

**CONNECTICUT GENERAL ASSEMBLY
COMMITTEE ON ENERGY AND TECHNOLOGY
HEARING ON PROPOSED S.B. NO. 106
FEBRUARY 7, 2017**

**STATEMENT OF THE ELECTRIC POWER SUPPLY ASSOCIATION IN OPPOSITION
TO PROPOSED S.B. NO. 106**

The Electric Power Supply Association (EPSA) appreciates this opportunity to comment on proposed legislation that would have the State of Connecticut unnecessarily funnel consumers' money to some electric power resources in the state at the expense of the millions of consumers picking up the tab, the state's other power suppliers including their employees and communities, and the rest of the regional grid upon which the state depends for electricity.

Celebrating its 20th anniversary in 2017, EPSA is the national trade association representing leading independent power producers and marketers. EPSA members provide reliable and competitively priced electricity from environmentally responsible facilities using a diverse mix of fuels and technologies, including owning, operating and developing major assets in Connecticut and throughout ISO-New England. EPSA members have invested billions of dollars in this state and region at their own risk, not on the backs of consumers. They did so in reliance on decisions in Connecticut and other states to depend on market forces, not cost-of-service regulation, to deliver safe, reliable electricity at the lowest cost to consumers. Power supplied on a competitive basis collectively accounts for 40 percent of the U.S. installed generating capacity. EPSA seeks to bring the benefits of competition to all power customers.¹

¹ These comments represent the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue.

Critical Context: The Dynamic and Interconnected Nature of Electricity

EPSA is mindful of the incredibly exciting times in which we live when it comes to electricity in these early years of the 21st Century. The National Academy of Engineering ranked electrification as the top engineering accomplishment of the 20th Century – ahead of autos in second place, airplanes in third place and the Internet in thirteenth place. EPSA shares the goal of building on that legacy with new technologies that provide greater customer choice and engagement while improving environmental performance at the lowest reasonable cost to consumers.

However, no act of Congress or a state legislature can repeal the laws of physics, electrical engineering or economics. The North American power grid, together with its component regional parts, has been correctly described as the largest single machine in the world. This single “machine” is composed of thousands of power plants deploying a variety of technologies using many different fuels to deliver reliable and affordable electricity over the transmission lines and distribution systems connecting power suppliers to end users. Connecticut and New England are no different.

No state or region has separate power grids, one each for nuclear, renewables, natural gas or any other fuel or technology. Instead, reliable and affordable electric service comes from many electric resources competing with each other within a state and across state lines in interstate commerce in a manner that is tightly linked physically and financially – more so than for any other good or service in the economy. Despite nascent gains in storage and other technologies, electricity is a service provided “just in time” that for the foreseeable future will rely heavily on conventional generation while the transition to new sources unfolds, as ISO-New England just reported.

Thus, proposals to selectively grant *some* resources preferential treatment without regard for the impact of doing so on the rest of the power supply system risk highly adverse and likely irreversible consequences. First and foremost, consumers will pay higher prices for the same electricity under the proposed power purchase agreements (PPAs) than would otherwise be the case, or else for the reasons detailed below those seeking PPAs would not be doing so. More broadly, and at a minimum, investors in resources without PPAs will price more political risk into their decision making. Once investors, developers and plant operators conclude the deck is stacked against them in favor of a few others, even though all compete with each other to be dispatched on a least-cost basis, the damage will have been done. Therefore, informed and prudent policy decisions require a complete analysis of, and appreciation for, *all* the consequences for *all* resources and *all* consumers.

ISO New England president and CEO Gordon van Welie framed the issues in ISO-NE's State of the Grid 2017 presentation just last week on January 30, 2017:

The region's challenge is to find a way to maintain competitive markets that appropriately reward both clean-energy resources and the conventional generators that will be needed for the foreseeable future. The states' initiatives will provide out-of-market financial support for clean-energy resources. To accommodate the resources supported by the states and to maintain the integrity of New England's wholesale markets, changes to the market rules will be required. Without these changes, price signals and revenues for both new and existing resources will be negatively impacted. As a consequence, resources could seek to return to a cost-of-service system. In the cost-of-service system before industry restructuring, all resources were allowed to recover their costs plus a rate of return. Such a system will undermine the benefits of competition and deter the investments needed to maintain resource adequacy.²

² Importantly, Mr. van Welie also reported that, "In 2016, wholesale electricity prices were the lowest since the current markets were launched in 2003. These low prices accurately reflected last year's historically low natural gas prices and mostly mild weather."

