STATE OF NEW HAMPSHIRE

Inter-Department Communication

DATE: July 10, 2015
AT (OFFICE): NHPUC

FROM: Alexander F. Speidel, Staff Attorney

SUBJECT: Gas Capacity Acquisitions by N.H. Electric Distribution Utilities

TO: George R. McCluskey, Assistant Director, Electric Division
Interested Stakeholders (IR 15-124)

Staff welcomes comments regarding this memorandum, e-mailed to alexander.speidel@puc.nh.gov, by August 10, 2015 (during the pendency of the Staff investigation and for incorporation into Staff's September 15 Report); these comments will be posted here:
http://puc.nh.gov/Electric/Investigation_into_Potential_Approaches_to_Mitigate_Wholesale_Electricity_Prices.html

In the context of the ongoing Staff Investigation into Potential Approaches to Ameliorate Adverse Wholesale Electricity Market Conditions in New Hampshire, docketed in Docket No. IR 15-124, the question has been raised by certain stakeholders: Do New Hampshire's Electric Distribution Utilities (EDCs), under existing New Hampshire law, have the corporate authority to enter into contractual arrangements to acquire pipeline, and/or Liquefied Natural Gas (LNG)-related, capacity to benefit their customers? If so, how can the costs of such arrangements be justified, and recovered from EDC customers through Commission-approved rates?

In examining this question from a legal perspective, Staff applies traditional New Hampshire principles of statutory interpretation, namely: the New Hampshire Supreme Court first looks to the language of a statute itself, and, if possible, construes that language according to its plain and ordinary meaning; the Supreme Court interprets statutes and regulations in the context of the overall statutory and regulatory scheme and not in isolation, with a goal to apply statutes in light of the Legislature's intent in enacting them, and in light of the policy sought to be advanced by the entire statutory and regulatory scheme; the Supreme Court construes statutes, where reasonably possible, so that they lead to reasonable results and do not contradict each other; when interpreting a statute, the Supreme Court must give effect to all words in the statute and presume that the legislature did not enact superfluous or redundant words; the Supreme Court reviews legislative history to aid its analysis when statutory language is ambiguous or subject to more than one reasonable interpretation. (*See Appeal of Old Dutch Mustard Co., Inc.*, 99 A.3d 290 (N.H. 2014); *State v. Collyns*, 99 A.3d 300 (N.H. 2014)).

This memorandum will not directly address the economic questions surrounding the advisability of EDCs making investments in gas capacity on behalf of their customers, presumably to reduce wholesale electric power costs prevailing in New England, beyond the role of such analysis as a factor in Commission decision-making. Also, this memorandum will focus on New Hampshire law, leaving aside the question of federal preemption (under the Federal Power Act, Natural Gas Act, and allied statutes) for now. Staff is of the opinion that any EDC participation in gas-capacity acquisition should be voluntary, as a private-sector business decision of each EDC, and not mandated by the Commission *a priori*. Staff considers such voluntary, permissive participation to pose less of a litigation risk on the question of federal preemption than a State-mandated program, in that the Commission's role in the wholesale markets in a voluntary approach would be in its traditional role as regulator, rather than as a direct market participant directionally enacting a specific approach. On this basis, Staff analyzes the potential legal issues faced by the Commission in deciding whether to approve a hypothetical EDC petition to acquire gas capacity, and recovery of related costs, in sequence.

Issue 1: Does the Electric Utility Restructuring statute (RSA Chapter 374-F) prohibit EDCs from acquiring gas capacity?

