

PETER SHUMLIN  
Governor



State of Vermont  
OFFICE OF THE GOVERNOR

August 25, 2014

The Honorable Senator Claire Ayer  
504 Thompson Hill Road  
Weybridge, Vermont 05753

The Honorable Senator Christopher Bray  
829 South Street  
New Haven, Vermont 05472

The Honorable Representative Willem Jewett  
P.O. Box 129  
Ripton, Vermont 05766

**Re: Vermont Gas Systems, Inc. - Addison Natural Gas Project Phase 2**

Dear Senators Ayer and Bray, and Representative Jewett:

Thank you for your letter of August 1 regarding Phase 2 of Vermont Gas's Addison Natural Gas Project. I understand that, while you support the expansion of natural gas infrastructure in Vermont in order to provide greater fuel choice to our homes and businesses, you have serious concerns about the International Paper (IP) natural gas project, commonly referred to as Phase 2. I appreciate your interest in this project and the sharing of your concerns and those of your constituents. I have reviewed the questions and comments that you submitted and discussed these with the Department of Public Service and Agency of Natural Resources.

First, I have been concerned and disappointed in Vermont Gas' rollout of these projects thus far. I am particularly concerned about the recent cost increases and the manner in which the company delayed notification to the Board. I am also concerned about the manner in which the easements and possible eminent domain actions have unfolded. Vermont Gas must work harder to demonstrate the public benefit of these projects in order to avoid risking the project's success because I firmly believe that the introduction of natural gas is an important option for Vermonter's homes and businesses. In Addison and Rutland Counties, it will save Vermonters money while displacing dirtier oil. The use of natural gas at IP, where it will displace No.6 fuel oil, will improve air quality for Vermont.

I want to address the issues that you raise:

**Constitutional Issues:**

I am aware of Senator Bray's previous commentary on this topic and his reference to Chapter I of the Vermont Constitution which speaks to private property rights. In any such circumstance, access to private property would not be taken without just compensation – hopefully by agreement, but if necessary, eminent domain. I will leave it to the lawyers to determine this issue but do understand

that the question is whether there is an overall “public good” through implementation of the project, whether one or a multitude of customers are served by it. In answering this question, many factors have to be considered; for instance, economic benefits and greenhouse gas and other emission reductions are “public goods.”

With respect to your request that any CPG issued for Phase 2 not include the right to eminent domain, I understand that it is not the CPG which grants or withholds that right. The right to proceed with eminent domain is provided by separate statute to a utility that has been awarded a CPG. So, if a CPG is issued by the Public Service Board for this project, Vermont Gas would have the right to use eminent domain by law consistent with certain conditions.

I know that the Department has been working with Vermont Gas to ensure this is an option of last resort, and has tried on numerous occasions to facilitate constructive discussions between Vermont Gas and landowners. The Department encouraged Vermont Gas to offer neutral mediation, something the company recently said it would adopt. Commissioner Recchia and his staff will continue to press for better process and communication on these issues, and to ask Vermont Gas to make every effort to minimize the use of eminent domain by Vermont Gas in Phase 1, and in any other projects granted a CPG to which it may apply.

Furthermore, I have asked the Department to participate in the valuation portion of any eminent domain proceedings that may be filed in any phase of the project, and to hire an expert outside appraiser through the Department’s billback authority to provide a valuation opinion in those matters. Although generally in the past the Department has weighed in on the necessity criterion of an eminent domain proceeding, and not on the valuation of the property itself, I am concerned at the transparency and equity issues that have been raised by Vermont Gas’s negotiations with landowners. I want to ensure consistent third-party valuations for property subject to condemnation in the event eminent domain proceedings occur. While landowners still may choose to retain their own valuation expert, as well as their own representation, in these proceedings, a neutral valuation expert retained for all such proceedings seems appropriate and necessary in these circumstances.

### **Climate Change Impacts:**

I hope and expect that the climate change analysis conducted jointly by my Agency of Natural Resources and Department of Public Service with respect to Phase 2 is more narrowly focused and easier to follow than that which was presented in Phase 1. I understand that the Phase 2 analysis shows because this project will primarily replace No. 6 fuel oil with natural gas, it is very likely that greenhouse gas emissions will be significantly reduced, to the climate’s benefit. There will also be reductions in other emissions, such as sulfur and nitrogen oxides that contribute to acid rain, fine particulates, regional haze and ground level ozone, all of which have benefits for the better health of Vermonters and our environment. I also understand that the Department and ANR will continue to seek commitments to renewable biogas, solar hot water, and other beneficial technologies that can be paired with Vermont Gas’s service.

