Dominion

Testimony before the Connecticut General Assembly's
Finance, Revenue and Bonding Committee
on
Senate Bill 843, *AAC Revenue Items to Implement the Governor's Budget*
by
Daniel A. Weekley
March 4, 2013

Co-chairs Fonfara and Widlitz, ranking members Frantz and Williams and members of the Finance, Revenue and Bonding Committee, thank you for the opportunity to comment today. I am Dan Weekley, Vice President of Government Affairs for Dominion Resources. I am here today to express Dominion's **strong opposition** to Section 7 of Senate Bill 843, *An Act Concerning Revenue Items to Implement the Governor's Budget*. This section re-authorizes a tax on the production of electricity in Connecticut that was scheduled to expire June 30, 2013.

I. Dominion

Dominion is one of the nation's largest producers and transporters of energy, with a portfolio of approximately 27,500 megawatts of generation, 11,000 miles of natural gas transmission, gathering and storage pipeline and 6,300 miles of electric transmission lines. Dominion operates one of the nation's largest natural gas storage systems with 947 billion cubic feet of storage capacity. We also serve about 5 million electric and gas retail customers across 15 states.

II. Dominion in Connecticut

a. Millstone Power Station

Dominion is the owner and operator of the Millstone Power Station in Waterford, CT. Millstone is the largest and one of the most reliable and important power stations in New England. It is also greenhouse gas emissions free and, in fact, does not emit any air pollutants of any type.

Dominion purchased the Millstone Power Station in 2001 for $1.3 billion via a state-sanctioned auction. Since acquisition, Dominion has invested over $600 million in safety, environmental, efficiency and reliability upgrades. These investments have benefited ratepayers by producing low cost, base load, emissions-free electricity. Today, Millstone's typical output is greater with two operational units than it was the decade before Dominion purchased the plant when there were three operational units. This increased, efficient output is the equivalent of building an additional 650 MW emissions free, base load power station. By contrast 650 MW of natural gas operating as base load would produce more than 2.5 million tons of greenhouse gas annually, and a coal unit of similar size would produce more than 5 million tons.

Dominion is proud of its commitment to Connecticut. Annually, we purchase approximately $200 million of goods and services from Connecticut-based vendors. Moreover, since 2001, Dominion has donated over $9 million to Connecticut's non-profit organizations.

b. Dominion Bridgeport Fuel Cell

In December, 2012, Dominion acquired a fuel cell project in Bridgeport, CT. At 15 MW, it will be the largest fuel cell power plant in North America. This project is a result of collaboration between Dominion, FuelCell Energy, the state of Connecticut and the city of Bridgeport. The project was developed by FuelCell Energy and is part of the state's Project 150 initiative – a legislative program that seeks to increase the amount of renewable energy installed in Connecticut by 150 MWs. Over the fifteen-year life of the project it is responsible for 161 jobs in Connecticut – mostly in manufacturing at FuelCell Energy's manufacturing plant in Torrington, CT and construction at the site in Bridgeport. Danbury headquartered FuelCell Energy recently announced that 50 additional manufacturing jobs were immediately being created directly attributable to the Dominion Bridgeport Fuel Cell facility and another project. An additional key point of the project, it is being constructed on a former brownfield site within the City of Bridgeport. The facility is scheduled to be completed and operational by the end of this year.

c. Dominion Retail

Dominion first entered the residential retail market for electric customers back in 2002. Consistently over this period we have been one of the state's largest retail providers and today we are proud to serve approximately 60,000 residential customers with a competitively priced product.

