

Memorandum

To: NESCOE

From: New England Public Power Sector Representatives

Date: May 8, 2014

Subject: Increasing Natural Gas Infrastructure for Electric Generation

On April 30, 2014, the New England States Committee on Electricity (NESCOE) issued a request for comments on the proposed approach to increase natural gas infrastructure into the region for electric reliability. Prior to that, on April 22, 2014, a group of electric distribution companies (EDCs) submitted a letter outlining a proposed approach for achieving the States' objectives. As representatives of the Publicly-Owned Entities sector, we are providing feedback through this memorandum on these two complementary proposals. While many of us have consulted with our respective governing bodies, please be advised that these comments do not constitute a commitment to support nor should they be construed as imposing an obligation to participate in the efforts contemplated by this framework by any publicly-owned entity.

With that said, public power generally supports the Governors' proposal for increased natural gas capacity, as we believe it represents the most promising initiative to address the region's natural gas pipeline infrastructure deficit. The Governors' proposal recognizes that the existing business model for financing, building and operating gas pipelines must change to accommodate the nation's paradigm shift to greater reliance on natural gas for electric generation and for home heating purposes. This shift was evident this past winter when New England's natural gas issues poured out of the region into PJM, New York, California and other regions. It also was identified clearly in comments at the FERC's April 1 Technical Conference on winter 2013-14 operations, where several participants spoke of a fuel shift of historic proportions within the nation's electric power markets. ISO New England and the region's natural gas pipeline companies have remained focused on the idea that the only solution involves generators signing long-term firm gas contracts, a construct that makes little sense, given the highly variable fuel supply requirements of individual electric generators. These entities refuse to recognize the need for a change in the planning process in order to adequately address the region's overall energy infrastructure needs.

In general, public power agrees that substantially increasing the ability to deliver natural gas into New England holds the promise of resolving the operational and reliability problems seen over the last two years (and according to ISO-NE may only get worse in the future with unit retirements), while at the same time reducing energy market price volatility and cost to consumers. If implemented properly, this approach holds the promise of 1) providing physical infrastructure resources to meet the region's reliability needs, 2) helping to address the economic disruption caused by high and volatile market

prices, and 3) helping to foster fuel diversity and environmental policy concerns in a manner consistent with state and community environmental policy.

The April 30 Memorandum references the opportunity for EDCs to enter into long term contracts with interstate pipeline companies and/or making an equity investment to support these incremental pipeline projects, subject to appropriate and acceptable cost recovery through a new FERC approved Tariff mechanism. This compensation would presumably reflect the lending quality and financial standing associated with EDC participation, either as contracting parties or as equity participants in incremental capacity expansion projects. To the extent that charges under this new Tariff would be allocated to customers of publicly-owned entities, such publicly-owned entities should have the opportunity for equity participation in the related initiative and receive the same form of compensation as the EDCs.

The Incremental Gas for Electric Reliability (IGER) model offered by NESCOE appears to be identical to the EDC model, with the exception that the “Contract Entity” is unnamed in the IGER model. In the EDC model, the EDCs are identified as the contract entity. As such, our comments above regarding the EDC proposal apply equally to the IGER model with respect to publicly-owned entity participation in this initiative.

The level of interest in exercising this option varies within the sector. At this point, however, no one has ruled out the possibility of participating under these terms. In general, the expectation is that the **maximum** possible level of public power participation would be limited to our load ratio share of the New England annual energy requirements. In rough terms, for planning purposes, we expect this upper limit to be in the neighborhood of 10% to 15% of the total project.

One of the major challenges will be to establish sufficient detail in terms of the structure of the contemplated business arrangements, as well as regulatory treatment at the federal and local level, to permit full evaluation and due diligence review of the arrangements. Such detailed assessments must be performed before we can take anything to our respective governing authorities. In some cases, review and approval may have to take place at two levels (i.e. initial review by the Utility Commission and formal sign off by the Town Council.) While it may be possible to “fast track” certain approvals, for planning purposes it would most likely take three to six months for some systems to get final approval. To be clear, any involvement by public power systems **must** be conditioned on full due diligence review, deliberation and approval by the respective governing authorities.

In terms of structuring the arrangements, our preference would be a structure that would allow us to take an “equity interest” in the incremental pipeline capacity, which would allow our customers to earn a return on their contributed capital over and above the debt portion of our capital structure. Several public power systems in the region have achieved this in conjunction with investing in regional electric transmission facilities. We also think that this approach has the added benefit of reducing overall revenue requirements, since most public power systems are not subject to federal or state income taxes, thereby eliminating the need to “gross up” the return on investment to cover the tax effect. In

addition, to the extent that a public power system can use tax-exempt financing, the average cost of debt should be lower than for similarly rated taxable debt.

Again, we believe that this project has the potential for delivering needed reliability, economic, and public policy benefits to electric consumers in the region. We appreciate the opportunity to provide this feedback and look forward to continuing to work with you to achieve this objective.