Important Lessons on Above Market Subsidies Learned from other States

Connecticut is not alone in receiving overtures from those seeking to vie for specially carved out subsidies and other out-of-market payments rather than compete in the marketplace to serve consumers while working together for any necessary regulatory and market reforms in how wholesale electricity is priced and procured.

EPSA was closely involved in similar debates in New Jersey and Maryland several years ago. More recently, EPSA and its members, in a broad coalition with others, succeeded in blocking attempts by Ohio utilities to obtain preferential long-term PPAs with *their* wholesale generation affiliates at prices substantially above market, even though, like Connecticut, Ohio is a restructured state. EPSA is also well aware of the recent controversies in New York and Illinois over the costly Zero Emissions Credit schemes (ZECs) which value the attributes – jobs, local tax payments, environmental performance and operational characteristics – of some, but not all, sources of electric power. ZECs are poised to drive retail rates for consumers in those states much higher. EPSA's involvement in all of these cases protects the markets and the fundamental reason States joined those markets: to deliver safe, reliable electricity to consumers at the lowest cost.

EPSA can attest to the fact that the more the public learns about schemes such as preferential PPAs and ZEC handouts, the less the public likes or supports them. This was just confirmed by public polling in Ohio. It is noteworthy that the diverse coalitions opposing these out-of-market schemes (for a variety of reasons to be sure) include consumer advocates, industrial and other business users, environmental groups, and those of us willing to continue to put private capital to work to *earn*

revenues from sales to customers, not be *guaranteed* revenues through anti-competitive special treatment. EPSA respectfully submits that policymakers should not rush to judgment when considering fundamental changes to the statutory and regulatory frameworks that govern electricity, because once any damage is done, the consequences can be costly and difficult if not impossible to reverse.

The Legislation's Text and Mechanics Underscore Serious Concerns

EPSA understands that in the absence of new legislative language to be released for S.B. No. 106 soon, witnesses today should look to S.B. No. 344 from last year as the framework for this year. EPSA has done so and below are the association's comments which underscore the concerns expressed in this testimony as to the many negative impacts of such legislation on state and regional electric service. EPSA looks forward to reviewing and commenting on new legislative language for S.B. No. 106, when available, including at subsequent legislative hearings.

S.B. No. 344 (2016) contemplated one or more solicitations from only certain types of narrowly defined electric suppliers for prescribed amounts of defined resources carved out of the bulk power market in which all compete against each other. These resources include class I renewables, large-scale hydropower, nuclear power (effectively defined in a rifle-shot or earmark fashion as apparently applying only to Dominion's Millstone units – more specifics below), and trash to energy. The solicitations would include associated transmission. For the reasons detailed below, the proposed legislation would effectively force Connecticut consumers into involuntarily backstopping Millstone, the state's largest electric generation facility, with consumers getting hit with all the downside and the plant's owners getting all the upside.

Central to understanding the harmful effects of S.B. No. 344 is a careful reading of subsections (e) and (g). Under subsection (e), Connecticut's electric distribution companies would be directed to enter into long-term PPAs for energy, capacity, environmental attributes, and associated transmission for only certain resources. Under subsection (g), energy from the resources awarded long-term PPAs of up to ten years for existing resources and up to twenty years for new resources would be sold into the "relevant market" (defined in subsection (a) as ISO-New England).

By contrast, power suppliers without PPAs operate in much shorter term markets (only day-ahead and real time throughout the 24-hour operating day for the energy they produce and only three years forward for capacity commitments). As a result, consumers gain the benefits of more efficient and desirable options as they become available. This also means they only pay for what they use and actually need to maintain reliability. At present, all competing suppliers generally play by the same rules. However, those armed with a preferential long-term PPA contract backed by consumers under the proposed legislation would be competing in the same regional market as those without them. Imagine a World Series where the American League gets a designated hitter but the National League does not, or a Super Bowl where one team starts at its own twenty-yard line and the other team starts at mid-field.