I recognize that the Public Service Board will face a complex challenge when it weighs the public good of the Phase 2 project, which is designed primarily to service one out of state company. That is why I am committed to seeking utilization of new technologies and proven strategies to curb the effects of climate change and mitigate the environmental impacts in the event Phase 2 proceeds, and I have instructed my Department of Public Service and Agency of Natural Resources to seek real and significant commitments to the public good from Vermont Gas for Phase 2 and all future natural gas

project. I expect to see further work on the part of Vermont Gas, the Department, and the other parties in front of the Board to accomplish this, and recognize that in its absence the Phase 2 project would not proceed.

### **Cost Benefit Analysis:**

This section of your letter asks about the costs of the project as they relate to the local communities. I hear the concern that hosting communities and property owners feel they receive all the costs and few of the benefits. I know it is disappointing that Vermont Gas is not presently offering service to more Vermonters along this route. However, an important point is that the economic costs are not “paid by the towns and landowners of Cornwall and Shoreham,” as stated. Obviously, there is burden borne by the local communities in hosting the pipeline that must be compensated for, but the towns would receive the benefit of property tax payments—just like every other town that may host utility infrastructure. In addition, the communities will receive the value of any other conditions negotiated with Vermont Gas or mandated by the Board as a part of the public good analysis to ensure that local communities who host but do not receive service from the project share in the benefit.

As far as actual costs of the Phase 2 project, I understand that International Paper is paying the majority (96%) of the costs, both for the spur to provide service for its operations, as well as for the enhanced reliability associated with the so-called Phase 7 looping project, which will benefit all Vermont Gas customers. Without Phase 2, Phase 1 would cost an additional \$28M. The only parts of Phase 2 that Vermont Gas customers (not the residents of Cornwall and Shoreham) will pay if approved is for the added diameter pipe necessary to go to Rutland without further pipeline upgrade, and local gate stations. That being said, Vermont Gas can do a much better job at conveying who will pay, how much it will cost and how it will benefit the public good.

### **Reliability of the Application’s Economic Analysis:**

While analysis continues to show the economic benefits of Phase 1 for all Vermonters, I am extremely disappointed that the cost overruns Vermont Gas recently disclosed are so high. I also share the concerns of many on the timing of the disclosure. I have asked Commissioner Recchia to ensure that he and his Department are very clear with Vermont Gas that any such changes in the project require a filing promptly to inform the Public Service Board, and that the Department itself will convey the information known to them if Vermont Gas fails to make a timely filing. The public expects no less. Based upon this recent incident, the Department will ask the Board to require Vermont Gas to provide at least quarterly updates to the budgets of both Phase 1 and Phase 2, and those will be subject to public scrutiny. Additionally, the Department has asked that the Board assess a financial penalty against the company. As has been shown in the Department’s recent response, they have taken this issue very seriously and have acknowledged that they should have done more to inform the public of this overrun. Systems are being put in place to prevent this type of lapse in public transparency and outreach in the future.

Presumably heeding the lesson of its recent failing, Vermont Gas has advised the Board and parties of capital cost increases in Phase 2. Clearly, Vermont Gas has eroded the public's trust through these cost overrun disclosure issues, and I believe it has recognized that in its recent comments. I am told that the Department will address this issue in more detail in its rebuttal testimony in the Phase 2 docket and most definitely in its consideration of the rate treatment afforded all of these costs. That said, I do not want to penalize Vermonters or our economy because of Vermont Gas’s failure to act

more quickly. The analysis provided by the Department continues to show that the project's benefits still significantly outweigh the costs, even after accounting for these substantial increases.

### **Alternative Financing:**

The availability of natural gas in Chittenden County and Franklin County over the past several decades has spurred economic growth by providing a cheaper, cleaner alternative to power and heat our businesses and homes. We have a duty to try to bring this choice to more Vermonters.

As you know, Vermont Gas operates in a rate and return regulated environment, unlike fuel oil companies. The Department tells me that the System Expansion and Reliability Fund, which is used to finance this utility expansion, will be substantially depleted following construction of Phase 1, and that it will take time to rebuild to accrue additional funds to go to Rutland. So while there will again be a balance in the Fund to go to Rutland in the future, the ability to use Phase 2 to get to Rutland sooner, though not "essential," is clearly an attribute in its favor. Higher rates or other means of cost recovery could be employed, but the Fund provides a more stable path.

