STATE OF NEW HAMPSHIRE

BEFORE THE

NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION

Docket No. DE 13-108

PUBLIC SERVICE COMPANY OF NEW HAMPSHIRE

Annual Reconciliation of Energy Service and Stranded Costs for 2012

CONSERVATION LAW FOUNDATION'S BRIEF ON OFFICE OF CONSUMER ADVOCATE "USED AND USEFUL" PROPOSAL

Conservation Law Foundation ("CLF") submits this brief pursuant to the Commission's invitation at the merits hearing in this docket on January 23 and 27, 2014. For the reasons discussed herein, CLF supports the Office of Consumer Advocate ("OCA") proposal that the Commission disallow a portion of the return on the value of Public Service Company of New Hampshire ("PSNH") fossil-fuel power plants (Merrimack, Newington, and Schiller Stations; the "fossil plants") because they are no longer fully "used and useful" (the "Proposal").[1]

I. THE "USED AND USEFUL" PRINCIPLE APPLIES TO PSNH FOSSIL PLANTS IN ALL ENERGY SERVICE DOCKETS.

Pursuant to N.H. RSA § 378:28, the Commission may not include in rates any "return on any plant, equipment, or capital improvement which has not first been found by the commission to be prudent, used, and useful." *See also* N.H. RSA § 378:27 (authorizing recovery of reasonable return on "the cost of the property of the utility used and useful in the public service"). The "used and useful" standard "judges [the value of an investment or expenditure] at the time its reflection in the rate base is under consideration." *Appeal of Conservation Law Found.*, 127 N.H. 606, 638 (1986) (seminal modern case discussing "used and useful"

[1] The Proposal is discussed in the Testimony of Steven Eckberg, filed by OCA on November 20, 2013 (Hearing Ex. 11).

requirement). *See Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168, 1190 (D.C. Cir. 1987) (Starr, J., concurring) ("The prudence rule looks to the time of investment, whereas the 'used and useful' rule looks toward a later time [and is] designed to assure that the ratepayers… will not necessarily … as a matter of simple justice, be required to pay for that which provides the ratepayers with no discernible benefit.").[2] In applying the principle, the Commission must "determine what can reasonably be done *now* with the fruits of investment" with considerable latitude to fashion appropriate rate outcomes. *Appeal of Conservation Law Found.*, 127 N.H. at 638 (emphasis added). *See Legislative Util. Consumers' Council v. Pub. Serv. Co.*, 119 N.H. 332, 343 (1979) ("'Used and useful' is not a rigid concept; rather, it is an elastic one."); *cf.* Order Denying PSNH Motion for Rehearing, DR 95-068 (Jan. 27, 1998) (cited in PSNH Rebuttal Testimony) (PSNH bears "the risk of disallowances under the used and useful standard" for plant investments that do not appropriately anticipate future requirements). In this regard, the Commission's decisions on usefulness of utility property "require the exercise of judgment and discretion in determining the recognition that is appropriately due to the competing interests of the company and its investors and of the customers who must pay the rates to provide the revenue permitted." *Appeal of Conservation Law Found.*, 127 N.H. at 638.

While the prudence of PSNH's past investments in its assets is not at issue here, this docket is plainly an occasion when the "reflection [of PSNH's assets] in the rate base is under

[2] Richard J. Pierce, Jr., The Regulatory Treatment of Mistakes in Retrospect: Canceled Plants and Excess Capacity, 132 U. Pa. L. Rev. 497, 512-13 (1984) ("Historically, the used and useful test was employed … to exclude from the rate base... investments in plants that are no longer used because of *obsolescence*, chronic mechanical failure, or an order from a government agency requiring termination of operations for a sustained period of time…. [A] plant can be the product of prudent decisions but not be used and useful because of factors beyond the control of the utility or because of *changes in conditions* beyond the reasonable foresight of the utility" (emphasis added).).

consideration." *See id*. Under the Commission's recent process for setting rates for PSNH default energy service, Commission decisions to approve PSNH's filings amount to discrete decisions to include the PSNH assets described in the filing in the effective rate base for the year in question. *See, e.g.*, Order 25,540, at 4 (July 9, 2013) (purpose of reconciliation docket is "to determine whether the Company should recover from ratepayers the costs claimed for a prior year"). In the context of this reconciliation docket's detailed review of PSNH costs and asset performance, the Commission is well-equipped to assess whether and to what extent PSNH fossil plants remained "used and useful" in 2012.[3]

II. THE PROPOSAL HAS SUBSTANTIAL SUPPORT IN NEW HAMPSHIRE LAW AND RATEMAKING PRECEDENTS OF OTHER JURISDICTIONS.

Contrary to PSNH's and Staff's responses, the Proposal is well-grounded in cost-of-service ratemaking law and practice in New Hampshire and elsewhere. In essence, the Proposal seeks to address a condition much like "excess generating capacity," which has long been a recognized subject of disallowances on "used and useful" grounds. *See Appeal of Conservation Law Found.*, 127 N.H. at 643 (Commission "could have considered exclusion [of excess generating capacity] from rate base at least on the usefulness principle"). PSNH's underutilization of formerly base-load fossil assets reflects a sustained condition that is the mirror image of the classic excess capacity problem, where a utility pursues generation investments without regard to realistic load forecasts and those investments are subject to exclusion from rate base.[4]

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[3] As discussed at the hearing, CLF is mindful that the Commission is undertaking efforts to address these issues in other dockets. However successful in the future, those efforts are no substitute for enforcing the "used and useful" requirement and other statutory mandates in all PSNH rate dockets as they continue to arise, including PSNH's request for approval of its 2012 costs and return in this docket.

