

D.T.E. 02-76

Petition of Cambridge Electric Light Company d/b/a NSTAR Electric for approval of the sale of its interest in Blackstone Station to the President and Fellows of Harvard College and for findings pursuant to G.L. c. 164, §§ 1A, 1G, 76, and 94.

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NSTAR ELECTRIC  
Petitioner

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HARVARD COLLEGE  
Intervenor

## I. INTRODUCTION

On November 21, 2002, Cambridge Electric Light Company d/b/a NSTAR Electric (“Cambridge” or “Company”) filed a petition with the Department of Telecommunications and Energy (“Department”), pursuant to G.L. c. 164, §§ 1A, 1G, 76, and 94, seeking:

(1) approval of the divestiture of the Company’s interest in the land and buildings that compose the Blackstone Station Facility (“Blackstone”), which includes a 16 megawatt (“MW”) cogeneration unit, located in Cambridge, Massachusetts, to the President and Fellows of Harvard College (“Harvard”) for \$14.6 million; and (2) approval of the Company’s proposed ratemaking treatment to reduce the variable component of its transition charge. The Department docketed this matter as D.T.E. 02-76.

Pursuant to notice duly issued, the Department held a public hearing on January 7, 2003. The Attorney General of the Commonwealth of Massachusetts (“Attorney General”) filed a notice of intervention as of right, pursuant to G.L. c. 12, § 11E. Harvard was permitted to intervene as a full party. The Department held an evidentiary hearing on January 16, 2003. In support of its petition, the Company sponsored the testimony of Geoffrey O. Lubbock, vice-president of financial strategic planning and policy for Cambridge’s parent company, NSTAR Electric and Gas Corporation. The evidentiary record contains 20 exhibits. On January 27, 2003, the Attorney General indicated that he did not identify any issues requiring comment and that he would not submit a brief. The Company filed its brief on January 29, 2003 (“Brief”).

## II. DESCRIPTION OF THE PROPOSED DIVESTITURE

Blackstone is a steam and electricity generation facility (Exh. GOL-1, at 5). Although Blackstone's steam turbine generator is rated at approximately 16 MW, it was damaged in November 2001 (Exh. DTE 1-10). Cambridge retired the electricity generation unit because of its age, low efficiency, and high repair cost (id.).<sup>1</sup> NSTAR Steam Corporation ("NSTAR Steam") continues to operate Blackstone to produce steam. Steam from Blackstone provides Harvard's campus with approximately 80% of its heating (Exh. DTE 1-9).

The cost of service of Blackstone historically was allocated between electricity generation costs paid by Cambridge's customers and steam production costs paid by NSTAR Steam's customers (Exh. GOL-1, at 5-6). NSTAR Steam's operations are not regulated by the Department. Although the sale also involves the divestiture of NSTAR Steam's interests in Blackstone, those aspects of the sale are not subject to the Department's review. Therefore, this Order addresses only the Purchase and Sale Agreement between Cambridge and Harvard ("PSA").<sup>2</sup>

Cambridge's right to sell its interests in Blackstone is subject to a 60-year right of first offer that the Company granted to Harvard on February 5, 1993, prior to electric industry

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<sup>1</sup> Cambridge estimates the repair cost at approximately \$10 million (Exh. DTE 1-10).

<sup>2</sup> The divestiture comprises four agreements: (1) the PSA (Exh. GOL-3); (2) a Steam Asset Purchase and Sales Agreement between NSTAR Steam and Harvard ("Steam Asset Agreement") (Exh. GOL-4); (3) an agreement by Cambridge to lease to Harvard certain buildings on the Blackstone premises until the close of the sale ("Lease Agreement") (Exh. GOL-5); and (4) an agreement between NSTAR Steam and Harvard obligating NSTAR Steam to continue to operate and maintain Blackstone for one year after the close of the sale ("Operating Agreement") (Exh. GOL-6).

