STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

Re: EnergyNorth Natural Gas, Inc. d/b/a National Grid NH

Docket DG 08-009

NATION GRID NH'S MOTION FOR REHEARING AND/OR RECONSIDERATION OF COMMISSION ORDER 24,972

EnergyNorth Natural Gas, Inc. d/b/a National Grid NH ("National Grid NH" or "Company") hereby moves the Commission, pursuant to RSA 541:3, to reconsider or conduct a rehearing of Order No. 24,972 issued May 29, 2009. In support of its Motion, National Grid NH states as follows:

I. Background

This case represents the Company's first request for a base rate increase since 1992. In the sixteen years between rate cases, while the price of gasoline, heating oil, groceries and postage have changed dramatically, the Company's delivery rates have not. The Company's cost-effective management of its distribution system and prudent approach to capital investment have enabled it to provide customers an unprecedented period of base rate stability despite inflation of approximately 50% and a near doubling of rate base during that time and, more recently, declining use per customer. Exhibit ("Exh.") 40 at 3. The Company was able to accomplish this, while implementing full customer choice for its commercial and industrial customers, implementing significant energy efficiency programs and supporting other state energy policy initiatives.

The Company's rate filing sought a 5.6% increase in rates, as well innovative rate design proposals and rate making mechanisms, such as a pension/OPEB[1] reconciling mechanism intended to address a cost whose highly volatile nature has the potential to harm both customers and the Company. Through settlement discussions, the Company agreed to a resolution of all issues except return on equity ("ROE"), compromising on many of its proposals and accepting a revenue increase that was effectively half of what it had proposed. Consistent with Commission policy favoring settlements and in an effort to partner with Staff, the Company also agreed to resolve two other outstanding, highly adversarial dockets.

In the only remaining litigated portion of this docket—relating to return on equity—the Company emphasized the need for the Commission to set a reasonable return that would attract the investment needed by the Company to fund an aggressive capital program and advance a progressive energy policy designed to promote the long-term interests of customers. Regrettably, the Commission's initial order setting an authorized return on equity of 9.54% falls short of meeting these needs. Accordingly, the Company respectfully requests that the Commission reconsider its Order No. 24,972 and grant a rehearing on return on equity.

II. Introduction: National Grid and New Hampshire

National Grid[2] and its predecessor companies have always been proud to operate in New Hampshire, providing service to customers and working with public and private stakeholders to

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[1] OPEBs are other post employment retirement benefits.

[2] The term National Grid is used in this brief to refer to National Grid USA, the parent company of EnergyNorth Natural Gas, Inc. and its electric distribution affiliate, Granite State Electric Company.

meet the many challenges faced by the state and its citizens. It has only been able to do so with the support of the Commission, which created an economic environment that promoted responsible investment for both the long-term benefit of New Hampshire and customers.

As times have changed, so too have customers' needs. Meeting those changing needs requires National Grid to increase its investment in its utility subsidiaries and bring innovative approaches to the operation of their distribution systems and the service they provide. For the Company to be able to meet this challenge, the Commission must set an economic policy that enables it to attract the substantial capital required to do so. If the Commission creates the right economic climate to attract the necessary capital, the Company in turn will be in a position to make these ambitious system investments—an outcome that will serve the long-term interests of customers, shareholders and the future of New Hampshire. However, if the Commission implements an economic policy that adopts returns that are lower than those in most other jurisdictions, investors in the increasingly competitive and global investment marketplace will act accordingly and make their investments in those states where policymakers encourage it. In this regard, the Commission stands at an important crossroads.

National Grid's overall vision is to be the foremost gas and electric company, providing efficient, safe, reliable service and being an innovative leader in energy management that safeguards the global environment for future generations. Exh. 6 at 22-23. This vision dovetails well with public policy regarding energy and climate change, which is redefining the role of the utility to address many of the major challenges faced by state and national policy makers. *Id.* at 39-52. With the filing of its rate request in this proceeding, the Company sought to take an important step toward creating a sustainable future—something it hoped, and still hopes, to be able to do together with the Commission and other stakeholders.

