

Testimony of

The United Illuminating Company

Re:

**Raised House Bill No. 5505
AN ACT CONCERNING ELECTRIC RATE RELIEF**

**Before the Energy & Technology Committee
Legislative Office Building
March 16, 2010**

Good afternoon, Senator Fonfara, Representative Nardello and members of the Energy and Technology Committee. My name is Alan Trotta, and I am the Manager of Wholesale Power Contracts for The United Illuminating Company (UI).

Raised House Bill No. 5505, An Act Concerning Electric Rate Relief (the Bill), has been raised to implement the recommendations of the Speaker's Rate Relief Panel (the Panel). As a participant on the Panel, I find it disappointing that the Bill is primarily focused on an expansion of state government and would add a further layer of "command and control" in the form of the Connecticut Electric Authority (the Authority) at a time when fiscal restraint is required. There were a number of proposals made by members of the Panel that could have merit, but they did not receive the same level of attention as did the Authority. UI believes that the Authority is unnecessary, adds bureaucracy and creates overlap with the electric distribution companies (EDCs) and with existing state entities. UI opposes the sections of the Bill pertaining to the establishment of an Authority, and believes that passage of those sections would have adverse impacts on customers.

As is discussed below there are other individual sections of the Bill that UI can support with some modification.

Section I of this testimony explains why the Authority is unnecessary, burdensome and disadvantageous for Connecticut ratepayers and taxpayers. Section II discusses aspects of the Bill that UI can support (with some modification). Section III discusses the concept of providing state financing to developers of new generation in exchange for low cost of service rates, which is the sole provision in the Bill related to the Authority that could have a positive impact.

I. A state run electric authority will place an unnecessary burden on taxpayers and electric ratepayers without providing real benefits.

I.1 The Authority's responsibilities overlap with those of the electric distribution companies (EDCs) and existing state agencies.

UI's understanding of the functions that would be performed by the Authority is consistent with functions currently performed by the Department of Public Utility Control (Department), Connecticut Clean Energy Fund (CCEF) and the EDCs, or that can be performed by these groups. The creation of a new branch of government is unnecessary when far less drastic changes to energy policy can achieve the primary goal of the electric authority concept, which is a decrease in electric rates over the long-run.

Specifically, the Bill lists the following as Authority functions:

(1) Increase the state's energy independence by promoting conservation and efficiency and the use of diverse indigenous and regional electric resources:

The EDCs with the advice and assistance of the Energy Conservation and Management Board (ECMB) (and ultimate approval by the Department), already perform this function exceptionally well. The current collaborative process between the EDCs, the ECMB and the Department has

delivered nationally recognized programs for the benefit of Connecticut ratepayers. Current energy efficiency programs have been so successful that they deliver a cost/benefit ratio of around \$4 in benefits for \$1 spent. There is no reason to derail this program given its consistent track record of success.

(2) Encourage the use of new electric technologies, particularly technologies that support economic development in the state and promote environmental sustainability:

This function overlaps substantially, and perhaps entirely, with the role of the CCEF. In addition, the encouragement of new technologies is supported by the energy efficiency partner program established by the legislature in 2007. Further, the overall concept of a centralized, state-run bureaucracy is more likely to stifle, rather than encourage, a competitive environment or development and deployment of new technologies.

(3) Minimize costs of electric services to state consumers while maintaining reliable service; (4) discourage undue price volatility of electric service:

The power procurement role of the Authority is duplicative of the procurement functions that are being, or can be, performed by the EDCs and the Department. The EDCs are fully capable of expanding their power procurement role to actively manage costs and volatility, and have in fact proposed such legislative changes. However, laws enacted during electric industry restructuring place strict limitations on how the EDCs are allowed to buy power for customers. Moreover, the EDCs already have the management expertise in place to successfully promote the low cost power procurement goals of the Bill. As is discussed in more detail in section II below, Section 17 of the Bill addresses some of these issues, but contains major flaws that would need to be addressed before the concept could be implemented.

The EDCs conduct all of their procurement activities under the oversight of the Department and with the participation of the Office of Consumer Counsel (the Attorney General has been invited to participate, but has not done so). This ensures that customer interests are fully represented and that procurement decisions are vetted by parties with differing viewpoints (thus creating appropriate checks and balances). There is no reason to believe that substituting the Authority for the Department would result in any improvement in a process that already runs very well within the confines of allowed procurement options.

Additionally, it is not clear how any action of the Authority would affect, or maintain the reliability of electric service, since this responsibility lies with the EDCs and ISO New England.

(5) Encourage competition, when in the interests of state consumers:

It is not clear how a state run electric authority would be an enabler of competition for the benefit of customers. To the extent that the Authority would be a buyer of power for resale to customers or to the EDCs, it would simply be another buyer of the same limited quantity of power being sold in the marketplace. This could harm rather than help consumers by providing sellers with additional buyers to pit against each other. The presence of a state Authority would not

encourage competition among suppliers, and could force generation developers to look elsewhere for investment opportunities.

