STATE OF CONNECTICUT
PUBLIC UTILITIES REGULATORY AUTHORITY

APPLICATION OF THE CONNECTICUT LIGHT AND POWER COMPANY TO AMEND RATE SCHEDULES	:	DOCKET NO. 14-05-06
	:	October 3, 2014

BRIEF OF GEORGE JEPSEN, ATTORNEY GENERAL FOR THE STATE OF CONNECTICUT

George Jepsen, Attorney General for the State of Connecticut ("Attorney General"), hereby submits his brief regarding the Application of the Connecticut Light and Power Company ("CL&P" or the "Company") to Increase Rates Schedules ("Application") filed on June 9, 2014. In its Application, CL&P proposed a distribution rate increase of $231.5 million, later revised to $221 million. Late Filed Exhibit ("LF") 3. The $221 million includes a request for the recovery of $73.3 million in major storm costs incurred in 2011 and 2012 and $25.3 million in system resiliency investments. The remaining $122.4 million represents CL&P's proposed increase in its revenue requirements. Application, 2. This $221 million increase, if granted, would represent a rate increase of more than 20% on the delivery portion of customers' bills and an overall rate increase of 7% for the average residential customer.[1]

The Public Utilities Regulatory Authority ("PURA" or "Authority") should reject CL&P's Application. The Company failed to meet its burden of showing that a 20% distribution rate increase is necessary or appropriate. To the contrary, the evidence clearly shows that CL&P's proposed rates are excessive and unwarranted. The Attorney General has identified more than $90 million in downward adjustments to the Company's

[1] *See* Docket No. 99-03-36, July 29, 2014 Filing, CL&P distribution average cost per kWh under 5 cents.

request that would greatly reduce the impact of CL&P's requested rate increase on its ratepayers. The Authority should make these adjustments, together with the additional downward adjustments proposed by the Office of Consumer Counsel ("OCC"), to ensure that the distribution rates approved for CL&P are no more than just and reasonable as required by Conn. Gen. Stat. § 16-19e.

I. CL&P'S APPLICATION

CL&P is the largest electric distribution utility in Connecticut, with more than 1.2 million customers in 149 municipalities in the State of Connecticut. Application, 3. CL&P's Application, which proposes a distribution rate hike of more than $221 million per year, includes a proposed return on equity ("ROE") of 10.2%. Hevert pre-filed testimony ("PFT"), 3. According to CL&P, the principal driver behind this rate increase is increased capital expenditure associated with system resiliency and reliability. Application, 3.

The rates proposed by CL&P greatly exceed levels that could be considered just and reasonable. CL&P's requested ROE of 10.2% is based upon a flawed analysis and is out of touch with current market conditions and recent Authority decisions. Further, the record in this proceeding shows that CL&P has overstated a number of its proposed expense items in its Application. These expense items include depreciation, the number of full time employees ("FTEs"), the amount of plant in service, executive retirement expenses, directors' and officers' liability insurance and incentive compensation.

The Authority is well aware that the past years have been difficult for Connecticut citizens. Connecticut is emerging from the most prolonged and profound economic contraction since the Great Depression eighty years ago, but many in the state still

struggle with lingering effects of the so-called "Great Recession." Moreover, Connecticut ratepayers must shoulder most of the extraordinary and burdensome costs associated with major storms in 2011 and 2012, as well as the infrastructure investment required in their aftermath.

Connecticut consumers – especially those on fixed or limited incomes – should not have to absorb any unwarranted increases in their cost of living, which this application would have them do. Electricity is far more than a modern convenience. It is a necessity, and the safe, reliable and affordable provision of electricity is critical to public health and safety. CL&P's customers are counting on the Authority to ensure that the electric utility rates approved will be no more than absolutely necessary.

II DISCUSSION

A. The Authority Should Reject CL&P's Proposed ROE

PURA should reject CL&P's proposed ROE of 10.2%. It is not consistent with recent PURA decisions or analysis and is based on flawed and unreliable cost of capital analyses. The Attorney General generally supports the OCC's cost of capital testimony and its recommended ROE of 8.9%. Woolridge PFT, 2. Adjusting CL&P's proposed ROE from 10.2% to the more reasonable 8.9% would result in a rate reduction of approximately $35 million per year.[2] The Attorney General believes, however, that the Authority should impose additional reductions to CL&P's authorized ROE to reflect the reduced business and operations risk from the revenue and sales decoupling mechanism[3]

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[2] This $34,975,200 represents 130 basis points difference in ROE times CL&P's pre-tax revenue requirement of $26,904,000 for each 100 basis points. Schedule A-1.

[3] This mechanism is to be implemented in accordance with the newly enacted Public Act 13-298, *An Act Concerning the Implementation of Connecticut's Comprehensive Energy Strategy* ("P.A. 13-298" or the "Act").

and to reflect an appropriate penalty for CL&P's deficient and inadequate performance preparing for and responding to the major storms in 2011.

1. CL&P's Proposed ROE is Out of Line with Recent PURA Precedent

In its Application, CL&P asked the Authority to approve a ROE for the Company's shareholders of 10.2%. Hevert PFT, 3. In determining an appropriate ROE the Authority should set a return that allows the company to provide safe and reliable electric service while maintaining the financial integrity of the utility. The return should be fair to investors and ratepayers, meeting the firm's need to attract capital while ensuring that rates are no more than necessary to provide appropriate utility service. *See generally, Bluefield Water Works and Improvement Co. v. Public Schools Commission of West Virginia*, 262 U.S. 679 (1923); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

The Company's proposed ROE is far out of line with recent PURA decisions and would be the highest authorized return for any major regulated public service company in Connecticut. In the last 18 months, PURA has not authorized a ROE over 9.2%. The Connecticut Natural Gas Corporation was recently authorized a return of 9.18% in Docket No. 13-06-08, *Application of Connecticut Natural Gas Corporation to Increase Its Rates and Charges*, the United Illuminating Company was authorized a return of 9.15% in Docket No. 13-01-19, *Application of the United Illuminating Company to Increase its Rates and Charges*, 1,and the Aquarion Water Company of Connecticut was

allowed a ROE of 9.13%[4] in Docket No. 13-03-20, *Application of Aquarion Water Company of Connecticut to Amend its Rates*, 1.