The Company's rate proposal sought to provide National Grid NH with recovery of on-going operating costs, timely recovery of its capital investments, and a rate of return that provides an incentive to invest aggressively in New Hampshire. National Grid knows that customers want cost-effective, reliable, and safe energy service. They also want access to information and assistance on a wide variety of energy products. National Grid is well-positioned to meet these needs because it is the interface between the Company's gas customers as well as the electric customers of the Company's affiliate, Granite State Electric Company, and commodity supplies and suppliers.

With its acquisition of Key Span Corporation, National Grid significantly expanded its presence in New Hampshire. Through both EnergyNorth Natural Gas and Granite State Electric, National Grid has indicated its desire to be a leader in energy conservation, safety, renewable resources, smart grid technologies, smart metering, and many other important initiatives that can eventually transform the state's energy infrastructure and better serve customers. *Id.* at 34-36, 43, 50-51, and 74. There are opportunities through additional investment to expand distribution service, implement and expand robust energy efficiency programs, construct and install smart grid infrastructure, build transmission for renewable energy sources, and bring customers the benefits of real-time energy use, pricing information and control. *See, e.g.,* Exh. 6 at 35-36, 50-51. There are many other areas in which National Grid can play an important role in working with the Commission, the state and customers, including programs that benefit low income customers or that foster economic development. *Id.* at 37. In addition, both state and federal policy are moving in a direction that is designed to seek utility participation in meeting the significant challenges posed by global climate change. *Id.* at 33. Getting to that future tomorrow requires a sustainable economic policy set by the Commission today, but the Commission's order in this case does not create that policy. Instead, the Commission's decision establishing a return on equity of 9.54% will cause rational investors to invest elsewhere because they see a higher return on equity in nearly every other jurisdiction. The state needs financially strong utilities that are committed to investing and continuing to operate in New Hampshire. The Company stands ready to continue that commitment in an environment that demonstrates a reciprocal regulatory commitment to a compact that allows a utility to earn a fair return on its investments for customers.

III. The Commission's Decision Is Contrary To the Public Interest.

The Commission's order sets a return on equity that disserves the long-term interests of New Hampshire. The Company recognizes that the return authorized by the Commission in this proceeding was arrived at after careful consideration of the testimony of the Staff and Company experts. The Company also recognizes that the Commission has a sincere desire to set a return that balances customers' interests in affordable rates and safe and reliable service, on the one hand, with the pragmatic need for investors to earn a reasonable return, on the other. Those interests are not at odds, however, because the Company needs investors to fund the work necessary to meet customers' needs. Meeting those needs requires the Commission to create an environment that encourages sustainable long-term infrastructure investment. While the Company has always made, and will continue to make, the investments required by its franchise obligation, in order to truly meet the needs of its customers going forward as well as public policy objectives and environmental imperatives, its investment should go beyond merely meeting franchise obligations – it should include investment needed to replace the aging infrastructure of the Company's distribution system in a timely fashion, bring innovative energy efficiency practices to New Hampshire and implement other forward looking programs that benefit customers and support important state and Commission policy initiatives and goals.

The Commission's order fails to give adequate consideration to the policy implications of the return it has set for the Company when compared to that of other utilities in other jurisdictions where an investor can earn a higher return. The Commission appears to have reached this result in part because it mistakenly relied on the Company's legal obligation to invest sufficient capital to maintain a safe and reliable system no matter what return it is able to earn. In doing so, the Commission failed to address the reality that the equity investors from whom the Company ultimately seeks to attract capital have a wide range of investment options with no obligation to invest in a particular industry or company.

The low ROE set by the Commission sends a message that New Hampshire is not an attractive place for those investors. The Company's management has a fiduciary obligation to shareholders to whom it is rightly accountable for the ultimate outcome of this case. If that outcome provides for one of the lowest returns in the country, the Company's management will ultimately be obligated to fulfill its fiduciary duty by pursuing investments on behalf of shareholders in more attractive jurisdictions.

