Cape Light Compact

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May 29, 2014

VIA EMAIL

Ms. Heather Hunt
Executive Director
New England States Committee on Electricity
655 Longmeadow Street
Longmeadow, MA 01106
RegionalInfrastructure@nescoe.com

RE: Comments on Natural Gas Infrastructure Proposals

Dear Ms. Hunt,

The Cape Light Compact (the "Compact") submits this letter as its comments pursuant to the request for comments by the New England States Committee on Electricity ("NESCOE") dated April 30, 2014 on proposed models to contract for new interstate pipeline capacity for use by gas-fired generation facilities.

As discussed below, the Compact agrees that New England's natural gas infrastructure problems have resulted in untenable market conditions in the winter season that require taking action to resolve economic and reliability concerns. The Compact supports the Incremental Gas for Electric Reliability ("IGER") concept put forth by NESCOE, but strongly objects to the joint proposal submitted by Northeast Utilities ("NU"), National Grid USA and United Illuminating ("UI"). The Compact believes any solution should involve a neutral, independent third party providing non-discriminatory gas transmission.

Background on the Compact

The Compact is a governmental aggregator under G.L. c. 164, §134 and consists of the twenty-one towns in Barnstable and Dukes Counties (Aquinnah, Barnstable, Bourne, Brewster, Chatham, Chilmark, Dennis, Edgartown, Eastham, Falmouth, Harwich, Mashpee, Oak Bluffs, Orleans, Provincetown, Sandwich, Tisbury, Truro, West Tisbury, Wellfleet, and Yarmouth) as well as the two counties themselves. It was originally formed in 1997 and is organized through a formal Inter-Governmental Agreement signed by all of the towns, as well as Barnstable and Dukes counties, pursuant to G.L. c. 40, §4A, as amended from time to time (the "Compact Inter-Governmental Agreement"). The purposes of the Compact include, among other things: (1) to negotiate the best terms and conditions for the supply and distribution of electricity for consumers on Cape Cod and the Vineyard; (2) to advance consumer protection and interests for the residents of Cape Cod and the Vineyard; (3) to improve quality of service and reliability; and (4) to utilize and encourage renewable energy development. Fifth Amended and Restated Compact Inter-Governmental Agreement at Article I (September 12, 2012).

The Compact operates a municipal aggregation competitive supply program, which offers electric power supply on an opt-out basis to all customer classes who are located within the Compact's service territory and would otherwise be served as Basic Service customers. All customers in the Compact's service territory receive local distribution service from NSTAR Electric. As a municipal aggregator, the Compact also operates as the program administrator of energy efficiency within the Compact's service territory. The Compact also operates *Cape Light Compact Green*℠, a program that allows the Compact's customers to match 50 or 100 percent of their power supply needs from New England renewable energy resources.

Background on Proposed Models

On April 30, 2014, NESCOE issued a request for comments on the IGER concept ("NESCOE Letter") as well as the proposal submitted on April 22, 2014 by the three holding companies, NU, National Grid USA and UI. Similar to NESCOE and other parties that have submitted comments, the Compact will refer herein to the latter proposal as the "EDC Proposal," but notes that the proposal letter was signed by officers of the holding companies rather than the electric distribution companies ("EDCs"). The EDC Proposal specifically touts the expertise of the holding companies' gas utilities in negotiating and contracting for new pipeline supply: "A number of New England utilities have participated in the AIM and CT Expansion projects, so have very recently evaluated such projects and negotiated such contracts. Gas utilities contract for and manage large and diverse portfolios of capacity and supply for their customer demand and are highly experienced at managing variable demands of customers." EDC Proposal at 2. This language demonstrates that the proposal is not primarily from the EDCs, but from the holding companies and the gas affiliates.

For the IGER concept, NESCOE specifically requested feedback on "the characteristics of the contracting entity and capacity manager in order to best serve electric customers and minimize costs, including but not limited to transaction costs." NESCOE Letter at 1.

The EDC Proposal would place the EDCs into the "Contract Entity" role where they would enter into long-term contracts with interstate pipeline companies for the gas capacity necessary to serve the electric generators and/or to make an equity investment to support these pipeline projects, subject to 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. The EDCs' role would be primarily to use their creditworthiness to support the pipeline expansions by some combination of making equity investments in the projects and entering into capacity contracts with the pipelines. In addition, they would supervise the Capacity Manager which would administer capacity releases to generators or the market. The EDC Proposal does not specify the required level of return on investment, but stated that it is "subject to the necessary cost recovery assurances and remuneration acceptable to them…" EDC Proposal at 3.

On May 15, 2014, NESCOE issued a follow-up letter stating that it would accept comments through May 30, 2014 and that it intends in early June to request expressions of interest and detailed information from entities interested in serving as the Contracting Entity under the IGER framework.