[4] Although application of the "used and useful" principle to excess capacity has typically been considered in the context of a plant's early life to address the risk of a utility overbuilding

Applying the "used and useful" principle, state public utilities commissions have fashioned a variety of solutions that protect ratepayers from the financial burdens associated with excess capacity in a manner that is fair to utility investors, including the mechanism reflected in the Proposal—disallowances of utility returns on the portions of generation capacity that are not useful to ratepayers. *See* Richard J. Pierce, Jr., The Regulatory Treatment of Mistakes in Retrospect: Canceled Plants and Excess Capacity, 132 U. Pa. L. Rev. 497, 514-17, 538-41 (1984) (collecting cases, such as *Iowa Pub. Serv. Co.*, 46 Pub. Util. Rep. 4th 339 (Iowa Commerce Comm'n 1982), which established formula for reducing utility's rate of return by amount proportionate to amount of excess capacity on utility's system). In a prominent example, Illinois's highest court held that the Illinois Commerce Commission could impose "used and useful" disallowances under a general "used and useful" statutory provision similar to New Hampshire's, including fractional exclusions of property from rate base where the utility's plants were "not *fully* used and useful" and not providing sufficient economic benefits to ratepayers; the Illinois commission proceeded to disallow equity returns for the utility's unneeded capacity. *See, e.g.*, *Bus. & Prof'l People for Pub. Interest v. Ill. Commerce Comm'n*, 146 Ill.2d 175, 222-29 (1991), *order on remand Commonwealth Edison Co.*, Docket No. 87-0427 at 75, 1993 WL 124650 (Ill. Commerce Comm'n, Feb. 24, 1993).

The New Hampshire Supreme Court has specifically authorized the same approach. In *Appeal of Conservation Law Foundation*, the Court observed that a proposal by Commissioner Lea Aeschliman favoring disallowance of equity returns on excess capacity investment could be a reasonable application of the "used and useful" principle:

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unneeded infrastructure, there is no logical reason why it should not apply in a plant's latter years, when its use declines due to sustained unfavorable market conditions and/or obsolescence.

> [I]t is important to bear in mind, as Commissioner Aeschliman's separate opinion indicates, that the principle of used and useful property will also be applicable in determining rate base. In the face of rate issues that are unparalleled in the State's history, we should recall that the usefulness principle lends itself to development over time and under new conditions. We therefore attend seriously to the suggestions … that the burden of excess capacity that may be created by such giant projects may appropriately be shared as between investors and customers, and that the usefulness principle may be applied to effect such a shared allocation. […] Commissioner Aeschliman's proposal is one of a variety of regulatory treatments that commissions have devised in order to allocate burdens between investors and customers.

Appeal of Conservation Law Found., 127 N.H. at 647-48.

More recently, at least one regulator within the New England electric market has employed the "used and useful" principle to ensure that ratepayers and utility investors share the burdens of changing economic realities. In Vermont, the Public Service Board enforces an *economic* "used and useful" requirement for major utility investments and contracts that reflects the same goals as the authorities applying the principle to excess generating capacity. The Vermont board describes its test as follows:

> Long-standing regulatory policy in Vermont, and throughout the United States, has held that a utility may fully recover in rates the costs of a resource only if it is both used — i.e., necessary for the utility's provision of service to its ratepayers — and useful — i.e., economic for the purposes that it is serving. A resource is not used and useful when it is not expected to yield net present value benefits, after consideration of non-price benefits, over its lifetime….
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> [T]he economic usefulness test… represents equitable and sound regulatory policy. *The test furthers the purpose of regulation as a substitute for competitive markets, by assigning some (but not all) of the risk of uneconomic decisions to companies.* The test produces equitable results; although regulation may limit the upside for investors should a utility's decision prove to be especially beneficial, the economic usefulness test symmetrically

> limits their downside risk by sharing the financial consequences of uneconomic decisions.

Citizens Communications Co., Order No. 6596, at 38, 39 (Vt. P.S.B. July 15, 2002) (emphasis added), *available at* http://www.state.vt.us/psb/orders/2002/files/6596final.pdf. Applying this economic usefulness test, the Vermont board has disallowed a portion of above-market costs associated with a utility's major power purchase contract where the contract price was shown to be above New England wholesale market prices over the term of the contract, after accounting for certain non-price benefits. *Id.* at 50. The Vermont approach supports the logic of the Proposal; like assets and contracts deemed uneconomic under Vermont's economic usefulness test, PSNH fossil plants have become uneconomic, and the recent reductions in their capacity factors provide a proxy for assessing the diminishment of their economic value to customers.

