



Connecticut
Light & Power

The Northeast Utilities System

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The Northeast Utilities System

TESTIMONY OF RICHARD A. SODERMAN
THE CONNECTICUT LIGHT AND POWER COMPANY
and YANKEE GAS SERVICES COMPANY
Planning and Development Committee—March 9, 2012

**H.B. 5406 AN ACT ESTABLISHING A TASK FORCE TO STUDY BARRIERS TO THE
FORMATION OF MUNICIPAL UTILITIES**

My name is Richard Soderman and I serve as Director of Legislative Policy for Northeast Utilities Service Company. I am appearing on behalf of the Connecticut Light and Power Company and Yankee Gas Services Company.

This bill proposes to perform a study of creation of municipal utilities. While we do not oppose a bill that would study this question, we note that Massachusetts has recently completed a study. Before Connecticut commits to spending additional funds on this study, it should consider whether that Massachusetts study provides the information that the proponents of this bill seek. I have attached a copy of the transmittal letter from the Department of Energy Resources Commissioner to the Massachusetts committee chairmen, which provides a brief summary of the report's highlights. The report was prepared with the assistance of an external consulting firm. A copy of the report is available at <http://www.mass.gov/eea/docs/doer/publications/doer-municipal-utility-rpt.pdf>.

Thank you for the opportunity to provide testimony on this proposal.



Deval L. Patrick
Governor

Timothy P. Murray
Lieutenant Governor

Ina A. Bowles
Secretary, Executive Office of Energy
and Environmental Affairs

Philip Gludke
Commissioner

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January 28, 2010

The Honorable Barry R. Finegold
Joint Committee on Telecommunications, Utilities & Energy
State House – Room 473-B
Boston, MA 02133

Re: Municipal Utility Report

Dear Chairman Finegold,

Pursuant to Section 107 of the Green Communities Act of July 2, 2008 ("the Act"), the Massachusetts Department of Energy Resources ("DOER") was required to conduct a study to examine potential impacts of municipalization of electric utility systems, which are primarily owned and operated by private investor-owned utilities ("IOUs"). In particular, Section 107 reads:

"The department of energy resources shall conduct a study of the fiscal impact, viability, statutory and regulatory barriers and long-term results of establishing and operating municipal-owned electric utilities in the commonwealth."

The attached report is submitted to the Joint Committee on Telecommunications, Utilities and Energy in compliance with Section 107 of the Act. The DOER, with the assistance of La Capra Associates, has assembled information that provides background information and some pertinent basic analyses on the issues associated with formation of municipal utilities for use by the legislature, regulators such as the Department of Public Utilities ("DPU"), and other interested parties as electric service municipalization policies are considered.

Section 107 of the Act also established an advisory commission to provide guidance and advice regarding the study. There were four meetings held with the commission to review scope, study methodology, analyses and the draft report. In addition, in preparing the report, individual interviews were conducted with most commission members in order to insure that all relevant issues were identified and addressed. Both oral and written comments on this report were

received and every effort was made to incorporate relevant issues identified by commission members in a fair and balanced manner.

The study's findings provide a number of important insights into the differences between existing municipal electric utilities and investor-owned utilities in the Commonwealth, and the process and some potential impacts of establishing new municipal utilities. In all events, however, it should be evident that the consideration of establishing any specific municipal utility will pose unique issues that will require situation-specific assessments. The circumstances of each will vary and proper due diligence will be required in each case.

Highlights

New vs. Existing Municipal Utility

While this report presents a number of analyses comparing the Commonwealth's existing municipal electric utilities to its existing investor-owned utilities ("IOUs"), the report emphasizes that a new municipal utility will not likely resemble an existing municipal utility for a number of reasons. First, a new municipal utility will need to carry significantly higher debt levels than a typical existing municipal utility. Existing municipal utilities have been operating for over 80 years and have, over time, significantly reduced their debt levels. In addition, existing federal tax law effectively precludes a municipality from purchasing the assets of an IOU with tax-exempt debt. Consequently, a new municipal utility will have higher debt levels at a higher cost than an existing municipal utility. With respect to power supply costs, many existing municipal utilities either have an ownership interest in power plants or have long-term entitlements to the value of that power. These arrangements have provided them with a significant hedge against rising power costs. A new municipal utility will not have the benefits of these arrangements. Finally, to the extent new municipal utilities will be required to continue to comply with the Commonwealth's energy policy objectives with respect to energy efficiency, renewable portfolio standards and retail competition, these requirements will further distinguish a new municipal utility from an existing one.