2. CL&P's Cost of Capital Analysis is Severely Flawed

CL&P's proposed ROE is based upon a flawed and unreliable cost of capital analysis. First, CL&P's testimony in support of its proposed ROE of 10.2% contains errors that have distorted the Company's discounted cash flow ("DCF"), risk premium ("RP") and capital asset pricing model ("CAPM") analyses and unreasonably inflated its proposed ROE. As a result, the Company's recommended ROE is substantially higher than other similarly situated utility companies and substantially higher than the levels that PURA recently approved for Connecticut's other public service companies.

The testimony and exhibits of J. Randall Woolridge[5] demonstrate that under current financial market conditions, 8.9% is a just and reasonable ROE. The Company's true cost of capital is much lower than presented by the Company's witness. Over the last five years, capital costs have fallen. During that time there has been an overall decline in interest rates and there is now a lower tax rate for investors, which has made stock investment more attractive. Moreover, as a result of the lingering effects of the Great Recession, the Federal Reserve has pursued an accommodating policy of targeting the federal funds rate between 0 and 0.25%, and instituted a policy of buying $85 billion in long term securities per month. Woolridge PFT, 9. While the Federal Reserve has begun tapering its bond buying program, it has "extended its commitment to keep short

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[4] Aquarion's base return on equity cited here does not include a 50 basis point premium rate of return that the Authority awarded the Company for its acquisition of failing water companies based on Section 8 of Public Act 13-78. CL&P is not a water company and therefore not eligible for such a premium. That decision awarding the 50 basis point premium has been appealed by the Office of Consumer Counsel.

[5] Woolridge is a Professor of Finance at The Pennsylvania State University.

term interest rates 'exceptionally low' until either the unemployment rates falls to 6.5% or the inflation rate exceeds 2.5% a year." *Id.*, 10. As a result:

> [c]apital costs remain at historically low levels. The increase in interest rates which was anticipated to occur when the Fed began tapering its bond buying program has not occurred. In fact, interest rates have declined since the beginning of the tapering program in January of 2014.

Id., 12. For these reasons, as well as those more fully explained in the pre-filed testimony of Woolridge on behalf of the OCC, the Attorney General supports the OCC's cost of capital testimony analysis.

The most reliable estimate of a company's cost of equity is generally derived from the discounted cash flow ("DCF") analysis. The DCF model is designed to replicate a market valuation of what investors would pay for a share of the company's stock. The price of the stock is equal to the discounted value of all future dividends that investors expect to receive from the company. The rate at which investors discount future earnings reflects the market's expected return on the stock. The DCF model employs a "proxy group" of companies similarly situated in terms of business risk, cash flow and investment return in order to determine a level of earnings necessary to attract needed capital at a reasonable cost to provide safe and adequate utility service.

CL&P's witness Hevert presented a number of analyses that unreasonably overstated and inflated the Company's true cost of capital. First, the Company's witness biased his results by selectively eliminating low-end DCF results as "outliers." Woolridge PFT, 55. While eliminating "outliers" is not of itself unreasonable, Hevert failed to eliminate comparable outliers on the high end of the range. Eliminating low end equity cost rates but not high end equity costs rates biased the Company's entire DCF analysis upward and produced an unreasonably overstated equity cost rate.

In addition, the Company's DCF analysis employed a projected gross domestic product growth rate of 5.7%, which is excessive and further upwardly biased the Company's cost of capital estimate. CL&P's proposed growth rate is based exclusively upon projected earnings per share forecasts by historically optimistic Wall Street analysts and without considering the dividend growth rate. Woolridge PFT, 56-7. As a result, CL&P's proposed growth rate is, "100 basis points above the projected long term GDP growth rates that come from government agencies, as well as economists." Tr., 1839. In addition, CL&P's growth rate is more than 100 basis points higher than the consensus estimate that CL&P agreed was appropriate in its ongoing transmission rate case before the Federal Energy Regulatory Commission ("FERC"), EL11-66, *Martha Coakley, Attorney General of the Commonwealth of Massachusetts, et al. v. Bangor Hydro-Electric Company, et al.* In that proceeding, CL&P agreed that the appropriate long term growth estimate should be 4.39%. Tr., 1840. Because CL&P selectively used an unsustainably high expected growth rate, its DCF model overestimated the true cost of capital and, therefore, its recommended return on equity. The Authority should reject CL&P's proposed growth rate as "upwardly biased and optimistic." Tr., 1841.

In addition to the DCF model for estimating the cost of capital, the Company also presented a capital asset pricing model ("CAPM") analysis to supplement its DCF projection. CAPM is a risk premium method of estimating the cost of capital. It is intended to represent investors' expected value for the increased risk associated with a stock offering as compared to a more secure bond instrument such as United States Treasury bills. The Company substantially overestimated the risk premium that should apply in this case. The greatest challenge inherent in any risk premium analysis is the

difficulty of measuring an investor's future expectation. CAPM is intended to replicate the expectations of today's investors' required rate of return for common stocks by evaluating the earnings per share ("EPS") growth rates. Hevert, for CL&P, applied an unreasonably overstated and unsustainably high estimate of earnings growth rate – indeed one much higher than the projected GDP growth rate. As noted by OCC's expert in this proceeding:

> [c]ompanies, overall, cannot grow their earnings faster than GDP. And, in this market risk premium model that Mr. Hevert uses, he used an expected earnings per share growth rate between 5 -- between 10 and 12 percent, and the fact is that -- and that's based on Bloomberg and Value Line projections. But the bottom line is, you can't grow earnings at a 10 or 12 percent in an economy that's supposed to grow 4 to 5 percent. It's just an economic unreality.

Tr., 1841-42.

