July 29, 2014

Ben D'Antonio
Counsel & Analyst
New England States Committee on Electricity (NESCOE)

Via Electronic Mail

RE: MMWEC Consumer Model for Natural Gas Infrastructure Development

Dear Ben,

On July 17, 2014 you emailed to me eight follow-up questions from NESCOE concerning MMWEC's proposed Consumer Model for Natural Gas Infrastructure Development. The questions and answers to those questions are below.

We would appreciate it if you could post these questions and answers on the NESCOE website. We see this as a productive process, as these and other questions we are being asked are helping to better define the MMWEC proposal. If these answers generate additional questions, please do not hesitate to call or forward additional questions to me in writing.

As stated in our earlier submissions, we appreciate and support NESCOE's efforts to implement the Governors' plan for natural gas infrastructure development in order to address the electric reliability issues and economic disparities facing New England consumers as a result of insufficient natural gas pipeline capacity.

Thank you for your continuing interest in the MMWEC proposal.

Regards,

David Tuohey
Director of Communications & External Affairs
Massachusetts Municipal Wholesale Electric Company (MMWEC)
(413) 308-1392
dtuohey@mmwec.org

1. *Please describe the authority MMWEC has under its charter or other organizational documents to own and operate an interstate natural gas pipeline? Please also include information about MMWEC's authority under its charter or other organizational documents to own and operate interstate natural gas pipeline facilities outside the Commonwealth of Massachusetts?*

   Answer: MMWEC was created in 1975 by Special Act of the Massachusetts Legislature pursuant to St. 1975, c. 775 as amended ("Chapter 775"). Chapter 775 serves as MMWEC's "charter" and defines MMWEC's powers and authority.

   Chapter 775 expressly authorizes MMWEC, among other things, to finance, construct, own and operate an interstate natural gas pipeline. Under Chapter 775, MMWEC has the rights and powers, among other things, to finance, acquire, construct, own and operate "energy facilities" within and without the Commonwealth.[1] Chapter 775 defines "energy facility" to include, among other things, (1) a system or facility for the transportation of "energy," which is defined to include natural gas, and (2) facilities or property for the transportation of fuel.[2] A natural gas pipeline plainly falls within MMWEC's authority to own and operate energy facilities.

   Chapter 775 expressly authorizes MMWEC to own and operate energy facilities "within and without the Commonwealth."[3] Because Chapter 775 defines energy facilities to include facilities for the transportation of natural gas, MMWEC has the authority, rights and powers to own and operate interstate pipeline facilities both inside and outside of Massachusetts.

2. *Is MMWEC able to finance 100% of a project through tax-exempt bonds, or only its load ratio share in New England? Please provide statutory citations and bond counsel opinions, if one is available.*

   Answer: MMWEC may finance 100% of the project through the issuance of bonds, subject to authorization of the bonds' issuance by the Massachusetts Department of Public Utilities ("DPU"). Under Chapter 775, MMWEC may issues bonds for any of its corporate purposes including project

[1] Chapter 775, §5(p).
[2] Chapter 775, §1
[3] Chapter 775, §5(p)

costs for the transportation of fuel.[4] The amount of bonds that MMWEC may issue is the amount that the DPU determines is reasonable necessary for the proposed purpose.[5] Therefore, subject to DPU authorization, MMWEC could finance 100% of the project through bonds.

MMWEC may issue both tax-exempt and non-tax-exempt bonds. Generally, tax-exempt bonds are debt obligations of state and local government, including MMWEC, the interest on which is tax-exempt. This means that the interest paid to bondholders is not included in their gross income for federal tax purposes.

Various requirements apply to the tax exempt status of bonds under the Internal Revenue Code and Income Tax Regulations, including requirements related to issuance, the proper and timely use of bond-financed property, and arbitrage restrictions and rebate requirements. Two important indicia of tax-exempt bonds are the ownership of property financed by the bonds and limitations on private use. Under the ownership test, all of the property financed by tax-exempt bonds must be owned by a governmental entity.[6] As the owner of the proposed pipeline, MMWEC would satisfy this test. Under the private use test, no more than 5% of the net proceeds of a bond issue may be used for a private use.[7] Use of bond proceeds or bond-financed property by a nongovernmental person other than the government entity borrowing the proceeds can result in private use.

It is reasonably clear that MMWEC could issue tax-exempt debt to finance, not only its own load share of the project through tax-exempt debt, but also the share used by all consumer owned utilities in New England. It has not been determined whether the remaining debt would be tax-exempt. MMWEC has not obtained such an opinion of bond counsel at this time, although there may be a case to be made that the proposed pipeline will serve a region-wide public purpose and have region-wide public benefits, which may be an argument to qualify all of the debt for tax exemption. However, even assuming that the remaining debt was not tax-exempt, we believe MMWEC's financing costs would be dramatically less than that of any investor-owned entity. Assuming that the consumer-owned portion of the project was 15%, the interest on tax-exempt debt was 3% and

[4] Chapter 775, §9.
[5] Chapter 775, §17.
[6] Internal Revenue Code, Section 145.
[7] *Id.*

the interest on taxable debt was 6%, MMWEC's financing cost would be about 5.6%. By comparison, financing by an investor owned utility likely would include both higher cost debt and return on equity ("ROE") to investors. For example, assuming 50/50 debt/equity financing at an interest cost of 7% and a ROE of 14%, the cost of such financing would be 10.5%, (exclusive of income tax effects) almost twice MMWEC's cost.