Generation Tax Background

In 2011, Connecticut became the first, and only, state in the country to adopt a broad-based tax on the production of electricity. The tax applies to Connecticut's coal, oil, natural gas and nuclear power plants. The tax is $2.50 for each MWh produced. To give you a sense of what this means, Dominion's Millstone Power Station produced a little more than 17 million MWh of electricity in 2012. Accordingly, Dominion paid almost $43 million in 2012 for this production tax. Another way to think about it is that Dominion paid about $35,000 per employee just for the generation tax. That is in addition to the over $30 million we already pay in state and local taxes. We are very proud of the safety and reliability investments (more than $600 million) that we have made at Millstone, but in an ironic way the more reliably the station operates the more we pay in taxes. In essence, the state is encouraging us not to be the "*best of the best*" which goes against any successful business goal.

It is important to note that of all the new taxes in the 2011 biennium budget, the production tax on electric generation was the only one that included a sunset provision. As a result, this tax is scheduled to terminate on June 30, 2013. The reason for the sunset was clear, the administration and the legislature did not want to do anything that would further increase already high electricity prices.

The sunset provision is crucial for Dominion. It is crucial because Dominion absorbed its portion of the tax for two years based on the commitment from the administration and legislature that the tax would expire. Dominion could have explored various scenarios to pass the tax on to consumers or avoid it altogether. As simple economics teaches, all costs of production by businesses, including taxes, are borne by consumers in the price they pay for the product. However, we chose not to take that path. Instead, we made a good-faith effort to the administration and the legislature in answering the "shared sacrifice" call. In fact, according to OPM Secretary Barnes, there was no single entity that sacrificed more in the 2011 biennium budget than Dominion.

III. Senate Bill 843

Senate Bill 843, *An Act Concerning Revenue Items to Implement the Governor's Budget*, calls for the two-year re-authorization of the production tax on electric generation. This is bad public policy for Connecticut for many reasons, but I will focus on three: 1) the negative impact this tax has on Connecticut's credibility; 2) the negative energy policy implications; and 3) the overall shortsightedness of this type of tax policy.

a. Credibility

Re-authorizing the production tax on electric generation is tantamount to Connecticut state government breaking its promise to let the tax expire. Breaking promises is not a good way to encourage long-term investment or growth in the state. In a February 7, 2013 article in the New London Day, Lee Howard wrote:

> Steven Lanza, a University of Connecticut economist, said it is understandable that Malloy, under severe budget pressure, would grasp for revenue sources already in place rather than propose new taxes. *But, he said, the governor and legislature are putting their credibility with the business community on the line if they promise the sunsetting of taxes that never go away* (emphasis added). "If taxes come and go, I think you can kind of get away with that," Lanza said. "But if the business

community thinks that this one is here to stay, they're going to re-evaluate their position and probably interpret this tax now as essentially a permanent fixture." (see http://www.theday.com/article/20130207/BIZ02/302079573/0/SEARCH).

Dominion has already been told once that the tax would expire. We have no choice but to view this new proposal, continuing the tax for two more years, as the equivalent of imposing the tax permanently. As such, we will not continue to absorb the tax. Regretfully, we will be forced to pass this tax on to consumers.

This issue has gained not only state attention but national attention as well. Without question it will be even harder for state officials to attract or retain businesses if the state's ability to honor its commitments are in doubt based upon recent history.

b. Higher Electric Rates

Connecticut has the dubious distinction of paying the highest electric rates in the continental United States (SEE EXHIBIT A). As mentioned, Connecticut is also the only state in the country with a broad-based tax on the production of electricity. It is counter-intuitive for Connecticut to burden itself with this disadvantage when it is struggling to compete for investment and jobs.

Some might argue that electric rates have come down recently. That's true, but it is for reasons that have little to do with state policy choices. Rates have come down because of record low natural gas prices due to newly produced formations in Pennsylvania, Ohio and Appalachia. More importantly, rates have come down everywhere. The better measurement is how do Connecticut's electric rates compare to other states? The answer, unfortunately, is poorly – they are still the highest in the continental United States. It is also important to note that because Dominion fulfilled its commitment of not passing on the temporary tax to ratepayers the state is not currently feeling the full effects of the tax. Based upon on our commitment, ratepayers have only been subject to about 1/3 of the total tax liability. Without credible debate, if Connecticut re-authorizes this self-imposed tax on the production of electricity Connecticut will continue to compare poorly for the foreseeable future and will see higher rates than would otherwise have occurred had the tax not been extended.

