



141 Tremont St., Boston, MA 02111

(t) 617-902-2354 (f) 617-902-2349

www.nepga.org

March 7, 2008

VIA HAND DELIVERY

Senator John W. Fonfara, Co-Chair
Representative Steve Fontana, Co-Chair
Energy and Technology Committee
Room 3900, Legislative Office Building
Hartford, CT 06106

RE: New England Power Generators Association, Inc.'s comments on House Bill No. 5783; An Act Concerning Electricity Market Incentive Rebates.

Dear Chairmen Fonfara and Fontana:

The New England Power Generators Association, Inc. ("NEPGA") hereby respectfully files these preliminary comments in opposition to House Bill No. 5783; *An Act Concerning Electricity Market Incentive Rebates*. NEPGA is the largest trade association representing competitive electric generating companies in New England. NEPGA's member companies represent approximately 25,000 megawatts of generating capacity throughout New England, and over 7,300 megawatts of generating capacity in Connecticut, representing the vast majority of electric generating capacity in Connecticut. NEPGA's mission is to promote sound energy policies which will further economic development, jobs, and balanced environmental policy. NEPGA requests that all further correspondence, communications and other documents relating to this matter be served upon the undersigned.

NEPGA strongly disagrees with the language included in HB No. 5783 that provides, *inter alia*, as follows:

1. The Connecticut Department of Public Utility will **determine the cost of service**, including a reasonable rate of return on equity, of each power generation plant in the state that uses uranium fuel or coal to produce all or part of its electric output.
2. The electric distribution company for the territory in which the power generation plant is located **shall offer to enter into a contract with the power generation plant** of a term of between five and fifteen years.

3. If a power generation plant **declines** to enter into a contract with an electric distribution company approved by the department pursuant to subsection (b) of this section, **such power generation plant shall be subject to an annual market incentive recovery charge.**

Beyond the impact that this tax proposal has on any industry, or narrow subset thereof, the very design of this thinly veiled windfall profit tax is flawed on the basis of fundamental economic policy. Windfall profits taxes have been unsuccessful when similarly thrust upon other competitive markets at a time when consumers had an increasing demand for the very products that those markets produced. For instance, a windfall profits tax placed upon oil production in 1980 proved unproductive in generating sufficient tax revenue and, more disconcertingly, reduced domestic oil production to its lowest level in twenty-years.¹ The same result should be anticipated in any industry where the incentives for production are diminished. Additionally, while the public may be more receptive to this approach for certain industries, nothing prevents this scheme of taxation from spreading to all industries based upon the mere perception of unfair profits.

Furthermore, this approach has been repeated in various forums and sessions despite the clear legislative and administrative intent to proceed with the existing competitive electric marketplace.² Most recently, the Connecticut Legislature denied a similar windfall profit tax on electrical generators last session. On September 12, 2005, Richard Blumenthal, Attorney General for Connecticut filed a complaint against ISO-NE requesting that the FERC amend ISO-NE's tariff, Market Rule 1, to require that all electric generation facilities in Connecticut be compensated on a cost-of-service basis, through reliability-must-run agreements. FERC denied that complaint in part on the basis that the locational marginal price design in New England provides the appropriate price signals indicating the value of additional resources in each area.³

1. HB 5783 Represents a Combined Scheme of Taxes and Subsidies that Unfairly Benefits Connecticut Electrical Distribution Companies by Forcing Generators into Below Market Contracts for the Sole Benefit of Connecticut Suppliers and Imposes An Undue Burden On Interstate Commerce.

¹ Thorndike, Joseph, J.; Historical Perspective: The Windfall Profit Tax – Career of a Concept, November 10, 2005.

² Interestingly, when New Hampshire proposed a similar plan for taxing Northeast Utilities' Seabrook, N.H., nuclear power plant, Connecticut brought suit at the U.S. Supreme Court claiming that the tax would add millions of dollars to its residents' electric bills, while New Hampshire residents wouldn't be affected because of various offsetting tax credits and refunds. *See, Connecticut v. New Hampshire*, 113 S. Ct. 1837 (1993); *See also, New Hampshire Alters Tax Plan for Seabrook, Averting Court Fight*, Wall Street Journal. (Eastern Edition). New York, N.Y.:Apr 14, 1993. p. B11.

³ *See*, 117 FERC ¶ 61,038, page 28.