The Authority.....shall oversee the implementation of the procurement plan approved by the Department of Public Utility Control pursuant to section 16a-3a:

Section 51 of Public Act 07-242 created the integrated resource planning (IRP) process. The EDCs recently filed the 2010 IRP with the Connecticut Energy Advisory Board (CEAB), and have received Department decisions on the 2008 and 2009 IRPs. The structure in place now is ideal because it allows the expertise of the EDCs to be applied to the development of the plan, but also allows for the oversight and input of state entities such as the CEAB and the Department of Environmental Protection (DEP), and input from other stakeholders such as the CCEF, the Office of Consumer Counsel and the general public. The Department has been appropriately tasked with reviewing the plan, and the myriad of inputs provided by the stakeholders, and determining what, if any, actions should be taken in response to the plan's findings. All of the necessary checks and balances are already in place, and just as with procurement oversight, there is no reason to believe that substituting the Authority for the Department would result in any improvement in the process. Checks and balances are, in fact, absent with respect to the Authority because, as a quasi-public agency, there is no recourse or rights with respect to Authority actions or decisions.

I.2 The qualification requirements for Authority members are wholly inadequate relative to the billions of dollars in decision-making responsibilities.

The Bill proposes the following criteria for Authority membership:

The Connecticut Electric Authority, which shall consist of seven members as follows: (1) One with experience in electricity regulation, appointed by the president pro tempore of the Senate; (2) one with experience in electricity generation appointed by the speaker of the House of Representatives; (3) two with experience in electricity consumer issues, one each appointed by the majority leaders of the Senate and the House of Representatives; (4) two with experience in electricity conservation issues, one each appointed by the minority leaders of the Senate and the House of Representatives; and (5) the chairperson appointed by the Governor pursuant to section 4-7 of the general statutes.

This proposed composition of the Authority is of great concern because members are politically appointed rather than considering actual practical experience and demonstrated success. In addition, appointees simply have to have "experience in... issues" to be eligible for membership. The fact that a person has "experience in issues" is not a robust qualification. Within the industry, individuals entrusted with the responsibility for making multi-billion dollar determinations have many years of practical experience and track records of success. However, there is no requirement that members of the Authority have long-run track records of success in critical areas such as power procurement, risk management, credit risk management, trading and energy contract law – just to name a few. This disconnect between real experience and member qualification demonstrates the conceptual flaws within the Authority concept and the potential for significant harm to the State's economy.

If the State chooses to procure electricity on a centralized basis, the parties responsible for procurement should be long-time professionals who have proven success in the field. An electric authority made up of political appointees is better suited to a higher level oversight role than a procurement role. Again, this oversight is already there today with the Department. There is no reason to add another layer of government to perform the same oversight.

I.3 The significant and unnecessary power granted to the Authority could cause considerable and lasting damage to customers.

While well intentioned, grants of power, such as envisioned in the Bill for the Authority, can and do go awry. Two examples come to mind that have, or will, cost Connecticut electric customers a substantial amount of money.

The first is the 1978 Public Utility Regulatory Policy Act (PURPA). PURPA was the federal government's version of what the Authority would be tasked with doing: requiring utilities to sign long-term power contracts solicited by the government. PURPA resulted in a number of long-term contracts being signed by Connecticut EDCs. Together the above market costs associated with these contracts that have been paid, or have yet to be paid, by customers total in the *billions* of dollars.

A more recent example is the approval and execution of four capacity contracts in accordance with Section 12 of Public Act 05-01. In response to PA 05-01, the Department conducted a solicitation for capacity contracts, and in Docket No. 07-04-24, it selected four contracts. The Department was focused primarily on ensuring that the State had sufficient capacity to avoid being designated as a separate capacity zone (and thus subject to higher capacity prices). In focusing narrowly on capacity, the Department did not procure energy at the marginal generation cost of the projects. Even though the intention was to sign beneficial contracts for customers, the net result may end up being substantially less beneficial than a purchase of capacity and energy would have been.

An electric authority is far more likely to make broad, sweeping strategic decisions than an EDC because there are no consequences for decisions that do not achieve the intended result – or simply end up as being wrong. The members of the Authority would likely serve limited terms and likely never be held accountable in any way for adverse decisions. This lack of accountability combined with the lack of experience discussed above in Section I.2 of this testimony creates an unprecedented level of economic danger for the State's electric consumers. Also, because the Authority would be made up of appointees serving limited terms, the strategic direction would be subject to frequent change depending on the then-current makeup of the legislature. This could lead to a high degree of inefficiency if the abandonment of a previous administration's long-term initiatives becomes a regular occurrence when Authority membership changes.

I.4 The creation of the Authority is a complex and costly endeavor

The creation of an electric authority is not a simple matter. There are issues that would need to be successfully addressed for an electric authority to commence operation:

- i. An electric authority would have to be capitalized and funded to a level that assures an investment grade credit rating. Participation in wholesale power markets requires a strong balance sheets and access to credit facilities.
- ii. An electric authority would have to be staffed with experts who are experienced and skilled in the wholesale power procurement/trading, contract administration, credit risk assessment, resource planning and quantitative analysis. Much of this staffing, particularly with respect to experienced leadership, is redundant with staffing already in place at the EDCs.
- iii. An electric authority would require specialized systems to track contracts, load obligations, and supplier credit.

