IR 13-020

Public Service Company of New Hampshire

(PSNH)

Preliminary Status Report Addressing the Economic Interest of PSNH's Retail Customers as it Relates to the Potential Divestiture of PSNH's Generating Plants

Prepared by:

Staff of the New Hampshire Public Utilities Commission

Accompanied by detailed valuation analysis prepared by:

La Capra Associates, Inc.

and

ESS Group, Inc.

April 1, 2014

This Report is presented by the Staff of the New Hampshire Public Utilities Commission (Commission), as ordered by the Commission in Order No. 25,545 (July 15, 2013). Order No. 25,545 was issued in the context of the Commission's Investigation, docketed in Docket No. IR 13-020, into the market conditions affecting Public Service Company of New Hampshire (PSNH) and its Default Service customers and the impact of PSNH's ownership of generation on the competitive electric market. La Capra Associates of Boston, Massachusetts, and ESS Group, Inc., of Waltham, Massachusetts were retained by Commission Staff to provide independent analysis of the value of PSNH's generating assets. Reports detailing their work and conclusions are included with this Staff report and are listed below:

- La Capra's "PSNH Generation Asset and PPA Valuation Report"; and
- ESS's "Public Service of New Hampshire Generation Asset Environmental Review" report

Using the results of the consultants' analysis, Staff presents this preliminary status report addressing the issue of "whether it is now in the economic interest of PSNH's retail customers for the company to complete restructuring and divest its interest in its generating plants." Further impetus for the creation of this Report was provided by the correspondence from the New Hampshire General Court's Electric Utility Restructuring Oversight Committee Members (Oversight Committee), dated October 16, 2013, the initial response from the Commission's Chairman, Amy L. Ignatius, dated October 25, 2013, and the subsequent response from Representative David A. Borden, Chairman of the Legislative Oversight Committee on Electric Utility Restructuring, dated November 1, 2013. Interested parties may review these informative documents, Order No. 25,545, and the written comments of various persons and entities, including PSNH, at the Commission's public website, at http://www.puc.nh.gov/Regulatory/Docketbk/2013/13-020.html.

In its correspondence, the Oversight Committee specifically requested that the Commission conduct the necessary analysis "to determine whether it is now in the economic interest of PSNH's retail customers for the company to complete restructuring and divest its interest in its generation plants." The Chairman of the Oversight Committee clarified the expectations by requesting "…a preliminary status report of your investigation by April 1, 2014, or earlier if feasible, that would include at a minimum the Commission's staff position on this issue, the associated analysis of any independent consultants, and any recommendations for legislation that may be needed to move the process forward."

The phrase "economic interest of PSNH's retail customers" and its connection to the divestiture of PSNH's generating units originate from RSA 369-B:3-a which reads as follows:

> **369-B:3-a Divestiture of PSNH Generation Assets. –** The sale of PSNH fossil and hydro generation assets shall not take place before April 30, 2006. Notwithstanding RSA 374:30, subsequent to April 30, 2006, *PSNH may divest its generation assets if the commission finds that it is in the economic interest of retail customers of PSNH to do so, and provides for the cost recovery of such divestiture.* Prior to any divestiture of its generation assets, PSNH may modify or retire such generation assets if the commission finds that it is in the public interest

> of retail customers of PSNH to do so, and provides for the cost recovery of such modification or retirement (emphasis added).

In many ways, our analysis and results mirror what was presented in our June 7, 2013 *Report on Investigation into Market Conditions, Default Service Rate, Generation Ownership, and Impacts on the Competitive Electricity Market* (available at http://www.puc.nh.gov/Electric/IR%2013-020%20PSNH%20Report%20-%20Final.pdf). In that report, we examined the existing market conditions and put forth for consideration different options with respect to PSNH and its generating fleet. In the report we provide today, we specifically address the question of whether it is currently in the economic interest of PSNH's retail customers for PSNH to divest its generation assets. While there have been developments in the fuel and energy markets since the issuance of Staff's June 2013 report—and there continue to be developments—it is important to not view the issues only based on current events. Rather, in examining the economic interest of PSNH's retail customers, especially as it relates to the future of the long-lived generation assets, a forward-looking view of potential and likely developments impacting the fuel and energy markets is necessary to appropriately examine the issues. This is the approach taken by Staff and its consultants.