The basic premise of this proposed legislation violates the fundamentals of the Commerce Clause by granting a preference to in-state purchasers of electricity and inequitably taxing economic activity that reaches across state lines. The legislation requires generators to sell their electricity at rates that are determined by regulatory oversight as opposed to those determined by the market. The electricity that is purchased through these out of market rates is used for **local distribution only**, thereby solely benefitting Connecticut electricity consumers. Electricity that is not sold to local distribution companies for in-state distribution through these out of market contracts can be sold interstate only after the imposition of a **market incentive recovery charge**. Therefore, the taxes imposed under the regime have an uneven effect on in-state suppliers of electricity over out of state suppliers of electricity and results in a per se violation of the Commerce Clause.

The Commerce Clause implications of this legislation are considerably broader than the very basic encroachments referenced herein. It is incumbent upon all organizations involved in interstate and intrastate commerce to dutifully maintain the protections afforded by the Commerce Clause. NEPGA maintains the right to expand its constitutional analysis in the event that HB 5783 proceeds through the legislature.

2. In the Absence of Changed Circumstances HB 5783 Represents a Collateral Attack to the Competitive Market Fundamentals Promulgated by the Legislature.

Under the competitive market construct implemented in Connecticut, retail customers may choose their retail energy suppliers (*i.e.*, generators, marketers or brokers) from among several competitive suppliers operating within the state, while the distribution portion remains regulated.⁴ Electricity rates are based on the competitive market price chosen by the consumer, plus a regulated delivery rate imposed by the distribution companies. The public policy behind competitive procurement of power supplies is implicitly sensible in that it drives innovation and efficiency in the power sector, more accurately reflects the underlying value of electrical production, including environmental externalities, and encourages the development of new energy infrastructure and necessary environmental improvements to existing energy infrastructure without subjecting ratepayers to the risk of stranded costs or cost overruns. The efficient energy infrastructure improvements procured through the competitive market have led to a decrease in fuel-adjusted electricity prices in New England of approximately 7% from 2000 to 2006,⁵ and an increase in generator availability.⁶ This legislative proposal represents an unfortunate reversal of energy policy away for competitive market principles.

⁴ Conn. Gen St. Ch. 283 §16-244; effective July 1, 1998, P.A. 98-28 replaced existing provisions of Connecticut statute regarding authority of corporations to sell, transmit, convey and deliver electricity.

⁵ *2006 Annual Markets Report*, ISO-NE, June 11, 2007 at 40, 41. The fuel-adjusted average electric energy price normalizes the electricity market clearing prices for the variation in the prices of fuels used by price-setting generating units.

⁶ *2006 Annual Markets Report*, ISO-NE, June 11, 2007, Page 5.

3. HB 5783 is Erroneously Premised on the Notion that Connecticut is a Separate and Distinct Market.

Connecticut is only part of a larger, highly interdependent, regional wholesale market and relies on substantial imports from neighboring states to meet its load obligations. ISO-NE operates the six-state regional market as a single control area, simultaneously benefiting all participating states with a diverse portfolio of generation. NEPGA recognizes the issues surrounding the rising electricity costs throughout the region. However, rising electricity costs have not been a signal of failure of the regional competitive markets; rather, rising costs are a direct result of rising fuel and other commodity costs, dependence on relatively expensive natural gas as a fuel source, and lack of indigenous energy resources. Rising costs have been experienced proportionately by all market participants.⁷ The majority of generation resources in New England are fueled by natural gas⁸, and natural gas prices have risen dramatically as a result of the same global influences that have led gasoline prices to be extremely volatile in recent months and increase by approximately 55%.⁹ The rise in fuel prices, and corresponding increase in consumer electricity costs, has illustrated an efficient market in which competition occurs on the basis of true marginal costs.

4. HB 5783 Would Undermine Bilateral Contracts and Would Impose a Substantial Impairment of the Contractual Relationships.

NEPGA maintains that voluntary forward power contracting by buyers, combined with purchases from a spot market with demand response is an efficient and low-cost way of meeting customer needs because both buyers and sellers can hedge risk as well as adapt to actual real-time supply and demand conditions according to their unique needs. However, the respective business objectives of buyers and sellers should direct the form and terms of such long-term contracts, and these will necessarily vary greatly for each contract scenario. Unlike shorter-term contracts, which exist today and enhance the liquidity of markets by lowering transaction costs for standardized products, it is unlikely that a single standardized product will suffice for any party's long-term needs. Therefore, it is vital that all contracting parties have the flexibility to

⁷ It is important to recognize that price increases have in no way been limited to restructured states. Since 1999, electricity prices have generally increased the same (34%) across states with organized markets and across those without such markets. In particular, increases in five selected regulated states (Nevada, Florida, Mississippi, Louisiana, and Oklahoma) ranged from 39% to 62% during this same time. Open Letter to Policy Makers from Vicky A. Bailey, et al, Former Chairs and Commissioners of the Federal Energy Regulatory Commission (May 31, 2007)

⁸ Approximately 43% of the generating capacity in New England uses natural gas as a primary fuel. ISO-NE, 2005 Regional System Plan.