Long-term historic earnings and growth rates have been about one-half of the Company's estimate and have typically ranged from five to seven percent in the United States. Woolridge PFT, Exhibit JRW-14. Moreover, most recent trends suggest that near future economic growth will be slower than historic averages. Id., 66-7. The Authority should reject CL&P's CAPM analysis as inflated.

3. The Authority Should Substantially Reduce CL&P's ROE to Account for Risk Reducing Effects of the Decoupling Provisions of Public Act 13-298

After determining a reasonable ROE for CL&P in this proceeding, the Authority should adjust that ROE downward to account for the substantial impact of decoupling as contemplated in Public Act 13-298, *An Act Concerning the Implementation of Connecticut's Comprehensive Energy Strategy* ("P.A. 13-298" or the "Act"). Section 11 of the Act provides that the Authority shall implement full sales decoupling by means of

a revenue adjustment mechanism that "decouple[s] distribution revenues from the volume of natural gas and electricity sales." Specifically, the Act provides that:

> (b) In any rate case initiated on or after the effective date of this section or in a pending rate case for which a final decision has not been issued prior to the effective date of this section, the Public Utilities Regulatory Authority shall order the state's gas and electric distribution companies to decouple distribution revenues from the volume of natural gas and electricity sales. For electric distribution companies, the decoupling mechanism shall be the adjustment of actual distribution revenues to allowed distribution revenues. For gas distribution companies, the decoupling mechanism shall be a mechanism that does not remove the incentive to support the expansion of natural gas use pursuant to the 2013 Comprehensive Energy Strategy, such as a mechanism that decouples distribution revenue based on a use-per-customer basis. In making its determination on this matter, the authority shall consider the impact of decoupling on the gas or electric distribution company's return on equity and make any necessary adjustments thereto.

(Emphasis added).

The adoption of a full revenue decoupling mechanism for CL&P will stabilize the Company's cash flows and revenue and will eliminate a number of risks that the Company now bears – including the risks of reduced sales because of variable weather, successful conservation efforts and economic downturns. PURA should reflect this very significant reduction in risk by making an appropriate downward adjustment to authorized ROE, as specifically provided in the Act.

The Authority has previously recognized that decoupling mechanisms reduce risk and warrant downward adjustments to a company's ROE. In Aquarion's latest rate case, the Authority determined that

> there must be a reduction in risk from the revenue adjustment mechanism as found in Section 3 of Public Act 13-78 when the Company has argued that historically, allowed revenues have been lower than actuals. The Authority takes into consideration the evidence that this reduction in risk cannot be measured and as such finds that only a nominal reduction of 10 basis points should be made to recognize this reduction in risk.

Final Decision, 13-03-20, *Application of Aquarion Water Company of Connecticut to Amend its Rates*, 110.

In other cases, the Authority has selected a return from the lower end of the range of reasonableness to reflect the downward adjustment. For example, in UI's most recent rate proceeding, the Authority concluded that it:

> will not make an explicit downward adjustment to ROE, but notes that financial theory indicates a decoupling mechanism, which virtually guarantees the Company's ability to achieve its allowed revenues, eliminates some business risk that UI would otherwise face. Therefore, the Authority finds that an allowed return selected from low to midpoint of the range of reasonableness is appropriate and supported by the record evidence and financial theory.

Final Decision, 13-01-19, Page 126.[6]

Here, an appropriate meaningful downward adjustment to CL&P's ROE is warranted in light of the Company's decoupling proposal and the explicit instruction of P.A. 298. While determining the precise value of the reduction of risk the decoupling represents is difficult, the Attorney General submits that at least a 20 basis point adjustment, similar to the adjustment that PURA applied for Aquarion, is reasonable. Such an adjustment would amount to an additional annual reduction to the company's revenue requirements of $5.4 million. Schedule A-1.

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[6] In CNG's most recent rate case, the Authority recognized the impact of decoupling on the company's risk profile, but declined to make any specific downward adjustments to the Company's ROE. "The Authority has not incorporated an explicit downward adjustment to ROE for decoupling, given the program has just been approved. The Authority shall monitor the effects of decoupling as it relates to issue of risk and return." Final Decision, Docket No. 13-06-08, *Application of Connecticut Natural Gas Corporation to Increase Its Rates and Charges*, 108.

4. The Authority Should Reject CL&P's Proposed Earnings Sharing Mechanism

CL&P's approved rate structure currently includes an earnings sharing mechanism ("ESM") whereby it shares all of its earnings above its authorized ROE equally between shareholders and ratepayers. In fact, each and every one of the state's major electric, gas and water companies has an earnings sharing mechanism that begins sharing at dollar one above their authorized ROE.

In its Application, CL&P proposed a new earning sharing mechanism whereby the Company would retain 100% of the excess earnings for the first 100 basis points above its authorized ROE. Hevert PFT, 45-47. Between 100 basis points and 150 basis points above its authorized ROE, the Company's shareholders would retain 75% and the ratepayers 25%. *Id.* For any remaining earning above 150 basis points, the Company proposed that its shareholders and ratepayers would share equally. The Company claims that its asymmetrical sharing mechanism would benefit ratepayers because the Company would be more strongly incented to achieve additional savings if it could retain the majority of those savings, and that ratepayers would be the ultimate beneficiaries after the next rate case when those lower costs were returned 100% to ratepayers. The Authority should reject CL&P's proposed ESM as entirely unfair to ratepayers. This is especially true where, as here, CL&P can expect to see increasing earnings and savings resulting from efficiencies created by the merger between NU and NStar. NU and NSTAR touted the customer benefits associated with those merger savings as a principal public benefit to the transaction. Now, however, CL&P's proposed ESM would funnel the vast bulk of those savings back to its shareholders. PURA should reject the Company's proposed

ESM and should order CL&P to share all earnings over its authorized return evenly between shareholders and ratepayers.

B. The Authority Should Reject CL&P's Proposed Depreciation Rates

CL&P has identified $138.8 million in total depreciation and $119.5 in adjusted depreciation expense. Spanos PFT, Ex. JJS-2, Depreciation Study, Table 1 and 2. This proposed expense rate represents more than a $20 million increase in depreciation expense over current rates, largely because of increases to negative net salvage. Pous, Revised PFT, 6. The Authority should reject this unwarranted increase.