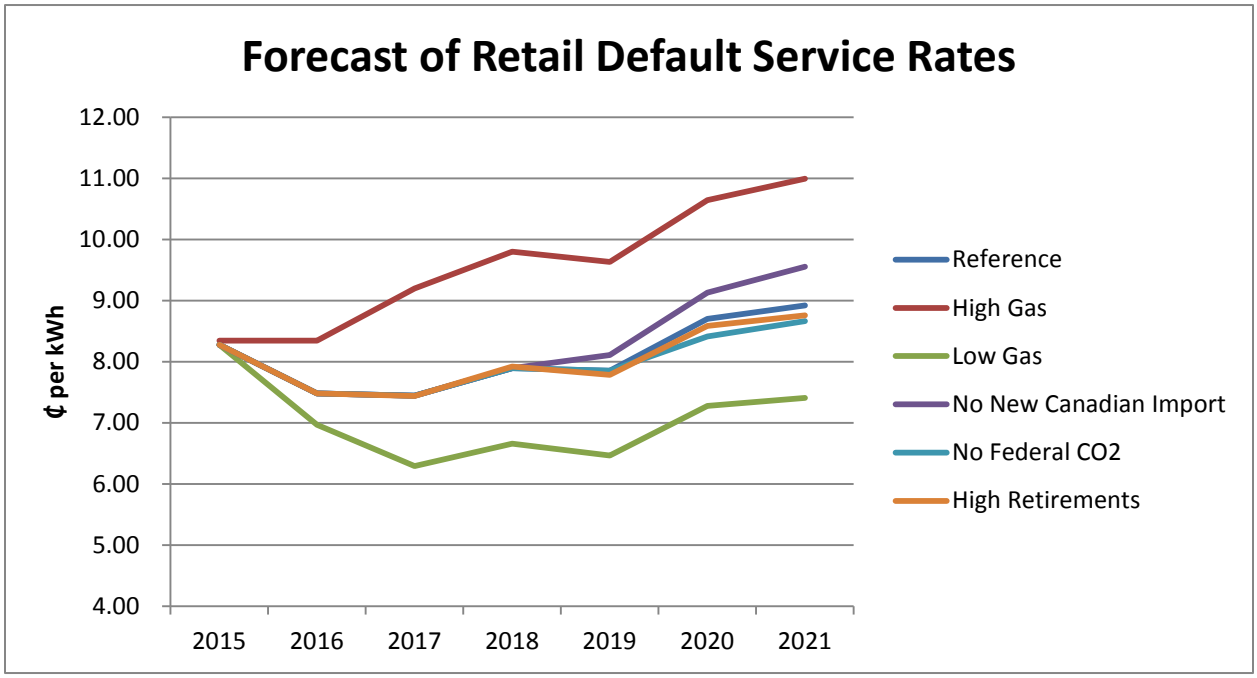
The Commission Staff's June 7, 2013 Report in Docket No. IR 13-020 also provides additional background information regarding the circumstances leading to the development of this Report. The Commission Staff acknowledges the trust that the Commission and the General Court have placed in Staff's ability to engage in a fair, robust analysis of PSNH's generation assets, and also thanks PSNH for its cooperation during this effort. It is Commission Staff's hope that the State of New Hampshire will gain valuable decisional information from this Report.

Considering the wide range of factors that can influence fuel and energy markets and, ultimately, the retail electricity rates charged to customers, it is important to understand what is covered by this Report and what is not. This Report focuses on the potential rate impacts to PSNH's retail customers in the event of divestiture of PSNH's generation assets versus no divestiture. If the plants are divested, any new owner could choose to operate some of them, all of them, or retire some of them. This Report does not address any potential actions that could take place post-divestiture. This Report also does not address retention or sale of the plants for reasons of fuel diversity or regional system reliability as those are issues within the purview of the regional system operator, ISO-New England. Finally, as the Oversight Committee requested our analysis of the economic interest as it relates to potential divestiture of PSNH's generation fleet, we did not examine the potential economic impacts of the retirement of one or more of the generating units.

Analysis

As explained by La Capra, in assessing the value of PSNH's generating assets it explored a variety of scenarios involving potential changes in fuel costs, carbon regulations, transmission development and generating plant retirements. Details regarding those scenarios are contained in La Capra's Generation Asset and PPA Valuation Report.

As part of our analysis, we used La Capra's locational marginal price (LMP) and capacity price forecasts (including alternative scenarios) to develop a projection of retail default service prices going forward.[1] The results are shown in the chart below.