The Compact Strongly Objects to the EDC Proposal

For the reasons provided below, the Compact believes that NESCOE should reject EDC participation in the IGER concept because it is contrary to electric restructuring, and raises concerns including market power, market manipulation, and improper influence over the location of capacity expansion. The Compact is also concerned that the EDCs may request a fee in an amount well above their costs to perform their role. Given these reasons, the Compact believes that NESCOE should look to alternative models to develop the natural gas infrastructure necessary for New England.

The EDC Proposal is contrary to electric restructuring legislation in Massachusetts (Chapter 164 of the Acts of 1997), Rhode Island (Utility **Restructuring** Act of 1996, H.B. 8124), and Connecticut (An Act Concerning Electric Restructuring, Public Act 98-28). The EDC Proposal should not be allowed in any state that has deregulated in the absence of specific legislative authorization, since it would allow the EDCs back into the generation business. Although the EDCs would not have ownership of generation, they could exert considerable control over generation development, operation and economics. EDCs should instead remain focused on distribution work (including grid modernization, distributed generation, energy efficiency) and their proper role in the restructured electric market.

In addition, the EDC Proposal should be rejected because it raises numerous conflicts. As noted above, the EDC Proposal was signed by the holding companies rather than the state-regulated EDCs, and by the gas director of National Grid rather than a director on the electric side. The holding companies and their affiliates have complicated interests in gas supply in New England, and their control of interstate pipeline capacity raises concerns about market power and market manipulation in the operation of the proposed capacity-release system. Specifically:

- NU owns two local distribution companies ("LDCs"): Yankee Gas in Connecticut and NSTAR Gas in Massachusetts.
- NU owns Public Service of New Hampshire ("PSNH"), which in turn owns the gas- and oil-fired 400 megawatt ("MW") Newington station. In the partially-restructured New Hampshire market, PSNH is under competitive pressure from third-party suppliers, especially as environmental retrofits drive up the costs of its Merrimack coal plant.
- National Grid USA owns gas LDCs operating under the National Grid name in Massachusetts, Rhode Island and multiple companies in New York.
- UIL owns the Connecticut Natural Gas and Southern Connecticut Natural Gas LDCs.
- UIL has a 50% interest in the gas-fired GenCon combustion turbines at Devon and Middletown. Its partner in GenCon, NRG, owns 1,300 MW of gas-fired capacity in New England and has proposed new gas-fired projects (e.g., Meriden and the Canal repowering).
- As the IOUs acknowledge, "A number of gas utilities provide service to non-firm gas supply service to electric generators both on and off-system, sometimes in conjunction with a third party" (EDC Proposal at 2), resulting in complex existing relationships with generators and gas marketers.

Each of these potential conflicts would require regulatory oversight to ensure that the holding companies could not manipulate the release of capacity to thwart competitors (e.g., PSNH), increase profits in competitive markets (e.g., GenCon), or reap performance incentives in regulated markets (e.g., LDC gas costs). Since the timing of capacity releases may allow New York gas users to lock in upstream resources before they become available to New England users, National Grid's New York operations may also influence the release of capacity.

Moreover, the role of the holding companies as pipeline owners, or as contracting parties with the pipelines, may allow them to influence the location of capacity expansions and thus to favor their shareholder interests at the expense of competitors and potentially ratepayers. That role might result in improved gas supply to favored generators rather than to an unaffiliated site that would be more valuable for New England and provide greater revenue to offset the pipeline cost.

The Compact also cautions NESCOE on the EDC Proposal's request for a required level of return on investment that would be "subject to the necessary cost recovery assurances and remuneration acceptable to them…" EDC Proposal at 3. The EDCs have argued that they are entitled to a fee for financial risks imposed by contracts whose costs flow through to ratepayers, but such arguments have been rejected (e.g., Connecticut DPUC Docket No. 05-07-18, Decision (Dec. 28, 2005) (rejecting utility's proposal to roll debt equivalence charges into capacity contracts)). The EDCs should only be compensated for costs they actually bear in their role in implementing the capacity expansion (e.g., legal bills, consultant fees and administrative costs). EDC participation should otherwise be rejected to the extent that the EDCs insist on a substantial windfall payment.

For the above reasons, the Compact believes that NESCOE should reject the EDC Proposal. The EDC Proposal could be made somewhat less objectionable if the participating EDCs are entities under state regulation (and not their holding companies), and the EDCs are passive parties in the model. Under that approach, the EDCs would be passive parties in signing the contracts and executing the instructions of the Capacity Manager (or assigning the management rights to the Capacity Manager). The Capacity Manager would be selected by a board appointed by the states, with the board made up of either those whose EDCs are providing the guarantee or all New England states. However, this approach would still raise concerns, including the reasonableness of the fee for utility participation. Any potential ability of the EDCs to exert market power or market manipulation would need to be eliminated.

