**UNITIL ENERGY SYSTEMS, INC.**

**DIRECT TESTIMONY OF**

**ROBERT S. FURINO**

**New Hampshire Public Utilities Commission**

**Docket No. DE 12-003**

**June 4, 2012**

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**I. INTRODUCTION**

**Q. Please state your name and business address.**

A. My name is Robert S. Furino. My business address is 6 Liberty Lane West, Hampton, NH.

**Q. What is your relationship with Unitil Energy Systems, Inc.?**

A. I am employed by Unitil Service Corp. (the "Service Company") as Director of the Energy Contracts department. The Service Company provides professional services to Unitil Energy Systems, Inc. ("UES").

**Q. Please briefly describe your educational and business experience.**

A. I received my Bachelor of Arts Degree in Economics from the University of Maine in 1991. I joined the Service Company in March 1994 and have worked in the Regulatory, Product Development, Finance and Energy Contracts departments. My primary responsibilities involve energy supply acquisition.

**Q. Have you previously testified before the New Hampshire Public Utilities Commission ("Commission")?**

A. Yes. I have testified before the Commission on many occasions.

## II. PURPOSE OF TESTIMONY

**Q. Please describe the purpose of your testimony.**

A. My testimony supports a proposal by UES to revise its default service power supply ("DS") solicitation process for its G1 and Non-G1 customers as approved by the Commission in Order No. 24,511, granting UES's Petition for Approval of a Default Service Supply Proposal for G1 and Non-G1 Customers and Approval of Solicitation Process as amended by the Settlement Agreement filed with the Commission on August 11, 2005 (the "2005 Order"). UES is proposing to change the duration and pricing structure of the DS solicitations for the G1 (large) customers; and the duration and customer grouping for the Non-G1 (small and medium) customers. UES also proposes to move the timing of its default service solicitations forward by one month. UES is proposing these changes become effective with the solicitation of DS power supplies for November 1, 2012.

**Q. Please summarize the approvals UES is requesting from the Commission.**

A. UES requests that the Commission:

- Approve UES's proposal to seek separate pricing for the small, medium and large customers groups for volumes equal to 100% of load requirements for six-month periods.
- Approve UES's proposal to seek variable pricing for the large customer group based on the locational marginal price and fixed monthly adder.

- Approve UES's proposal to move the timing of its periodic solicitations forward by one month.
- Issue an order granting the approvals requested herein on or before August 3, 2012, which is two (2) business days before the issuance of UES's next RFP.

## III. SOLICITATION PROCESS

**<u>Current Procurement Process</u>**

**Q. Please discuss the procurement structure UES currently employs to secure default service power supplies.**

A. The current default service procurement structure for G1 and Non-G1 customers was approved by the Commission in the 2005 Order. Under the current structure, UES solicits 100% of load requirements for its G1 default service power supply for three-month periods. For the Non-G1 customers, UES solicits blocks of 25% of load requirements for periods of either 12-month or 24-months.

For both the G1 and Non-G1 customers, UES issues a Request for Proposals ("RFP"). Bidders respond providing fixed monthly price bids and UES conducts its analysis to determine which bidder provides the greatest value for the service sought. Subsequent to this, UES notifies bidders, executes contracts and prepares its regulatory filing for the Commission to review and approve.

**Proposed Procurement Process**

**Q. Please describe and explain the procurement structure UES is proposing for the Commission to review and approve.**

A. UES proposes the following changes to the DS procurement structure: (1) move the effective dates for DS supply contracts, and thus the RFP issuance dates, forward by one month; (2) for Non-G1 customers, change the duration and percentage of Non-G1 load requirements to be purchased and split the Non-G1 load into small and medium customer groups each of which would be contracted for separately; and (3) for G1 customers, change the pricing structure from fixed pricing to variable pricing and change the duration of the supply purchases. As discussed below, UES believes these proposed changes will result in more efficient pricing for customers.