What's more, Connecticut's tax not only has a negative impact on Connecticut ratepayers, but it is also negatively impacting other consumers in the northeast. The wholesale electric market in New England is regional. Therefore, Connecticut's production tax on electric generation is flowing into the retail electric markets in our neighboring states. In fact, Attorney General Martha Coakley (D-MA) and Attorney General Peter Kilmartin (D-RI) responded immediately to Governor Malloy's budget proposal that called for the extension of the production tax on electric generation by urging Connecticut's legislative leaders not to re-authorize this harmful tax

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(SEE EXHIBIT B). They're right. The continuation of the production tax on electric generation will drive electric rates higher in Connecticut and in the northeast generally, thereby disadvantaging both the state and the region in competing for jobs and new investments.

c. Tax Policy

Connecticut's tax on electric generation is a production tax. It is the only state in the country with this type of broad-based tax on the production of electricity. The tax applies simply if you produce electricity. It does not matter if you are profitable or not. This matters because of what's happening in the United States energy markets. For instance, Dominion recently made the difficult decision to shut down and decommission a nuclear power plant that we own in Wisconsin based simply on economics. I raise this, not because we have any current plans of shutting down Millstone, but rather to highlight that Wall Street has taken notice (SEE EXHIBIT C).

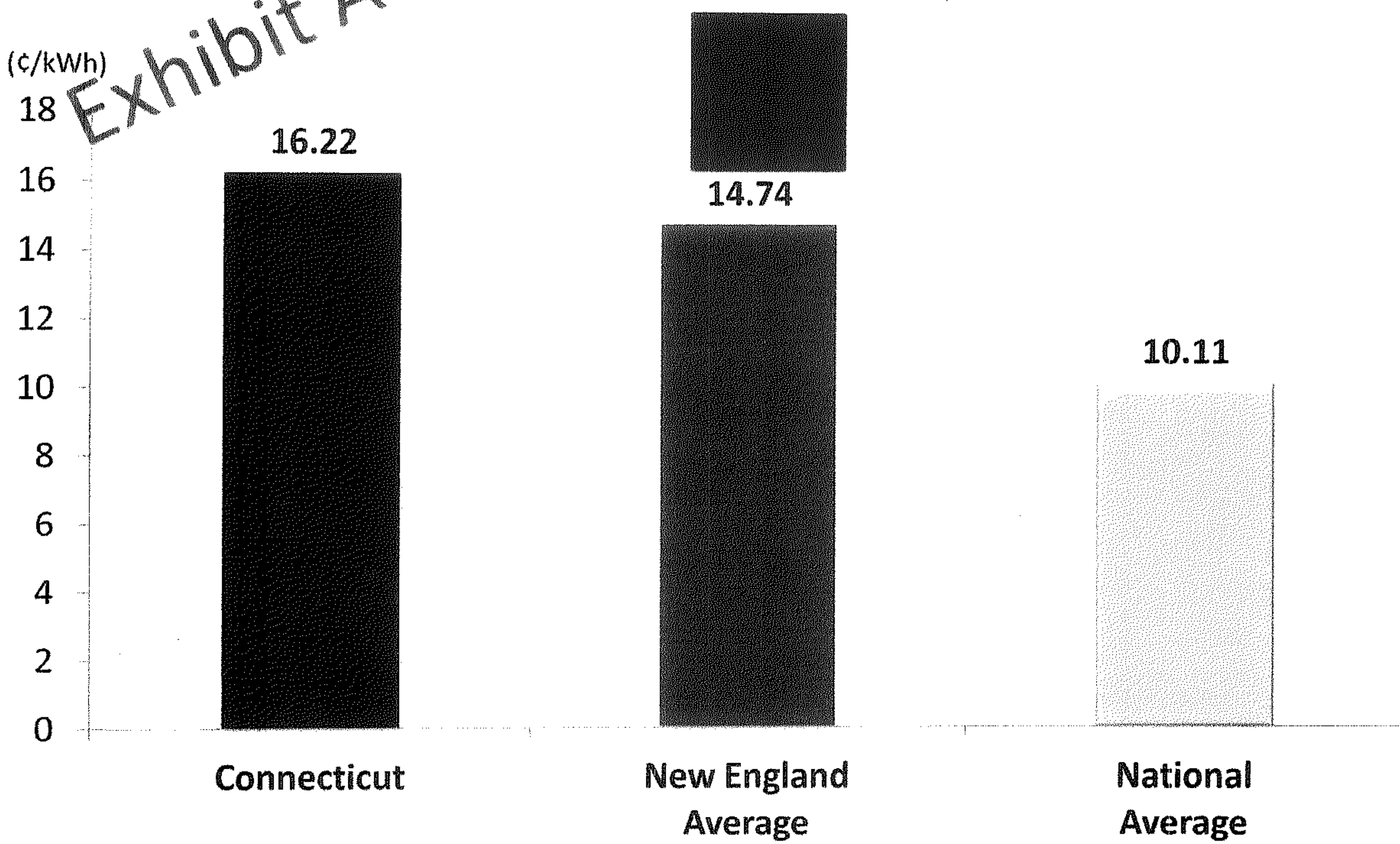
In its analysis, UBS opined that Dominion's announcement regarding its Wisconsin plant is "the canary in the coal mine." Since the research note was published, a utility announced it was shutting down a nuclear power plant in Florida and other plant retirements are projected to happen. Markets are changing and businesses are being forced to make difficult decisions. Perhaps the most significant observation by UBS is that they believe there will be "regulatory and political intervention to save plants" because of the sheer number of jobs they represent and their overall economic impact. Connecticut has taken the opposite approach. It has decided now is a good time to saddle plants facing significant economic pressures with additional costs by adopting, and now proposing to extend, the only broad-based production tax on electric generation in the country. If the tax continues it will have long-term negative impacts on the energy industry in Connecticut.