Policymakers should not take subsection (d) at face value. Under this provision, awarding one or more PPAs nominally requires a finding that doing so is "in the best interest of ratepayers." This finding includes a determination that "benefits" exceed "costs." However, this is a highly subjective and speculative exercise, much like predicting the weather which carries no penalty for being wrong.

Putting aside that “benefits” and “costs” are not defined, what happened in Ohio is that utilities seeking PPAs and other subsidies hired outside consultants to use whatever assumptions are required to show that benefits exceed costs *on paper*. In Ohio, this took the form of using much higher assumptions about future natural gas and power prices that were outside the mainstream of competitive market expectations.

Predictions across any ten or twenty-year time spans, as the terms for the PPAs to be authorized by this legislation allow, are by definition fraught with peril. That is more true for electricity as even a cursory comparison shows how quickly the multi-year forecasts of the professionals at the U.S. Energy Information Administration and private firms prove to be incorrect, often wildly so, even just after a year or two of a multi-year forecast. However, once a PPA is granted for up to ten or twenty years, whether based on assumptions that “cook the books” on costs and benefits, or while well intentioned simply prove to be wrong, there is no recourse for *all* who are required to pay for the PPAs. There is no “do-over,” “back cast” or “true up” if once implemented a PPA’s benefits actually end up below the costs paid by consumers, despite initial forecasts.

The Proposed Legislation Shifts Risks to Consumers and Harms Competition

S.B. No. 344 would shift the many risks associated with certain power plants from private investors to captive consumers. This will occur not only for the resources receiving the PPAs, but eventually for the rest of the resources serving the state. This will happen as the above-market PPAs erode wholesale markets, including by diminishing the size of the market left for non-PPA competitors. The volumes under the PPAs are effectively sheltered from competition and reserved for the holders of the PPAs, which is precisely *why* those eligible for the PPAs strongly favor this legislation.

Reducing competition is rarely if ever good for consumers, but especially so given the dramatic changes underway in how and by whom electricity is produced, consumed and managed. For example, continued improvements in energy efficiency, demand side management, and distributed resources are already reducing how much electricity is bought from the centralized power grid. The PPAs would effectively immunize the owners of the PPA resources from future changes in usage patterns yet require consumers to pay for those resources for decades anyway. Another example is that the increased use of renewables requires greater access to more flexible complementary resources that can ramp up and down quickly in the opposite direction as renewables to maintain reliability. By contrast, nuclear units are generally inflexible and their output cannot be adjusted so rapidly, though they have other advantages. The key point is an evolving power grid needs all types of resources at amounts that will vary over time. Thus, the *system's* needs, not any subset of suppliers' needs, should be paramount.

It is one thing for informed private investors to take on the risks of an evolving power system, but the long-term PPAs under this legislation would allow PPA recipients to bet with consumers' dollars and keep the guaranteed winnings regardless of actual future needs. The proposed PPAs would handcuff the state's customers by locking in price, quantity and technology types for *all* customers of the state's electric distribution companies for up to the next one or two decades covered by the PPAs. This is the classic case of privatizing profits, while socializing across all consumers the costs and risks even if less expensive and more desirable alternatives exist or emerge that are as effective in achieving the state's energy and environmental public policy objectives.

Case in Point: Following the Money at Dominion's Millstone Units

The potential for a long-term PPA covering Millstone deserves especially close scrutiny. While several types of resources are potential recipients of the special PPAs contemplated by the legislation, it is no secret that the largest single beneficiary would be Millstone and thus its parent company, Richmond, Virginia-based Dominion Resources.