**Q. Is UES proposing any changes to the RFP process and the regulatory approval process?**

A. No, the solicitation process itself would remain the same. UES would continue to issue RFPs for its DS power supplies and would continue to provide a similar filing following each solicitation seeking Commission approval of the recovery of costs from the resulting contracts. The RFPs would remain the same except for conforming changes to reflect the proposed changes that are approved, such as the frequency of issuance, customer group composition and G1 pricing structure. Schedule 1 provides a sample RFP, which has been redlined against the most recent RFP issued by UES, to demonstrate the changes proposed herein. The sample RFP is dated for supplies beginning December 1, 2013, which allows time for the transition schedule to be fully implemented.

**Q. Please describe the changes UES is proposing to make to the Non-G1 DS procurement structure.**

A. Currently, UES solicits for the Non-G1 (small and medium) customers on a combined basis. The Non-G1 customers include the Domestic customer class ("DOM"), the Regular General Service class ("G2") and Outdoor Lighting ("OL"). Under this proposal, UES seeks approval to contract separately for two customer groups: DOM, or the "small customer group," and G2OL, or the "medium customer group." UES currently solicits for 25% of load requirements for 1-year or 2-year periods. UES proposes to shorten the contract period to six months and to seek 100% of load requirements with each solicitation.

**Q. What changes are being proposed for the G1 DS solicitation?**

A. Currently, UES solicits for 100% of load requirements for G1 customers, or the "large customer group," for three-month periods. Under this proposal, UES would lengthen the contract period to six-months. In addition, UES currently receives fixed-price bids for G1 customers. The Company proposes to change the pricing structure for G1 customers to a variable-price model where potential suppliers would submit bids for fixed monthly adders to be added to the weighted average locational marginal price ("LMP") each month.

## IV. RATIONALE FOR PROPOSED CHANGES

**<u>Solicitation Start Date</u>**

**Q. Could you please explain why UES proposes moving the start date for the DS period forward by one month?**

A. Certainly. UES's current Non-G1 procurement cycle, which occurs every six months, provides for service commencing each May $1^{st}$ and November $1^{st}$. Moving UES's procurement period forward by one month provides the following benefits. It would match the solicitation schedule of UES's Massachusetts affiliate, Fitchburg Gas and Electric Light Company ("FG&E"), which provides for service effective each December $1^{st}$ and June $1^{st}$. Doing so will bring a larger load to market at one point in time thereby attracting more interest from potential bidders. UES's current solicitation schedule for service effective each November $1^{st}$ and May $1^{st}$ competes with National Grid for supplier interest. Since wholesale suppliers have limited resources they must decide whether or not to participate in UES's RFP. The same amount of work is required on the part of a wholesale supplier who decides to participate in a utility default service RFP regardless of whether the utility has a very large load or a small load. When there are bigger opportunities, suppliers may decide to participate only in the RFP that provides the biggest opportunity. Moving the procurement period forward by one month avoids this concern with respect to National Grid, who seeks supplies for Massachusetts Electric Company and Nantucket Electric Company at the same time they seek supply for Granite State Electric Company. UES's proposed timing also avoids issuing a solicitation coincident with NStar and NU/WMECo who solicit DS for effect each January 1st and July 1st.

**Q. Is there an additional benefit associated with this timing change?**

A. Yes. Under the current solicitation process, Unitil issues eight separate solicitations during a calendar year for the provision of default service for both UES and FG&E. If the UES proposal is adopted, the number of solicitations for UES alone would decline from four to two per year. Unitil also intends to propose to change FG&E's large customer group contract period from three to six months. If the proposals in both jurisdictions are ultimately adopted, the number of DS solicitations could decline from eight to two per calendar year. While Unitil would still complete separate filings in each jurisdiction, there would be an administrative benefit associated with a reduction in the number of RFPs.