The result reflected in the Commission's order makes National Grid NH a less desirable investment opportunity than other companies, including other utilities. This is not in the public interest. Although a settlement of all issues other than ROE was achieved in this case, as in all settlements, all parties made compromises. The Company made its compromises in an effort to build a strong relationship with Staff and to further Commission policy favoring settlements. The Company's compromises naturally placed additional competitive pressures on it to operate in a manner that enables it to recover all of its costs. That challenge is further increased by the Commission's traditional use of an historic test year with only limited pro forma adjustments and the fact that the Company is operating in an environment that includes declining use per customer. Such a regulatory environment is one that makes it difficult to persuade investors that their capital is well spent, a task that will become untenable in the face of a Commission order authorizing a return that is well below the national average. The Commission's decision in this case signals investors that the Company is operating in a jurisdiction where it is not possible to earn an industry standard return unless the Company makes cost reductions to expense levels below what was allowed in the settlement. Further, because the authorized return is below industry standards, the decision also signals that the Company should not invest any more than what is minimally required to meet its legal obligations.

The evidence in this case plainly demonstrated that an allowed return on equity of 9.54% is significantly out of line with returns being authorized for gas utilities in other jurisdictions across the United States. Utility industry investors closely monitor and analyze the regulatory climates in which utilities operate, and base their views on the appropriate prices and terms for utility securities on these analyses. In particular, as the Company's expert testified, the ROE allowed by a state regulatory commission plays a critical role in determining the extent to which the investment community perceives regulatory support for a utility's investments in a particular state. Transcript ('Tr.") Day 1 at 70-71. The Commission should expect that its order will discourage investment in the Company. Likewise, the Commission's action is likely to discourage other utilities from committing capital to the state because doing so will put them at odds with their fiduciary obligation to shareholders as well as the realities of the international capital markets in which all companies must ultimately compete for limited funding. For companies not yet in New Hampshire, the Commission's action will discourage new entrants who find conditions for businesses more hospitable in nearly every other state.

The Company recognizes that, from a legal perspective, the Commission has broad discretion in determining a proper return on equity. The Commission should be concerned, however, that even if the return established by its order is ultimately determined to be lawful, it is insufficient to enable the Company to attract the necessary outside capital to invest in New Hampshire, and will likely have the effect of driving existing investors to more attractive opportunities elsewhere. Such an outcome is not consistent with the public interest.

IV. The Commission's Reliance on a Single Analytical Model Caused It to Establish A Return on Equity That Is Too Low.

Because it adhered to a single analytical model without serious reference to other important indicators of the opportunity cost of capital, the Commission's analysis produced an unreasonably low result in this case. In its post-hearing brief, the Company urged the Commission to seriously factor in the results of multiple analytical models and other real world data to compensate for the admitted infirmities of the DCF model relied on by Staff, particularly in the current economic environment. Instead, the Staff's recommendation and the Commission's order are based almost entirely on a rote mathematical calculation. Such an approach is inconsistent with the task with which this Commission is charged in determining ROE. *New England Tel. & Tel. Co. v. State*, 113 N.H. 92, 95 (1973) ("Rate-making cannot be reduced to an exact science by which a mathematically precise rate of return can be produced by a competently programmed computer.")

Reliance upon the DCF model to the exclusion of all other models (as well as relevant external considerations such as the comparable investment data described above and in Section V below) produces an incomplete analysis, even if the Commission has traditionally followed such an approach. As both experts testified, the DCF model is limited because the assumptions on which it is based do not bear out in the real world. Even the Staff's expert acknowledged that the prudent approach is to consider multiple analytical models when determining the appropriate rate of return. Tr. Day 2 at 119-20; Tr. Day 1 at 66. The Company's brief provided ample precedent to support the use of multiple analytical models in determining a reasonable return on equity and provided multiple indicators that demonstrated that a narrow reliance on the Staff's DCF model in this case would lead to an unreasonable result.