Regardless of this issue, I agree with you that each phase must rest on its own merits. Phase 2 must be deemed to be in the public good on its own merits, and while a part of that analysis will include its overall economic effect, including on future phases of expansion, I would expect that the Board would not rest on that point alone. I know you are aware of and support the strong desire to receive natural gas service in and around Rutland. As Governor, I have an obligation to consider the statewide needs and impacts of energy projects and I continue to believe that expanding natural gas service is an important part of our overall energy strategy for all of the reasons I've mentioned.

We will continue to press Vermont Gas for significant benefits for Vermont, and my Department is also willing to explore with you any options you believe better advance the public good. I am concerned, however, that your statement that the capital cost increases in Phase 1 diminish the total net benefit of Phase 2 misses a fundamental concept of the financing structure proposed for both Phase 1 and Phase 2: In the event that Phase 2 is not approved and constructed, it is important to note that all of the Phase 1 costs – including the increases – would be borne by Vermont ratepayers. My understanding is Phase 1 would cost ratepayers at least \$28M dollars more if Phase 2 does not proceed.

### **Alternative Technologies:**

As a part of our overall energy planning, my administration continues to look at advancement in technology and gives great thought to how and when they might be integrated into Vermont's energy portfolio. As you know, we have made significant strides in bringing in and demonstrating new technologies that improve our energy diversity, reduce our impact on the environment and on climate change, and simultaneously prove to be very cost-effective for consumers. For example, I have been delighted to see the advancements made with regard to cold climate heat pumps. They indeed are likely to be an option for Rutland and many areas of Vermont, but they nevertheless in many cases require a primary fuel source – which brings us back to the original discussion about fuel choice and displacing dirtier fossil fuels. A heat pump utilizing natural gas as a primary fuel will still be cleaner and more economical than the same heat pump using oil as the fuel. Other forms of natural gas besides piped delivery (CNG and LNG) may have different climate change impacts but also can prove cost-effective and favorable in certain applications, and we have supported both CNG companies and LNG solutions since I have been governor.

In addition to my commitment to integrating new technologies, I have tasked my Department to press Vermont Gas to explore not only greater use of biogas and possible incentives to increase the renewable component of any future gas supply, but also ways to better support solar hot water systems in its service territory. Both of these would serve as further ways to reduce the amount of natural gas a consumer might need, and to continue to advance our renewable goals.

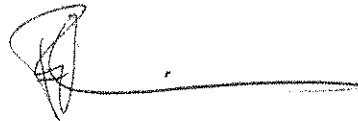
While we have made great progress in adding renewables to our electric sector, we can do more to get us to an energy future that is cleaner, meets our renewable energy objectives, and is more cost-effective for Vermonters than our current portfolio. I support natural gas expansion because I continue to believe that it is unwise to block access to any heating option that is cleaner and less expensive than those fuels presently available and that is appropriate to give consumers this option.

### **Natural Gas as a Bridge Fuel:**

This leads me to the last concern you've raised. As I have said repeatedly, I strongly support the need to wean ourselves off of fossil fuel as we fight climate change worldwide. I strongly believe, however, that we shouldn't scuttle the good in favor of the perfect as we seek to build a more sustainable energy future for all Vermonters. Successful expansion of natural gas service will help replace decades of dirty fuel oil use in favor of a cleaner burning, less expensive fuel. These gas projects are important contributors to making our energy transition that will reduce the costs of heating and manufacturing, and enable businesses, industries and Vermonters to save money, and hopefully invest those savings in energy efficiency improvements, technologies and jobs for many years to come.

Thank you for your letter and for your interest in this project. I, too, welcome ongoing discussions and expect a vigorous examination of all aspects of this project before the Public Service Board makes a decision on Phase 2. I expect Vermont Gas to bring significant benefits to the public as a part of the Phase 2 process. I expect the Department to press Vermont Gas further as noted above and to push for more transparency at every stage of the process. In the end, I am confident that the Board process will produce a result that is in the public good of the state and Vermonters as a whole. If you wish to discuss any aspect of this further, please feel free to contact me or Commissioner Recchia at any time.

Sincerely,

A handwritten signature in black ink, consisting of a stylized initial 'P' followed by a long horizontal line extending to the right.

Peter Shumlin  
Governor