**Non-G1 Customer Group**

**Q. Discuss the reasons for the proposal to split the Non-G1 customer group into small and medium customer groups.**

A. UES is proposing to solicit separately for the DOM/small customer group and the G2OL/medium customer group to promote more efficient pricing for all Non-G1 customers. A major consideration is that the two groups have experienced stark differences in migration to third party retail supply. The rate of migration of the DOM/small customers to competitive supply is approximately 1% of total energy sales, whereas that figure for the G2OL/medium customers is over 30%. From a supplier's perspective, increased customer migration translates into additional load volume risk, which typically increases their cost to be able to provide a fixed price. Thus, other things being equal, the higher migration rate translates into a higher supply cost to serve the G2OL/medium customers.

**Q. Can you provide data that demonstrates the differences in migration to third party retail supply that you discuss?**

A. Yes. Schedule RSF-2 provides a history of UES retail sales by customer group and supply type. Page 1 of Schedule RSF-2 lists kWh sales and percentage of sales provided as DS and those provided by third party suppliers as competitive generation ("CG") from January 2006 to present. As of April 2012, CG accounted for 0.8% of small customer sales and 32.9% of medium customer sales. Pages 2 through 4 of Schedule RSF-2 provide area charts of the data provided on page 1, which depict the migration trends for each customer group.

**Q. Are there other differences between the small and medium customer groups that could impact pricing from suppliers?**

A. Yes, the impact of migration rates is somewhat counteracted by the differences in load profiles and load factor between the DOM/small and G2OL/medium groups. The G2OL/medium customer group has a higher load factor.[1] During 2011, the DOM/small customer load factor was 56% and the G2OL/medium customer load factor was 63%.[2] Other things being equal, a higher load factor will lead to better pricing because it typically means that more energy is consumed in the off peak when power is cheaper and because less capacity is required for each unit of energy (kWh) sold. The difference in cost to serve each customer group is reflected in the weighted average LMP over time. During 2011, the weighted average LMP for the small group was $49.57 and the medium group was $48.79, which was 1.6% lower.

**Q. Since migration rates and load factor are offsetting considerations in terms of supplier pricing, why does the Company believe that separating the Non-G1 group into small and medium groups will promote efficient pricing?**

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[1] Load Factor refers to the ratio of the average load in kilowatts per hour during a designated period to the peak load in kilowatts occurring in that period.

[2] For comparison purposes, during 2011, FG&E's small customer load factor was 56% and FG&E's medium customer load factor was 61%.

A. Although migration rates would tend to favor the small customer group and load profile / load factor would tend to favor the medium customer group, there are many differences among suppliers in terms of their specific approaches to pricing and their levels of risk tolerance. Separating the small and medium customers allows suppliers to provide their best pricing for each group. If a given supplier would offer a better price to either the small or medium group, bundling their offers would result in cross-subsidization. If different suppliers would offer better pricing to each group, the result would be lower overall pricing.

**Q. Does FG&E utilize small and medium customer groups, and what has been their experience in terms of pricing?**

A. Yes, FG&E utilizes small and medium customer groups. In FG&E's experience, during certain periods each of the small and medium customer groups have received the lower price. In addition, during a majority of the time, the small and medium customer groups have been awarded to different suppliers, supporting the notion that separating the Non-G1 into two customer groups will provide for more efficient pricing. Please see Schedule RSF-3. Page 1 of Schedule RSF-3 lists historical contract pricing for the small and medium customer groups since June 2006 and indicates which received the lower price. Page 2 of Schedule RSF-3 lists the historical suppliers since June 2006 and indicates whether the small and medium groups were awarded to the same supplier or to different suppliers.

**Q. You stated that UES is proposing to move to a six-month contract period for a 100% load share for the DOM and G2OL customer groups. Please explain the basis for this proposal.**

A. There are two potential benefits associated with this change. First, other things being equal, suppliers view longer term obligations as inherently more risky since factors not known at the time of bidding are likely to increase over time. A shorter contract period (six months) would therefore reduce any premiums bidders may place on longer contract periods (one or two years). Second, when determining whether to participate in a given solicitation, suppliers will review the peak load requirement. The higher the load requirement, the more likely suppliers are to participate and the resulting increased competition should bring better pricing. Currently, the peak load requirement of one block (25%) for the Non-G1 group is approximately 47 MW. By comparison, the small group (100%) would be 189 MW and the medium group would be 65 MW.[3] The lower risk to suppliers associated with the shorter contract period and the increased competition from offering more load to the market are expected to improve pricing.