IV. Conclusion

The legislature should reject Governor Malloy's proposal to re-authorize Connecticut's production tax on electric generation. The legislature should keep its promise and let the tax expire. This will have immediate positive impacts on Connecticut's credibility with businesses and families. Moreover, allowing the tax to expire as scheduled will have the additional positive impact of reducing electric rates. Connecticut has the opportunity to erase $70 million from the cost of producing electricity. Finally, Connecticut cannot afford to adopt production taxes to close budget deficits without putting in the requisite thought of what the long-term impacts might be. Dominion urges you to keep your promise and allow this tax to expire.

CT's Average Retail Electric Rates are the HIGHEST in the continental United States

Exhibit A



Source: Edison Electric Institute, *Typical Bills and Average Rates Report: Summer 2012*. Total retail average rates 12 months ending June 30, 2012.

Exhibit B

Attorney General
Martha Coakley

Attorney General
Peter Kilmartin

February 7, 2013

The Honorable Donald E. Williams
Senate President Pro Tempore
Legislative Office Building, Room 3300
Hartford, CT 06106

The Honorable Brendan Sharkey
Speaker of the House
Legislative Office Building, Room 4100
Hartford, CT 06106

The Honorable Martin M. Looney
Senate Majority Leader
Legislative Office Building, Room 3300
Hartford, CT 06106

The Honorable Joe Aresimowicz
House Majority Leader
Legislative Office Building, Room 4110
Hartford, CT 06106

The Honorable John McKinney
Senate Minority Leader
Legislative Office Building, Room 3400
Hartford, CT 06106

The Honorable Larry Cafero
House Minority Leader
Legislative Office Building, Room 4200
Hartford, CT 06106

Re: **Reauthorization of the Generator Tax: Impact on Ratepayers Throughout New England**

Dear Senate President Pro Tempore, Speaker, and Leaders:

We are writing today to express our ongoing concern with a tax that the State of Connecticut assessed on electricity generators in 2011 and to express our strong desire that Connecticut not reauthorize this tax in 2013. We were disappointed that the Governor included such a proposal in his Fiscal Year 2014-15 budget released this week.

