9 in Exhibit 2.3 to Constellation's rebuttal testimony is a NARUC study entitled
10 Competitive procurement of Retail Electricity Supply: Recent trends in State
11 Policies and Utility Practices. In table 1 of this report, it is noted that in
12 restructured states with retail choice (such as Rhode Island), procurement
13 methods include FRS, long term contracts, utility ownership of generation with
14 some degree of portfolio management by the utility, public power authority, and
15 specialized procurements such as for renewable energy. As to who is responsible
16 for supply portfolio management, Table 1 indicates that it is variously assigned to
17 the market and to the utility. Connecticut, Delaware, Illinois, Ohio, and
18 Pennsylvania are listed as state examples. Thus, it is clear from Constellation's
19 own references and exhibits that some states employ a managed portfolio
20 approach.

21 **Q. Constellation states that long-term renewable energy contracts required by**
22 **Rhode Island law are acceptable, but any additional long-term contracts**

1 **hinder meeting SOS customer interests. Constellation further states that if**
2 **the Commission does require additional long term contracts, it should limit**
3 **the term to five years. (page 9 - 11) Please respond.**

4 A. The Rhode Island legislature has determined that long term contracts are an
5 appropriate component of a utility SOS power supply. The execution of long-
6 term contracts, especially for renewable energy sources and individual projects,
7 can facilitate the construction of new capacity by providing cash flow and debt
8 service coverage assurance. Long-term contracts beyond what are legislatively
9 mandated should be considered and objectively evaluated on their own merits.
10 Long-term contracts from both renewable energy and conventional sources can
11 add price stability and savings over time. I oppose the suggestion to limit any
12 long-term contracts to terms of five years or less. A five-year contract may not be
13 long enough to facilitate the financing and construction of new generating assets.
14 And for many assets, there could be savings after five years, as debt is decreased
15 and the asset is depreciated and becomes less costly than a new unit.

16 **Q. Constellation claims that an open position is too risky. (page 12-13) How do**
17 **you respond?**

18 A. The vast majority of municipal electric systems in Massachusetts own no
19 generation and purchase their power supplies to meet their customers' needs.
20 These utilities care deeply about the price that they charge for power, as they are
21 owned by their customers, the voters in each town. These utilities could use any
22 procurement method they want, including reliance on FRS. Because they are

1 highly incentivized to keep rates as low and stable as possible, the vast majority
2 of these systems use a managed portfolio approach, including some open energy
3 position. The comparison of power supply costs for Massachusetts municipal and
4 investor-owned utilities provided previously showed that, in the last five years,
5 the managed portfolio approach used by the municipal systems (including open
6 energy positions) produced lower, more stable rates. Citizens and Wellsboro also
7 use a managed portfolio approach and maintain some open position, and their
8 power supply costs were lower than utilities in the same market that rely on FRS
9 contracts. This demonstrates that maintaining a reasonable open position in a
10 managed portfolio is not too risky.

11 **Q. But doesn't Constellation state that the managed portfolio approach**
12 **approved for PECO Energy and PPL Utilities were approved only for**
13 **residential customers? (page 37)**

14 A. What Constellation neglects to note is that the testimony I submitted in
15 Pennsylvania was on behalf of the Office of Consumer Advocate. This testimony,
16 which justified the approval of a managed portfolio approach, was filed on behalf
17 of only residential customers, because they are the constituents of the Office of
18 Consumer Advocate. Due to the nature of the client, I was unable to advocate a
19 managed portfolio approach for other classes of customers. Thus, the
20 Commission approved a managed portfolio approach for the class of customers
21 for which such a method had been advocated.

1 **Q. Constellation states that the premium contained in FRS is a monetization of**
2 **risk. (page 14) Please respond.**

3 A. FRS suppliers such as Constellation will attempt to monetize risk so to avoid
4 losing money on the transactions that they enter into. They also add a profit
5 margin. But many of these FRS suppliers purchase blocks of peak and off-peak
6 energy, capacity, and ancillary services in order to fulfill their supply obligations.
7 The sellers of these individual products include their own risk monetization and
8 profit margin. So FRS suppliers will make these purchases and add additional
9 risk monetization and profit margins. By buying the products separately, a
10 portfolio manager can avoid the extra profit margin and can likewise manage risk
11 by diversifying the portfolio. The result is a lower cost for SOS power supplies.