The threshold question regarding any potential proposal for gas capacity acquisition by a New Hampshire EDC is whether the Electric Utility Restructuring statute, which was originally enacted in 1996 with subsequent amendments, categorically prohibits such activity. RSA 374-F:3 outlines the Restructuring Policy Principles meant to govern the Commission's approach to electric market matters. RSA 374-F:3, III plainly states: "Generation services should be subject to market competition and minimal economic regulation and at least functionally separated from transmission and distribution services which should remain regulated for the foreseeable future. However, distribution service companies should not be absolutely precluded from owning small scale distributed generation resources as part of a strategy for minimizing transmission and distribution costs." An acquisition of gas capacity, of the type referred to by certain stakeholders, most certainly does not qualify as a small-scale distributed generation resource. The Commission may determine that this Restructuring Policy Principle is prescriptive and overrides any other statute related to the Commission's jurisdiction, including any other Restructuring Policy Principle. On this basis, the Commission could reasonably conclude that an EDC acquisition of gas capacity for the use of gas-fired generators and, by extension, the benefit of EDC customers, would violate the principle of separation of distribution and generation functions, and is therefore prohibited.

However, the Restructuring Policy Principle presented in RSA 374-F:3, III related to separation of generation and distribution functions does not stand in isolation. RSA 374-F:3, I states: "Reliable electricity service must be maintained while ensuring public health, safety, and quality of life." RSA 374-F:3, VI: "A nonbypassable and competitively neutral system benefits charge applied to the use of the distribution system may be used to fund public benefits related to the provision of electricity. Such benefits, as approved by regulators, may include, *but not necessarily be limited to*, programs for low-income customers, energy efficiency programs, funding for the electric utility

industry's share of commission expenses pursuant to RSA 363-A, support for research and development, and investment in commercialization strategies for new and beneficial technologies" (emphasis added). RSA 374-F:3, XII: "New Hampshire should work with other New England and northeastern states to accomplish the goals of restructuring. Working with other regional states, New Hampshire should assert maximum state authority over the entire electric industry restructuring process." RSA 374-F:3, VIII: "Continued environmental protection and long term environmental sustainability should be encouraged….As generation becomes deregulated, innovative market-driven approaches are preferred to regulatory controls to reduce adverse environmental impacts."

The Commission may find that a proposal by an EDC to acquire incremental gas capacity, for the use of gas-fired generators, could enhance power system reliability (especially in winter when existing gas capacity is constrained), and thus help the EDC meet its duty to provide reliable service under RSA 374:1; provide public benefits related to the provision of electricity (e.g., less price volatility, enhanced winter reliability, etc.); and serve as an element of New England-wide cooperation to reduce gas capacity constraints in order to provide for the displacement of oil and coal-fired electric generation by cleaner gas-fired electric generation. If the Commission were to decide that these goals were congruent with various Restructuring Policy Principles, and that these principles were not overridden by the single principle of generation-distribution separation in RSA 374-F:3, III, it could conclude that RSA Chapter 374-F does not preclude such an EDC capacity purchase. Furthermore, an EDC making such a proposal could argue that provision of gas capacity to unaffiliated merchant generators does not violate the functional separation principle of RSA 374-F:3, III in the first instance, in that New Hampshire EDCs would not actually acquire the gas capacity for their own use, but rather, would make such capacity available for the use of merchant generators in a bilateral transaction. If the Commission were to accept this broader approach, it could rule that EDC acquisition of gas capacity for the benefit of gas-fired generators does not violate RSA Chapter 374-F.

In addition, RSA 374-F:3, V(e) offers a path for EDCs to potentially seek approval of gas capacity acquisition programs in the context of their provision of Default Service supply to their customers: "Notwithstanding any provision of subparagraphs (b) and (c), as competitive markets develop, the commission may approve alternative means of providing transition or default services which are designed to minimize customer risk, not unduly harm the development of competitive markets, and mitigate against price volatility without creating new deferred costs, if the commission determines such means to be in the public interest." If the Commission were to evaluate the costs and benefits of a gas capacity acquisition program designed to benefit EDC's Default Service customers with lower electricity costs, and found that such means were to be in the public interest using these criteria, it would be a finding embedded within the terms of the Restructuring Statute itself, and could likely be upheld against challenge under RSA 374-F:3, III.