Ratepayers pay a utility for the return of and on capital investments that are used and useful for providing utility service. Depreciation expense represents a company's recovery of its investment in plant over the useful service life of that plant. Depreciation expense also considers the "salvage" value of that plant once it has been removed from service. In the event the salvage plant has a positive value, the depreciation expense is reduced by that value. In the event the salvage value is negative (i.e., the costs to remove the plant are higher than its value) than the depreciation expense is increased by that cost. Depreciation rates are intended to provide the company with a revenue stream to pay the return of the capital investment to coincide with the actual expected service life of the particular investment being recovered. "Depreciation accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any) over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner." Pous PFT, 7.

CL&P's depreciation study, however, understates the average service life of its physical plant and overestimates its future negative net salvage costs. The Company's

analysis, therefore, unreasonably accelerates its recovery of its investment and raises the overall annual expense to ratepayers. In so doing, it forces today's customers to pay disproportionately for distribution infrastructure that will service future customers for many decades to come.

1. Average Service Life

With respect to average service life, the OCC's witness identified two areas where the Company significantly understated the expected life of its investment. First, in Account 362 – Distribution Station Equipment, the Company did not adequately reflect the increasing average service lives of plant, both through the Company's actual historical data as well as the applicable industry standards. Pous PFT, 19-20. CL&P similarly understated the average service lives for plant in Account 365 – Overhead Conductors and Devices. When asked for the evidence or basis supporting the Company's proposed service lives, CL&P was unable to provide any support. As noted by OCC's expert depreciation witness:

> [w]ith the exception of informed judgment, which includes Mr. Spanos' 28-years of depreciation experience related to the electric utility industry obtained in the general conduct of depreciation studies, there is no additional information in the determination of life and salvage parameters proposed for each account.

Interrogatory Response OCC-33. OCC's witness further testified that CL&P

> provides either no specific support, or very limited specific evidence that can be reviewed, analyzed, or tested in support of . . . [its] specific proposals, other than the actuarially derived OLT that must be interpreted. Indeed, the Company and Mr. Spanos declined to provide requested specific information regarding the claimed industry values that played a significant role in its selection of life parameters.

Pous Revised PFT, 16.

The OCC's witness, by contrast, better matched the Company's actual observed life table ("OLT") with the appropriate life "survivor curve" enabling an estimated average service life that better matched CL&P's actual depreciation experience. Adopting the OCC's proposed adjustments to average service life for these plant accounts would reduce depreciation expense by $3.7 million per year. Pous Revised PFT, 28.

2. Negative Net Salvage

Negative net salvage refers to the future costs of retiring an asset, which means the scrap value of the asset less any costs of removal (such as digging up the pipeline, environmental remediation, etc.). The Company proposed a significant increase in its net salvage expense. CL&P's net salvage level is currently negative 30% for its distribution station equipment, 50% for poles and towers, 10% for underground conductors and 20% for services.[7] The Company proposes to increase sharply those net salvage levels for each of those accounts.[8] Spanos PFT, Exhibit JJS-2.

Again, however, the Company failed to support its request to increase its net salvage levels. Pous PFT, 37; OCC-225. "The Company provide[d] no specific basis for its proposal. The Company present[ed] a generalized overall basis, which as stated in its 2013 Study, is the word 'judgment.'" Pous Revised PFT, 31. The Authority should reject the Company's proposals to increase sharply the negative net salvage rates as entirely unsupported. To the contrary, the record in this proceeding shows that there are good reasons for reducing negative net salvage rates. For example, the price of copper has

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[7] A negative net salvage of 100% means that for every dollar of plant invested, the Company expects to incur an additional dollar in the future to remove it. If a company has a negative salvage rate of 100%, for every dollar invested the company would seek to recover $2 in depreciation rates.

[8] CL&P proposes to increase those rates to 35%, 60%, 25% and 100% respectively.

increased exponentially over the past ten years. The retirement of transformers, which typically contain a large quantity of copper, should produce substantial positive salvage value for CL&P. Tr.,792-96; Pous, Revised PFT, 33. In addition, the Company can and should identify more plant that can be "abandoned in place," reducing the overall cost of retirement. Tr., 663-4; Pous Revised PFT, 39. Adopting the OCC's specific and supported recommendations would reduce negative net salvage expense by $8.7 million.

3. Software Amortization

CL&P has identified $13 million in annual software depreciation expense. Schedule WPC-3.32. The Company has a history, however, of understating the useful service life of its software and unreasonably accelerating its software depreciation for accounting purposes. The "Company identifies in excess of 45 different software systems that have been fully recovered and retired for accounting purposes, yet were still in use." Pous Revised PFT, 47. This has created an intergenerational inequality where fully 30% of the Company's fully depreciated software is still used and useful in providing service to its customers. Id. The OCC's expert witness recommends that:

> [g]iven the Company's historic practice of underestimating useful life expectancy for its software investment and the fact that other utilities often rely on 12-, 15- or 20-year amortization periods for major software systems, I recommend extending the amortization periods to reflect an overall 15-year period for these six remaining systems.

Pous, PFT, 48.

The Attorney General supports the OCC's recommendation of extending the remaining software amortization period to 15 years, and such an adjustment would reduce CL&P's depreciation expense by $5.3 million. Taken together, these adjustments

would reduce annual depreciation and amortization expense by $19.2 million. Pous Revised PFT, 6.

C. The Authority Should Reject Certain of CL&P's Proposed Expense Items

In its Application, CL&P overstated a number of revenue and expense items. Taken together with the Attorney General's recommended changes to the Company's proposed ROE, appropriate revenue and expense adjustments as discussed below would eliminate the need for a significant portion of the Company's requested rate increase. The following discussion addresses a few of the notable adjustments to larger rate base, revenue and expense items that the Authority should impose. In addition to addressing the merits of these particular proposals, this discussion is intended to provide examples of the many revenue requirement adjustments that are warranted in this case and is not intended to represent an exhaustive list.