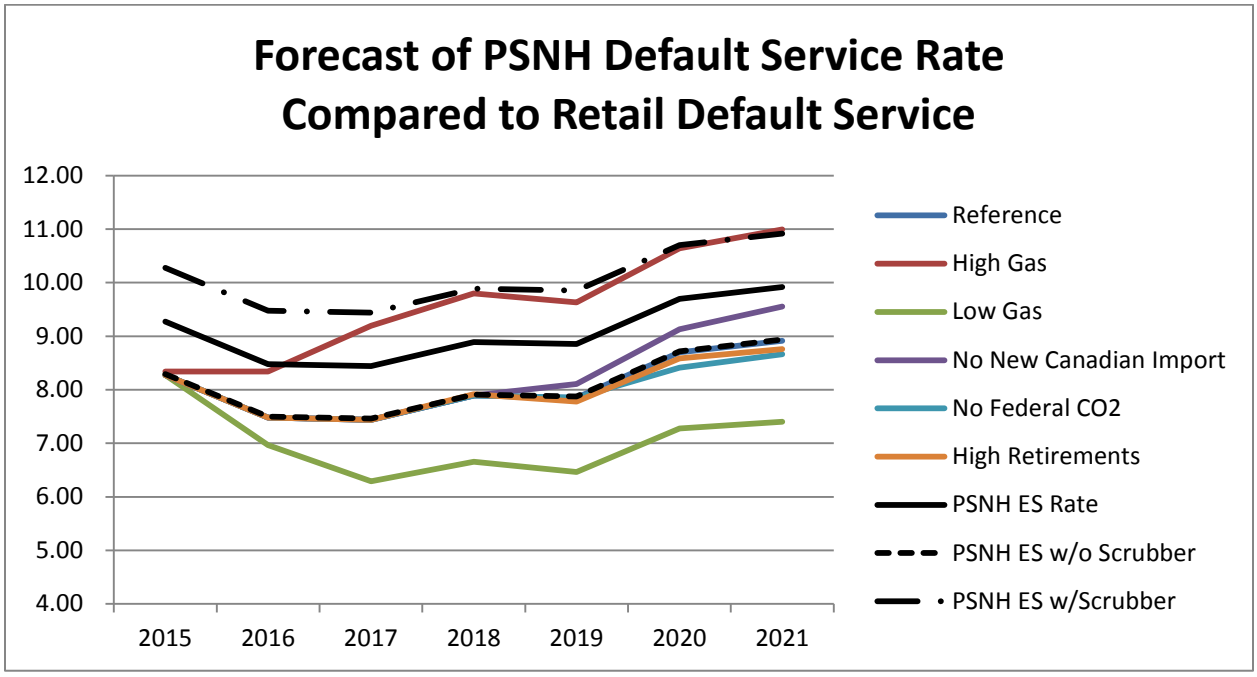


These forecasted rate paths present what retail default energy service prices to PSNH's customers might be (under various scenarios) if PSNH were to serve its default service load through the use of competitive solicitations as Unitil Energy Systems (UES) and Granite State Electric Service (GSEC) currently do. From 2010 through 2013, PSNH's ES rate has varied from the average default service price that UES and GSEC charged to residential customers by anywhere from approximately 0.5 cents per kilowatt-hour (kWh) to approximately 2.0 cents per kWh. As of January 1, 2014, the average residential default service price of UES (9.556 cents per kWh) and GSEC (8.889 cents per kWh) was essentially equal to PSNH's ES rate of 9.23 cents per kWh. Comparisons between the default service rates of the three utilities can be affected by factors such as the respective timing of the solicitation for UES and GSEC versus the timing of PSNH preparing its rate calculations, so while the rates are not perfectly comparative at any point in time, it is instructive to view the comparisons over time.

[1] Assumptions used in preparing the retail forecast are a load factor of 54%; ancillary and other charges at 6% of the Locational Marginal Price; distribution line losses of 6%; and risk/profit factor of 5%.

As a further point of comparison between PSNH's ES rate and market prices, a review was performed on March 27, 2014 of competitive retail offerings by competitive electric power suppliers (CEPS) registered to serve customers in New Hampshire. The CEPS offer a variety of pricing alternatives that include fixed or variable pricing, differing durations of fixed prices, and products promoted as being from renewable sources. PSNH's ES rate is initially set for an annual period but subject to an adjustment mid-year, so it is effectively fixed for a six-month period. As of March 27, 2014, supply options from the CEPS with fixed pricing for less than a twelve-month period were between 0.24 cents per kWh and 1.33 cents per kWh lower than PSNH's current ES rate of 9.23 cents per kWh. Again, these offerings are by no means perfect comparisons with PSNH's ES rate,[2] but they are mentioned for informational purposes.