Issue 2: Do New Hampshire EDCs have the corporate power under RSA Chapter 374-A, and allied statutes, to acquire gas capacity?

RSA Chapter 374-A is an act, originally passed in 1975, "Authorizing Electric Utilities to Participate in Electric Power Facilities." Under RSA 374-A:1, II, "Domestic electric utility" is defined as "an electric utility resident in, or organized under the laws of this state." All of New Hampshire's EDCs would therefore qualify as "Domestic electric utilities." Further, "Electric power facilities" are defined under RSA 374-A:1, III as "generating units rated 25 megawatts or above and transmission facilities rated 69 kilovolts or above planned to be placed in service in New England after June 24, 1975."

RSA 374-A:2, entitled "Powers of Domestic Electric Utilities," states: "*Notwithstanding any contrary provision of any general or special law* relating to the powers and authorities of domestic electric utilities or any limitation imposed by a corporate or municipal charter, but subject to the conditions set forth in this chapter, a domestic electric utility shall have the following additional powers:

I. To jointly or separately plan, finance, construct, operate, maintain, use, *share costs of*, own, mortgage, lease, sell, dispose of *or otherwise participate in* electric power facilities or portions thereof *within or without the state* or the product or service therefrom or securities issued in connection with the financing of electric power facilities or portions thereof; and

II. To enter into and perform contracts and agreements for such joint or separate planning, financing, construction, purchase, operation, maintenance, use, *sharing costs of*, ownership, mortgaging, leasing, sale, disposal of *or other participation in electric power facilities, or portions thereof*, or the product of service therefrom, or securities issued in connection with the financing of electric power facilities or portions thereof…." (emphasis added).

Under the plain language of RSA Chapter 374-A, it would appear that New Hampshire EDCs are granted the corporate power to share the costs of, or otherwise participate in, electric generating units rated 25 megawatts or above, or portions thereof, both inside and outside of New Hampshire. Arguably, the contracting for gas capacity from pipeline and/or LNG enterprises, on behalf of electric generators of at least 25 MW, would constitute permissible contracting under RSA 374-A:2, II for the sharing of costs of, and a form of other participation in, such electric power facilities. Furthermore, the actual transfer of such capacity rights, and the payment therefor, would arguably be allowable sharing in the costs of, or otherwise participating in, such electric power facilities under RSA 374-A:2, I. These provisions were not repealed twenty years later, with the advent of restructuring, but have rather remained as part of the statutory scheme administered by the Commission. Staff anticipates that the Commission could consider RSA Chapter 374-A as an ongoing basis for authority to act by New Hampshire EDCs, and that if the Commission initially rules that EDC participation in a gas capacity acquisition program did not violate the Restructuring Principles of RSA Chapter 374-F, RSA Chapter 374-A would grant authorization to the EDCs to enter into such activities, subject to Commission review.

As part of its analysis of RSA Chapter 374-A, Staff engaged in research at the New Hampshire State Archives regarding the 1975 legislative history in this enactment,

which is scanty. Staff does note that references were made to New Hampshire EDCs (then vertically integrated) being granted authorization to participate in the New England Power Pool (NEPOOL) through the statute, which is to be expected. However, there were more general public policy considerations at work. In the words of Senator Stephen W. Smith, on May 29, 1975, "I feel that what [RSA Chapter 374-A] will do as far as the consumer is concerned is that in the long haul it is going to allow the consumer to have adequate power facilities so that we can have electricity in our homes and factories and other places. I think it is going to give the consumer the ability to have this power and in the long run at a lower rate." (N.H. Senate Journal, 29 May 75, at p. 971). Staff considers RSA Chapter 374-A's survival into the current "restructured" age to be worthy of attention, in that it potentially offers EDCs the ability to engage in creative approaches towards reducing their customers' energy costs through the acquisition of gas capacity resources, as part of the costs of electric power facilities. Within the language of RSA Chapter 374-A itself, there is no affirmative limitation on the powers enumerated to the NEPOOL context alone, and the savings clause "[n]otwithstanding any contrary provision of any general or special law…" still stands, which should be a factor for consideration by the Commission when interpreting RSA Chapter 374-A in light of the Restructuring Principles of RSA 374-F.