1. The Authority Should Reject Ratepayer Funding of Directors' and Officers' Liability Insurance

In its Application, CL&P included $467,000 for Directors' and Officers' Liability ("D&O") Insurance in the test year. OCC-89. CL&P claimed that D&O insurance is fully recoverable from ratepayers as a prudent and necessary expense and that it will not be able to attract qualified individuals to serve on the board of directors without it.

The Authority should reject CL&P's request to have ratepayers fund 100% of the Company's D&O insurance and, consistent with PURA precedent, allow no more than 25% of this cost be allocated to ratepayers. *See* Final Decision, Docket No. 13-01-19, *Application of The United Illuminating Company to Increase Rates and Charges*, 72. D&O insurance is intended to "protect shareholders only from the actions of the

management they selected." Final Decision, Docket No. 05-06-04, *Application of the United Illuminating Company to Increase its Rates and Charges*, 47. The Authority should therefore disallow at least $350,000 from CL&P's revenue requirements.

2. The Authority Should Reject CL&P's Proposed Employee Incentive Compensation Funding

In its Application, CL&P proposed that its ratepayers fund 100% of its incentive plans that annually pay the Company's employees $10.38 million in incentive bonuses. OCC-100. PURA should reject this proposal. CL&P's proposed incentive plans are generally designed to incent and achieve goals, such as profit levels, that benefit the Company's shareholders, not its ratepayers. Shultz PFT, 26, 29. Ratepayers should not be forced to fund incentive plans that benefit only the Company, especially when so many Connecticut ratepayers are in difficult economic circumstances.

Moreover, the Company's incentive program does not appear to be structured to provide any "incentive" whatsoever, as the compensation is not truly at risk. Rather, CL&P's "incentive" plan appears to be a base compensation measure under another name. As indicated in OCC-101, 99.7% of CL&P's employees who are eligible for incentive compensation received incentive compensation from 2008 through 2013. Ratepayers should not be forced to pay "incentive" compensation that is neither at risk nor designed to benefit the ratepayers. The PURA should therefore eliminate the entire $10.3 million from the Company's proposed revenue requirements and from rates.

3. The Authority Should Reject CL&P's Supplemental Executive Retirement Plan

CL&P seeks to recover from its customers $2 million in Supplemental Executive Retirement Plan ("SERP") benefits for its executives. Schedule C-3.27. SERP payments

are allegedly designed to provide post-retirement payments for executives that are similar to the pensions received by non-executives relative to their pay.

The DPUC should reject CL&P's proposal to collect any amount of SERP from its ratepayers, which would result in a reduction in the Company's revenue requirements of $2 million. This is consistent with the Authority's treatment of SERP costs in the two recent rate cases for Southern Connecticut Gas and Connecticut Natural Gas, Docket Numbers 08-12-07 and 08-12-06 respectively. Specifically, the Authority held

> that ratepayers should not have to fund excessive benefits in these difficult economic times. The Department cites precedent in this issue where in the Decision dated October 13, 1995 in Docket No. 95-02-07, Application of the Connecticut Natural Gas Corporation for a Rate Increase PH01, the Department stated, "[a]lthough the Department has allowed this in past rate cases, it is too great of an expense to be borne by ratepayers struggling under a poor economy." Decision, p. 45. Based on the aforementioned, the Department disallows for ratemaking purposes the EEC SERP expense. The Company has the option of charging this expense below the line for shareholders to pay.

Final Decision, Docket No. 08-12-06, 49.

4. Storm Reserve

CL&P proposes to increase the annual storm reserve payments that are funded by its ratepayers from $3 million to $11 million to cover additional costs from catastrophic storms. Mahoney PFT, 30-1; Bowes PFT, 54-5. This represents an additional $8 million per year and is nearly a fourfold increase to the storm reserve.

The Authority should reject this request at this time as unsustainably burdensome for ratepayers. As noted above, CL&P is already asking ratepayers to pay $90 million per year for costs associated with the 2011-12 storms and an additional $25 million for the investments in system resiliency necessitated by those storms. Application, 2-3. Those extraordinary storms caused more damage and expense than any previous weather

events in CL&P's history, and ratepayers will be paying those enormous costs for another six years.

The Attorney General appreciates that it may in the future be appropriate to raise the storm reserve to ensure that ratepayers are better protected against the rate shock that can occur should the Company incur catastrophic costs from additional storms. The Authority should recognize, however, that beginning December 2014, ratepayers could be subjected to paying an additional $115 million per year for the 2011-12 storms and system resiliency. That alone is sufficient rate shock.

Moreover, CL&P's proposed increase to the storm reserve raises issues of inter-generation fairness. Today's ratepayers will be heavily burdened by the costs associated with three catastrophic storms in 2011 and 2012 for the next six years. This amount of major storm activity is historically unusual. Ratepayers should not be further burdened to protect the next generation of ratepayers from a similar rate shock. The Attorney General urges the Authority to defer any such increase until such time as the costs associated with the 2011-12 storms are fully or at least mostly paid off. The Authority should maintain the storm reserve funding at its current level of $3 million per year.

4. Customer Service Charge

In its Application, CL&P proposed to raise its residential customer service charge from $16 to $25.50 per month, an increase of nearly 60%. Davis PFT, Ex. EAD-6, Schedule E-2.3. The Company testified that increasing the fixed portion of a customer's bill would reduce the Company's sensitivity to variable consumption trends and further its decoupling program through rate design. Goodwin PFT, 16-7.

The Authority should reject this proposal as unnecessary, overly burdensome and poor public policy. As discussed above, P.A. 13-298 requires the Authority to implement full sales decoupling by means of a revenue adjustment mechanism that, "decouple[s] distribution revenues from the volume of natural gas and electricity sales." CL&P has proposed precisely such a sales decoupling mechanism in this proceeding. Increasing the customer service charge is therefore completely unnecessary to further the intent of decoupling in this case.