The EDCs are already capitalized and creditworthy, and already have much of the needed specialized leadership personnel needed to successfully perform all functions contemplated for an electric authority. A shift from the procurement of full requirements service to portfolio management and cost of service rates for new generation can form the framework for an approach to procurement that better controls customer costs.

II. Sections of the Bill that UI supports, with some modification.

The Bill does contain changes in energy policy that are far less drastic than the creation of an electric authority. These concepts make sense (subject to the flaws in Section 17 being addressed):

Section 1 of the Bill: UI has submitted separate written comments in support of this section of the Bill.

Section 3 of the Bill requires that the Connecticut Energy Advisory Board conduct a study on the costs, benefits and statutory restrictions for nuclear energy. The 2010 IRP included the evaluation of a hypothetical scenario where 1,100 MW of new nuclear capacity was added in-state. The nuclear scenario had lower customer rates, and dramatically lower emissions of CO₂, SO₂ and Nox, than any other scenario tested. While these results are not conclusive, they do demonstrate that nuclear energy has enough long-run potential to be worthy of further study.

Section 17 of the Bill creates improvements in the standard service procurement process. While UI supports the general concept of Section 17, there are four flaws that render the section unworkable.

The first flaw is the change to Subdivision (3) of Subsection (c) section 16-244c of the general statutes which appears to limit the "laddering" of standard service procurements to 6 months (it is currently 3 years). This change is short sighted. If laddering is an acceptable concept, then we should not overreact to current market conditions and shorten the contract period. We have

currently entered into a period of relatively low prices due to increased production of shale gas and reduced demand for natural gas that was largely a result of the recession. While it is reasonably likely that natural gas prices will remain moderate for at least the next few years, it is not a certainty. Any number of events could occur that would result in higher gas prices and, by consequence, higher electric prices. It may be advisable to reduce laddering to some extent, but to eliminate it altogether would place customers in a situation where they would be 100% exposed to future price spikes. While it is true that current standard service prices are higher than the prevailing short-term market due to past laddering, it is also true that laddering saved customers hundreds of millions of dollars during the run-up of crude oil and natural gas prices that took place in later 2007 and 2008.

The second flaw is in Subdivision (6) where a “cost-based analysis” of bids is required to assess bids received pursuant to Subdivision (3). These bids are for full-requirements electric service, which is a market-based product. It is unclear exactly what would be used as a benchmark for the “cost-based analysis”, but anything other than a comparative market analysis would be an “apples to oranges” comparison, and would likely adversely impact the entire procurement process.

Subdivision (6) also allows the Authority ten business days to approve or reject bids. This third flaw to section 17 makes the procurement process unworkable. The Department was originally allowed ten business days to approve or reject standard service bids, but quickly realized that an expedited bid review was necessary to minimize costs to customers. The Department now approves or rejects bids the same day that it receives them, which is only one business day after bids are submitted. Suppliers have developed confidence in the Department’s review process, and UI has seen risk premiums decrease, partly as a result of this confidence. Simply put, if suppliers are required to hold fixed prices open for ten business days, customers would end up paying substantial risk premiums to the very few suppliers (if any) who would be willing to bear that level of regulatory risk.

The fourth flaw is contained in Subdivision (7) which requires that contracts be signed after approval of bids by the Authority. This will likely have an adverse impact on supplier participation. Currently, the EDCs execute contracts with suppliers on the day of procurement, with such contracts being subject to regulatory approval. This provides suppliers with the comfort that they have binding contracts as long as the contracts are approved by regulators. The contracts set out in detail what happens in the event that regulatory approval is not obtained, or even more importantly, what happens is regulatory approval is partially obtained. If the process is reversed, suppliers will be put into a situation where they are bound to contractual commitments that their counterparties are not bound to. This will be an untenable risk for many suppliers, and customers will end up paying for this risk in the form of higher contract prices.

III. State financing of new power generation in exchange for cost of service rates.

Section 7(d) of the Bill states that:

The authority may negotiate contracts with electricity generators for the provision of electric generation services offered pursuant to subsection (c) of section 16-244c of the general statutes.

as amended by this act. Such negotiation may be in connection with the provision of financing or other assistance to an electricity generation services supplier for the construction or reconstruction of a generation facility.

UI agrees, in concept, that the provision of low cost, state-sponsored financing can be exchanged for low cost of service rates and benefit customers. The ability to access state financing for power generation projects is the singular advantage that the Authority has over procurement by the EDCs. However, this can all be achieved without the creation of an Authority by providing the Department with the ability to direct such financing to generation developers.

Alternatively, the state can establish a board whose responsibility is limited to the arrangement of financing for generation projects in exchange for cost of service generation rates. The procurement experts at the EDCs could be utilized to negotiate and manage the resulting contracts, and such contracts would of course be subject to department approval. Cost of service arrangements could be accomplished either through the distribution companies or developers under a competitive bidding process similar to that used for the peaking generation process.