As noted in the Company's post-hearing brief, even Staff has supported the use of more than one ROE methodology, using *three* ROE methods in Docket DW 06-073 to establish a range of reasonableness, and arguing in that case that the Commission should adopt the midpoint of a range of figures. *Re Pennichuck Water Works*, Order 24,751 at 18 (May 25, 2007); Tr. Day 2 at 127-28. And the Commission itself, despite its historical primary reliance upon the DCF formula, has acknowledged that it is appropriate to consider multiple methodologies when determining rate of return, rather than adhere to any one specific formula. *See, e.g., Re Verizon New Hampshire*, 89 NH PUC 17, 36 (2004) ("neither the DCF nor any other method is conclusive"); *Re Kearsarge Telephone Co.*, 73 NH PUC 320, 325-26 (1988) ("Neither *Hope*, *Bluefield* nor any of the New Hampshire cases require the commission to use any specific formula to make this [return on equity] determination.") The need to utilize more than one analytical model has been recognized by commissions in other jurisdictions as well, given the strengths and flaws inherent in any single model. *See, e.g., Matter of Southwest Gas Corp.*, 213 P.U.R. 4th 53 (Ariz. Corp. Comm'n 2001) ("[I]t is important to utilize a variety of financial models to derive a cost of equity. Each model has its strengths and drawbacks.")

If the Commission is to fulfill its legal and policy obligations to apply its judgment in determining an appropriate return on equity, it should ask whether there is a reason that so many indicators point toward a return that is substantially in excess of Staff's recommendation and whether a return of 9.54% is adequate to meet the opportunity cost standard that the Commission is charged with applying. The Company respectfully urges the Commission to consider giving meaningful weight to analytical methods other than the DCF.

V. The Return on Equity Established by the Commission Is Unconstitutionally Confiscatory.

The 9.54% rate of return on equity established by the Commission in Order No. 24,972 is confiscatory because it is too low to attract the investment capital necessary for National Grid NH to meet increased demands for improvement and extension of its services, including the significant capital required to meet the ongoing need to replace the aging infrastructure in the Company's distribution system. Exh. 40 at 7. In particular, the Commission misconstrued the standard to be applied when balancing the interests of investors and customers, which in turn led it to disregard evidence that demonstrated persuasively that the 9.54% return on equity it authorized is considerably lower than authorized returns for other gas utilities. As a result, rational investors will understandably direct their capital to other investments that afford them an opportunity for a more favorable return with comparable risk. To avoid that outcome, the Commission should reconsider Order No. 24,972 and authorize a return on equity commensurate with rates of return allowed to other gas utilities, or, alternatively, grant a rehearing on the issue of return on equity.

In setting rates, the Commission is charged with following "a process of identifying consumer and producer interests competing for recognition, with an ultimate goal of striking a fair balance or accommodation between them, to be reflected in charges to customers that may be described as just and reasonable both to the customer and to the utility." *Appeal of Public Serv. Co. of N.H.*, 130 N.H. 748, 750 (1988). In doing so, the Commission must set a rate of return that falls within a "zone of reasonableness," neither so low as to be unconstitutionally confiscatory nor so high as to impose an extortionate charge upon the customer. *Appeal of*

Conservation Law Foundation, 127 N.H. 606, 635 (1986); *see also Appeal of Pub. Serv. Co. of N.H.*, 130 N.H. at 750.

