Docket No. DE 13-108
Public Service Company of New Hampshire
Reconciliation of Energy Service and Stranded Cost for 2012

Staff Brief

At the hearing in this matter, the Commission allowed the Parties and Staff to address arguments regarding the "fully used and useful" policy advanced in testimony presented by the Office of Consumer Advocate (OCA) in written briefs.

The OCA's theory is set forth in its testimony. In summary, the OCA witness Mr. Stephen Eckberg opined that Public Service Company of New Hampshire (PSNH) did not use its owned fossil fuel-fired generation assets[1] in calendar year 2012 "to the full extent that these assets were built and intended to provide service" and on that basis, he argued that the Commission should disallow PSNH a return on the full value of the plant. Ex. 11 at 9. Mr. Eckberg selected two time periods—1993-2001 and 2009-2012, and developed what he characterized as "average capacity factors" for those two periods. He then calculated a "used and useful fraction" of each generation asset based on those "average capacity factors"-- using 1993-2001 as the denominator and 2009-2012 as the numerator-- and he proposed that the Commission grant shareholders a return only on that "used and useful fraction." *Id.* at 11. The OCA further stated that "[i]f the Commission were to approve the Company's 2012 energy service reconciliation as proposed, customers would pay PSNH shareholders a return on assets which are not fully used and useful. Such an action would conflict with NH law." *Id.*

The purpose of this proceeding is to reconcile PSNH's 2012 estimated stranded costs and energy expense with its actual costs and revenues for the years. In making a decision in this reconciliation proceeding, the Commission must observe the following statutory requirements:

[1] Although Mr. Eckberg's argument is framed around PSNH's fossil fuel-fired (i.e., coal and oil) plants, he includes Schiller Unit 5, a biomass-fired plant, in his analysis.

RSA 369-B:3, IV (b)(1)(A) which states in part that "until the completion of the sale of PSNH's ownership interest in fossil and hydro generation assets located in New Hampshire, PSNH shall supply all . . . default service offered in its retail electric service territory from its generation assets and, if necessary, through supplemental power purchases in a manner approved by the commission. The price of such default service shall be PSNH's actual, prudent, and reasonable costs of providing such power, as approved by the commission;"

(See also Order No. 24,177 (January 30, 3003) 88 NH PUC 16 in Docket DE 02-166 where the Commission approved the two-step process for setting PSNH's rates, the second of which is this reconciliation proceeding);

RSA 378:27, (Temporary Rates) which states with respect to temporary rates "that such temporary rates shall be sufficient to yield not less than a reasonable return on the cost of the property of the utility used and useful in the public service less accrued depreciation, as shown by the reports of the utility field with the commission, unless there appears to be reasonable grounds for questioning the figures in such reports."; and

RSA 378:28, (Permanent Rates) which incorporates the requirements of RSA 378:27, and states in part that"[t]he commission shall not include in permanent 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. Nothing contained in this section shall preclude the commission from receiving and considering any evidence which may be pertinent and material to the determination of a just and reasonable rate base and a just and reasonable rate of return thereon."

The OCA proposal is not consistent with these provisions of New Hampshire law and is contrary to the requirement that rates result in "a just and reasonable rate of return." Staff's analysis follows.

The concept of used and useful utility plant is a principle of rate-making that requires the regulator to review and value the investment made by a public utility that is used and useful in the delivery of utility service. According to traditional rate-making principles, only prudent investments in utility plant that are used and useful in providing service to the public are

included in a utility's rate base and subject to a return on investment; provided, however, that the resulting rates are "reasonable" (RSA 378:27 and :28) or "just and reasonable" (RSA 378:7).[2]

In *Appeal of Conservation Law Foundation*, 127 N.H. 606 (1986), the New Hampshire Supreme Court stated that the development of reasonable rates involves a process whereby the interests of the ratepayer in the lowest possible rates are balanced with that of the investors who desire higher rates to recover a return on the investment found "used and useful" in providing service to customers. *Conservation Law Foundation* at 633. In reviewing the principles governing rate setting by the Commission, the Court stated that the Commission must consider whether the utility was prudent at the time it made those investments, and whether a particular investment is "used and useful" in providing utility service to ratepayers to determine whether the value of the investment should be recovered be included in rate base and be eligible for a reasonable return through rates. *Id.* at 634

As the Court further explained, the concepts of prudence and used and useful have significant difference, in that while "prudence judges an investment or expenditure in the light of what due care required at the time an investment or expenditure was planned or made, usefulness judges its value at the time its reflection in the rate base is under consideration. Under the 'used and useful' principle, the commission is not asked to second-guess what was reasonable at some time in the past, but rather to determine what can reasonably be done now with the fruits of the investment. It is therefore not surprising that the commission's flexibility in applying the usefulness principle extends to judgments about the inclusion or not of investment in property held for future use." [citations omitted] *Id.* at 638. Based on this analysis, the Court acknowledged that the Commission must exercise judgment and consider the competing interests

[2]See Conservation Law Foundation, 127 N.H. 606 (1986) at 633-640.

of customer and investors in determining what investments in rate base are prudently incurred, the use and usefulness of those investments, and the development of reasonable rates that recognize the competing interests involved. The Court recognized the provision of a reasonable return as a statutory mandate: "The application of any rate-making standard without reference to such return would be inconsistent with the statutory mandate. Thus, the customer's interest may not be recognized to the derogation of a reasonable return . . ." *Id.* at 639.