3. *Does MMWEC anticipate funding 100% of a proposed interstate natural gas pipeline and/or allowing other public power entities to participate?*

Answer: The primary objective of MMWEC's proposed Consumer Model for natural gas pipeline development is to avoid unnecessary costs for all New England electric consumers, who will benefit under this model regardless of whether they are customers of public power or investor-owned utilities. There are no added or different benefit for any of these consumers if MMWEC finances 100% of the pipeline on its own or if other public power entities participate in the financing. Public financing and ownership of the pipeline can reduce project costs by billions of dollars, thereby reducing the proposed regional electric tariff charges to all New England consumers.

Consistent with the objective of minimizing costs for all consumers, MMWEC anticipates financing 100% of the proposed interstate natural gas pipeline. Our thinking and belief is that financing by a single public entity will be most efficient and cost-effective, as opposed to having multiple public entities conduct separate financings to raise the required funds. For example, if $1 billion in financing is required, and four public entities participate equally in funding this requirement, each entity would be responsible for issuing $250 million in bonds. This would mean four separate bond issues, four different sets of financial documents and associated legal fees, and four different sets of agency and/or state regulatory approvals required. In addition to these multiple and duplicative activities associated with financing, some type of joint participation and funding agreement among the participating entities would need to be created and approved, accommodating the interests of the individual entities as well as other interested parties. There also likely would be a need for separate Gas Infrastructure Billing and Collection Agreements between each entity and ISO-New England to provide credit support for the individual bond issues.

In short, participation by multiple public power entities in funding the pipeline, as opposed to funding by a single entity, would add significantly to the cost, schedule and financial and regulatory risk associated with the project. If there was an increase in public benefit associated with multiple entity participation in financing the project, perhaps the increased costs and risks could be justified; but there is not. In fact, the opposite is true. Multiple public power entity financing of the pipeline, as described above, will increase project costs, thus increasing tariff revenue requirements and the cost to all New England electric consumers.

While public entity ownership and financing of the pipeline involves services provided at cost, with no profit or return on equity required, the costs to be recovered are greater with multiple entities participating in financing, as opposed to a single entity.

4. *Will MMWEC require a certificate of public need and convenience or other licensure by the Federal Energy Regulatory Commission under the Natural Gas Act in order to own and operate an interstate natural gas pipeline? If so, how long does MMWEC anticipate it will take to obtain necessary authority from FERC?*

Answer: The question of how an MMWEC-owned pipeline will be regulated also surfaced in recent MMWEC meetings with Commissioners and staff of the Federal Energy Regulatory Commission (FERC). It also surfaced at the July 22 meeting of the NEPOOL Transmission Committee. As with other interstate natural gas pipelines, there is a requirement for regulatory oversight of whatever pipeline proposal emerges from the NESCOE process. If what emerges is a stand-alone, MMWEC-owned pipeline, MMWEC anticipates it will be responsible for adhering to the FERC certification process for interstate pipelines. This includes filing a voluntary request with FERC to use the pre-filing process and application for a certificate of public convenience and necessity for the construction and operation of an interstate pipeline. MMWEC also will request tariff approval from the FERC, and MMWEC is willing to undertake these and other activities required of pipeline owners under the Natural Gas Act.

If what emerges from the NESCOE process is an incremental addition to an already proposed pipeline, resulting in joint ownership of a pipeline by MMWEC and an interstate pipeline company, then the requirements and process for certifying such an incremental addition to an existing pipeline proposal may be different. In any event, MMWEC would anticipate participation in a pre-filing process at the FERC, where the certification of natural gas pipelines can be expedited by having Commission staff actively participate in the pre-filing process to identify and address potential issues prior to the filing of an application for certification.

The FERC pre-filing and certification process can take 20 months or more to complete.

5. *Will any pipeline owned and operated by MMWEC require inspection or other approvals from US Department of Transportation?*

   Answer: The FERC reviews applications for the construction and operation of natural gas pipelines under Section 7 of the Natural Gas Act. In reviewing such applications, the FERC ensures that the applicant has certified that it will comply with the U.S. Department of Transportation's Pipeline and Hazardous Materials Safety Administration (PHMSA) requirements. MMWEC will comply with all PHMSA requirements.