Exhibit 10 of this report provides an illustrative example to try and better understand how the capital cost structure of a new municipal utility, under three different asset value scenarios, might affect its overall cost relative to existing IOUs. For all other cost components, averages for existing IOUs and municipal utilities were used except for power supply which was held constant for IOUs and municipal utilities. This exhibit suggests that even under the lowest asset value case, it may be difficult for a new municipal utility to match an existing IOUs costs, especially considering that no pre-acquisition or start-up costs are assumed in this exhibit for a new municipal utility. It should be emphasized again, however, that this exhibit largely relies on the best available operating cost data for existing utilities and that any analysis of the impacts for a specific municipality will depend heavily on the particular circumstances associated with that municipality and the facilities used to serve it.

Valuation

Valuation of utility assets continues to be controversial. There is only a single DPU case post-1940 involving the purchase of utility assets where the town of Stow desired to purchase the

electric distribution assets from the Hudson Light Department, a municipal utility that serves Stow. The DPU issued a ruling that utilized a methodology to value the assets based on an equal weighting of the original cost of the assets less depreciation (“net book”) and the replacement cost of the assets less depreciation, adjusted for the condition of the assets. That methodology was upheld by the Massachusetts Supreme Judicial Court (“SJC”). In December 2009, the Massachusetts Appeals Tax Board issued a ruling on the value of National Grid’s natural gas assets located in the City of Boston. In its decision, it utilized essentially the same methodology used by the DPU in the Stow-Hudson case and affirmed by the SJC. These rulings suggest that replacement cost of the distribution assets, not just net book, is an appropriate consideration for determining value.

Barriers to Municipalization

The most significant barrier to municipalization identified by proponents of municipalization is that the IOU has no requirement to sell its distribution assets to any municipality, regardless of the price it is willing to pay. The role of the DPU is as arbiter on the value of the assets and other related issues but there is no obligation on the part of the IOU to accept the DPU’s findings and proceed with a sale even if the municipality is willing to accept those findings and proceed with the purchase. In addition, proponents argue that this barrier not only enables the IOU to thwart any sale but also deters municipalities from investing the necessary resources to determine whether municipalization of electric utility assets would be desirable.

From the IOU’s perspective, the existing legislation is not a barrier at all but simply mirrors the process it uses whenever it is presented with an opportunity to sell all or some of its assets to any party, regardless of whether it is to a municipality, public corporation or private investors. Any offer of a purchase of assets is evaluated by management and if management determines the transaction offers shareholders superior value and is consistent with the public interest (the legal standard for DPU approval), then it has a fiduciary responsibility to its shareholders to proceed with the transaction or to recommend Board or shareholder approval of the transaction if such approval is required.

Local Control

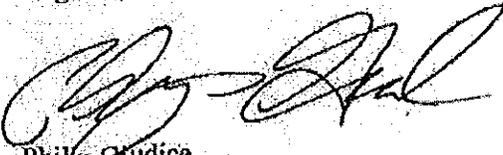
One attribute of municipalization whose value is difficult to quantify is the attribute of local control. A new municipal utility, by definition, will allow for greater control and input by residents into utility investment policies and decisions, services and service levels. Unlike IOUs, a municipal utility is owned and controlled by the municipality through its local utility board, over which residents can exercise a much greater level of control. The presumption is that the electric municipal utility’s “shareholders” share more common interests than those of the IOU and are likely to make different choices than those made by the IOU as well as be more responsive to local needs and issues.

From the perspective of the DPU and IOUs, the service quality standards approved and enforced by the DPU address the interests of all customers. While these standards do not cover every aspect of an electric utility's operations and are not location specific, they do cover every important service provided by electric utilities relating to system reliability, safety and other aspects of the customer's experience.

Finally, greater local control has potential implications for the Commonwealth's energy policy objectives. Existing municipal utilities are exempt from implementing many of the state's energy policies. Those policies include robust energy efficiency programs, renewable portfolio standards, net metering, retail competition and a variety of other initiatives under the Green Communities Act. While many municipal utilities have voluntarily adopted various aspects of the Commonwealth's energy policies, many have not. In addition, the initiatives of those municipal utilities that have adopted portions of these policies are far less robust than those of the IOUs in both scope and size. Serious consideration should be given to requiring new municipal utilities to comply with the Commonwealth's goals and initiatives regarding its energy future.

It was not the intent of this study to reach definitive conclusions regarding whether electric municipalization is, or is not, a desirable outcome. Moreover, that conclusion can only be reached by evaluating a specific transaction against a set of objectives and goals that may vary from municipality to municipality, and perhaps sometimes even between a municipality and the Commonwealth.

Regards,



Philip Giudice,
Commissioner