Although the New Hampshire Supreme Court has granted the Commission substantial deference in determining a utility's authorized return on equity, the Commission's discretion is limited by the principle that a low rate of return that discourages outside investment of necessary capital is unconstitutionally confiscatory and not within the "zone of reasonableness." "With regard to investment interests, a just and reasonable rate is one which reflects, among other things, a rate of return 'commensurate with returns on investments in other enterprises having corresponding risks.'" *Petition of Public Serv. Co. of N.H.,* 130 N.H. at 275 (emphasis added); *see also Appeal of Conservation Law Foundation*, 127 N.H. at 635 (1986); *New England Tel. & Tel. Co. v. State*, 113 N.H. 92, 95 (1973). While this standard may be a difficult one to meet on appeal, it reflects a critical legal and policy consideration—namely, that a prudent investor should not, and will not, bear the risk of supplying capital to a utility that promises a below-market rate of return when it can bear the same risk for the prospects of a higher return elsewhere.

National Grid NH presented unrefuted evidence that the return on equity authorized for a broad array of gas utilities in other jurisdictions is considerably higher than the return supported by Staff and that ultimately approved by the Commission. The Company's Chief Operating Officer testified that the Company's Rhode Island affiliate was recently awarded an authorized return on equity of 10.5%. Tr. Day 2 at 73; Exh. 56. The Company also submitted an authoritative survey of return on equity decisions for the period January 2007 through December 2008, demonstrating that the average return on equity authorized for gas utilities approximated 10.4% in 2008, an increase from 10.2% in 2007. Exh. 55 at 1. In addition, as National Grid NH showed in its brief, the most recent reported returns on equity for all of the companies in the peer group relied upon by the Staff's witness are at or above 10%, even before taking into account subsequent declines in stock prices and increases in the cost of equity.[3] The evidence presented by the Company amply demonstrated that any return on equity below 10% would not be commensurate with returns for similar investment opportunities in the market. Yet the Commission disregarded this evidence and, with a negligible adjustment, adopted Staff's methodology in its entirety.

The Commission's decision suggests that it may have misunderstood the argument advanced by the Company in its post-hearing brief. The Commission summarized National Grid NH's argument as follows:

> According to the Company, in setting a return comparable to that for companies of similar risk, regulators must also consider that investors and utilities make their decisions in a world with multiple investment options, all competing for the same capital. <u>In the Company's view, the relative levels of allowed returns in different jurisdictions matter because the various jurisdictions compete for discretionary capital investments made by utility holding companies doing business in multiple jurisdictions</u>.

Order No. 24,972 at 53 (emphasis added). The Commission then proceeded to dismiss National Grid NH's evidence on the following grounds:

> We do not consider that determining an ROE for the Company in New Hampshire is part of a competition among the states for National Grid's discretionary investment dollars. . . . The capital attraction standard alluded to in <u>Appeal of Conservation Law Foundation</u> and discussed in the seminal <u>Hope</u> and <u>Bluefield</u> cases relates to an allowed ROE that will attract capital from the investment community generally, and not an ROE sufficient to motivate a holding company to invest discretionary capital in a utility subsidiary.

Id. at 54-55. In other words, it appears that the Commission incorrectly construed the Company's legal argument to be that the Commission should not set too low a return on equity because it would discourage the *parent company* (National Grid USA) from investing capital in

[3] As noted in the Company's post-hearing brief at page 24, the most recent allowed returns on equity for Staff's peer group demonstrate that an allowed return of less than 10% is simply unreasonable. Those returns were: Atmos Energy--10.7%, Laclede Group--10.0%, Nicor--none reported, Northwest--10.1%, Piedmont--10.6%, Southwest--10.0-10.5%, and WGL (Washington Gas)--10.0%.

its subsidiary New Hampshire utility (National Grid NH). The Company did not then and does not now advance that argument..

