



May 9, 1997

Bernard M. Fox
Chairman, President and Chief Executive Officer

The Honorable John D. Dingell
Ranking Member
Committee on Commerce
U. S. House of Representatives
2125 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Dingell:

Thank you for the opportunity to address the important questions you posed in your letter of April 10, 1997.

1. ***From your company's point of view, is it necessary for Congress to enact legislation bearing on retail competition, and why? If you favor legislation, please outline which issues should be addressed and how you think they should be resolved.***

ANSWER: Northeast Utilities (NU) is a multi-state holding company which operates in Connecticut, Massachusetts and New Hampshire.

Although our region of the country is advancing rapidly toward retail competition, there are some matters which only Congress can address, consequently, federal legislation, to some degree is indeed necessary. Congress must affirmatively act on the following issues:

- PUHCA and PURPA should both be repealed. This is a procompetitive step only the Congress can take.
- FERC's Orders 888 and 889 should be legislatively applied to public power utilities which are now exempt.
- State and Federal regulatory jurisdictions need to be clearly defined.
- Reciprocal treatment should be required, in order to encourage "closed" utilities in "closed" states to open up their own retail markets, as a condition of entering newly-opened retail markets in other "open" states.

On the other hand, Congress should refrain from acting in certain areas: Previous prudence decisions by FERC and the states clearly should be respected. Likewise, existing wholesale and retail contracts should be unaffected by any federal action.

2. ***If the state(s) you serve has adopted or is considering adopting retail competition, what are your biggest concerns? Please be specific. Indicate how you are dealing with them and any recommendations you may have.***

ANSWER: All three of our state jurisdictions are in fact either considering, or have adopted, retail competition plans. In many ways, this region represents a case study in how restructuring efforts should be undertaken.

Like many utilities, NU has considerable stranded cost exposure. Therefore, a threshold issue for the Company is the recovery of these costs. To date, both Massachusetts and Connecticut have understood that fair treatment for utilities on stranded costs was the key that unlocks the door. Without such treatment we have a legal duty to oppose any efforts to bring about retail competition.

Unfortunately, New Hampshire, our third jurisdictional state, has instead chosen to artificially restrict our ability to recover stranded costs. Their recent New Hampshire Public Utilities Commission order would result in our subsidiary, Public Service Company of New Hampshire (PSNH), to go off Financial Accounting Standards Board rule 71. This would trigger a massive write off of assets and making PSNH insolvent. Obviously such an outcome is unacceptable. As a result, we have brought suit in Federal District Court in Rhode Island to block implementation of this order. The Court has issued a temporary restraining order and set hearing on an injunction for mid June. Copies of our complaint, and the Court's recent order are attached.

You have asked for recommendations. The simplest recommendation I can provide is based on the above circumstances; namely fair treatment for utility stranded cost based on full recovery of prudently incurred, legitimate and verifiable costs. Such treatment is absolutely a prerequisite in order to have an orderly and consensual transition to competition.

3. ***Whether or not you favor federal legislation, please indicate your position on the following specific issues (to the extent not addressed in your prior responses):***

- a. ***A Federal mandate requiring states to adopt retail competition by a date certain. If retail competition is under consideration in the state(s) you serve, do you believe Congress should provide additional direction or authority?***

ANSWER: A "date certain" in any Federal mandate is not essential. In many states retail competition is on an aggressive timetable; this seems to be particularly true in higher cost regions.

If Congress chooses to adopt a date certain for retail competition it must also provide for the recovery of stranded investments. There is a legal symmetry to the two issues. It is the mandate to open the utilities' lines which creates the potential for stranded investments. It is, therefore, substantively asymmetrical and constitutionally suspect for Congress to mandate the opening of the wires without providing for compensation to make the utility economically whole.

From a practical standpoint, it will be very difficult, if not impossible for most utilities to support any federal mandate without the threshold issue, stranded investment recovery, being addressed satisfactorily. Instead, as noted above, utilities will have considerable legal and fiduciary incentives to contest the passage of legislation which would amount to a taking of their property.

- b. ***Recovery of stranded investment. If the state(s) you serve already has adopted retail competition, how was this issue addressed and are you satisfied with the outcome? If your state(s) is considering adopting retail competition, how would you recommend that this issue be treated? Do you think Congress should enact legislation relating to stranded cost issues, and if so what would you recommend? Is securitization a useful mechanism for dealing with stranded costs, and whom does it benefit?***

ANSWER: As noted above, stranded investment recovery is critical in order to proceed with any plan for retail competition. Unfortunately, the term stranded investment has become misconstrued, demagogued and highly politicized.