As you may be aware, a 2011 ISO New England study found that because all generators reap a windfall as a result of higher prices caused by the tax on Connecticut generators, New England ratepayers were likely to pay approximately $58 million more to purchase electricity because of the tax, and that approximately 75% of the higher energy costs resulting from the tax were likely to be borne by ratepayers outside of Connecticut. In essence, the ratepayers of our states and others are bearing the burden of higher energy market prices that are the direct result.

New England's relatively high electricity costs are an economic drag on each of our states and New England as a whole. Our Offices work every day to oppose unnecessary and inappropriate electricity rate increases to protect the ratepayers of our states. As our commercial and industrial ratepayers attempt to compete with other businesses across the country and the world, high electricity costs hurt their ability to keep jobs and bring new jobs to the region. Meanwhile, our residential ratepayers are still feeling the effects of the recession and higher electricity costs makes it harder for them to afford other basic needs.

We are sympathetic to Connecticut's budget challenges as our individual states are also looking for creative means to address our challenges. But Connecticut's generator tax is inappropriately raising the rates of our states' families and businesses in order to benefit Connecticut's coffers. We urge you to not reauthorize this tax.

Thank you for your attention.

Cordially,

Martha Coakley
Massachusetts Attorney General

Peter F. Kilmartin

Peter Kilmartin
Rhode Island Attorney General

Cc: The Honorable Dannel P. Malloy, Governor of Connecticut

UBS

Exhibit C

Global Equity Research

Americas

UBS Investment Research

US Electric Utilities & IPPs

Electric Utilities

Sector Comment

Re-Evaluating Merchant Nuclear

2 January 2013

www.ubs.com/investmentresearch

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- **We believe gas and policy mandates threaten nuclear units in 2013**

Following Dominion's recent announcement to retire its Kewaunee nuclear plant in Wisconsin in October, we believe the plant may be the figurative canary in the coal mine. Despite substantially lower fuel costs than coal plants, fixed costs are approximately 4-5x times higher than coal plants of comparable size and may be higher for single-unit plants. Additionally, maintenance capex of ~$50/kW-yr, coupled with rising nuclear fuel capex, further impede their economic viability and mask underlying FCF generation when comparing EBITDA and ascribing EV/EBITDA multiples. Units at particular risk include Exelon's Clinton unit in Central Illinois, and its Ginna plant (CENG) in upstate NY, as well as ETR's Fitzpatrick and Yankee plants. We see risk to primarily deregulated assets in New York and Midwest, which suffer from low capacity payments due to over-capacity and structural regulatory interference, in conjunction with low power prices.

- **Modest upside to estimates on retirement, but negative to sentiment**

We believe moves to decommission nuclear plants early would be accretive to near year EPS, potentially bolstering aggregate cash flows for generators such as EXC and ETR as they adapt to the lower gas price environment. That said, we believe the perception impact of retiring 'leverage' to the upside (and with timing/liabilities on decommissioning plants unclear) may limit upside to shares. Additionally, we believe as investors increasingly appreciate the limited FCF generated by the nuclear portfolios (despite positive EBITDA), financing and paying down associated debt will come into greater focus; this is particularly relevant for Entergy with ~$3 Bn in parent recourse debt. We anticipate the subject of nuclear economics and viability will feature prominently with 4Q12 results.