CL&P's proposal to increase the customer service charge by 60% is also unduly burdensome for residential ratepayers. If approved by PURA, residential customers would incur a monthly rate increase of $9.50 before any of the other elements of CL&P's requested $231.5 million rate increase are reflected in their distribution rate increases. Moreover, the Company's proposed customer service charge is far higher than those imposed by other New England electric utilities. For example, CL&P's affiliate Western Massachusetts Electric Company charges its customers $6 per month – less than half of CL&P's current customer service charge and less than a quarter the size of the Company's proposed charge. Tr., 835.

Finally, the Company's proposed increase in the customer service charge represents poor public policy in two other ways. First, this proposed increase would disproportionately impact low use electric customers, many of whom are on fixed and limited incomes and simply cannot afford it. The Authority should proceed very cautiously before imposing such a dramatic reallocation of costs to residential customers. Second, this proposed increase would tend to discourage conservation and energy efficiency. As noted by OCC's expert witness:

> [a] high customer charge tends to inhibit energy conservation. Minimizing the customer charge provides the ratepayer with a greater ability to control his/her bill on the basis of usage. For that reason, an excessive customer charge can promote wasteful energy consumption. Connecticut has numerous statutory programs which provide incentives for increased energy efficiency, evincing a staunch policy in favor of reduced energy consumption. The increase in customer charge runs counter to that state policy.

Johnson PFT, 39. *See also*, tr., 970-75. The Authority should not approve any customer service charge in excess of the $16 per month charge currently in rates.

5. <u>Decoupling Mechanism</u>

In its Application, CL&P proposed a revenue-based decoupling mechanism that would reconcile the Company's actual revenues to allowed revenues. Goodwin PFT, 10-13. As noted in Section II.A.3 *supra*, the adoption of a full revenue decoupling mechanism for CL&P will stabilize the Company's cash flows and revenue and eliminate a number of risks that the Company now bears – including the risks of underearning because of variable weather and sales.

P.A. 13-298 contemplates symmetrical decoupling. In the event that the Company's actual sales do not meet forecasted levels, ratepayers make the Company whole. At the same time, in the event that the Company's sales exceed forecasts, those extra revenues would be returned to ratepayers. The Company's witness acknowledged that the decoupling relationship is intended to be symmetrical, with risks and potential benefits for both the Company's shareholders and its ratepayers.

> Q. (Wright) But there is a symmetry to it. The decoupling mechanism, it caps the downside for the company because you are not going to underearn by virtue of increased conservation investments, weather variability, and also caps the upside so you won't – so ratepayers will receive benefits in return. There is symmetrical distribution of risk with respect to a decoupling mechanism. Correct?

A. (Goodwin) That much I would agree, that decoupling does – is structured in symmetrical fashion.
Q. (Wright) Okay. Potential benefits and costs for both ratepayer and the company?
A. (Goodwin) Sure, symmetrically, yes.

Tr., 955-56.

Despite the clear statutory intent that the risks and rewards of decoupling should be symmetrical, the Company's actual decoupling proposal contained a major exception that severely upsets the intended balance of decoupling. The Company proposed to exclude all revenues associated with "brand new customers." CL&P defined a 'brand new' customer "as a new service location for which no existing physical electric service connection exists, and thus, at a minimum, a brand new service line and meter would need to be installed." OCC-293. In other words, the Company proposed that it keep revenues associated with new customers even after it makes its sales revenues projections.[9] The Company claimed that it needed to exclude such revenues to offset the costs of serving these new customers. CL&P did not, however, provide evidence to support that position.

The Authority should reject the Company's unbalanced proposal to exclude revenues from "brand new customers" from its decoupling mechanism as plainly inconsistent with Section 11 of Public Act 13-298. The Act makes no provision for the exclusion of any revenue from the revenue reconciliation. Indeed, no other utility in Connecticut has sought or received such an exception for itself to retain revenues in excess of those allowed to meet revenue requirements. CL&P has not presented any

[9] The Company subsequently modified its proposal, see LF-15, but admitted that "[t]he net result of this alternative approach is absolutely no different than the original approach." *Id.*

coherent explanation why it should be allowed to segregate certain revenues that would otherwise flow through the decoupling reconciliation. Whatever the Company's justification for its novel approach to decoupling, it is asymmetrical and would improperly benefit shareholders at the expense of ratepayers.

6. Other Adjustments Proposed by OCC

The Attorney General supports many of the other downward adjustments to CL&P's rate request that were proposed by the OCC in this matter. These include downward adjustments to full time employees, plant in service, cash working capital, non-industry dues and memberships, property taxes, outside services and corporate charges. Cumulatively, these adjustments, together with those proposed by the Attorney General, would allow the Authority to reject a significant portion of CL&P's proposed rate increase.

D. The Authority Should Impose An Appropriate Reduction to CL&P's Authorized ROE as a Consequence of the Five Areas in Which CL&P's Response to the 2011 Storms Was Deficient and Inadequate

In its Final Decision in Docket No. 11-09-09, *PURA Investigation of Public Service Companies Response to 2011 Storms* ("Docket No. 11-09-09"), the Authority determined that CL&P's responses to Tropical Storm Irene in September of 2011 and the October 2011 Nor'easter were inadequate and deficient in five principal areas and established a rebuttable presumption that CL&P should have imposed upon it an appropriate reduction to its ROE in its next rate case; the present proceeding. Specifically, the Authority concluded that:

> [t]he Connecticut Light and Power Company's performance in the aftermath of the 2011 storms was deficient and inadequate in the areas of outage and service restoration preparation of personnel, support of its municipal liaison program, development and communication of restoration

> times to customers, and overall communication to customers, other service providers and municipalities, as to warrant regulatory sanction. In this Decision, the Public Utilities Regulatory Authority also concludes that because of The Connecticut Light and Power Company's failure to obtain adequate assistance in advance of the October 29, 2011 storm, its response to that storm was deficient. Because of The Connecticut Light and Power Company's failure to adequately fulfill its duties imposed by law and to adequately and suitably provide for the overall public interest with regard to these particular areas of performance, the Public Utilities Regulatory Authority establishes in this Decision, a rebuttable presumption that The Connecticut Light and Power Company should have imposed on it, an appropriate reduction to its allowed return on equity in its next ratemaking proceeding as a penalty for poor management performance and to provide incentives for improvement. In addition, in conformance with the merger agreement between Northeast Utilities and NSTAR, the Public Utilities Regulatory Authority retains further jurisdictional approval for recovery of an appropriate level of 2011 storm costs at the time The Connecticut Light and Power Company seeks recovery of any such costs.