Stranded investments are merely those investments made to serve customers which potentially become uneconomic when the government, either state or federal, require the utility to provide open access to its wires at less than a market based price. In effect this constitutes a taking of property both as a regulatory taking and as a physical occupation. Although it is clearly within the government's authority to undertake such an action, the U. S. Constitution does require that the government provide compensation for such a taking.

Most of the approximately 10 states which have adopted retail choice plans over the last year have provided for full recovery of retail "stranded" costs—likewise FERC, in its landmark Order 888. This approach is appropriate legally, analytically and is sound public policy.

Generally speaking, these states have sought solutions which allowed utilities a reasonable opportunity to recover their legitimate and verifiable stranded costs. Consequently they have seen their plans to introduce retail competition proceed reasonably smoothly.

As noted previously, all three states which we serve are attempting to introduce electric retail competition. In two of those states, Massachusetts and Connecticut, we have been actively engaged in the process and are seeking to assist policy makers achieve their objectives with respect to reducing rates and giving people more choices. It is no coincidence that both of these states have proposed a responsible and fair treatment for our stranded costs.

Likewise, it is no surprise that our third jurisdiction, New Hampshire, has its retail competition plan stayed by order of the federal courts. New Hampshire does not allow for full cost recovery; instead they have chosen

to adopt a plan which would require massive write-off of company assets and likely push the company into insolvency.

You have asked whether Congress should enact legislation relating to the stranded cost issue. Once again, the concepts of access and stranded cost recovery are legally linked. Therefore, should Congress decide to mandate retail access by a date certain it must also enact legislation to allow utilities to recover their stranded costs.

You have also asked about the merits of securitization. We believe that it is indeed a useful tool. It has a unique effect of allowing for full stranded investment recovery by the utility and also providing for some near-term rate relief for ratepayers. As a result all benefit from it application. Customers get lower rates and more choices, while utility shareholders are held harmless.

- c. ***Reciprocity. Can states condition access to their retail markets on the adoption of retail competition by other states? Should Congress enact such a requirement? Could such a requirement create an incentive for states with low electric rates not to adopt retail competition, in order to keep cheap power at home?***

ANSWER: Although conventional wisdom suggest that states may not condition access to their retail markets on the adoption of retail competition in other states, the recent Supreme Court case, General Motors Corporation v. Tracy, February 18, 1997, would suggest otherwise. This case upholds broad state powers to impose different taxes on different kinds of “gas marketers” in Ohio—even though the more heavily taxed type of marketers were often interstate companies, while the exempted type were generally in-state companies.

While, this recent decision suggests some authority for states to condition access to their markets, a cleaner, less problematic approach will be for Congress to definitively speak to the issue. In doing so Congress has two options: It may impose such a reciprocity requirement directly pursuant to its Commerce Clause powers, or in the alternative, it could authorize “open” states to discriminate against “closed state utilities,” just as Congress did in the case of low-level nuclear waste regulation.

4. ***If Congress enacts comprehensive restructuring legislation, should it mandate “unbundling” of local distribution company services? What effects would this have, and would they differ for various customer classes? Would this entail substantial expense, and who would incur any such costs?***

ANSWER: A functional separation of competitive services could increase the likelihood of economic gains through the efficient delivery of those services. However, this separation or “unbundling” can be appropriately addressed on a local level, thereby minimizing the need for mandatory divestiture. Also, the complexity of this issue would make it very difficult for legislation to adequately address the many types of utility services and the differences in local utility practices. Please note that the definitions of competitive services

and basic delivery services which should be regulated are fundamental issues that are not easily resolved and likely evolve with technological change.

If “unbundling” is mandated, there would be different effects across customer classes, but it is difficult to describe how the classes would be affected. Overall, the experiences of telephone or airline deregulation provide some guidance for the possible ramifications of electric deregulation. Generally customers will have greater selections requiring greater information to make efficient decisions, but savvy, strong customers with superior shopping skills will be the ones who get the best deals.

Initially, separation of services could entail substantial expenses which ultimately would be incurred by customers. In the long run, the net impact of efficiency gains and added expenses is unclear. Also, please note that in the long run electric costs will continue to be determined by energy costs, equipment costs, technological change, supply and demand. This will create a potentially less stable price of electricity and certainly a less predictable price.