III. THE PROPOSAL IS A REASONABLE APPROACH TO ENFORCING THE "USED AND USEFUL" REQUIREMENT.

The Proposal offers the Commission a moderate and concrete mechanism to help confront an undeniable economic reality discussed in CLF's closing statement: the sustained decline in the economic usefulness of PSNH fossil plants to PSNH default energy service customers. As discussed in Staff's Report on its Investigation into Market Conditions, Default Service Rate, Generation Ownership and Impacts on the Competitive Electricity Market in Docket IR 13-020 (June 9, 2013) ("Staff Report"), PSNH "resources, taken as a whole, have gone from saving customers money *to costing them significantly*, relative to available market alternatives." Staff Report at 1. As testimony in this docket affirms, PSNH fossil plants were designed and operated to run at relatively high capacity factors for most of their useful lives but no longer do so. *See, e.g.*, Testimony of Stephen Eckberg (Hearing Ex. 11) at 9-11; Attachments

to Testimony of William Smagula (Hearing Ex. 1) at Bates 000145-000146.[5] At the capacity factors experienced in 2012 (and 2013), the plants sit idle and generate no energy revenue for most of the year (for Newington and Schiller Units 4 and 6, the vast majority of the year), and ratepayers nonetheless are asked to pay for the plants' fixed costs and PSNH's return. The plants' uncompetitive marginal costs relative to other generating plants in New England are driving them to this diminished role in the market. *See* Staff Report at 20 (Hearing Ex. 10).[6] "What can reasonably be done now with the fruits" of PSNH's fossil fleet is much less than in prior years, to ratepayers' detriment.

The Proposal is far from draconian: while the "used and useful" principle arguably sanctions larger disallowances, the Proposal would impose a fractional disallowance that affects only PSNH's return and is based on a multi-year average of unit capacity factors, which substantially reduces the disallowance that would arise from using 2012 capacity factors alone.

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[5] In this regard, the context for underutilization of PSNH fossil plants fundamentally differs from the hydro and distribution plant hypotheticals that Staff, PSNH, and Commissioner Scott explored with Mr. Eckberg at the hearing, and applying the "used and useful" principle to PSNH's fossil units (the last major cost-of-service fossil units in New Hampshire, let alone New England) would not necessarily require a similar inquiry for assets of entirely different operating profiles and uses.

[6] For many reasons, the changes in the plants' utilization and the resulting rate impacts are extremely unlikely to reverse. In this regard, the authors of the Staff Report:

> found no supportable basis for optimism that future market conditions will reverse this unsustainable trend [in PSNH rates], especially in the near term. To the contrary, the PSNH fossil units face uncertainties that combine to create a risk of further, potentially substantial increases in costs….
>
> [O]ver the period during which PSNH's default service will experience the continued increases that we project, there is a very high level of confidence that circumstances will not change enough to reverse the growing burden.

Staff Report at 1, 4.

The Proposal's moderation recognizes as well that, despite their economic decline, the plants operate and generate energy revenues for part of the year, and they provide capacity and other ancillary services revenues.[7]

As discussed above, the Proposal's fractional, return-only disallowance approach is well within the Commission's broad and flexible authority to enforce the "used and useful" requirement and to ensure some measure of fairness for ratepayers. *See Appeal of Conservation Law Found.*, 127 N.H. at 648 ("[R]egulatory concepts are subject to development in the light of new conditions and … the traditional ratemaking process gives the commission flexibility to accommodate the legitimate interests of both customers and investors…. '[T]here is substantial economic leverage to establish a rate level that will not be oppressive to consumers or the New Hampshire economy or which is unfair to stockholders...'" (quoting *PSNH*, 70 N.H. PUC 164, 66 Pub. Util. R. 4th 349, 423 (1985).); *Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168, 1190 n.1 (D.C. Cir. 1987) (Starr, J., concurring) ("The 'used and useful' rule operates as a restraining principle, reminding utility managers that they must assume the risk of economic forces working against an investment which is prudent at the time it is made.").

WHEREFORE, CLF respectfully requests that the Commission:

A. Adopt the OCA proposal to disallow PSNH's return on a portion of the net plant value of its fossil plants; or, in the alternative, adopt a similar mechanism to disallow recovery of a

[7] A further moderation that the Commission could consider and that Mr. Eckberg suggested during cross-examination might be appropriate would be to limit the proposed disallowance to PSNH's return on equity. This approach would be consistent with the New Hampshire Supreme Court's suggestions in *Appeal of Conservation Law Foundation* and the decisions of other states that shareholders may appropriately share in the risks of underutilized or unneeded capacity at power plants. *See* 127 N.H. at 648 (citing, in particular, Commissioner Aeschliman's suggested approach to limiting return on equity for excess capacity, discussed *supra*, and similar rulings by other state commissions).

portion of PSNH's generation costs and/or return reflecting the recent reduction in economic usefulness of its fossil plants; and

B. Grant such further relief as it deems appropriate.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing brief has on this 4th day of February 2014 been sent by email to the service list in Docket No. DE 13-108.

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