Since mid-April 2012, PSNH's ES rate includes a temporary adder of 0.98 cents per kWh for cost recovery associated with a wet flue gas desulfurization scrubber (Scrubber) installed at its Merrimack Station generating plant at a cost of approximately $420 million. Final cost recovery associated with the Scrubber is the subject of an ongoing proceeding at the Commission, DE 11-250 (see: http://www.puc.nh.gov/Regulatory/Docketbk/2011/11-250.html), so the final rate impacts associated with that project are unknown at this time. However, using the forecasted retail default service rates from the chart above, it is informative to use the comparison of PSNH's ES rate to the default service rates of UES and GSEC along with some ranges of recovery for the Scrubber project and add some more lines to the chart as shown below:



[2] For example, a CEPS may have underlying contracts with power producers for certain amounts of power over certain periods of time. It could also view PSNH's ES rate as a "price to beat" and price its offering slightly below PSNH's ES rate and try to maximize its profit margin. Pricing strategies differ among suppliers and among competitive offerings.

In preparing the above chart, the following assumptions and parameters were used:

- PSNH's ES rate has averaged approximately 1.0 cent per kWh higher than the default service rates of UES and GSEC over the last few years;[3]
- For the low end of Scrubber cost recovery, for simplicity purposes it was assumed that PSNH is allowed no cost recovery.[4] With zero cost recovery, the 0.98 cents per kWh temporary adder would cease; and
- At full Scrubber cost recovery, it was assumed that the overall rate impact would be approximately 2 cents per kWh for a period of years.[5]

The "PSNH ES Rate" line projects PSNH's ES rate at 1.0 cents per kWh above the reference case and is assumed to include the Scrubber temporary rate adder. The "PSNH ES w/o Scrubber" line uses rates 0.98 cents per kWh below the rates for the "PSNH ES Rate" to remove the temporary rate adder, and the "PSNH ES w/Scrubber" line adds an additional 1.0 cent per kWh to the "PSNH ES Rate" line to reflect the total Scrubber recovery at approximately 2.0 cents per kWh.

Looking at the chart, it is apparent that except for a scenario in which PSNH is not allowed any cost recovery associated with the Scrubber project, its ES rate can be expected on an average annual basis to exceed prevailing market prices. There are times, however, such as happened during the winter periods of 2012 – 2013 and 2013 – 2014, when PSNH's ES rate may be below prevailing market prices, but those periods are expected to be more the exception than the rule. As shown in La Capra's analyses, given current expectations in the fuel and energy markets, it does not appear likely that the situation will reverse itself in the foreseeable future. Given that, the question arises: What should happen with PSNH's generating plants?

To address that question, La Capra performed an extensive analysis of the value of PSNH's generation portfolio, including existing power purchase agreements (PPAs) with the Lempster Wind facility in Lempster, New Hampshire and the Burgess BioPower facility in Berlin, New Hampshire. Through its analysis, which used a variety of methodologies and examined several scenarios, La Capra determined the following values for PSNH's generating units and the PPAs:

[3] The average 1.0 cent per kWh differential takes into account period both before and after the existence of the 0.98 cents per kWh Scrubber temporary cost recovery adder. For purposes of this analysis, the UES and GSEC default service rates are assumed to equal prices in the reference case.

[4] In DE 11-250, the lowest cost recovery position put forward by a party was $10 million, approximately 2% of the total project costs.

[5] This is consistent with the position taken in Staff's testimony in DE 11-250. Staff uses that position for illustrative purposes in this Report.

Generating Units:	
Reconciled Value	$ 225,000,000
Upper Value	$ 410,500,000
Lower Value	$ 171,600,000
Power Purchase Agreements	
Mark-to-Market Final Valuation[6]	($ 120,000,000)
High Value (High RECs)	($ 17,500,000)
Low Value (Low RECs)	($ 191,400,000)

As stated earlier, we were asked by the Committee "…to determine whether it is now in the economic interest of PSNH's retail customers for the company to complete restructuring and divest its interest in its generation plants." Using the values of PSNH's plants listed above and comparing those amounts to the net book values of the plants, one is able to determine whether any potential sale would generate sufficient sales revenue to allow PSNH to fully recover the remaining book value of the plants. As of December 31, 2013, the net book value of PSNH's generating plants was approximately $660,200,000,[7] so as shown by the range of values listed above, all scenarios explored by La Capra resulted in expected values that are below the existing net book value of the plants. As explained by La Capra, the PPAs are not physical assets, so their value was calculated by comparing the estimated stream of future payments over the life of the agreements to the projected market replacement value. Comparing the existing net book value and ranges of sales values above results in the following:[8]

	Reconciled Value	Upper Value	Lower Value
Plant Market Values	$ 225,000,000	$ 410,500,000	$ 171,600,000
Plant Net Book Values	$ 660,200,000	$ 660,200,000	$ 660,200,000
Stranded Costs - Plants Only	$ (435,200,000)	$ (249,700,000)	$ (488,600,000)
PPA Values	$ (120,000,000)	$ (120,000,000)	$ (120,000,000)
Stranded Costs - Plants + PPAs	$ (555,200,000)	$ (369,700,000)	$ (608,600,000)

[6] Under the mark-to-market final valuation, the Lempster PPA was estimated to have a positive value of $5 million and the Burgess BioPower PPA a negative value of $125 million over the remaining lives of the respective agreements.