5. ***Recently Chair Moler of the Federal Energy Regulatory Commission recommended that, as part of comprehensive legislation, Congress authorize the Commission to enforce compliance with North American Electric Reliability Council standards to help maintain reliability of service. Do you believe this is necessary, and why or why not?***

ANSWER: Northeast Utilities (NU) is a founding member of the Northeast Power Coordinating Council (NPCC), one of the ten Regional Councils of the North American Electric Reliability Council (NERC). The criteria, guidelines, and procedures of the NPCC have historically been more demanding and specific than NERC policy. For thirty years, NPCC’s bylaws specified voluntary rather than mandatory compliance. Voluntary compliance was achieved amongst NPCC’s members. NPCC’s bylaws mandated engineering reviews and continuous operating audits to ensure criteria, guideline, and procedure compliance. As the restructuring of the electric utility industry unfolds we are not as certain that voluntary compliance will work. It’s also evident that the other nine Regional Councils do not have as strong a Council as NPCC. Their criteria and procedures are not as defined and specific thus allowing greater member independence resulting in differing accepted standards in both the design and operation of member interconnected transmission systems.

Not knowing the exact direction and more importantly the impact restructuring will have on service reliability, NU supports mandatory compliance with North American Electric Reliability Council standards throughout the United States. NU takes this position to ensure reliability of service for our customers. Lastly, the NERC standards must be specific and demanding; audits by NERC, the Regional Councils or an independent party must be mandated in the standards.

6. ***What concerns does your company have with respect to the role of public power and federal power marketing agencies in an increasingly competitive wholesale electric market? In markets in which retail competition has been adopted? Are there concerns you would like to***

have addressed if Congress enacts comprehensive restructuring legislation? Should Congress consider changes to federal law as it applies to regulation of public or federal power's transmission obligations?

ANSWER: Generally, it is almost axiomatic that there must be parity between public and private power.

In order to have full and fair competition all market participants must play by the same rules. This includes, but is not limited to, such matters as applicable taxes, access, rates and charges, reciprocity rules, reliability requirements, purchase mandates, antitrust penalties, review of affiliate transactions, the duty to recover all fixed and operating costs in current charges to consumers. This is not presently the situation. For example, some generators (such as QFs) enjoy regulatory preference denied to other generators. Likewise, some multi-state utilities are exempt from SEC regulation under PUHCA, while other multi-state utilities are not. Continuing these artificial regulatory differences may not reward efficiency it only creates artificial winners and losers in the new electric world.

7. ***If Congress enacts comprehensive restructuring legislation, should changes be made to federal, state or local tax codes, and if so why? Please be specific.***

ANSWER: Yes, changes should be made federal and state tax codes. The advent of deregulation and competition make much existing tax law obsolete.

Federal Income Tax Issues

A very important tax rule unique to public utilities is the rule dealing with "normalization requirements". This rule deals with the rate making treatment of both accelerated tax depreciation and investment tax credit, under traditional cost of service rate making. Normalization essentially requires that the tax benefits of the above two items be reflected in a utility's rates over the period in which the ratepayers bear the cost of the property that gave rise to the benefits. If they are not so reflected then the utility company would lose those accelerated tax benefits. The price our customers pay for electricity is expected to be determined in the future by a method other than traditional cost of service calculations. Retention of those benefits under a market drive price is imperative

Another important issue involves the current deduction for the funding of nuclear decommissioning costs. If traditional costs of service rate making ceases to exist a revision to the existing federal income tax rules may be required to maintain this tax incentive for the prefunding of these costs.

There are issues, primarily the timing of deductions, for utility property made uneconomic under market conditions.

Complex tax rules apply to spin-offs, mergers, acquisitions and other corporate transactions that may occur as part of industry restructuring. If a particular form of corporate restructuring is considered appropriate from a public policy perspective, but could result in adverse tax consequences to utility companies,

Congress should consider relief that is sure to be requested by utility companies.

State Tax Issues

Utility companies will need to ensure that the desirable federal income tax treatments that come from restructuring are respected for state income tax treatments.

Utility companies desire a level playing field. Today the gross earnings tax that we are required to pay in Connecticut is not levied on all our competitors equally. This tax is also levied on our out of state sales. The gross earnings tax laws need to be changed to adjust to our changing industry. We'd like to see the tax repealed, or phased out, but short of that a fair tax on all providers would be acceptable.

Property tax laws will in some instances favor one type of tax payer over another. Again, the industry desires a level playing field. Jurisdictions in which we operate tax identical property differently depending on whether it is owned by a utility or a non-utility -- this needs to be cured. Differences also exist in the taxation of real and personal property. Some states tax real property and not personal property or the property could be taxed in different ways and/or at different rates. The classifications as to what is real property and what is personal property are sometimes not consistent from taxpayer to taxpayer or jurisdiction to jurisdiction.