Final Decision, Docket No. 11-09-09, 1. The Authority further stated that "[t]he AG, the OCC and other participants will have the opportunity to challenge any request for storm cost recovery at the time of CL&P's next rate case." Final Decision, Docket No. 11-09-09, 17.

The evidence in Docket No. 11-09-09 fully supported the Authority's determination that CL&P's storm response was inadequate and deficient sufficient to "warrant regulatory sanction." *Id.* CL&P was utterly unprepared to respond to the large 2011 storms. The Authority's consultant, The Liberty Consulting Group ("Liberty") found that "CL&P's storm performance was below average." Liberty Report, 1. Liberty cited to failures in CL&P's tree trimming program, its restoration estimates, its management command system, its ability to acquire outside resources and its coordination with towns as all deficient. Liberty Report, 1-2. CL&P did not seek meaningful outside resources until after the storm hit and caused numerous service outages. Liberty Report, 78; Davies Report, 21.

In addition, CL&P's Emergency Response Plan ("ERP") did not adequately stress training and drills. Liberty Report, 13, 18. CL&P employees questioned the plan and its application during the two 2011 storms and suggested that it was written for regulators, was not applied during the 2011 storms, lacked adequate specificity and that while it may have worked on paper, it was not the subject of adequate training. Liberty Report, 18-19. There is no evidence that CL&P drilled or exercised its ERP for at least five years prior to the 2011 storms. Witt Report, 17.

There was also substantial evidence in the record of Docket No. 11-09-09 that CL&P's municipal liaisons were poorly prepared, poorly supported and often ineffective. The results of CL&P's unpreparedness and mismanagement were disastrous for the affected towns and their citizens. Docket No. 11-09-09, Werbner Pre-Filed Testimony, 3. Elected representative from the towns of Simsbury, South Windsor, Tolland, Redding, Newtown, and Ridgefield appeared before the Authority and testified concerning CL&P's failures and the impacts on their towns. Final Decision, Docket No. 11-09-09, 5-9. For example, CL&P could not tell Tolland leaders where company crews were working, where the outages in town were, or provide real-time progress reports on restoration. Werbner PFT, 4. CL&P's inability to provide accurate restoration projections "had a material adverse impact on the town's ability to protect the health and safety of town residents." Glassman PFT, 5. Simsbury had no accurate information on which to schedule its shelter operations and care for its elderly and disabled. Id.

The Authority received more than one thousand written complaints and an additional one thousand telephone calls from customers concerning CL&P's deficient and inadequate response to the 2011 major storms. PURA stated that:

> [t]he majority of the customers who were affected by the 2011 Storms were concerned with the length of time it took the companies to restore service and the difficulty receiving information from the companies. Several customers stated that the companies were unprepared, mismanaged, and had underestimated the magnitude of the storm by not having sufficient repair crews available. Consumers believed that the lack of information provided by the companies left them unable to prepare for a longer than normal outage.
>
> Customer comment varied, but frustration regarding the amount of time the utility companies required to repair and restore service was a common theme. Several customers mentioned that Connecticut has the highest electric rates in the country and therefore, warrants better customer service. Customers suggested ways to help avoid future outages such as trimming trees and burying power lines. Others felt that customers with wells or septic systems should have their restoration of service prioritized because of the public health issues.

Final Decision, Docket No. 11-09-09, 5.

CL&P's unreasonable level of unpreparedness for major storms and its failure to respond to the 2011 storms in a reasonable and prudent manner caused the service restoration process to take longer than it otherwise would have. The failure of the municipal liaison program, as well as the delay in restoration for many customers, caused the towns to incur significant additional costs. Docket No. 11-11-09, Tr., 409-14. As the Attorney General argued in Docket No. 11-09-09, CL&P's imprudence, especially with respect to the October 2011 Nor'easter, turned extended power outages into crisis situations, caused significant public anxiety and severely impacted residents' and towns' abilities to deal effectively with the outages.

CL&P has argued throughout this proceeding that it should not be punished for its deficient and inadequate preparation for and response to the 2011 storms. The Company argued both that its 2011 storm response was reasonable, see Bowes PFT, Ex. KBB-3, *CL&P's Performance in the 2011 Storms*, and that its performance has substantially

improved since the 2011 Storms. *See* Bowes PFT, Ex. KBB-3, *Examples of Improvement CL&P has Made Since the October 2011 Nor'easter.*

PURA should reject the Company's first argument out of hand. The Authority carefully examined CL&P's preparation for and responses to the 2011 major storms in Docket No. 11-09-09 and properly concluded that the Company's actions and inactions were not merely deficient and inadequate, but were sufficiently deficient and inadequate as to warrant an appropriate penalty to its ROE in this rate case.

PURA should also find that any improvement in the Company's major storm performance since 2011 does not obviate the need for an appropriate ROE penalty in this proceeding. While CL&P's performance before and after Storm Sandy in 2012 was much improved from its performance during the 2011 storms, this subsequent improvement does not rebut the presumption applied in Docket No. 11-11-09 that CL&P should have an appropriate penalty to its ROE for its deficient and inadequate conduct during the 2011 storms. First, PURA made clear in Docket No. 11-09-09 that an ROE penalty should be imposed both "as a penalty for poor management performance and to provide incentives for improvement." The penalty for the Company's poor performance must be imposed in this case and cannot be avoided based on subsequent actions. CL&P's ratepayers pay among the highest rates for electric service in the United States. They have a right to expect that CL&P will perform its public service duties safely and adequately as required under Connecticut law. *See generally*, Conn. Gen. Stat. §§ 16-11, 16-20. That quite clearly did not happen before, during or after the 2011 storms. That CL&P has improved its storm response since should not exempt it from a significant

penalty for the demonstrably poor management performance which PURA has already found.

