

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Cambridge Electric Light Company)
d/b/a NSTAR Electric)

D.T.E. 02-76

INITIAL BRIEF OF CAMBRIDGE ELECTRIC LIGHT COMPANY

d/b/a NSTAR ELECTRIC

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I. INTRODUCTION

On November 21, 2002, Cambridge Electric Light Company d/b/a NSTAR Electric (“NSTAR Electric” or the “Company”) petitioned the Department of Telecommunications and Energy (the “Department”), pursuant to G.L. c. 164, §§ 1A, 1G, 76, and 94, to review and approve the divestiture of the Company’s interest in the land and buildings that comprise the Blackstone Station Facility (“Blackstone”) to President and Fellows of Harvard College (“Harvard”). Blackstone is a 16-megawatt (“MW”) electricity and steam generating facility located in Cambridge, Massachusetts.

The Company’s initial filing included a Petition (the “Petition”) and the following exhibits: (1) the pre-filed testimony of Geoffrey O. Lubbock (Exh. GOL-1); (2) a Right of First Offer (the “Right of First Offer”) between Cambridge and Harvard (Exh. GOL-2); (3) the Purchase and Sale Agreement (“PSA”) signed by Cambridge and Harvard (Exh. GOL-3); (4) the Steam Asset Purchase and Sale Agreement between NSTAR Steam Corporation (“NSTAR Steam”) and Harvard (Exh. GOL-4); (5) a Lease between Cambridge and Harvard (Exh. GOL-5); (6) an Operating Agreement between

NSTAR Steam and Harvard (Exh. GOL-6); (7) a Service Agreement between NSTAR Electric & Gas Corporation (“NSTAR E&G”) and NSTAR Steam (Exh. GOL-7); (8) a Preliminary Calculation of Net Proceeds (Exh. GOL-8); and (9) a calculation of the Company’s net deferrals after applying the proceeds of the divestiture to the Company’s current deferrals. On December 17, 2002, the Company supplemented its initial filing with exhibits and schedules associated with the PSA (Exh. GOL-3 (Supp.)).

Between December 17, 2002 and December 23, 2002, the Office of the Attorney General (the “Attorney General”) and Harvard filed petitions to intervene in the above-referenced proceeding. On January 7, 2003, a public hearing was held followed by a procedural conference during which the Hearing Officer granted the previously referenced petitions to intervene. The Department held an evidentiary hearing in this proceeding on January 16, 2003. There have been 28 exhibits entered into the record in this case.

In support of the Petition, the Company presented the testimony of Geoffrey O. Lubbock, Vice President, Financial Strategic Planning & Policy for NSTAR E&G. Mr. Lubbock provided descriptions of: (1) Blackstone; (2) the Right of First Offer; (3) the divestiture process; and (4) the various agreements associated with the divestiture. Mr. Lubbock’s testimony also addressed the proposed ratemaking treatment and the positive effect of the sale of Blackstone on the Company’s Transition Charge. As set forth below, the price offered for Blackstone by Harvard was arrived at through rigorous, arms’-length negotiations. As a result, the divestiture will result in the maximum mitigation of transition costs and approximately \$10 million in net savings for the Company’s customers.

Accordingly, the Company has demonstrated that it has met the standards established in the Electric Restructuring Act, Chapter 164 of the Acts of 1997 (the “Act”), regarding the divestiture of generation facilities, and that the divestiture is consistent with: (1) the Company’s restructuring plan (the “Restructuring Plan”), as approved by the Department in Cambridge Electric Light Company, et al., D.P.U./D.T.E. 97-111 (1998); and (2) Department precedent. Therefore, the Company respectfully requests that the Department approve its Petition.

II. BACKGROUND OF BLACKSTONE AND THE TRANSACTION

A. Blackstone’s Critical Role in Supplying Heat to Harvard Made Harvard the Best Candidate To Purchase the Facility In Order To Maximize Mitigation of Transition Costs.

The Blackstone facilities have produced steam and/or electricity since about 1930 (Exh. GOL-1, at 5).¹ Blackstone’s primary use today is to produce steam for resale by NSTAR Steam to two major customers: Harvard and Genzyme Corporation (*id.*). As noted by Mr. Lubbock in his testimony, Harvard’s interest in Blackstone has been particularly strong because the steam sold and delivered to Harvard provides the sole means of heating Harvard’s Cambridge and Allston campuses (*id.* at 6).

