



# OLR RESEARCH REPORT

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## **PROPOSED MASSACHUSETTS SETTLEMENT ON NU/NSTAR MERGER**

By: Kevin McCarthy, Principal Analyst

You asked for a summary of the major provisions of the settlements proposed in connection with the proposed merger of Northeast Utilities (NU) and NSTAR, a Massachusetts utility holding company. The proposed settlements were submitted to the Massachusetts Department of Public Utilities (DPU) on February 15, 2012 for its approval. In Connecticut, the Public Utilities Regulatory Authority (PURA) is also reviewing the proposed merger (docket 12-01-07).

### **SUMMARY**

There are two proposed settlements affecting the proposed merger of NU and NSTAR. The parties to the first settlement are NSTAR and its electric and gas operating companies, NU, Western Massachusetts Electric Company (WMECO, an NU operating company), and Massachusetts Department of Energy Resources (DOER) and attorney general. Under the proposed settlement, each of the operating companies would remain a separate company subject to DPU jurisdiction until they applied to merge as provided by Massachusetts state law.

If approved by the DPU, the settlement would freeze the base distribution rates of the operating companies, subject to specified adjustments, for 44 months. It would provide a one-time customer rate credit of \$21 million for customers of these three companies, an amount

that equals half of the estimated four-year savings the companies expect to net from the merger. The settlement would require NSTAR Electric and WMECO to defer recovery of the costs they incurred in responding to Tropical Storm Irene and the October snowstorm. It would specify how the net costs of the merger, if any, would be treated for ratemaking purposes. It would require the affected companies to notify DOER and the attorney general of any facility closings or layoffs. The settlement has a number of other provisions, such as how goodwill will be accounted for in ratemaking.

The provisions of the proposed settlement are non-severable and are contingent on DPU approving the entire settlement on April 4, 2012. If the settlement is not approved on this date, or the merger does not go forward for any reason, the settlement and its supporting documents would be considered withdrawn and cannot be used for any purpose.

Under the proposed settlement, DOER and the attorney general may, in their sole discretion, rescind the settlement at any time before DPU approves it. This provision is intended to give them enough time to review PURA's final decision to assure that it has no negative impact on Massachusetts' ratepayers.

NSTAR, its electric and gas operating companies, WMECO, and DOER submitted a second proposed settlement to DPU. The second settlement has a number of environmental provisions, several of which apply to NSTAR Electric but not WMECO. These include requirements to buy power from the Cape Wind project or another renewable energy source, enter into long-term contracts to buy power generated by solar facilities, and establish an electric vehicle pilot program. The second settlement would increase energy efficiency targets for both companies. It has employment security provisions that apply to WMECO and NSTAR Electric, as well as to the NSTAR holding company and its gas operating company.

The settlement documents are available at <http://www.mass.gov/eea/energy-utilities-clean-tech/electric-power/proposed-nstar-nu-merger-settlement-documents.html>.

## **BACKGROUND**

On November 24, 2010, NSTAR and NU and their operating companies (NSTAR Electric and NSTAR Gas and WMECO, respectively), petitioned DPU to approve their proposed merger. DOER and the attorney general sought discovery from the companies and negotiated with them regarding the merger.

The parties raised a wide range of issues in the negotiations but ultimately sought to enter into settlements that would not establish any precedent or principles that would apply to future proceedings. The parties sought to ensure that the impact of the merger would be comparable to results achieved in other states with regard to merger savings, service improvements, and employment impacts.

## **FIRST PROPOSED SETTLEMENT**

### ***Distribution Rate Freeze***

Under the first settlement, the base distribution rate in effect on January 1, 2012 would be frozen for 44 months, with no new rates going into effect before January 1, 2016. This rate covers the companies' costs of shipping power or gas on their distribution systems to individual customers. In the case of electricity, the rate applies whether the customer buys power from the electric company or a competitive supplier.

Mechanisms that modify these rates that are approved by or pending at DPU as of January 1, 2012 would not be affected by the settlement. The rates are subjected to adjustment for exogenous variables (those beyond the company's control, e.g., changes in its property tax bills), that exceed 0.32% of their distribution revenue. DOER and the attorney general reserve their rights to dispute filings to adjust rates for these variables.

The operating companies would not be allowed to propose new distribution rates or adjustment mechanisms during the freeze period, except for those specifically mandated by the legislature. If a new rate or mechanism is implemented pursuant to legislation, the cost associated with the legislation cannot also be recovered as an exogenous cost under current rates.

The three operating companies agree that no more than two of them can have distribution rate cases pending before DPU at the same time. The third company would have to wait six months after the second case is filed to submit its rate case.

### ***Billing Credit***

Under the settlement, the operating companies would provide a one-time \$21 million billing credit that they could not recover from their ratepayers. Of the credit, \$15 million would go to NSTAR Electric, \$3 million to NSTAR Gas, and \$3 million to WMECO. The credit would be allocated among customer classes proportionally with their monthly customer charges and would appear as a flat dollar amount for each class. The credit would not bar customers from gaining other benefits under the merger.

### ***Storm Cost Recovery***

The settlement would require NSTAR Electric to defer recovery of costs associated with Tropical Storm Irene and the October 2011 snow storm for two years, until January 1, 2014, and then recover these costs, plus interest, over five years subject to a DPU prudence review. The company could only recover incremental costs. WMECO's recovery of its October storm costs would be deferred until DPU issues its final decision in a pending proceeding (DPU 111-19-C).