6. *Please describe MMWEC's experience and expertise that gives MMWEC confidence about its ability to execute its proposal.*

   Answer: MMWEC's experience and expertise in financing and ownership of energy facilities throughout New England gives it confidence in its ability to execute the Consumer Model for pipeline development. Such confidence also comes from MMWEC's experience and first-hand knowledge of the consumer benefits associated with public entity ownership of energy facilities. In the case of the governors' proposal, which seeks plans to "increase natural gas infrastructure in New England in a way that delivers the highest value to electric consumers ," we are fully confident that the Consumer Model for pipeline development is the best possible method to achieve that objective.

   MMWEC's primary role with respect to the Consumer Model is related to its financing and ownership of pipeline facilities funded via a tariff charge on New England electric consumers. MMWEC's experience in financing and owning energy facilities includes its operation and principal ownership of the Stony Brook power plant in Ludlow, Massachusetts, a 526-megawatt, combined-cycle generating station. MMWEC also owns and operates a 5.6-mile natural gas pipeline that serves the Stony Brook plant. MMWEC issued nearly $300 million in bonds in 1979 and 1980 to finance its ownership interests in Stony Brook. The original bonds were refinanced on several occasions until all of the debt associated with Stony Brook was retired in 2008. Retirement of the Stony Brook debt, after a nearly 30-year cycle of public debt management by MMWEC, demonstrates not only the soundness and success of the MMWEC financing system but also the financial management expertise of the MMWEC organization.

MMWEC also has issued bonds to finance its joint ownership interests in Seabrook Station in New Hampshire, Millstone Unit 3 in Connecticut and Wyman Unit No. 4 in Maine. Debt associated with the Wyman Unit was retired in 2008, while debt associated with MMWEC's ownership in Seabrook and Millstone will be retired by 2019.

As a minority joint owner, MMWEC contracted with the lead owners to construct, operate and maintain these facilities. Monitoring and oversight of lead owner performance is a contractual responsibility of MMWEC to ensure that these units are operated in the best interests of its project participants. There are strong similarities between these arrangements and the one proposed in the Consumer Model, under which MMWEC would contract for and oversee the construction, operation and maintenance of natural gas pipeline facilities.

MMWEC claims no expertise and only limited experience in the construction, operation and maintenance of interstate natural gas pipeline facilities. Under the Consumer Model, those tasks would be performed by entities that are fully qualified and have the required experience and expertise.

7. *Can MMWEC provide an overview of its financing activities over the last ten years, including any financings that were started and not fully subscribed?*

Answer: MMWEC's financing activities over the last ten years have included two refunding bond issues, one to retire higher-interest debt and the other to replace variable-rate with fixed-rate debt. On June 16, 2011, MMWEC issued $96,685,000 in fixed-rate, tax-exempt revenue bonds to purchase and retire the bulk of its variable-rate debt. The purpose of this bond issue was to diversify the MMWEC debt portfolio with a more favorable mix of fixed and variable-rate bonds, and to hedge exposure to the potential for rising interest rates. On January 26, 2012, MMWEC issued $164.8 million in tax-exempt revenue bonds to refund and retire higher-interest debt. This refunding bond issue reduced MMWEC's debt service costs by approximately $16.8 million.

On July 1, 2014, MMWEC retired the debt associated with a portion of its ownership in Seabrook Station and Millstone Unit 3. MMWEC currently has $167,110,000 in debt outstanding, all of which will be retired by 2019. Since its establishment in 1975 as a non-profit, public corporation and political subdivision of the Commonwealth of Massachusetts with authority to issue various forms of debt, including tax-exempt and taxable revenue bonds, MMWEC has issued more than $4.7 billion in bonds to finance and refinance its approximate 735-megawatt ownership interests in several New England electric generating facilities.

In September 2010, the three major credit rating agencies – Fitch Ratings, Standard & Poor's and Moody's Investors Service – issued credit ratings upgrades that put all of MMWEC's ratings into the "A" category. These ratings, affirmed by all three rating agencies last fall, include A+ ratings from Fitch Ratings; A+, A and A- ratings from Standard & Poor's and A3 ratings from Moody's. There are no MMWEC financings that were started and not fully subscribed.

8. *When MMWEC discussed its proposal with natural gas pipelines, could it communicate any feedback?*

Answer: MMWEC has not discussed its proposal with natural gas pipelines, nor has it been approached by natural gas pipelines to discuss its proposal. Given the Consumer Model requirement for strategic partnerships between MMWEC and gas pipeline companies for construction, operation and maintenance of pipeline facilities, MMWEC recognizes the need for discussions with pipeline companies. To facilitate and expedite those discussions, MMWEC requests that NESCOE's Request For Proposals (RFP) for pipeline development requires respondents to submit separate development proposals based upon 1) the Incremental Gas For Reliability (IGER) concept, and 2) the MMWEC Consumer Model concept. In addition to spurring discussion between MMWEC and natural gas pipelines, this approach could have the added benefit of bringing a higher level of competition to the process. Moreover, responses to an RFP structured in this manner will help to clarify the differences between the IGER approach and the Consumer Model, particularly with respect to cost differences. This information is critical in the decision-making process to ensure that the selected proposal "delivers the highest value to electric consumers".