Given the critical role Blackstone plays in heating the campuses, in 1993, Harvard approached the Company and COM/Energy Steam Company (predecessor to NSTAR Steam) and suggested that a long-term steam service agreement was critical to Harvard and that such an arrangement would be possible only if Harvard’s concerns over long-term steam security were addressed (*id.*). Accordingly, the Company and Harvard

¹ Blackstone ceased producing electricity in November 2001.

negotiated the terms of the Right of First Offer (Exh. GOL-2), which controlled the Company's rights to sell or agree to sell Blackstone's electric facilities, steam facilities, or both, without first offering in writing to Harvard to convey them to Harvard (id. at 6-7).

In conjunction with signing the Right of First Offer, the Company and Harvard entered into a long-term steam contract, which provided Harvard the needed assurance that a long-term, economical and reliable supply of steam would be available to its campuses (id. at 7). The Company's customers benefited from these agreements because they ensured that a favorable, long-term steam agreement with Harvard was in place, which would permit the costs associated with Blackstone Station to be shared in a manner that reduced costs to the Company's customers (id.).

After the passage of the Act, the Company had significant interest in divesting the Company's other generation assets. However, in the context of determining the best means of divesting Blackstone, the Company believed that the Right of First Offer encumbered the facility from being successfully included in a competitive auction, because of the likelihood that Harvard would seek to enforce rights to purchase the facility, and thus, inhibit the value of bids from other parties (id. at 7-8). Conversely, in considering the best means to divest and maximize the value of Blackstone, the Right of First Offer demonstrated that Harvard had an obvious heightened interest in the ownership of Blackstone and its steam supply, and thus, that it would likely pay more than other potential buyers (id. at 8; Exh. DTE-1-8; Exh. DTE-1-9). Accordingly, the Company decided to negotiate with Harvard, rather than pursue other options to divest the facility, such as an auction, in order to maximize mitigation for customers.

B. The Company Has Maximized the Mitigation of Blackstone's Transition Costs.

The negotiations with Harvard resulted in the signing of a PSA for Blackstone's real estate and equipment on August 1, 2002 (Exh. GOL-3; Exh. GOL-3 (Supp.)). In addition, Harvard has agreed to purchase Blackstone's steam assets, as represented in the Steam Asset Agreement (Exh. GOL-4). In order to provide a smooth transition in ownership from the Company to Harvard, NSTAR Steam will continue to operate Blackstone for Harvard and will continue to employ NSTAR Steam's existing employees that serve the facility, for a period of one year, pursuant to the Operating Agreement (Exh. GOL-6). Moreover, prior to closing on the PSA and the Steam Asset Agreement, the Company has agreed to lease Harvard space at Blackstone, pursuant to the Lease Agreement (Exh. GOL-5).

Subject to closing adjustments, the sale price for Blackstone is approximately \$14.6 million, which will result in net savings for Cambridge's customers of approximately \$10 million. Accordingly, the Company's negotiations with Harvard resulted in a price for the facility that represents the maximum mitigation for the Company's transition costs associated with Blackstone, consistent with the Department's standard of review for such transactions.

III. STANDARD OF REVIEW

Approval of asset divestitures are subject to the Department's jurisdiction pursuant to G.L. c. 164, §§ 1A, 1G, 76, and 94. The Act requires that the Company undertake all reasonable steps to mitigate its transition costs and encourages companies to divest their non-nuclear generating assets. See G.L. c. 164, § 1G(d)(1). The Company's divestiture of Blackstone must be shown to be consistent with the Act by demonstrating

that the sale process was equitable and maximized the value of the generation facilities being sold. Id. at § 1A(b)(1).

The Department has previously approved the Company's Restructuring Plan, finding, among other things, that the Company is committed to the maximum mitigation of its transition costs, "principally by auctioning off their PPAs and generating plants" in compliance with the Act. Canal Electric Company, Cambridge Electric Light Company, Commonwealth Electric Company, D.P.U./D.T.E. 97-111, at 64 (1998). In this case, Blackstone Station is unique among the Company's assets in that it is and has been subject to a Right of First Offer held by Harvard. The Right of First Offer, entered into well before industry restructuring (February 5, 1993), restricted the Company from selling or agreeing to sell Blackstone Station, or its steam operations, or both, without first offering in writing to convey such assets to Harvard. Accordingly, the Company's options to sell Blackstone Station through a general auction were constrained by the Right of First Offer.

