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The Northeast Utilities System

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NEW HAMPSHIRE
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AIR RESOURCES DIVISION

November 30, 2009

Robert R. Scott, Director
Department of Environmental Services
Air Resources Division
29 Hazen Drive
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Joseph T. Fontaine, Trading Programs Manager
New Hampshire Dept. of Environmental Services
Air Resources Division, Technical Services Bureau
P. O. Box 95, 29 Hazen Drive
Concord, NH 03302-0095

Re: PSNH Comments on DES Preliminary Determination
re: Bonus $CO_2$ Allowances (as amended)

Dear Director Scott and Mr. Fontaine:

Public Service Company of New Hampshire ("PSNH") herewith submits its comments on the preliminary determination issued by the Department of Environmental Services ("DES") on October 30, 2009.[1] The DES determination specifies the number of Bonus CO2 Allowances to be awarded to PSNH for four qualified projects pursuant to RSA 125-O:5,III:

> For expenditures made by PSNH independent of SBC funds for energy efficiency, new renewable energy projects, or conservation and load management, the department shall provide emissions allowances to PSNH equivalent to the amount of such allowances that could have been purchased at market prices by the same dollar amount as the expenditure made [repealed in 2008].

Concurrently, and as part of these comments, PSNH incorporates all filings described below in order to preserve all rights for appeal purposes, consistent with our service obligations to our customers.[2]

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[1] The DES preliminary determination is entitled "New Hampshire Department of Environmental Services (DES) Response to Public Service Company of New Hampshire (PSNH) Regarding Request for Bonus Carbon Dioxide (CO2) Allowances (amended by DES; October 2009)."

[2] These filings specifically include, but are not limited to, the PSNH Appeal from (Request for Reconsideration of) DES Final Responses for Bonus CO2 Allowances (and attachments) dated May 1,

PSNH appreciates the efforts of the Air Resources Division to resolve this long-standing issue which, as we have stated in prior filings, has a direct economic impact on our customers. Our first filing requesting Bonus CO2 Allowances in accordance with the applicable law dates back to April 2007. In response to that filing, in September 2007, DES issued its first Preliminary Determination regarding Bonus CO2 Allowances to be awarded to PSNH for the Schiller Station Unit 5 renewable energy project (also known as "the Northern Wood Power Project") and the Smith Hydro efficiency project, and requested comments on that determination. PSNH responded on November 21, 2007, including in its comments an assessment by Dr. David Harrison, a leading expert in climate change markets and a primary advisor to the European Union in its creation of the European Union Emissions Trading System ("EU ETS"). By that time, the primary issue had crystallized—DES and PSNH agreed the projects at issue were absolutely qualified for Bonus Allowances but differed on the correct market standard to apply in translating "the market expenditures" into bonus allowances. DES argues that the EU ETS is the correct market standard while PSNH, supported by Dr. Harrison, contends the Chicago Climate Exchange or CCX is a better analog.

In 2008, to further complicate the issue, the Regional Greenhouse Gas Initiative took center stage in the political arena as the legislature considered adaptations of the RGGI Model Rule for New Hampshire and the implications for our first-in-the-nation Multiple Pollutant Reduction Program, known as the Clean Power Act. Various stakeholders expressed concerns regarding the impact of the Bonus CO2 Allowances on the RGGI program and the State's anticipated auction proceeds. As a result, the legislature, recognizing that PSNH had in fact relied upon the existing law in making certain investments for which it would receive Bonus CO2 Allowances, put in place a provision (referred to as "the flow-control provision") unique to New Hampshire's RGGI law, specifically addressing this situation in that the number of Bonus CO2 Allowances that PSNH could utilize for compliance on an annual basis was limited (2.5 million allowances in 2009, 2010, 2011, and 1.5 million allowances in each year thereafter) with a cumulative cap of 12 million prior to December 31, 2014 (unless the legislature upon reconsideration authorizes differently). In addition, with the passage of RGGI, the provision at issue here, RSA 125-O:5,III, was repealed—in effect, going forward, Bonus CO2 Allowances would no longer be provided as an incentive for renewable energy projects or energy efficiency projects.

It was not until April 2009, almost a year and a half after releasing its first Preliminary Determination, that DES issued a decision entitled "Final Responses to Requests for Bonus Carbon Dioxide Allowances for the Northern Wood Power Project and the Smith Hydro Project." In response, in May 2009, as a result of the unique procedural nature of the matter, PSNH filed an appeal of the DES final determination (to preserve its appeal rights) and concurrently filed a request for reconsideration with DES. PSNH requested the Air Resources Council to hold the PSNH appeal in abeyance, mindful of the need to conserve the Council's resources, until such time as DES had the opportunity to reconsider its decision substantively (and to correct a mathematical error).

PSNH submitted a proposed resolution to DES on September 29, 2009, utilizing the EU ETS as the standard while reserving its rights regarding its original position regarding the CCX as possible grounds to appeal a future final decision. In regard to the choice of the EU ETS, our argument was, and steadfastly remains, that if that is to be the market standard utilized to determine a corresponding value of "market expenditures," then that standard must be applied consistently. This is, above all, an issue of equity, of fairness to PSNH's customers.

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2009, the September 29, 2009 PSNH Letter from PSNH to Director Scott, and all other relevant correspondence in ARD Files.