For starters, all indications are that Millstone is profitable, at least for many years; Dominion has certainly not disclosed otherwise. Under RTO rules, Millstone is committed to remain in operation until at least 2020, if not longer. Should Millstone face true financial difficulties, there are procedures already in place that include notice requirements, financial disclosures, and a reliability assessment should it contemplate closing, with the potential for a reliability must run (RMR) contract if the facts justify it. The issue is not whether Millstone remains in operation, producing jobs, taxes and other benefits as all power plants do, but importantly at what price will Connecticut consumers pay Millstone's owners and for how long despite the availability of better alternatives.

Dominion Resources' own first quarter earnings call held just last week (February 1, 2017) helps to provide a road map to "follow the money."³ Dominion's Chief Financial Officer Mark F. McGettrick said that:

It has been evident for some time that 2017 will be a challenging year for Dominion to achieve its historical earnings growth rate. Now that we have hedged most of Millstone's 2017 expected output, we estimate a \$10 to \$12 per megawatt hour **reduction** and realized energy prices versus last year, **impacting 2017 earnings** by about \$0.15 to \$0.20 per share. (emphasis added)

³ The audio replay is available via the investor relations section of the company's corporate web site and a verbatim transcript is available at www.seekingalpha.com.

In addition, Mr. McGettrick stated that:

We have hedged 85% of our expected 2017 production at Millstone and 100% of first quarter production. **We also expect to limit our hedging of 2018 production until we see the outcome of pending legislation in the Northeast.** (emphasis added).

Understanding hedging is *essential* to following the money from Connecticut consumers to Dominion's shareholders should this legislation be enacted. EPSC members and other competitive power suppliers, including Dominion Resources, routinely hedge all or a portion of future expected output from their power plants to lock in future revenues by engaging in various risk management transactions with financial and non-financial counterparties. This is essentially a form of insurance. Commercial hedges are not free, involving fees, margin calls, letters of credit, and other detailed financial provisions. Corporate hedging strategies are closely tracked by financial analysts covering the stocks of publicly traded utility companies and power producers. This is precisely why all this was discussed so early on Dominion's earnings call and disclosed in more detail in slides accompanying the earnings release.

When competitive suppliers enter into commercial hedges in arm's length transactions, the risks are on the private parties, namely the power supplier and the entity taking what is essentially a bet on future power prices. Consumers are not impacted as they pay whatever the wholesale price turns out to be. **What Mr. McGettrick revealed about the lack of hedging for Millstone beyond this year shows why Millstone wants legislation enacted in a hurry.** ISO-New England prices are "extraordinarily low" (Mr. McGettrick's words), and have been on a downward trend for several years. Thus, the prices at which Dominion **and other suppliers** can hedge their future output have been coming down and will likely remain lower than in the past.

Now that Dominion has gone out in the marketplace where all power suppliers go to hedge future output, and has done so for almost all of Millstone's expected 2017 generation, Millstone's revenues have dropped significantly by \$10 to \$12 per megawatt hour compared to 2016. The disclosure that the financial impact on Dominion and its shareholders is 15 to 20 cents per share translates into \$94 million to \$125 million in lower corporate earnings. Remember that earnings from Millstone were cited *first* by the company's CFO on the earnings call as the reason why "2017 will be a challenging year for Dominion to achieve its historical earnings growth rate."

The key question is why has Dominion decided **not** to hedge **any** output from Millstone **at all** in 2018, and admitted it did not do so while it awaits your deliberations here in Hartford over this legislation? Dominion is counting on *you* letting *them* make *all* Connecticut consumers into unwitting "counter-parties" to hedge Millstone's output at what must be above market prices or they would not be pursuing it. All kinds of future prices are hedged between private parties every day. Would the legislature step in and rescue any other business should it find market prices not to their liking and require *present and future* consumers to underwrite those other businesses to boost earnings?

Mr. McGettrick's comments about the "very modest increase in power prices in the Northeast" in 2018 due to a "normal slow recovery in the Northeast on power" are very telling. They prove that Dominion is leaving Millstone completely unhedged after this year, waiting for enactment of this legislation, so that it can get a better deal for Millstone's output from the long-term PPAs backed by Connecticut consumers than it could receive from a customary commercial hedge with sophisticated counter-parties in the open market under present and expected future conditions.