### ***Recovery of Merger Costs***

Under the settlement, subject to DPU review and approval, the companies would be able to recover their reasonable transaction and integration costs through the distribution rates of the operating companies, to the extent these costs exceed merger-related savings. The compensation for employees who are laid off but subsequently re-hired or retained as consultants must be excluded from the calculation of savings. Change of control and retention payments are not eligible for recovery from ratepayers. The former are payments made to the officers of the holding companies, operating companies, or their successors when they leave the employment of these companies. The latter are special payments to executives of the companies who remain with the post-merger organization.

### ***Notice of Facility Closings***

The settlement requires that if a utility facility closes or there is a layoff of employees of any of the operating companies or the merged holding company, the affected company must give the attorney general and DOER 30 days' advance notice. The settlement does not reduce any collective bargaining rights regarding reductions in the work force.

## **SECOND PROPOSED SETTLEMENT**

The second settlement contains a number of environmental and employment security provisions in addition to the rate freeze and billing credit provisions described above. The settlement is contingent on approval of the first settlement and also must be approved by DPU on April 4, 2012 to go into effect.

As is the case with the first settlement, the provisions of the second settlement are non-severable and do not create precedent. The settlement allows DOER, in its sole discretion, to rescind the settlement before it is approved by DPU. It also allows DOER to extend the deadline for DPU approval until two business days after the final decision on the merger rendered in another jurisdiction.

### ***Clean Energy/Cape Wind Project***

Under the settlement, the parties agree that NSTAR Electric will enter into a 15-year contract to purchase 27.5% of the electricity output from Cape Wind, the offshore wind energy project planned for Nantucket Sound. This contract would satisfy the (1) utility's need to meet greenhouse gas reduction goals under the DPU's net public benefit standard for utility mergers and (2) renewable energy procurement requirement under Massachusetts' law. The proposed settlement does not include an actual contract between NSTAR and Cape Wind, in the form of a negotiated power purchase agreement, but requires that such a contract be submitted to DPU for its approval by March 30, 2012. NSTAR Electric is not required to execute this contract if DPU rejects either of the proposed settlements.

If the Cape Wind project has not broken ground by 2016, NSTAR must purchase an equal amount of clean energy from another source with a contract term of at least 15 years. NSTAR Electric would be paid 4% of the annual payments under the Cape Wind or alternative contract for its acceptance of the long-term contract.

### ***Energy Efficiency***

Massachusetts, like Connecticut, requires electric companies to develop energy efficiency plans. The settlement raises the 2012 savings target by approximately 11,000 megawatt-hours (2%) over the level specified in the plan. If NSTAR Electric and WMECO do not jointly reach this target, NSTAR Electric would be penalized \$24.40 for each megawatt-hour of the shortfall.

Starting in 2013, the two companies would be required to increase their aggregate target so that at least 2.5% of retail demand is met through efficiency, so long as there is no material change in the (1) framework for measuring program success, (2) incentives for meeting the targets, and (3) efficiency program funding. This requirement is in effect during the rate freeze period. If the Energy Efficiency Advisory Council determines that there should be a higher target and DPU approves its recommendation, NSTAR Electric and WMECO must meet the higher target.

### ***Solar Energy***

Under the settlement, NSTAR Electric agrees to submit long-term contracts for 10 megawatts of solar electric generation to DPU for its approval. The generation must be located in Massachusetts and owned by third parties. NSTAR Electric must issue the first request for proposals (RFP) for such contracts, for five megawatts of generating capacity, within three months of the merger closing and submit the selected contracts to DPU for its approval by November 1, 2012. NSTAR Electric must issue the second RFP within 30 days after DPU approves the first contract and submit the second group of contracts within 180 after the second RFP is issued.

In Connecticut, PA 11-80 has somewhat similar provisions.

### ***Hydroelectric Power***

Massachusetts, like Connecticut, requires electric companies to procure some of their power from renewable resources under a renewable portfolio standard (RPS). The second settlement would bar NSTAR Electric and WMECO, through December 31, 2016, from (1) meeting any part of their RPS obligations by buying power produced by large hydroelectric facilities with a generating capacity over 25 megawatts or (2) selling such power into the market. Starting January 1, 2017, the settlement would require the two companies to seek to (1) keep energy supply costs competitive and (2) buy power from large-scale hydroelectric facilities.

### ***Electric Vehicles***

Under the settlement, NSTAR Electric would be required to develop and implement a pilot electric vehicle program and an associated tariff (electric rate). The program would seek to identify the most cost-effective way to establish charging stations in the service territory of the merged company. It would have to (1) consider working with neighborhoods,

parking authorities, and employers to set aside areas for such stations and (2) explore off-peak charging of the vehicles. NSTAR Electric would have to submit its proposed program to DPU for its approval within six months of DPU's approval of this settlement.

### ***Other Renewable Energy Provisions***

Under the settlement, NSTAR Electric would agree to (1) petition DPU to review the standby (backup power) charges the company imposes on renewable energy facilities with the goal of eliminating these charges, (2) evaluate existing requirements that wind facilities have specified open areas around them in case they fall down, and (3) file its policies regarding customer-funded interconnections of on-site generation with DPU.

### ***Employment Security***

The parties agree that, following the merger, reductions in the work force in Massachusetts or transfers of jobs or functions would be made on a fair and equitable basis, considering previous work history, job experience, and qualifications. Any workforce reduction in Massachusetts cannot (1) be disproportionate to reductions in other jurisdictions where the merged entity operates (e.g., Connecticut), (2) diminish customer service operations, or (3) diminish compliance with emergency response plans. The settlement reiterates the layoff notice requirements of the first settlement.

### ***Service Quality***

Under the settlement, NSTAR Electric agrees to make measurable improvements to its service quality by December 31, 2015, calculated in accordance with DPU guidelines.

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