Despite the fact that Phase I allowances dropped in price at the end of Phase I, prior to the transition to Phase II, the Phase I allowances could still be purchased and used for compliance. The purchase of such Phase I allowances would thus inarguably be the only reasonable course of action for a regulated entity. For DES to determine that the end result of such a consistent approach would be unpalatable in today's political climate does not justify the selection of an arbitrary date, a date for which justification cannot be provided, a date which gives the appearance of being backed into for the express purpose of limiting the number of Bonus CO2 Allowances to be awarded for qualified projects. This is, after all, an issue of customer money. The October 30 determination issued by DES has a sidebar note from DES (at page 10) stating: "***Selection of October 2006 is arbitrary***. A case could be made for a May 2006 date. However, my most recent analysis was based on a volume-weighted average beginning as soon as Phase II allowances became available. Volume-weighting automatically accounts for the low volumes of Phase I allowances in 2007, and I recommend using this approach" [emphasis added].

PSNH contends that a far more rational case could be made for a December 2006 date based on the commonsense, demonstrated, ***required*** behavior of a regulated entity given the choice of purchasing lower or higher priced allowances for compliance purposes. A test for the rationality of a proposed approach is the prudency standard to which PSNH is held by the New Hampshire Public Utilities Commission ("PUC"). Would the PUC determine that PSNH acted in accordance with the best interests of its customers if it purchased higher priced allowances when lower priced allowances were still viable for compliance purposes? Would such behavior withstand the scrutiny of regulators from an economic standpoint? Unjustifiably costly decisions by a regulated utility would be deemed imprudent and excess costs disallowed by the PUC.

It is important to keep in mind the RGGI "flow-control provision" which, regardless of the size of the Bonus CO2 Allowance award, limits the use of those Bonus Allowances. The legislature anticipated that the award of Bonus CO2 Allowances might well be high enough to affect the projected economic gains resulting from the RGGI auctions, and as a result used this provision to ensure a limited impact.

The RGGI provisions, based on the Model Rule, were integrated into the Clean Power Act in June 2008. The controversy surrounding the award of the Bonus CO2 Allowances was fully developed well before that time and was understood by legislators as the "flow-control provision" illustrates.[3] The definition "international trading program" [4] was added to the RGGI provisions in 2008 by the Air Resources Division, in a significant departure from the Model Rule which does not contain such a definition nor endorse an international accord or cooperative arrangement since this would immediately raise constitutional concerns. In response to comments objecting to what might appear to be a rather overt attempt to bolster the DES choice of the EU ETS, the definition of "international trading programs" was explicitly limited to offset programs. As a result, that June 2008 definition should not now be used by DES as justification for its choice of the EU ETS a year and a half earlier as the correct market standard. DES states in the Preliminary Determination: "...in RSA 125-O:22, I(b) [*sic*], the legislature allowed allowances from 'international trading programs' to be used 'as approved by

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[3] In addition to the legislative record, emails exchanged between DES staff and legislators confirm familiarity with the issue. DES Response to PSNH FOIA Request.

[4] "International trading programs" means international programs approved by the department such as the European Emission Trading Scheme (ETS) and offset credits established under the Clean Development Mechanism (CDM) to be used to obtain equivalent RGGI offset allowances pursuant to RSA 125-O:22,II(b). RSA 125-O:20,VIII.

the department.'" However, the provision when read in full applies ***only*** to stage-2 trigger event offsets and does not provide the justification for the EU ETS that DES seeks.[5]

As stated earlier, PSNH incorporates all earlier arguments made in PSNH filings supporting the use of the CCX as the correct market standard or, alternatively, the use of RGGI allowance prices as an appropriate analog as proposed by Dr. Harrison. ("If the rationale for providing expenditures with credits was to provide 'early action' credits...reasonable prices can be derived using estimates of RGGI allowance prices...Moreover, at this point, actual RGGI auction prices can be used (properly discounted to provide appropriate values)."[6]) Interestingly, RGGI pricing is comparable to the CCX pricing, a position DES does not dispute. DES has offered no credible basis for avoiding RGGI, the current mandatory GHG market in the U.S. and the official carbon-trading program within which New Hampshire participates, and PSNH respectfully submits none could exist.

In conclusion, and most critical at this point, if DES adheres to its selection of the EU ETS as the appropriate market standard, then the standard must be utilized in a manner consistent with the behavior of a regulated utility. We respectfully request DES to reconsider its admittedly "arbitrary" selection of an October 2006 date as the point at which a regulated utility would stop purchasing available, valid, less expensive Phase I allowances and begin purchasing more costly Phase II allowances. Such an economic decision could not withstand scrutiny in the world of utility regulation and would not be consistent with our obligations to customers.

Yours truly,

Terrance Large LTL

Terrance J. Large, Director
Business Planning &
Customer Support Services

cc: John M. MacDonald, Vice President Generation-PSNH
Michael Walls, Assistant Commissioner, DES
Linda T. Landis, Senior Counsel, PSNH

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[5] The provision at issue, RSA 125-O:22,II(b) states: "If a stage-2 trigger event occurs, the compliance period shall be extended 4 years and an affected CO2 source may use offset allowances for up to 10 percent of its compliance obligation, including offset allowances or credits permanently retired from eligible international trading programs, as approved by the department."

[6] David Harrison, Memo on DES Final Response, April 29, 2009, Exhibit 12 to PSNH Request for Reconsideration, April 2009.