12 **Q. Constellation states that SOS should be a plain vanilla, low risk product, and**
13 **that customers should be allowed to choose or manage risk for themselves.**
14 **(page 15) How do you respond?**

15 A. Nothing in my testimony suggests or implies that customers will not be able to
16 choose their generation suppliers, nor manage risk in any way they please. I
17 propose a method for procuring SOS power supplies that I believe will produce
18 lower, more stable prices. Customers will still have choices, in that they can still
19 choose a competitive supplier if they prefer.

20 **Q. Constellation states that reliance on FRS better promotes competition. (page**
21 **16) Please respond.**

1 A. I disagree with that claim. In a managed portfolio approach, the individual
2 products purchased, such as energy and capacity, are procured through
3 competitive solicitations, similar to the solicitations for FRS. However, a
4 managed portfolio approach facilitates more competition by allowing a larger,
5 more diverse group of entities to bid. Only a handful of large providers, such as
6 Constellation, can supply FRS. The owner of a renewable energy facility could
7 bid to sell capacity, energy, and RECs under a managed portfolio approach but
8 could not bid to supply FRS. This will enhance competition, not hinder it.

9 **Q. Constellation states that FRS insulates customers from short-term price**
10 **increases. (page 16) Do you agree?**

11 A. No. It is the laddering of staggered contracts and attention to the wholesale
12 market price environment that smoothes out price fluctuations. This can be done
13 with a managed portfolio approach.

14 **Q. Constellation claims that La Capra Associates may have a vested interest in a**
15 **managed portfolio approach. (page 20) Please respond.**

16 A. Constellation could not be more wrong about this. La Capra Associates does
17 advise certain clients on purchasing power supplies, and we do use a managed
18 portfolio approach. However, La Capra Associates does not make money on the
19 price of those power supplies, nor any profit margin contained in those prices, as
20 Constellation and other FRS suppliers do. Rather, La Capra Associates charges
21 for this advice based upon our billing rates and the number of hours worked, so it
22 has no vested interest in any particular transaction type or procurement method.

1 If we recommended or used a procurement method that was inferior, our clients
2 would seek advice elsewhere. The only “vested interest” that La Capra
3 Associates has is to offer the best advice possible. We recommend and use a
4 managed portfolio approach simply because we believe it produces a better
5 outcome and allows us to retain our clients.

6 **Q. Constellation suggests that competition among FRS suppliers will result in**
7 **lowest cost in order to win bids. (page 26) Please respond.**

8 A. It is true that FRS suppliers compete for the right to provide SOS. However, if
9 FRS is a high cost method of procuring power supplies, the cost of FRS will still
10 be higher than what is otherwise achievable under a managed portfolio all else
11 being equal (i.e., at the same time and in the same wholesale markets). A
12 managed portfolio approach allows more bidders to compete to sell more
13 products, which is more likely to result in truly low cost SOS.

14 **Q. Constellation states that the Wellsboro congestion incident proves that FRS**
15 **is better than a managed portfolio approach. (page 27) Do you agree?**

16 A. No. The incident cited by Constellation involves Wellsboro Electric, a very small
17 utility in Pennsylvania that utilizes a managed portfolio approach to purchase its
18 power supplies. Wellsboro is served by a single 34.5 KV aggregate node and
19 relies on the transmission system of FirstEnergy. Due to the failure of a large
20 transformer, Wellsboro experienced a high level of congestion until the
21 transformer was repaired. The cause of the congestion and the prudence of
22 FirstEnergy were investigated, and a settlement was reached closing the

1 investigation. This example is not applicable to Narragansett Electric Company,
2 which is served by many pricing nodes, most often at higher voltages than the
3 34.5 kV system under which Wellsboro is served. What happened to Wellsboro
4 cannot happen to Narragansett Electric Company, and this example should not be
5 used to detract from the benefits of a managed portfolio.

6 **Q. Constellation states that your testimony contains contradictory statements**
7 **about NGRID's ability to implement a managed portfolio. (page 28) Please**
8 **respond.**

9 A. Constellation points to a statement made in my prior testimony in this case, where
10 I indicated that NGRID should settle its financial swaps against actual prices, not
11 futures prices that exist several months before actual prices are known. My
12 suggestion to improve NGRID deployment of financial swaps in no way
13 contradicts my statement that NGRID has the capability to implement a managed
14 portfolio. The fact that NGRID was able to identify financial swaps as a product
15 in its SOS power portfolio, specify the amounts needed during peak and off-peak
16 periods for each month of the purchase, issue an RFP to procure the swaps and
17 evaluate them against FRS purchases demonstrates that NGRID has the capability
18 to manage a portfolio of SOS power supplies.