Though Staff is of the view that RSA Chapter 374-A provides New Hampshire EDCs with the most foursquare statutory authorization for entering into gas capacity activities, such as that is available, additional indirect statutory support may be found at RSA 374:57, titled "Purchase of Capacity." The "capacity" in question is not specified as either gas or electric capacity: "Each electric utility which enters into an agreement with a term of more than one year for the purchase of generating capacity, transmission capacity or energy shall furnish a copy of the agreement to the commission no later than the time at which the agreement is filed with the Federal Energy Regulatory Commission pursuant to the Federal Power Act or, if no such filing is required, at the time such agreement is executed. The commission may disallow, in whole or part, any amounts paid by such utility under any such agreement if it finds that the utility's decision to enter into the transaction was unreasonable and not in the public interest." RSA 374:57. It could be argued that this reporting requirement does not only pertain to electric transmission capacity arrangements by New Hampshire EDCs, but to gas transmission capacity arrangements as well, which would dovetail with the corporate powers of RSA Chapter 374-A, and establish a public interest standard for a Commission review proceeding.

Issue 3: Could New Hampshire EDCs recover the costs associated with gas capacity acquisition in rates under RSA Chapter 378 and allied statutes?

If the Commission were to rule, upon receiving an EDC proposal, that (1) participation in capacity-purchase arrangements by New Hampshire EDCs did not violate the Restructuring Principles of RSA Chapter 374-F, and (2) the corporate powers granted to EDCs by RSA Chapter 374-A did embrace such activities, and that exercise of such powers would be in the public interest per RSA 374:57, the Commission would then be left with the question of whether the costs of such programs could be recovered from

EDC ratepayers, and under what terms. RSA Chapter 374-A itself, within RSA 374-A:6, III, specifies: "In addition to ownership, sole or joint in electric power facilities, the commission shall include in the rate base of a domestic electric utility any investments, including securities, prepayments or other investments, acquired by it in connection with its participation in an electric power facility within or without the state." This provision contemplates cost recovery for investments made by New Hampshire EDCs pursuant to RSA 374-A:2 through rates, without specifying the rate category from which this recovery would be made. Arguably, a recurring expense item for gas capacity reservation by an EDC could qualify as an "investment" for inclusion in rate base in this context.

Further guidance may be found in RSA 374:2, which states: "All charges made or demanded by any public utility for any service rendered by it or to be rendered in connection therewith, shall be just and reasonable and not more than is allowed by law or by order of the public utilities commission. Every charge that is unjust or unreasonable, or in excess of that allowed by law or by order of the commission, is prohibited." RSA Chapter 378 further elaborates on the Commission's ability to adjudicate proposed rates for all utilities, and, under RSA 378:8, establishes that the burden of proof for higher rates lies with the utility petitioning for such rates.