If Dominion truly thought that actual market prices in 2018 and later were going to be *higher* than today, or similarly that the price it could hedge its 2018 and later output for today would be higher than what it would receive under a long term PPA, it would have a legal duty to its shareholders to reject such a PPA. Does anyone really believe they would be seeking a long-term PPA if the PPA prices would likely be *lower* than wholesale market prices in ISO-New England? Of course not.

Instead, Dominion is waiting to hedge anything after 2017 while seeking enactment of this special legislative treatment. The only rational reason is precisely because the company thinks that the *PPA prices* for up to ten full years will be *higher* than the market price. The rub is that in order to do so, the PPA would effectively make all the consumers of electricity in Connecticut regardless of their financial ability into involuntary “counter-parties” to this “hedge” for the benefit of a major industry market participant. Is that really in the best interests of Connecticut consumers?

The Proposed Legislation Raises Significant Legal Issues

S.B. No. 344 appears to run considerable risk of ultimately being found to be preempted by the Federal Power Act based on the U.S. Supreme Court’s decision in *Hughes v. Talen Energy Marketing* (2016). In a unanimous opinion in a case in which EPSC filed an amicus brief in support of the Court upholding unanimous lower court decisions finding the Maryland program preempted and therefore unlawful, the Court struck down a scheme much like S.B. No. 344. Maryland, just like S.B. No. 344, directed electric distribution companies to enter into long-term PPAs backed by all their customers for statutorily defined “special” resources, sheltering *only them* from the stormy seas of competitive market forces and technological changes.

Millstone has what is known as “market-based rate authority” from the Federal Energy Regulatory Commission pursuant to the Federal Power Act. As was the case in Maryland, S.B. No. 344 requires that the output subject to the PPAs be sold into the FERC-jurisdictional wholesale markets. This and other features of the proposed legislation that would interfere in the rates and terms of wholesale power transactions would most likely constitute impermissible “tethering” per the Supreme Court in *Hughes*. At a minimum, there will be years of litigation, amply demonstrated by how long it took the Maryland case cited above to be decided. The same held true for a parallel case involving New Jersey in which the Supreme Court eventually let stand a lower court ruling that New Jersey’s statutory scheme was preempted. The controversy over nuclear ZECs in New York has already resulted in contentious federal litigation and Illinois is likely next.

If ultimately preempted, state legislation such as S.B. No. 344 would only have sent a chilling message to private investors otherwise willing to develop and maintain in-state resources without long-term PPAs, while not gaining any of the supposed “benefits” of the PPAs. Make no mistake about it, ringing the bell signaling higher prices at less risk for some competitors, while leaving the rest of us to rely solely on historically low revenues from a challenging and difficult marketplace, is not reversible once the bell is rung.

At a minimum, legislators should ask probing questions about these legal and other issues, while closely following developments in pending court cases. The legislature certainly has the time to carefully consider these issues and should take the time to do so before a costly mistake is made.

Conclusion

In conclusion, EPSA and its members greatly appreciate the public policy leadership that Connecticut has displayed over the years and continues to exercise in promoting strong energy and environmental policies consistent with the state's public policy objectives. EPSA members and their employees have contributed to (and will continue if the ground rules allow) to help achieve these successes by investing in competitive power resources here and throughout New England. These successes include helping to address climate change through lower greenhouse gas emissions, which has been aided by Connecticut's leadership role in the Regional Greenhouse Gas Initiative (RGGI) now undergoing a periodic review to consider improvements.

At the same time, EPSA also appreciates that more thought and action must occur in reconciling wholesale market rules and operator practices with legitimate state public policy goals in New England and elsewhere as to energy and the environment. The ISO-New England wholesale markets are delivering reliable service at historically low prices, which challenges the economics of *all* market participants on the supply-side, *not just* those who would be eligible for special contracts under S.B. No. 344.

In the final analysis, everyone's employees, customers, suppliers, and the communities in which they operate in Connecticut and throughout New England are deserving of fair treatment and consideration for the many valuable contributions *they* make to electric service and the economy of Connecticut. The proposed legislation seeks to grant special treatment to some resources at the expense of consumers and the rest of the state's power suppliers.