Instead, the legal principle articulated in the Company's brief was the capital attraction standard articulated in *Appeal of Conservation Law Foundation* and other New Hampshire cases, which requires the Commission to establish a return on equity that will attract capital from the investment community generally. *See* National Grid's Post-Hearing Brief at 8-9, 23-25. The Company's reference to returns available in other jurisdictions was intended to demonstrate that investors generally, and National Grid USA specifically, have other comparable investment opportunities that they will and must take into account to fulfill their fiduciary duties, and that an authorized ROE of less than 10% in New Hampshire would be insufficient to attract capital. In other words, all investors (whether the Company or others) make rational decisions about where to make investments, and those decisions are reasonably based in part on what the anticipated return will be on the investment. The Company's reference to the motivations of its holding company was intended only to point out that (1) even where there are no near-term plans to access new outside equity capital, a utility and its parent company must still make capital investment decisions that require regulators to authorize a reasonable return, and (2) even though the Company is not publicly traded and does not access the capital markets directly for new equity, its parent company (the immediate source of its capital) must still (a) attract that outside investment in a competitive marketplace in the first instance and (b) decide how best to invest the shareholder capital to prove the value of the investment decision because those are the investors to whom management is ultimately responsible and for whom many other attractive investment options will continue to exist if this one does not provide an appropriate return.

The Commission statement that National Grid is "obliged to invest large sums of money towards infrastructure improvements" is, of course, correct. *See* Order No. 24,972 at 53, 55; just as Staff correctly argued "that as a public utility the Company is required to continue to provide safe and reliable gas distribution service at a reasonable cost regardless of whether ROE is 9.33% or 12.25%." *Id.* at 39. But the Commission's observation and that of its staff overlook the well-established principle that the return on equity must be sufficient to attract *outside* investment capital and provide a rate of return commensurate with those allowed for comparable entities, as well as the very real fact that failure to authorize a reasonable return will ultimately devalue the investment of existing shareholders. Such a result is the essence of confiscation.

The Company, Commission and Staff agree that National Grid NH is legally required to meet its obligations to its customers and therefore must expend a certain level of capital *regardless of the return it earns*. Indeed, the Company's expert made exactly the same point. Tr. Day 1 at 135-37. Yet, in setting a return on equity, the Commission cannot rely on this obligation if its goal is for the Company to make the ambitious investments needed to fund the future infrastructure needed to meet the state's and the Company's long term goals and serve customers' long term interests. Sound policy and basic constitutional principles require regulators to set a return that ensures that even existing investors—whether they be investors in a public company or a holding company that owns the stock of a subsidiary—have an opportunity to earn a reasonable return, despite the fact that they may be obligated to continue to provide safe and reliable service.

Ironically, it is the Commission that appears to have wrongly premised its decision on the fact that the Company's immediate source of capital is a large utility holding company, assuming that because *the Company* has a minimum obligation to invest its own earnings so that its distribution system is maintained in a particular manner, the Company's *parent* (i.e., its shareholder) has a corresponding obligation to invest its capital (i.e., to inject new debt or equity) when needed. That assumption is simply incorrect. If the Company's earnings are insufficient to meet its ongoing capital needs, National Grid is under no obligation to continue to make new debt or equity capital available. At some point, National Grid's obligation to its own investors will result in a situation where the Company will face the same reality it would encounter as a stand-alone entity—loss of access to the capital it requires because of its own insufficient earnings. As such a scenario unfolds, third parties such as gas suppliers, pipelines and others who rely on the Company's creditworthiness are likely to become unwilling to enter into agreements with the Company as well. The consequences of such a situation are many and would have a significant adverse cost impact on customers, in addition to affecting the quality of the service they receive. Plainly such a result is not in the pubic interest, whether viewed from a customer or investor perspective.

Because the Commission may have misconstrued the Company's argument and, as a consequence, failed to properly analyze whether or not the return on equity was too low to attract investment capital in light of returns available from other investment opportunities, it should reconsider its order or grant a rehearing on the issue of return on equity.

VI. CONCLUSION

For the foregoing reasons, National Grid NH respectfully requests that the Commission reconsider or grant rehearing regarding its Order No.24, 972.

Respectfully submitted,

ENERGYNORTH NATURAL GAS, INC. d/b/a
NATIONAL GRID NH

By its Attorneys,

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Date: June 29, 2009

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Certificate of Service

I hereby certify that on June 29, 2009, a copy of the foregoing Motion has been forwarded to the parties listed on the Commission's service list in this docket.

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Steven V. Camerino