restructuring (Exhs. GOL-1, at 4-5; GOL-2). Cambridge granted the right of first offer in connection with a long-term steam contract that NSTAR Steam's predecessor, COM/Energy Steam Company, negotiated with Harvard (Exh. GOL-1, at 6-7). The right of first offer obligated Cambridge to provide to Harvard a written offer to sell its interests in Blackstone at fair market value along with a statement of Cambridge's opinion of Blackstone's fair market value (Exh. GOL-2, at § 2). If Cambridge and Harvard were unable to agree upon the fair market value, Harvard would have had the right to request an appraisal of that value (id.). In the event that Harvard did not accept the offer to purchase Blackstone at the agreed-upon or appraised fair market value, Cambridge would have been able to sell Blackstone free of any obligation under Harvard's right of first offer (id.).

After arm's length negotiations that began in 1998, the parties agreed that Cambridge would sell its interests in Blackstone for \$14.6 million (Exh. GOL-1, at 8). The proposed sale is not the result of an auction. Cambridge states that Blackstone is unique among the Company's assets in that it is subject to Harvard's right of first offer (Exh. GOL-1, at 4). Cambridge explains that the right of first offer restricts the Company from selling Blackstone, or its steam operations, or both, without first offering the assets to Harvard (id.). Cambridge claims that a traditional auction process was not desirable because Harvard's possible assertion of rights to negotiate for the purchase of Blackstone pursuant to the right of first offer could cause significant delay or possibly jeopardize a sale (id. at 8, 11-12; Exh. DTE-1-8, at 1). Therefore, Cambridge argues that an auction of Blackstone would not have been practical or appropriate (Brief at 7).

Cambridge claims that the price obtained for Blackstone maximizes the value of the plant (Exh. GOL-1, at 4). Cambridge states that the proposed sale price of \$14.6 million, which amounts to \$911 per kilowatt (“KW”), is among the highest prices per KW of capacity for generation sold in New England since electric industry restructuring began (Tr. at 29). Cambridge asserts that the value of generation assets has depressed significantly since 1998 (Exh. DTE-1-6, at 1). Cambridge maintains that on a weighted-average dollar per KW basis, prices for generation in New England have fallen from \$521 per KW in 1998 to \$241 per KW in 2002 (id.).

Cambridge claims that treatment of the costs associated with the transfer of plant employees to the new owners, and severance and retraining costs for these employees, further maximized the sale price of Blackstone (Exh. DTE-1-8, at 2). Cambridge states that, in other generating plant sales, such costs were absorbed in the selling price, which reduced the residual value credit for customers (id.). Cambridge states that such costs will be the responsibility of NSTAR Steam, and that the selling price of \$14.6 million will not be reduced by these costs (id.).

Cambridge proposes to apply the net proceeds of the sale, approximately \$10.514 million,<sup>3</sup> to reduce the variable component of its transition charge (Exhs. GOL-1, at 19; GOL-8; GOL-9). Cambridge claims that this would allow the Company to offset regulatory deferral balances (Exh. GOL-1, at 19). The Company argues that the Department

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<sup>3</sup> In calculating the net proceeds of the sale, Cambridge reduces the sale price by net plant of \$3.195 million, \$172,000 for legal fees, \$219,000 for brokers fees, and \$500,000 for miscellaneous selling costs and contingency (Exh. GOL-8).

has previously approved the approach of using divestiture proceeds from the sale of generating assets to reduce the variable portion of the transition charge (Brief at 10, citing 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 Company further argues that the Department has also recognized the importance of avoiding the accrual of high deferrals (Brief at 10, citing Commonwealth Gas Company, 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)). Cambridge asserts that its ratemaking proposal benefits customers by: (1) expediting the return of the net proceeds to customers; and (2) creating headroom in meeting the rate-cap requirements set forth in G.L. c. 164, § 1B(b), which will allow the Company to reduce deferrals (Petition at 4). Cambridge argues that eliminating deferrals will benefit customers because it avoids the necessity for customers to pay for those deferrals at a later date, with carrying charges, as would otherwise occur (id.). Additionally, given the compliance with the rate-cap requirements, Cambridge claims that these deferrals can be recovered from customers without affecting the overall level of the Company's rates (id.).