The Company's arms'-length negotiation with Harvard has resulted in a price for Blackstone that is higher than the highest price per kilowatt ("kW") of capacity for any comparable generation asset sold in New England since the advent of retail access in Massachusetts (March 1, 1998) (see Tr. 1, at 30-32; Exh. DTE-1-4; Exh. DTE-1-4 (Att.)). Accordingly, the Company has met the Act's requirement for divestiture in that a high and reasonable price was achieved that maximizes the asset's value, especially as compared to the value of other generation assets sold through prior divestitures. The Company has presented the results of its arms'-length negotiation for review and is requesting that the Department approve the proposed ratemaking treatment and

transaction as in compliance with the Act and the Company's approved Restructuring Plan.

IV. THE DIVESTITURE OF BLACKSTONE IS CONSISTENT WITH THE ACT AND THE COMPANY'S APPROVED RESTRUCTURING PLAN

A. The Company's Decision to Negotiate With Harvard Maximized the Value of Blackstone and Maximized Mitigation of Blackstone's Transition Costs.

The Company's decision to negotiate with Harvard to sell Blackstone, rather than subject the facility to an auction, is consistent with the Act and the Company's Restructuring Plan because it has resulted in the Company obtaining a price for the facility that is far greater than that obtained for other comparable assets. Although many electric companies, including the Company, have subjected generation assets to a competitive auction, the Act's divestiture provisions do not require such companies to do so. Rather, the Act requires electric companies to maximize the value of their generation assets through an equitable sale process, and thus, maximize the mitigation of transition costs associated with such assets. G.L. c. 164, § 1A(b)(1).

With regard to an auction, it would not have been practical or appropriate to subject the facility to an auction, either along with Cambridge's former generation assets, or in isolation, given the Right of First Offer and Harvard's obvious heightened interest in Blackstone. As noted by Mr. Lubbock, it was clear to the Company that an auction would have proceeded at significant risk of challenge from Harvard, ultimately leading to disputes, delays, additional costs to customers and, at a minimum, clouding the prospects of a successful divestiture of Blackstone and the Company's other generating assets through an auction (Exh. GOL-1, at 8-12; Exh. DTE-1-8). Further, despite a provision in the Right of First Offer setting forth that the Company could auction the entire

Blackstone site without necessarily triggering Harvard's prior refusal rights, the Company determined that Harvard might assert legal and factual questions as to whether the divestiture of Blackstone in these circumstances would qualify under that provision (Tr. 1, at 26). Accordingly, the Company determined that auctioning Blackstone would likely lead to legal challenges from Harvard, and thus, depress the sales price for the facility.

The Company also determined that, in light of the unique location of the Blackstone facility and its central role in meeting Harvard's steam requirements, it was obvious that Harvard would place the highest value on owning Blackstone (Exh. GOL-1, at 8; Exh. DTE-1-8; Exh. DTE-1-9). For these reasons, it made little sense from both a practical and legal perspective to auction the Blackstone facility, without exhausting negotiations with Harvard. In fact, as noted by Mr. Lubbock during evidentiary hearings, and supported by exhibits presented in response to the Department's discovery questions, the prices received for New England generation assets that are comparable to Blackstone are in the range of \$100 per kW of capacity to \$272 per kW (Tr. 1, at 9, 30-32; Exh. DTE-1-4 (Att.)), as compared to the \$911 per kW of capacity that Cambridge will receive by divesting the facility to Harvard.

The valuation studies presented by the Company also support the Company's contention that the price to be paid for Blackstone by Harvard will produce maximum mitigation of transition costs for Cambridge's customers (see Exh. DTE-1-1; Exh. DTE-1-1(a) (Att.) **CONFIDENTIAL**; Exh. DTE-1-1(b) (Att.) **CONFIDENTIAL**; Exh. DTE-1-1(c) (Att.) **CONFIDENTIAL**; Exh. DTE-1-1(d) (Att.) **CONFIDENTIAL**). These studies have included various assumptions regarding the use of the Blackstone site, from

continued operation of Blackstone Station as a steam generating facility to redevelopment of the Blackstone site with either residential or commercial uses other than for generating steam (Exh. GOL-1, at 10). Depending on the assumptions used and the timing of the study, the value of Blackstone ranged from approximately \$3 million to over \$30 million (id.). However, the studies were performed at various times since 1998 and none included full environmental remediation costs in their assumptions (id.). Further, the value of electric generation assets generally has depressed significantly since 1998 (Exh. DTE-1-6). Accordingly, a purchase price for Blackstone of \$14.6 million falls comfortably within the various valuations of Blackstone performed over the last few years.