**G1 Customer Group**

[3] The focus here is on UES, however, under the proposal, UES would solicit for this load at the same time as FG&E, which would add another 24 MW, resulting in a total of 225 MW.

**Q. Please explain the benefit of changing from a three-month to a six-month contract period for G1 DS supply.**

A. G1 customers are the large customer group for UES. The three-month G1 contract term was intended to reflect current market pricing in the DS prices and not undermine retail choice. As discussed below, variable pricing better reflects market pricing and moving to a six-month contract period has the benefit of likely increasing market interest by combining the G1 load with Non-G1 loads and increasing the energy volume sought by doubling the contract term. These factors are expected to increase market interest, potentially yielding better pricing. Also, as discussed earlier, a six-month contract period would be administratively more efficient resulting in two fewer regulatory filings per year.

**Q. Please discuss the proposed change whereby suppliers would be asked to provide variable pricing rather than fixed pricing for G1 customers.**

A. UES proposes changing the G1 DS pricing from fixed monthly prices to variable prices where potential suppliers submit bids for fixed monthly adders to be added to the LMP. Specifically, the solicitation will seek through the competitive bidding process adders which would be fixed each month, but may vary by month. The resulting monthly contract price would be determined by adding the fixed monthly adder to the real-time LMP for the New Hampshire load zone weighted by the hourly loads of all G1 customers who receive DS. The real time

LMP covers the cost of wholesale energy market charges and the fixed adder covers such things as non-energy wholesale charges including capacity and a supplier's margin. Unitil has over five years of experience with this methodology with its Massachusetts affiliate FG&E.

**Q. Please provide an example of how the contract price would be determined under your proposal.**

A. Please refer to Schedule RSF-4, which provides the monthly calculation of the contract price for FG&E for the month of May 2012. The primary calculation is a "sumproduct" of FG&E's large customer hourly load and the LMP for the West Central Massachusetts (WCM) load zone, which when divided by the sum of hourly loads, yields the weighted average LMP. The RFPs would result in contracts for fixed monthly adders. The contract price is the sum of the weighted average LMP and the fixed adder. The results of this calculation are shown at the top right of page 1. The remaining pages provide the hourly detail.

**Q. Do you have a concern with maintaining the current fixed price structure for G1 customer DS supply?**

A. Yes. UES has experienced significant participation in the retail choice market among G1 customers. As shown on page 1 of Schedule RSF-2, currently 84% of energy sales for the large customer group are provided by a competitive supplier.

Volume risk associated with migration changes is a major risk factor for potential suppliers who must honor a fixed price. When a potential supplier is bidding to provide fixed price supply, the supplier has to account for the risk associated with increased migration or reverse migration (i.e., customers returning to DS when current market prices increase). In order to protect against this risk, a potential supplier would likely include a premium in its pricing to compensate for this risk. When migration rates are high (i.e. most load is on competitive supply), the potential for reverse migration is high. This may result in larger risk premiums being embedded in fixed price offers, resulting in less efficient pricing, and may result in unwillingness among suppliers to offer a fixed price.

**Q. Can you discuss further the risks of providing a fixed price when migration rates are high in order to explain why premium are to be expected in prices?**

A. When a supplier plans to serve a DS load obligation, it would typically enter into arrangements to cover its expected obligation under prices that can be recovered given the fixed prices they bid in the RFP. Using current numbers, a supplier would expect to serve 16% of UES's G1 load, or a peak load of 12.5 MW. If the supplier is awarded a contract under a fixed price and subsequently market prices change, the DS obligation could increase or decrease and because the load is small, even small changes can become a large percentage of the transaction. If reverse migration occurs in response to higher market prices, the supplier would have to honor the additional load at the contract price and would lose money on the unexpected sales. If additional migration occurs, perhaps in response to lower market prices, the supplier would lose expected sales at the contract price and would have to sell the power, reserved for DS, into the market at a loss.