### III. STANDARD OF REVIEW

The Legislature has vested broad authority in the Department to regulate the ownership and operation of electric utilities in the Commonwealth. See, e.g., G.L. c. 164, § 76. The

Department's authority was most recently augmented by the Electric Industry Restructuring Act. St. 1997, c. 164 ("Restructuring Act"). Boston Edison Company, D.P.U./D.T.E. 96-23, at 9 (1998). The Restructuring Act requires that each electric company organized under the provisions of G.L. c. 164 file a plan for restructuring its operations to allow for the introduction of retail competition in generation supply. G.L. c. 164, § 1A(a). Among other things, the Restructuring Act requires that all restructuring plans contain a detailed accounting of the company's transition costs and a description of the strategy to mitigate those transition costs. Id. One possible mitigation strategy is the divestiture of a company's generating units. G.L. c. 164, § 1.

In reviewing a company's proposal to divest its generating units, the Department considers the consistency of the proposed transactions with the company's restructuring plan, or in some cases the company's restructuring settlement, and the Restructuring Act. A divestiture transaction will be determined to be consistent with the company's restructuring plan or settlement and the Restructuring 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." G.L. c. 164, § 1A(b)(1).

The Restructuring Act provides that all proceeds from any such divestiture of generating facilities "shall be applied to reduce the amount of the selling company's transition costs." G.L. c. 164, § 1A(b)(3). Where the Department has approved a company's restructuring plan or settlement as consistent or substantially compliant with the Restructuring Act, the Department



will approve the company's proposed ratemaking treatment of any divestiture proceeds if the company's proposal is consistent with the company's approved restructuring plan or settlement.

#### IV. ANALYSIS AND FINDINGS

##### A. Divestiture of Blackstone

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, or in some cases the company's restructuring settlement, and the Restructuring Act. The Department approved the Company's restructuring plan in Canal Electric Company, Cambridge Electric Light Company, Commonwealth Electric Company, D.P.U./D.T.E. 97-111 (1998).

Although the Company's restructuring plan provides for mitigation of transition costs "principally by auctioning off [its power purchase agreements] and generating plants," D.P.U./D.T.E. 97-111, at 64, a divestiture transaction will be determined to be consistent the Restructuring Act if the company demonstrates that the "sale process is both equitable and maximizes the value of the generation facilities being sold." G.L. c. 164, § 1A(b)(1).

Cambridge reached an agreement for the sale of Blackstone Station to Harvard through an arm's length negotiation process (Exhs. GOL-1, at 2; DTE-1-8). No party contested the Company's assertion that the sale process was equitable. Cambridge demonstrated that an auction of Blackstone was neither practical nor appropriate. Accordingly, the Department finds that the divestiture process used by Cambridge was equitable.

The Department notes that the sale price of \$14.6 million for Blackstone represents more than four times the net utility plant value, or book value, of Blackstone (Exh. GOL-8).

The Department further notes that the price at \$911 per KW of capacity for Blackstone is almost double the price obtained by the Company through an auction for its fossil fuel fleet.<sup>4</sup> Cambridge has also demonstrated that the weighted-average price for generation capacity in New England has declined from \$521 per KW in 1998 to \$241 per KW in 2002.

The Department recognizes that it is difficult to compare the results of sales of generation assets because of differences in the type and vintage of the assets and differences in the terms of the transactions. Nonetheless, such comparisons are helpful as factors in determining whether the sale value of the assets has been maximized. The Department finds that the proceeds of this sale, on the basis of the ratio of sale price to book value, and on the basis of dollars per KW, compare favorably with the proceeds from other transactions. E.g., Western Massachusetts Electric Company, D.T.E. 99-29, at 12 (1999); D.T.E. 98-78/83, at 11; New England Power Company, Massachusetts Electric Company, and Nantucket Electric Company, D.P.U./D.T.E. 97-94, at 33 (1998); (see also Exh. DTE-1-6, att. A). In addition, the Department notes that no party contested the Company's assertion that the negotiation process maximized the value of the assets sold. Accordingly, the Department finds that the divestiture process used by the Company maximized the value of the generating assets for ratepayers. Thus, the proposed sale satisfies the Restructuring Act and is consistent with the Company's restructuring plan.