<u>Alternatives to the EDC Proposal</u>

The Compact agrees that it is imperative to secure the rational increase in pipeline capacity, but it must be accomplished through a neutral and objective planner offering non-discriminatory service. As noted above, the Compact does not object to the IGER concept that would involve a separate and independent nonprofit third party that could undertake the project with tax-exempt financing and offer gas transmission on a non-discriminatory basis.

A non-profit alternative has been offered in the proposal by the Massachusetts Municipal Wholesale Electric Company ("MMWEC"), which would provide lower-cost financing than either the pipeline companies or the EDC Proposal. Significantly, it would also eliminate the requirement for any special "compensation." Unfortunately, MMWEC and its members own gas-fired generation (the Stony Brook combined-cycle plant in Ludlow Massachusetts and the Waters River combustion turbines in Peabody) and may develop additional gas generation in the future. If MMWEC is the vehicle for public financing of additional pipeline capacity, appropriate safeguards would need to be implemented to ensure that it does not favor gas access for its own generation over other (perhaps more efficient) gas generators.[1]

<u>Additional Concerns with the EDC Proposal</u>

[1] The same would be true for the Connecticut Municipal Electrical Energy Cooperative or any other existing or potential owner of generation.

While the Compact believes that the EDCs should not be involved, if the EDC Proposal did move forward, the proposal would need to be fully vetted and safeguards would need to be in place. Some of these issues must be addressed, even if the EDC role is eliminated or is entirely passive.

1. The role and supervision of the Capacity Manager are not detailed in the IGER or EDC models and would need to be clearly set forth, including the options available to it for capacity. The supervision of the Capacity Manager would have to be carefully designed so that it does not become an entity that is unaccountable and unresponsive to ratepayer interests. The States should ensure that they maintain some state regulation to protect ratepayers.

Regarding the Capacity Manager's options for capacity, if the purpose is to increase the supply of non-firm gas transmission into and within New England, so that spot-market prices for generators will fall, the Capacity Manager could simply release all of its capacity all the time and accept whatever price the market provides. Then, the only choice open to the Capacity Manager would be how much of the capacity to release on an annual basis, or monthly, weekly, or daily. On the other hand, if FERC permitted it, the Capacity Manager might retain control over some capacity and provide that capacity (or delivered gas) on a daily basis for specific generators. That would be a much more complicated role (potentially more helpful in ensuring that the generators can reduce their bid prices), but would also be subject to greater errors and abuse, requiring greater oversight from some type of regional regulator.

Normally, capacity owners can only release capacity for resale at auction-determined prices not to exceed the regulated price. Hence, seasonal or daily releases can never recover the cost of the capacity. Since FERC does not regulate the price of delivered gas, the Capacity Manager can increase revenues by purchasing gas in the mid-Atlantic and selling the delivered gas in New England. This latter approach would reduce the costs flowing through ISO New England and perhaps allow ratepayers to capture a larger share of the benefit of increased gas supply, rather than having it primarily benefit generators. Yet, this more complicated operation would require a more sophisticated (and expensive) Capacity Manager as well as increased oversight.

2. Careful regulation would be required to avoid cross-subsidization among the capacity-release program, the holding companies' LDCs, regulated generation, unregulated generation and potentially future gas marketing affiliates.

3. If generators receive gas at a lower price due to a ratepayer subsidy, it would raise the question whether the generators would be obligated to limit their prices to some reasonable heat rate times the gas price, plus a reasonable allowance for variable operating costs. Alternatively, the subsidized gas prices might simply result in higher profits for the gas-fired generators.

4. NESCOE should carefully consider the appropriate sizing of the natural gas supply expansion. On one hand, additional gas supply would have many economic and environmental benefits, including reducing winter prices for electricity, reducing operation of dual-fuel plants on more-polluting oil, hastening the retirement of the remaining coal-fired generators and the oil-only steam plants, and facilitating the conversion of oil to gas space heating and other end uses. On the other hand, a flood of gas supply may tend to encourage development of new gas-fired generation in preference to renewables, undermining state policies (including the Massachusetts Global Warming Solutions Act) of supporting renewables and reducing carbon emissions. In addition, a glut of cheap released capacity (subsidized by electric ratepayers) may allow third-party gas marketers to undercut LDC prices, leaving the LDC ratepayers with large bills for excess long-term capacity purchases. Accordingly, NESCOE should

ensure that the process it initiates and supports does not lead to excessive and disruptive expansion of gas supply.

Conclusion

The Compact appreciates the opportunity to submit these comments to NESCOE as well as NESCOE's efforts on natural gas infrastructure to resolve the electric reliability and economic issues in New England.

Sincerely,

Margaret T. Downey
Administrator
Cape Light Compact