- **Fukushima related costs remain a key uncertainty into 2013**

Among our greatest concerns for the US nuclear portfolio into 2013 is the risk of greater Fukushima-related costs. While expectations around the need for hardened vents differ, we see cost risks of up to $30-40 Mn/per unit under a worst case scenario; while other estimates suggest costs range in the $15 Mn ballpark. Notably PPL ests. Fukushima-related costs of $50-60 Mn, excluding vents for its 1.6 GW Susquehanna unit. We await the next update from the NRC on hardened vent retrofits in February, with capital likely to be spent by the NRC's 2016 target. Additionally, concerns over once-through cooling regulations pervade (albeit with the primary point of contention around Entergy's Indian Point plant near NYC).

- **Will the policy reaction differ? One thing to close coal, another nuclear.**

With the gas glut dragging into its fifth year, we believe what started as a focus on coal plant retirements has been expanding into growing risk of retirement of all fuel types, particularly nuclear and oil-fired units. With limited public policy support for capacity markets (as demonstrated by efforts in the Midwest ISO and NYISO), and a lack of any policy encouraging a diverse fuel mix, we see this as an unavoidable outcome. That said, given the substantial tax base and employment supported by nuclear plants, as well as the material increases in capacity/power prices resulting from a retirement, we see real potential for regulatory and political intervention to save plants, particularly in IL & NY.

Where are Economics for Nuclear Generators Headed?

We believe 2013 will be another challenging year for merchant nuclear operators, as NRC requirements for Fukushima-related investments become clearer in the face of substantially reduced gas prices. While the true variable cost of dispatching a nuclear plant remains exceptionally low (and as such will continue to dispatch at most hours of the day no matter what the gas price), the underlying issue is that margins garnered during dispatch are no longer able to sustain the exceptionally high fixed cost structures of operating these units. Nuclear units, with their high dispatch factors have among the greatest exposure to gas/power price volatility, as they are price takers. In tandem, nuclear generators have continued to see rising fuel and cost structures of late, with no anticipation for this to abate. Moreover, public policy initiatives, such as Fukushima-related retrofits and mandates to reduce once-through cooling (potentially requiring cooling towers/screens for some units) and new taxes on others (Vermont Yankee, Dominion's Millstone) have further impeded the economics of nuclear. Among the large nuclear generators, we see Entergy's nuclear portfolio as particularly vulnerable to these factors given their disproportionate relicensing risk and generally smaller-sized units. We estimate 2-3 GW of nuclear (2-5 plants) as being at risk of retirement in the next several years, as generators re-assess plant viability in the face of weakening balance sheets.

While retirement announcements may initially be perceived negatively due to the sentiment around the implications to the broader portfolio, we believe these announcements could likely be coupled with *positive* EPS and FCF revisions. While we have identified specific units below that are at risk, understanding the dynamic across nuclear portfolios as it relates to allocated costs remains unclear, as services are clearly amortized across the portfolios. In the near term though, improving clarity around NRC-mandated Fukushima-related safety retrofit costs (including hardened vents) may drive *up* projected capex and costs for nuclear operators such as Exelon and Entergy.

Last year, the term coal-to-gas was pervasive with constant monitoring of this trend; we believe on a going forward basis, the notion will increasingly be gas-switching, as other fuel sources are increasingly pushed out of the market. Notably different from coal plant retirements of 2012, nuclear retirements would have a meaningful impact on aggregate dispatch as these units continue to operate at meaningful capacity factors (in contrast to the clipped run rates of coal units in recent years), driving a greater MW-for-MW impact on coal-to-gas switching.

Cost Inflation: Rising Nuclear Fuel Capex and O&M

Notably, despite declining gas prices, market prices for nuclear fuel have been risen dramatically in recent years, and is projected to continue to rise using Exelon's latest projections. While still relatively insignificant (moving up from $5-6/MWh historically to $8-9/MWh eventually), coupled with underlying cost inflation, impact is We also caution that because nuclear fuel is technically a capex item, which is amortized as used, the income statement lags in reflecting these rising costs, contributing to a de-linking between EBITDA and FCF