[7] The net book value of PSNH's plant as of December 31, 2013 includes the full value of the Scrubber. If in DE 11-250 the Commission adjusts the amount of Scrubber costs PSNH is allowed to recover, the analysis would need to change accordingly as the amount of potential stranded costs would also change.

[8] For purposes of the rate analysis that follows and to avoid presenting numerous scenarios, the PPA valuation was kept constant at the mark-to-market final valuation of ($120,000,000).

As shown, significant stranded costs[9] would exist under any of the plant sales scenarios, numbers that would increase if the PPAs were also sold. If the generating plants are sold and the PPAs are not sold, theoretically PSNH could use the PPAs to serve a portion of its default service load and obtain the remainder of its supply needs via competitive solicitations. Such a scenario, however, would not result in PSNH "complet[ing] restructuring" and some of today's existing questions related to the half-in/half-out restructuring status of PSNH would remain.

The next step in the analysis is to compare the rate impact of such levels of stranded costs with the rate impact of not selling the plants and PPAs. However, when examining the "economic interest of PSNH's retail customers," one must be mindful that while all PSNH customers can be considered those customers connected to PSNH's electrical system, there are essentially two sub-groups of customers: a) those who receive default supply service under PSNH's Rate ES and b) those who either received supply service from competitive suppliers or self-supply from their own generation source. The economic impacts of a PSNH generating fleet sales scenario will vary greatly between the two subgroups for reasons that will be explained below. This is a much different paradigm than existed at the time of passage of RSA 369-B:3-a in 2003. At that time there was virtually no customer migration and, therefore, the two subgroups described above did not exist. Eleven years later, the landscape has changed and evaluating the economic interest of all of PSNH's retail customers involves evaluating different paths.

Currently, all costs associated with PSNH's ownership and operation of its generating plants are recovered through its Rate ES default service charge, a rate that is only assessed to and paid by default service customers of PSNH. As of December 31, 2013, while approximately 75% of PSNH's 500,000 customers remained default service customers of PSNH (ES Customers), those customers accounted for only approximately 46% of PSNH's total retail load. The remaining 25% of PSNH's customers, and 54% of retail load, were either receiving service from competitive options or self-supplying (Non-ES Customers).

What follows is an analysis of recovering the stranded costs from PSNH's customers using a range of options including:

- Sale of the generating plants and PPAs;
- Sale of the generating plants only;
- Recovery from all PSNH customers (ES Customers and Non-ES customers) through a non-bypassable charge;
- Recovery only from ES Customers through the Rate ES default service charge; and
- Recovery through the use of securitized bonds at interest rates of 2%, 4% and 6%.

The results of the analysis involving stranded cost recovery from all PSNH customers are shown in the following table:

[9] "Stranded costs" can generally be defined as uneconomic assets or investments that an electric utility would reasonably expect to recover under the regulatory structure that existed prior to electric industry restructuring, but would not be recovered under the restructured industry regulatory structure without the provision of a specific recovery mechanism. *See* RSA 374-F:2.

		Stranded Costs to All Customers		
Divestiture of:	Stranded Cost	Average Rate Impact (per kWh)		
Plants Only	Amount	2%	4%	6%
Reconciled Value	$ 435,200,000	$0.00419	$0.00474	$0.00529
Lower Value	$ 488,600,000	$0.00471	$0.00532	$0.00593
Upper Value	$ 258,700,000	$0.00249	$0.00282	$0.00314
		Average Rate Impact (per kWh)		
Plants + PPAs		2%	4%	6%
Reconciled Value	$ 555,200,000	$0.00535	$0.00604	$0.00697
Lower Value	$ 608,600,000	$0.00586	$0.00663	$0.00739
Upper Value	$ 378,700,000	$0.00365	$0.00412	$0.00460

Securitization was an issue discussed in Staff's June 2013 report and it requires the use of dedicated revenue sources to pay the bonds in exchange for lower interest rates. Securitization was previously used by PSNH to recover stranded costs as a result of enabling legislation (see RSA 369-B) and the Restructuring Settlement Agreement reached in DE 99-099.[10] In that case, a certain portion (Part 1) of PSNH's stranded cost recovery charge was dedicated solely for repayment of the securitized bonds. If stranded costs are charged to all PSNH customers through a non-bypassable charge, the likelihood of PSNH being able to obtain securitized bonds is much higher than if the stranded costs of the generating assets were only charged to ES Customers. Due to the ability of ES Customers to migrate to competitive supply options and, therefore, avoid paying such stranded costs, it is doubtful that PSNH would be able to obtain securitized bonds in that instance. However, given that, and for purposes of illustration, the table below shows the rate impact to ES Customers if the stranded costs were recovered solely from them as part of the ES rate:

		Stranded Costs to ES Customers Only		
Divestiture of:	Stranded Cost	Average Rate Impact (per kWh)		
Plants Only	Amount	2%	4%	6%
Reconciled Value	$ 435,200,000	$0.00902	$0.01019	$0.01137
Lower Value	$ 488,600,000	$0.01012	$0.01144	$0.01277
Upper Value	$ 258,700,000	$0.00536	$0.00606	$0.00676
		Average Rate Impact (per kWh)		
Plants + PPAs		2%	4%	6%
Reconciled Value	$ 555,200,000	$0.01150	$0.01300	$0.01451
Lower Value	$ 608,600,000	$0.01261	$0.01426	$0.01590
Upper Value	$ 378,700,000	$0.00785	$0.00887	$0.00989

[10] The total amount securitized at that time was $525 million.

In such a scenario, it is likely that the migration of ES Customers to competitive supply options would increase, which would continue to shrink the kilowatt-hour sales over which PSNH could recover the stranded costs, thereby putting further upward pressure on the ES rate.[11] To be clear, Staff would not recommend such an approach. The analysis was presented to provide a more complete understanding of the rate impacts under available options.

From the two preceding tables and the earlier discussion of default service rates, the following conclusions can be drawn:

- If the plants are sold, regardless of whether the PPAs are also sold, and stranded costs are charged to all PSNH customers:
    - ES Customers would see a net economic rate benefit; i.e., the expected market-based default service rate plus the new stranded cost charge would be lower than the PSNH default service charge going forward.
    - Non-ES Customers would experience a rate increase as that group of customers is not currently paying any costs associated with PSNH's generation ownership.
- If the plants are sold, regardless of whether the PPAs are also sold, and stranded costs are charged to only PSNH ES Customers:
    - ES Customers would initially experience a slight net rate decrease or no net change, but going into the future the rate impact would depend highly on the future levels of customer migration.
    - Non-ES Customers would not experience any rate impacts, and the gap between their overall electric rate and that of ES Customers would grow.

Conclusions and Recommendations

The valuation analysis conducted by La Capra with input from ESS, based primarily on a discounted cash flow model, is a detailed and objective assessment of PSNH's generating assets and the Burgess BioPower and Lempster Wind PPAs. It is based on current data and information, most of which was provided by PSNH, as well as forecasts of the operations of the plants using expected plant costs and operational characteristics in the context of the ISO-NE market over a 15-year period for the thermal generating units and up to 40 years of operation for the hydroelectric generating assets. The purpose of the DCF analysis and use of comparable sales is to provide estimates of what a hypothetical third party buyer could be expected to pay for the PSNH fossil and hydroelectric assets. La Capra concludes that the overall value is substantially less than the net plant value of $660 million on PSNH's books as of December 31, 2013, a result similar to what was estimated in the June 7, 2013 "Report on Investigation into Market Conditions, Default Service Rate, Generation Ownership and Impacts on the Competitive Electricity Market" by Staff and the Liberty Consulting Group.

The La Capra study provides a more detailed and needed analysis of the value of PSNH's generating assets and the PPAs than what was contained in the June 7 Report. The implications, however, have not changed in any material manner. The La Capra analysis provides a firm basis for Staff's rate analysis of the potential economic impact to PSNH's customers. Staff's economic

[11] Grated, increased customer migration away from PSNH's default service even in the event of no divestiture would also put upward pressure on the ES rate, all else being equal.

analysis confirms the findings from Staff's June 7, 2013 Report that there will continue to be a disparity between PSNH's default service rates and market prices going forward. There will be periods, such as occurred this past winter and during parts of the winter of 2012-2013, when PSNH's generating assets will provide substantial value to its customers. The increasing lack of fuel diversity in ISO-NE combined with serious volatility in New England's natural gas markets are expected to continue to have a profound effect on New England electricity prices, at least until more natural gas capacity and generating capacity becomes available in the region. The analysis contained in Staff's Report and the accompanying La Capra Report, however, assumes those short-term effects will be resolved over time, an assumption based upon market forecasts, but one nonetheless we recognize is undergoing critical discussion in the region as this Report is written.