B. The Company's Proposal To Flow Back Blackstone's Proceeds to Customers Via the Variable Component of the Company's Transition Charge Is Consistent with Department Precedent.

The Company's proposal to flow back the net proceeds of Blackstone via the variable component of the Company's transition charge is consistent with Department precedent.² Moreover, it will allow the Company to offset the regulatory deferral balances that the Company has accrued over the past few years. The deferral balances have a negative impact on customers: (1) because customers pay carrying charges on the deferral balances; and (2) because deferred costs are collected over time, and the customers on whose behalf the Company incurs costs may not be the same customers who pay for such costs in the future (Exh. GOL-1, at 19-20).

² The Company has included an estimate of Blackstone's net proceeds in its current transition cost reconciliation filing, D.T.E. 02-80-B, and has applied the amount to Cambridge's transition charge, subject to reconciliation after the closing of the sale of Blackstone.

The Company's Department-approved Restructuring Plan allows the Company to use proceeds from the sale of its generating assets to offset transition costs associated with its regulatory assets. See Cambridge Electric Company, Commonwealth Electric Company and Canal Electric Company, D.P.U./D.T.E. 97-111, at 61-62 (1998). Previously, the Department has approved the Company's use of divestiture proceeds from the Canal generating asset to be used to reduce the variable portion of the transition charge (e.g., Seabrook and Pilgrim buy downs). See Cambridge Electric Light Company, Canal Electric Company and Commonwealth Electric Company, D.T.E. 98-78/83-A at 12-13 (1998) (Canal divestiture and establishment of Energy Investment Services); Commonwealth Electric Company, D.T.E. 98-119/126, at 71-72 (1999) (Pilgrim buy down); Cambridge Electric Light Company and Commonwealth Electric Company, D.T.E. 99-89, at 10-11 (2000) (Seabrook buy down).

The Department has also recognized the importance of avoiding the accrual of high deferrals. See, e.g., Commonwealth Gas Company's Request for Authorization to Adjust its Gas Adjustment Factor, D.T.E. 01-14, at 5-9 (2001); Standard Offer Service Fuel Adjustment, D.T.E. 00-66/67/70, at 2-3 (2000). Moreover, the flowback of the Blackstone proceeds through the variable component of the transition charge is consistent with the sale of distribution properties (Tr. 1, at 25; see, e.g., Exhibit COM-BRK-1 (Supp 2), page 5, column H in D.T.E. 01-79.) Since the generation of electricity ceased at Blackstone in 2001 and the future value of the site is not generation-related, it is especially appropriate to flowback the proceeds through the variable component. Accordingly, the Company's proposal to flow Blackstone's net proceeds to customers via

the variable component of its transition charge is consistent with Department precedent and will directly benefit the Company's customers.

V. CONCLUSION

Based on the evidence presented during this case, and for all of the reasons set forth above, the Companies request that the Department find:

- A. That the Divestiture process used by the Company to sell Blackstone was equitable as required by G.L. c. 164, § 1A(b)(1) and (2);
- B. That the Divestiture process used by the Company resulted in a price for Blackstone that maximized the value of the generating assets for customers as required by G.L. c. 164, § 1A(b)(1) and G.L. c. 164, § 1G;
- C. That the proposed ratemaking treatment, as described by Mr. Lubbock, is consistent with and in substantial compliance with § 1A(b)(3) of the Act, and with the Company's Plan, and is approved;
- D. That the Company will submit in its next transition cost reconciliation filing, following approval of the Petition by the Department and subsequent transfer of title of Blackstone to Harvard, a final accounting of the transaction reflecting a reconciliation of the application of the actual net proceeds of the sale to customers; and
- E. That the Department grant any other approvals and make any requisite findings as may be necessary or appropriate in relation to this Petition.

Respectfully submitted,

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