Broad discretion is assigned to the Commission in the fixing of rates. This memorandum will not serve as a primer for utility rate regulation in New Hampshire; however, Staff has developed a framework for analyzing issues that would arise from an EDC seeking rate recovery for a gas-capacity related recurring cost or expense. Initially, though RSA 374-A:6, III does authorize the addition of qualifying EDC investments in electric power facilities into rate base, which could potentially embrace a recurring expense item for gas capacity reservation, Supreme Court precedent has held that "[p]roperty not devoted to the production and delivery of energy to the consumer is not includable in the rate base." *Legislative Utility Consumers' Council v. Public Service Co.*, 119 N.H. 332, 354 (1979). It could be argued that this principle would override the authorization of RSA 374-A:6, III for inclusion of gas-capacity related costs in rate base, in that there would be too tenuous a link between the electrical energy delivered to EDCs' customers and the gas capacity proffered to merchant generators by the EDCs. This problem would be less attenuated if an EDC were to rely on RSA 374-F:3, V(e) alternative default service provision authority, in that the EDC could more firmly argue that lower Default Service rates made possible through a gas capacity arrangement with merchant generators (through, for instance, paired energy supply contracting arrangements with merchant generators/suppliers receiving the gas capacity) would result in direct delivery of lower-cost energy to the EDC's Default Service customers, and thereby be in the public interest. This, in turn, could justify rate recovery for such a program through Default Service rates approved by the Commission, with a fairly tight nexus between the gas-capacity acquisition activities of the EDC and the energy supplied to Default Service customers.

However, an EDC seeking recovery of gas capacity acquisition costs through distribution rates (as opposed to Default Service rates) could argue that, in a seamless

ISO-New England electricity supply market, the provision of gas capacity to merchant generators in the region would still be "devoted to the production and delivery of energy to the consumer," in that all EDC distribution customers draw energy from the same collective ISO-New England system. Furthermore, such an EDC could argue that the lower electricity prices resulting from a gas-capacity acquisition program would benefit all classes of distribution customers, including those taking supply service from competitive suppliers, insofar as all EDC customers are exposed to ISO-New England prevailing market conditions to some extent. Conversely, competitive suppliers or other stakeholders could raise objections to such an approach on the basis that such intervention into ISO-New England pricing structures could impair the value of their business arrangements with their wholesale upstream suppliers and/or merchant generators, and their competitive position in the supply market generally, and thereby violate the Restructuring Principles and the "just and reasonable" standard of ratemaking. In seeking to expand the Commission's ability to develop novel ratemaking approaches to these questions, authority could be sought by an EDC under RSA 374:3-a (Alternative Regulation), which states: "Upon petition of a regulated utility or upon its own initiative and after notice and hearing, the public utilities commission may approve alternative forms of regulation other than traditional methods which are based upon cost of service, rate base and rate of return, provided that any such alternative results in just and reasonable rates and provides the utility the opportunity to realize a reasonable return on its investment."

In any event, Staff has developed the following list of preliminary criteria, subject to future expansion, for the assessment of whether a proposal by a New Hampshire EDC for the acquisition of gas capacity resources for provision to merchant generators, and recovery of related costs, would be in the public interest, and result in just and reasonable rates for approval by the Commission:

I. There must be a clear, verifiable cost-benefit advantage for EDC customers that would result from enactment of the gas capacity program. Such an advantage should be demonstrated through hard pricing data and quality studies. If the program is limited to recovery from Default Service customers (authority sought pursuant to RSA 374-F:3, V(e)), rate reductions for Default Service must be demonstrated. If rate recovery is sought from all EDC customers, through distribution rates, electricity cost savings for all customers, including those taking competitive supply, must be demonstrated.

II. In order for rate recovery to be held just and reasonable, and the program costs in rate base to be considered prudently incurred, it is imperative that EDC gas capacity-acquisition arrangements with pipeline and/or LNG counterparties be accomplished at arm's length, in compliance with affiliate transaction rules, and through RFP-based project selection processes applying least-cost and reliability criteria in EDC decision-making.

III. An EDC seeking Commission authority to engage in gas-capacity acquisition should demonstrate that such activity would not result in "re-vertical

integration" of the ISO-New England wholesale electricity market, would not result in undue competitive harms to New Hampshire competitive electric suppliers, nor cause undue competitive harms to wholesale electric market participants generally. RSA 374-F:3.

IV. An EDC seeking authority to engage in such gas-capacity arrangements must demonstrate that the proposed program is unlikely to result in stranded, or deferred, costs for EDC customers.

Staff expects to provide more legal analysis of these and related matters in its September 15 Report.