19 **Q. Constellation claims that a managed portfolio approach can't be shown to be**
20 **least cost. (page 30) How do you respond?**

21 A. Constellation has provided no evidence or even a single comparison that shows
22 that its approach, that relies 100% on FRS contracts, produces a least cost

1 outcome. On the other hand, I provide two comparisons that demonstrate that a
2 managed portfolio approach does produce lower, more stable results over time.

3 **Q. Constellation claims that a managed portfolio approach places more burdens**
4 **on the Commission. (page 33) Do you agree?**

5 A. No. Purchasing the individual components of a managed portfolio is done
6 through competitive solicitations where standard products are bought and the
7 suppliers with the lowest price are selected. Thus, it is no more difficult or
8 burdensome to review the results of a solicitation for the components of a
9 managed portfolio than it is for FRS contracts. The Commission has already
10 reviewed the solicitation and evaluation of financial swaps, which are similar to
11 physical block energy purchases, so it has been shown that such a process is not
12 burdensome or onerous.

13 **Q. Constellation states that a managed portfolio approach requires market**
14 **timing. (pages 34-36) Please respond.**

15 A. A managed portfolio approach does not depend upon timing the market, though
16 purchases of the diversified product mix comprising the portfolio can benefit from
17 an awareness of the wholesale market price environment at the time purchases are
18 made. Decisions to accelerate purchases when wholesale market prices are
19 relatively low by historical standards, and deferring and minimizing purchases
20 when they are relatively high by historical standards, are examples of how
21 awareness of market conditions can improve outcomes. The application of this
22 market awareness can and should apply to FRS purchases as well.

1 Finally, while I have proposed certain narrow windows within which to make
2 purchases, it should be noted that regardless of the product purchased, a date for
3 consummating the deal must eventually be selected in any case. This is true for
4 both a managed portfolio and FRS transactions.

5 **Q. Constellation claims that all of the larger utilities in New England use FRS.**
6 **(page 40) How do you respond?**

7 A. I do not agree. Large utilities in Vermont do not rely upon FRS contracts for their
8 power supplies. One of the Constellation exhibits lists Connecticut as a state
9 which is moving away from 100% reliance on FRS. Furthermore, the comparison
10 described earlier in this testimony shows that the large utilities in Massachusetts
11 have higher, less stable power supply costs than the municipal electric systems
12 which use a managed portfolio approach.

13

14 **RESPONSE TO NGRID REBUTTAL TESTIMONY**

15 **Q. What issues are raised in the rebuttal testimony of NGRID that you wish to**
16 **respond to?**

17 A. In my direct testimony, I recommend that NGRID have separate procurements for
18 residential customers, and group the C06 customer class with other commercial
19 customers. In his rebuttal testimony, Mr. Smithling states that he prefers to keep
20 the C06 customer class grouped with the residential customer class. In support of
21 his preference, Mr. Smithling cites the average customer size and the low
22 probability of switching for the C06 customer class.

1 **Q. Do you agree?**

2 A. I continue to believe that having a separate procurement for residential customers
3 is a preferable grouping. Residential customers are the least likely to switch to
4 competitive suppliers, significantly less than even the smallest commercial
5 customers. As shown in Exhibit RSH-7 in my direct testimony, the load shape of
6 the C06 customer class is much more similar to the load shape of other
7 commercial customer classes than it is to the load shape of residential customers.
8 Finally, I note that NGRID has a separate procurement for its residential customer
9 class in Massachusetts, so doing so in Rhode Island should not be problematic.

10

11 **CONCLUSION**

12 **Q. Does this conclude your testimony?**

13 A. At this time, yes. I note that several data requests have been submitted to
14 Constellation regarding its rebuttal testimony. As of the writing of this surrebuttal
15 testimony, responses to those questions have not been received. I would like the
16 opportunity to supplement this rebuttal testimony as necessary, if responses arrive
17 before the closing of the record in this proceeding.