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<sup>4</sup> The Department found that a \$470 per KW price for capacity sold by the Company and its affiliates maximized the value of the assets and, "compare favorably with the proceeds from other transactions." D.T.E. 98-78/83, at 11-12.

B. Ratemaking Treatment

An approved transition charge recovers the above-market costs of generation-related investments and obligations that utilities have incurred in providing service to their customers under traditional utility regulation. G.L. c. 164, § 1G(b)(1). This divestiture will reduce the total amount of transition costs to be recovered through transition charges from the levels approved by the Department most recently in Cambridge Electric Light Company and Commonwealth Electric Company, D.T.E. 00-83-A (2002).

In approving the Company's restructuring plan, the Department permitted the Company to recover transition costs for the Blackstone plant through the fixed component of the Company's transition charge, subject to reconciliation. D.T.E. 97-111, at 55-57, 61-62, 65. The Company correctly notes that the Department has in the past approved proposals to apply divestiture proceeds to reduce the variable component. See, e.g., D.T.E. 98-119/126, at 71-72 (Pilgrim buy-down). The Restructuring Act directs the Company to take "all reasonable steps to mitigate to the maximum extent possible the total amount of transition costs that will be recovered and to minimize the impact of recovery of such transition costs on ratepayers in the commonwealth." G.L. c. 164, § 1G(d)(1).

To date, the Company has recovered the transition cost for Blackstone through the fixed component. Accordingly, flowing back all of the net proceeds of the divestiture through the variable component would not satisfy the Act's direction. Ratepayers have been paying for this

generating asset through the fixed component, not through the variable component.<sup>5</sup> Further, the Department notes that these payments have occurred since the effective date of the Company's restructuring plan, March 1, 1998. Therefore, satisfying the Act requires that the Company's proposal be modified. The Company must return the proceeds in a manner that symmetrically mitigates total transition costs, taking into consideration the carrying charges that ratepayers have borne to date for Blackstone Station.

Therefore, the Department directs the Company to include a symmetrical portion of the proceeds in the residual value credit. The amount of this credit shall be set at a level where, on a going forward basis, ratepayers will be treated in a manner consistent with the recovery of these charges to date, that is, prior to the divestiture of Blackstone Station, by its conveyance to Harvard. This method will result in a negative charge for the fixed component over the remaining transition period, calculated at the Company's weighted cost of capital, since the residual value credit will exceed the Company's transition costs at all times during this period. The Company shall return the balance of the net proceeds through the variable component.

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<sup>5</sup> The carrying cost for the fixed component of the transition charge is at the Company's weighted cost of capital. See D.P.U./D.T.E. 97-111, at 72-73. The carrying cost of the variable component of the transition charge is at the Company's customer deposit rate. Id., at 76.

V. ORDER

After notice, hearing, and consideration, it is

ORDERED: That the Petition of Cambridge Electric Light Company for approval of the sale of its interest in Blackstone Station to the President and Fellows of Harvard College is APPROVED; and it is

FURTHER ORDERED: That the Company's proposed ratemaking treatment to apply the net proceeds of the sale of its interest in Blackstone Station to reduce the variable component of its transition charge is APPROVED as modified above; and it is

FURTHER ORDERED: That the Company shall submit in its next transition cost reconciliation filing a final accounting of the transaction reflecting a reconciliation of the actual net proceeds of the sale consistent with all directives in this Order; and it is

FURTHER ORDERED: That the Company shall comply with all other directives in this Order.

By Order of the Department,

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/s  
Paul B. Vasington, Chairman

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/s  
James Connelly, Commissioner

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/s  
W. Robert Keating, Commissioner

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/s  
Eugene J. Sullivan, Jr., Commissioner

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/s  
Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).