8. ***What, if any, concerns do you have about the reliability of the electric system? If the industry moved to retail competition, will adequate reserves be available? Is the transmission system capable of handling full retail competition?***

ANSWER: At the regional level, reliability is dependent upon an assurance of adequate supply of generation throughout New England, 24 hours a day, 365 days a year, as well as operation of the interconnected transmission system to transmit the power from the generating plants to consumers. Regional reliability is built upon the foundation of the New England Power Pool (NEPOOL) that operates in accordance with national reliability standards through required procedures placed upon transmission providers and all suppliers of power to consumers so that everyone in the entire region can be assured of dependable electricity. Recent changes to the NEPOOL agreement will assure that national reliability standards are maintained while offering greater opportunity for market forces to decide which resources each power supplier will use to meets its NEPOOL responsibilities.

The enhanced provisions to NEPOOL procedures include:

- Providing the proper market signals to promote efficient use of resources to meet established reliability criteria.
- Opening of NEPOOL membership to all (utilities, marketers, brokers, and generators) that want to transact power arrangements in New England so that competition will be broad-based with many market participants.

- Establishing an efficient spot wholesale market for trading energy, capacity and ancillary services throughout New England that will supplement the contractual market that now exists.
- Creating an independent system operator (ISO) that will operate the transmission system and dispatch generation separately from market participants.

These changes will assure that reliability in the region is maintained at its historically high levels while also accommodating introduction of competition (regardless of how each of the six New England states decide to restructure the electric industry).

At the state level, reliability is a factor of adequate supply of generation within Connecticut *and* the ability to import power from outside of Connecticut over the transmission lines. As a practical reality, regardless of how the transition to competition is accomplished within Connecticut, any plan must allow consumers to rely on existing, local generating plants for a period of time before large-scale alternatives (from either outside of Connecticut or new facilities built in Connecticut) would be available. A reasonable transition, along with a commitment to keep local generation available for several years is critical to protect reliability. This enables the transition of Connecticut's nuclear facilities to competition and allows for competitive alternatives to be put in place on a timely basis as required for reliability or economic considerations.

Historically, Connecticut utilities, under regulation, planned and built generating plants adequate to supply all customers' electricity needs while also reflecting state and federal requirements concerning environmental impact and fuel diversity and security. Transmission and generation options were evaluated together in a least-cost fashion to keep total system costs as low as possible. Under normal operating conditions, when most of its existing generating plants are available to operate, Connecticut has adequate local generating supplies to meet its full electricity needs. However, while usually an exporter of electricity, when a large share of its generating plants are not operating, Connecticut must import a significant supply of electricity.

Under normal conditions when competition occurs within Connecticut, as long as a significant portion of local generating plants are operating (either to sell within the state or externally), the reliability of the state's electric system will continue.

If a large portion of Connecticut's existing generation is not operating (e.g. its nuclear plants), then Connecticut must rely on imports of power that may strain or exceed the transmission system's capacity. In this case, reliability might be in jeopardy.

When significant amounts of Connecticut generation is not available (especially its nuclear generation), Connecticut has only 4065 megawatts of supply compared to its peak load of 5750 megawatts. To keep power available to customers, Connecticut must import at least 1685 megawatts from other parts of New England and New York. Based upon the transmission capacities of ties to other states, Connecticut can import only 2520 megawatts from Massachusetts, New York, and Rhode Island. However, if one of the major transmission lines bringing power into the state is out of service, less than 1500 megawatts can be imported. Thus, without its remaining

nuclear plants over an extended period, Connecticut would be hard pressed to maintain reliability.

The situation today in Connecticut with three nuclear plants that are unable to operate for much of 1997 is a case in point. Until the nuclear plants return to service, reliability hinges on the cooperation that integrated utilities can bring to bear to coordinate interim fixes to the transmission system, to reactivate older generating plants or install new generators, and to find customers willing to reduce their power requirements or interrupt their loads. It is unclear whether such cooperation will be possible (or even allowed) in the future restructured world.

Once again, thank you for your interest in our views, we are honored to have been included in your review of these very important issues. Should you or your staff have any questions, please feel free to contact Greg Butler, Vice President, Governmental Affairs at (860) 665-3181.

Very truly yours,

A handwritten signature in cursive script that reads "Bernard A. Foye". The signature is written in dark ink and is positioned below the typed name "Bernard A. Foye".

cc: G. B. Butler