⁹ Natural gas prices increased 51.5% between 2002 and 2003, 10.5% between 2003 and 2004, and 37.6% between 2004 and 2005. *Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy*, The Electric Energy Market Competition Task Force, 2006 at 41.

behave in a commercially responsible way, and the market should serve as the ultimate arbiter of whether the contracting decision was prudent.

5. HB 5783 Would Reduce Liquidity in the Wholesale Markets and Shift Risk to Connecticut consumers.

Coal and nuclear units provide increased liquidity, price certainty and reliability to the New England electricity market. A reduction in liquidity that would result by forcing these facilities into out of market contracts would dampen price signals for forward contracting thus gutting the pricing arrangements in existing contracts. Of greater concern for Connecticut consumers is forcing the electric distribution companies into fixed contracts with a mechanism that will ensure the distribution companies revenues sufficient to cover the costs of the long-term contracts in the event that the transaction becomes imprudent.¹⁰ The mechanism provided to the Utilities under existing Connecticut law shifts the uneconomic cost of one contract onto the electric consumers via subsequent electricity purchase arrangements.¹¹ Whereas in a competitive market cost recovery is not guaranteed, rather generators are merely guaranteed the *opportunity* to recover their costs through the competitive market.¹² The more prudent energy policy involves incenting competitive market participants to enter into long-term, market based contracts that don't risk imposing stranded costs onto the consumers.

6. HB 5783 Would Discourage Investment in New Generation in Connecticut.

Peak demand for electricity in New England is projected to grow nearly two percent per year over the next decade, and Connecticut's growth in demand will grow at a slightly larger rate than the aggregate of the region.¹³ This requires adding the equivalent of roughly a 500-MW power plant to the New England system every year.¹⁴ Based on ISO-NE's projections, Connecticut needs to provide for a prudent mix of energy resources to accommodate the projected growth.

Developing markets thrive on certainty and abhor the insecurity that is created by constantly changing tax regulations, or the threat thereof. Between 2000 and 2004, private

¹⁰ HB 5783 § (c) provides that "the costs and administrative costs of any contracts described in this section shall be recovered from ratepayers through nonbypassable federally mandated congestion charges or other nonbypassable charges."

¹¹ See, Conn. Gen. St. 16 § 245(e)(f) (1) "The department shall calculate the stranded costs for long-term contract costs that have been reduced to a fixed present value ... the department shall net purchased power contracts approved by the Federal Energy Regulatory Commission that are below market value against any such contracts that are above-market value."

¹² See, e.g., *Bridgeport Energy, LLC*, 112 FERC ¶ 61,077 (2005) (*Bridgeport*) at 39.

¹³ 2007 Regional System Plan, ISO New England Inc., October 18, 2007

¹⁴ See, *Id.*

Messrs Fonfara and Fontana

March 7, 2008

Page 6 of 6

companies invested more than \$6 billion in new, modern power plant capacity, adding 9,000 megawatts of supply, much of it in Connecticut. At the same time, additional increases in generating infrastructure are critically necessary for a region that recently experienced a peak in electrical demand of 28,048 MW. These investors entered Connecticut with the clear expectation that they would be able to provide low cost and efficient power in a competitive power market. Despite the success of competitive electricity markets, New England has an ongoing need for energy resources; therefore, now is the time to move forward with substantial investments of energy infrastructure by supporting the continuity and transparency of consistent competitive market conditions. NEPGA is confident that Connecticut can continue to incent private investment in new energy infrastructure technology to accelerate the benefits that improve the environment, while maintaining adequate electrical supply. However, these infrastructure enhancements are contingent upon a business climate that guarantees sound and prudent investments through a consistent regulatory and legislative environment.

7. HB 5783 Requires Disclosure of Commercially Sensitive and Proprietary Information.

The disclosure of proprietary information regarding affected facilities that would be required to comply with this proposal would provide an unfair competitive advantage to remaining market participants. NEPGA considers any such information to be confidential, proprietary or trade secret information, and considers the harm suffered by its disclosure to be incalculable and irreparable.

For the foregoing reasons, NEPGA opposes House Bill No. 5783; *An Act Concerning Electricity Market Incentive Rebates*. Thank you for your consideration of these comments. If you have any questions, please don't hesitate to contact me.

Respectfully submitted,



Christopher P. Sherman
General Counsel