Moreover, the Company's improved response to Storm Sandy in 2012 was largely due to the measures the Company was ordered to undertake and due to infrastructure investment that is being paid for by ratepayers. It reflects a level of service that customers should have received, but did not, in 2011. CL&P should not be allowed to escape appropriate penalties for its deficient and inadequate performance in the 2011 storms because it subsequently provided a more reasonable response in the 2012 storm.

The Authority now has the opportunity to make good on its promise to hold the Company accountable for its many profound failures in the 2011 storms. The Authority should impose a penalty to the Company's authorized ROE of at least 35 basis points. That penalty would amount to approximately $9.4 million per year for the next three years. This penalty is both reasonable and modest in light of penalties the Authority has imposed in the past, both to companies' ROEs or as a disallowance for recovery of costs.

For example, in Docket No. 10-09-08, Application of United Water Connecticut, Inc. to Amend Rate Schedules, dated April 27, 2011, the DPUC again imposed an ROE penalty for imprudent management. In that case, the DPUC found that the United Water Company's accounting, record keeping and billing methods were lacking and imposed a fifty basis point downward reduction to its ROE "as a penalty and strong warning to improve its business management practices." Id., 83.

Similarly, in Docket No. 08-12-06, Application of Connecticut Natural Gas Corporation for a Rate Increase, dated June 30, 2009, the Department of Public Utility Control ("DPUC"), PURA's predecessor agency, found that CNG did not properly

include certain charges in its bills and that, as a result, some customers were overbilled while others were undercharged. *Id.*, 95. The DPUC found that the company's management that oversaw billing and rates was imprudent and imposed a 10 basis point reduction to its return on equity as an imprudence penalty. The DPUC further noted in that case that such ROE adjustments are designed to ensure that rates reflect prudent and efficient management as required by Conn. Gen. Stat. § 16-19e(a)(5) and that such ROE adjustments have been upheld in other jurisdictions. Id., note 14. Certainly, CL&P's mismanagement of its major storm response in 2011 merits a more severe penalty than that imposed on CNG in Docket No. 08-12-06. Importantly, the DPUC did not require in either of these recent cases any finding or showing that the company's imprudent actions caused actual losses or damages.

In other cases, the Authority has repeatedly imposed substantial cost recovery disallowances where it has found CL&P acted imprudently. *See e.g.* Final Decision, Docket No. 96-10-06, *DPUC Investigation Into Whether The Connecticut Light and Power Company Fulfilled Its Public Service Responsibilities With Respect To Its Nuclear Operations* (imprudence disallowance of $600 million in replacement power costs due to shutdown of Millstone reactors / disallowance of additional $360 million in other incremental costs);[10] Final Decision, Docket No 90-02-03, *Connecticut Yankee Nuclear Plant Shutdown* (imprudence disallowance of $31,269,000 in replacement power costs for shutdown of Millstone reactor);[11] Docket No 91-10-02, *DPUC Investigation into the Millstone 1 Shutdown on October 4, 1990* (imprudence disallowance of $2,865,000 in

[10]http://www.dpuc.state.ct.us/FINALDEC.NSF/0d1e102026cb64d98525644800691cfe/c04189b326f26210852564f70067170b?OpenDocument&Highlight=0,96-10-06

[11]htttp://www.dpuc.state.ct.us/FINALDEC.NSF/0d1e102026cb64d98525644800691cfe/9859926a05428ae985255fad006183f1?OpenDocument&Highlight=0,90-02-03

replacement power costs for shutdown of Millstone reactor).[12] In none of these cases were CL&P's customers placed in as extreme circumstances as the extended outages following Tropical Storm Irene and the October 2011 Nor'easter.

A penalty of at least 35 basis points to the ROE that PURA determines to be otherwise just and reasonable is reasonable and fair under the circumstances. Thirty five basis points is less than the basis point penalty assessed to United Water, but for conduct which was far more damaging to its customers.[13] The Attorney General believes that 50 basis points would be an appropriate penalty, but recognizes that CL&P has made improvements to its storm response and those improvements should count as an offset to the overall ROE penalty. This proposed penalty, when measured in terms of dollar impacts, is also somewhat more than the $2.9 million disallowance for the October 1990 Millstone shutdown, but again far less than the $600 million disallowance from the 1996 Millstone shutdown. CL&P failed in its public service responsibilities in the aftermath of the 2001 storms, and the Authority should hold CL&P appropriately accountable.

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[12] http://www.dpuc.state.ct.us/FINALDEC.NSF/0d1e102026cb64d98525644800691cfe/b9ee075767b4efcd85255fb00055b3b5?OpenDocument&Highlight=0,91-10-02

[13] The Attorney General suggests an ROE penalty here of less than that assessed to United Water in recognition of CL&P's generally improved storm performance in 2012 and the fact that he is suggesting other ROE reductions, as discussed in section A, above.

Summary of Adjustments

Return on Equity	$40.4 million
Depreciation	$19.2 million
Employee Incentive Compensation	$10.4 million
Storm Reserve	$8 million
SERP	$2 million
D & O Insurance	$350,000
Penalty for 2011 Storms	$9.4 million
Total	$90 million

III. CONCLUSION

The $221 million per year rate increase requested by CL&P is unwarranted, unsubstantiated and would result in rates that are more than just and reasonable. The Authority should reject the Company's Application and instead set rates that reflect reasonable adjustments to the Company's request as discussed herein. PURA should also impose an appropriate penalty to CL&P's authorized ROE for its poor management performance during the 2011 major storms. The cumulative effect of these adjustments would greatly reduce the harmful impact that CL&P's proposed rate increase threatens to have on its customers.

Respectfully Submitted,

GEORGE JEPSEN
ATTORNEY GENERAL
STATE OF CONNECTICUT

Service is certified to all parties and interveners on this agency's service list.

John S. Wright