The current valuation of the PSNH assets varies based on different scenarios and forecasts, primarily the forecast of delivered natural gas prices into New England; however, the reference case indicates that $120 million of the estimated $225 million of value comes from PSNH's hydroelectric assets with $90 million of the remaining $105 million coming from Newington Station, due to the revenues it would receive in the ISO-NE Forward Capacity Market. As detailed in the accompanying La Capra report, a third-party buyer could be expected to pay only $225 million for the PSNH fossil-hydro assets. Such a sale, if it were to occur, would result in approximately $435 million of stranded costs depending largely on the Commission's adjudication of the Scrubber docket, DE 11-250, in which pre-filed testimony has been filed that includes allowing for recovery in permanent rates of values that range from $10 million to approximately $420 million. Staff's rate impact analysis has included the full net book value of the Scrubber as supported by Staff's testimony in that proceeding. At the full net book value of PSNH's generating assets, the rate impact of divestiture would depend largely on whether all PSNH customers will pay the stranded costs or the resulting stranded costs will only be paid by default service customers as well as whether the PPAs will be divested and included in stranded costs. Staff's calculation of stranded costs indicates a stranded cost recovery rate, if recovered from all customers using securitized bonds with a 4% interest rate over a fifteen-year period, would be $0.00474 per kWh without including the PPAs and $0.00604 per kWh if the PPAs, valued at a negative $120 million, were included in a sale.

Staff continues to believe that over the long term, PSNH's default service rate will be substantially higher than market prices resulting in continued upward pressure on default service rates. Based on La Capra's forecast of wholesale prices in New Hampshire and adjusted for retail, Staff's rate analysis indicates that PSNH's default service customers would be better off under a divestiture of the PSNH assets if the stranded costs were recovered from all customers. Customers who do not receive default service from PSNH, however, would see rate increases through the imposition of a stranded cost charge. While we recognize the volatility in today's energy markets, the value of PSNH's "hedge" will likely diminish over the long term and will continue to be at risk due to potential environmental legislation.

Based on our report and the accompanying reports from La Capra and ESS, we recommend that:

1. The Commission complete the Scrubber docket before conducting any proceeding involving divestiture of PSNH's generating assets and PPAs in order to get a firm picture of the recoverable net book value of the assets;

2. The Legislature makes the necessary statutory changes described below that would allow the Commission to conduct a full review of the PSNH generating assets and to proceed with divestiture if, after a comprehensive proceeding at the Commission, the Commission finds it is in the economic interest of PSNH's customers to divest; and

3. The Commission requests ISO-NE to conduct a study of the potential reliability and economic effects of the closure or retirement of PSNH's fossil generating plants.

Potential Legislative Changes

Potential legislative changes were addressed in Staff's June 7, 2013 Report, and the section that follows is largely reproduced from that Report with adjustments to address current legislative proposals.

Many existing New Hampshire statutes were written to pertain to then-existing conditions with respect to electric industry restructuring, and particularly with regard to conditions in PSNH's service territory. As market changes have taken place since those laws were enacted, attempts to apply those statutes to current conditions can be viewed in some instances as either illogical or impossible. What follows is a discussion of certain statutes that may require legislative review and modification. By no means is this an all-inclusive list. Rather the discussion serves to highlight major areas of interest.

Divestiture of PSNH Generation Assets Under RSA 369-B:3-a

Throughout the process of restructuring, the New Hampshire Legislature has proactively sought to guide the structure and timing of restructuring events as pertaining to PSNH through highly detailed statutory enactments. This role peaked in the early 2000's, both with the approval of PSNH's rate reduction bond packages, with the concurrent requirement for PSNH to divest its nuclear generation interests, and the Legislature's efforts at slowing down the divestiture of PSNH's fossil-fueled and hydroelectric generating assets. This effort at delaying the full impact of restructuring on PSNH's operations culminated in the passage of RSA 369-B:3-a in April 2003, in the wake of the California energy crisis. The statute specifies that, following April 30, 2006, "PSNH may divest its generation assets if the [C]ommission finds that it is in the economic interest of retail customers of PSNH to do so, and provides for the cost recovery of such divestiture." RSA 369-B:3-a further specifies that "[p]rior to any divestiture of its generation assets, PSNH may modify or retire such generation assets if the [C]ommission finds that it is in the public interest of retail customers of PSNH to do so, and provides for the cost recovery of such modification or retirement."

As discussed earlier, decisions regarding "the economic interest of PSNH's retail customers" have become more complicated due to the emergence of competitive supply options and the related migration of PSNH retail customers away from PSNH's default service. This has created two subgroups of PSNH retail customers for whom the economic impacts of potential divestiture can vary greatly depending on decisions made regarding stranded cost recovery. Given the present circumstances, the Legislature should consider revising RSA 369-B:3-a to address those varying interests.