**Q. How does the pricing proposal under consideration for the G1 customer group alleviate this concern?**

A. Under the variable pricing proposal, a DS supplier is not at risk of having to honor a fixed price. Should market conditions cause migration patterns to change, a DS supplier is insulated from the risk of increasing or decreasing loads. Using a variable pricing structure with an adder to the LMP, a supplier receives the LMP plus the adder. If market prices increase, then the price the DS supplier receives will increase, and vice versa. This pricing mechanism helps insulate the supplier from volume risks and should result in lower premiums being built into DS prices.

**Q. Are there additional benefits expected under this G1 pricing proposal?**

A. Yes. Under the G1 pricing proposal, DS pricing for the large customer group would be more reflective of current market conditions as the price paid would be based on the monthly LMP (a market-based price) and would not be fully known until after the fact. There have been concerns over behavior generally referred to as gaming, whereby customers and retail suppliers may return load to DS when prices rise and the utility has published a fixed, lower price. The variable pricing proposal eliminates gaming because the utility is not publishing a fixed price until after the period of service. Another benefit we would expect to see is an increase in supplier participation in bidding to serve large customer DS loads since many suppliers will not bid to serve large customers because of the inherent risks.

**Q. Can you discuss the experience of FG&E with variable pricing?**

A. FG&E has used variable pricing as described herein in tandem with fixed pricing since March 1, 2007. Under the FG&E process, both fixed and variable price bids are sought and during the RFP evaluation process (if both fixed and variable bids are received) FG&E selects which one it believes will provide the greatest value to customers. Since its inception, FG&E has overwhelmingly contracted under the variable price. Schedule RSF-5 provides a history of FG&E's pricing experience since the introduction of the variable price option, including migration percentages. The exhibit shows the lowest fixed prices bid, the actual variable prices as determined after the fact, FG&E's price chosen and the price that turned out to be lowest. As shown in Schedule RSF-5, the variable price has predominantly been the lower price option. In presenting this proposal, UES is not recommending a fixed price alternative. Unitil intends to propose that FG&E, in moving to a six-month procurement period, discontinue the fixed-price alternative. UES believes there is ample evidence that variable prices are more efficient and that offering a fixed price for a six-month period would result in even higher fixed prices.

## V. IMPLEMENTATION OF NEW SOLICITATION PROCESS

**Q. How long will it take for UES to fully transition to the proposed DS procurement structure?**

A. From a timing standpoint it will take two RFP issuances, or one year, to complete the transition from the current procurement structure to the new structure. This time would be needed to contract for the additional month associated with moving the contracting schedule forward by one month and to water off the current 25% blocks of DS supply already under contract for Non-G1 (small and medium) customers, which were purchased for periods of either 12-month or 24-months. Assuming approval of this petition by August 3, 2012, the proposed changes would begin with contracts for November 1, 2012, and the transition would be complete such that the RFP issued thirteen months later on September 1, 2013, would seek bids for 100% of load requirements for each of the small, medium and the large customer groups for six-month contract periods of December 1, 2013 through May 31, 2014.

**Q. Can you please provide more detail on your proposed transition schedule?**

A. The Company anticipates issuing two interim RFPs during the transition. UES's next RFP, scheduled to issue August 7, 2012, would cover a contract period of November 1, 2012, through May 31, 2013, as follows:

- Small Customer Group (25% share for 6 mo.; 75% share for 1 mo.)
- Medium Customer Group (25% share for 6 mo.; 75% share for 1 mo.)
- Large Customer Group (100% share for 7 mo.)

The next RFP would be for cover the contract period of June 1, 2013, through November 30, 2013, as follows:

- Small Customer Group (75% share for 5 mo.; 100% share for 1 mo.)
- Medium Customer Group (75% share for 5 mo.; 100% share for 1 mo.)
- Large Customer Group (100% share for 6 mo.)

Schedule RSF-6 provides a visual depiction of this proposed default service RFP transition schedule.

## VI. CONCLUSION

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

A. Yes, it does.