The current version of House Bill 1602 (HB 1602) directs the Commission, prior to July 1, 2014, to commence a proceeding to examine whether some or all of PSNH's generation assets should be divested or retired. As part of such a proceeding, the Commission may also order PSNH to divest or retire some of its generation assets. Those proposals are generally consistent with our conclusions and recommendations described above, but further discussion may be necessary with respect to timing to determine how best to mesh the ongoing Scrubber proceeding with a potential divestiture/retirement proceeding.

Definition of Stranded Costs

In conversations regarding the future of PSNH's generation fleet, much of the discussion concerns the subject of "stranded costs." It is important to understand, then, what stranded costs are and how they are currently defined in New Hampshire law. As stated earlier, stranded costs can generally be defined as the difference between costs expected to be recovered under regulated rates and those recoverable in a competitive environment. In New Hampshire law, stranded costs are defined in RSA 374-F:2, IV as follows:

> "Stranded costs" means costs, liabilities, and investments, such as uneconomic assets, that electric utilities would reasonably expect to recover if the existing regulatory structure with retail rates for the bundled provision of electric service continued and that will not be recovered as a result of restructured industry regulation that allows retail choice of electricity suppliers, unless a specific mechanism for such cost recovery is provided. Stranded costs may only include costs of:
>
> (a) Existing commitments or obligations incurred prior to the effective date of this chapter;
>
> (b) Renegotiated commitments approved by the commission; and
>
> (c) New mandated commitments approved by the commission, including any specific expenditures authorized for stranded cost recovery pursuant to any commission-approved plan to implement electric utility restructuring in the territory previously serviced by Connecticut Valley Electric Company, Inc.

The "effective date of this chapter" referred to in subsection (a) above was originally 1996, with the most recent change to the statute occurring in 2003. With respect to a potential divestiture of PSNH generation plants, especially considering post-statute capital additions, none of the subsections of the law as it currently exists would appear to allow for inclusion of any unrecovered net book value of the plants as stranded costs. That is an important concept because RSA 374-F:3, XII provides that stranded costs be recovered through a "nonbypassable" charge, i.e., from all customers of a utility, regardless of whether they receive default service from the

utility or receive service from a competitive supplier. Given the current statutory stranded cost definition, it does not appear that any stranded costs arising from divestiture of PSNH's plants would be eligible for recovery through such a nonbypassable charge, absent a legislative change, meaning that default service customers could be left with that cost burden.

Referring again to the current version of HB 1602, proposed subsection (d) would expand the definition of stranded costs to include "*[c]osts approved for recovery by the commission in connection with the divestiture of PSNH generation assets pursuant to RSA 369-B:3-a.*" That proposal appears to be sufficient to encompass the impacts of a potential future plant divestiture.

Electric Rate Reduction Financing (a/k/a Securitization)

Electric industry restructuring in PSNH's service territory was accomplished through a combination of the *Agreement to Settle PSNH Restructuring* (Restructuring Settlement) considered by the Commission in Docket DE 99-099 along with the enactment of certain enabling statutes. Chapter 369-B of the New Hampshire Revised Statutes Annotated provided for the issuance of bonds with a dedicated and prioritized revenue source as a method for PSNH to recover a category of its stranded costs arising from the Restructuring Settlement.[12] The dedicated revenue source combined with the specific requirements of the bonds created an attractive investment vehicle for bond investors and allowed for lower interest rates than what would be considered "standard issue" utility bonds. These bonds have been referred to in the past as "rate reduction bonds" or "securitized bonds."

Considering the potential magnitude of stranded costs—depending on the future path taken with respect to PSNH's generation fleet—securitization may be an avenue worth pursuing. However, as the enabling legislation in Chapter 369-B dealt specifically with the particulars of DE 99-099, the statutes would need to be revised to accommodate the present day circumstances.

PSNH's Provision of Default Service

RSA 369-B:3, IV(b)(1)(A) sets forth current requirements for PSNH's provision of default service:

> From competition day until the completion of the sale of PSNH's ownership interests in fossil and hydro generation assets located in New Hampshire, PSNH shall supply all, except as modified pursuant to RSA 374-F:3, V(f), transition service and default service offered in its retail electric service territory from its generation assets and, if necessary, through supplemental power purchases in a manner approved by the commission. The price of such default service shall be PSNH's actual, prudent, and reasonable costs of providing such power, as approved by the commission.

[12] The last of the rate reduction bonds from DE 99-099 were extinguished during the second quarter of 2013.

As prescribed in the statute, PSNH must use its generation assets combined with supplemental purchases until such time as it completes the sale of its fossil and hydro assets. The Legislature may need to revisit these requirements in the event that only some of the generation assets or the PPAs were to be divested.