As noted above, the relevant statutes, RSA 378:27 and :28 embody the rate-making goal of fairness and symmetry between the ratepayer and investor. RSA 378:27 states in full as follows:

> RSA 378:27 Temporary Rates. In any proceeding involving the rates of a public utility brought either upon motion of the commission or upon complaint, the commission may, after reasonable notice and hearing, if it be of the opinion that the public interest so requires, immediately fix, determine, and prescribe for the duration of said proceeding reasonable temporary rates; provided, however, that such temporary rates shall be sufficient to yield not less than a reasonable return on the cost of the property of the utility used and useful in the public service less accrued depreciation, as shown by the reports of the utility filed with the commission, unless there appears to be reasonable ground for questioning the figures in such reports. (emphasis added).

Contrary to the legal principles enunciated in RES 378:27 and :28, the OCA casts aside the required balancing of customers' interests with shareholders' interests by advancing the idea that only a fraction of PSNH's fossil-fueled generating plant is eligible for a shareholder return because it is not "fully" used and useful. Staff borrows from the language used by the Court in *Conservation Law Foundation* and suggests that the OCA is recommending that the Commission should "second-guess" the "used and usefulness" of PSNH's fossil-fueled plants and abandon the attempt to balance the interests of ratepayers and shareholders. Instead, the OCA advocates that the Commission consider only the interests of ratepayers with respect the fossil fuel-fired power plants owned by PSNH. At hearing, the OCA witness repeated his testimony that shareholders

should be denied a return on a certain arbitrary fraction of the fossil-fueled plants value based on the OCA's "fractional capacity value" calculation. Yet, at the same time, the OCA argued that ratepayers should benefit from the full capacity and ancillary revenues that PSNH is eligible to receive from the Independent System Operator-New England (ISO-NE) based on the availability of 100% of those fossil fuel plants in the ISO-NE wholesale market. In other words, the OCA argues that the Commission should recognize only a fraction of the plant for purposes of allowing return to ratepayers, but should recognize the full value of the plant when it comes to recognizing customers' benefit of all energy, capacity and ancillary revenue received from the ISO-NE. This position is self-contradictory in that the OCA agreed that the facilities, when available, are 100% used and useful in the context of the ISO-NE market, but the value of the plants should only be "fractionally" available for investors to receive a return on the investment in the plant.

The OCA chose not to explain this inconsistency and presented no legal basis for its proposal that this Commission change a fundamental policy of rate-making. For example, the OCA acknowledged that the New Hampshire statutes do not use the word "fully" in characterizing the used and useful nature of a plant investment but did not seem troubled with deviating from the statutory definition. The OCA acknowledged that it did not know if the "fully used and useful" test was used by other Commissions and that it had not introduced this concept in any other proceeding before the Commission.

In its cross examination of the OCA, the attorney for CLF asked whether the OCA's theory was a reflection of the "diminishing economic value" of the fossil plants to ratepayers. The phrasing of the inquiry begs the question whether CLF was attempting to imply that only the perceived "economic" value of the plant be considered in evaluating the usefulness of PSNH's

fossil-fueled plants. Such an end result test has been used regarding how to treat public utility investment in canceled nuclear power plants, and a specific example of how this test has been applied is contained in the U.S. Supreme Court decision in *Duquesne Light Company v Barasch* (109 S. Ct. 609) 1988.[3]

In *Duquesne,* the Supreme Court suggested that an appropriate method to determine whether a utility's return on investment was sufficient was to determine, in the final analysis, whether the utility earned an adequate return. The subject matter in *Duquesne* was whether the disallowance of a return on investment in abandoned nuclear plants a taking where investors had the expectations of earning a return on the plants. Two regulated electric utilities claimed that they should be allowed to recover from ratepayers the costs associated with four nuclear power plants which were voluntarily abandoned prior to completion. There was no disagreement that the canceled plants would never provide service to ratepayers. The utilities argued that (1) the investment was prudent at the time it was made, and (2) the plants were abandoned due to unforeseen increased costs and the utilities' decision that the extra capacity offered by the plants was not needed to meet the load requirements of customers. The utilities insisted that, as originally planned, the investments were prudent and should be eligible for a return and recovered through rates.

During the course of regulatory hearings on the matter, the Pennsylvania legislature passed a law requiring a utility investment to be used and useful for the costs of such investment to be recovered by ratepayers. The Pennsylvania Public Utility Commission issued a decision siding with the utilities which was reversed by the Pennsylvania Supreme Court. The utilities appealed to the U.S. Supreme Court which affirmed the lower court's decision denying the

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[3] *See*, also Jonathan A. Lesser, *The Used and Useful Test; Implications for a Restructured Electric Industry*, Energy Law Journal, Vol. 23, p. 349, October 10, 2002.

utilities recovery of the costs associated with the abandoned plant because the investment did not turn out to be used and useful.

In addition to the used and useful finding, the Supreme Court applied an economic test that evaluated the impact of the rate decision on the utilities' overall return on investment. The Court noted that the utilities did not claim that the economic impact (the disallowance of a return on the abandoned plant investment) would have a significant negative impact on their overall rates or on the utilities' financial condition.[4] The Court further said that despite the fact that investors expected recovery of the investment made in the abandoned plants, "[n]o argument has been made that these slightly reduced rates jeopardize the financial integrity of the companies, either by leaving them insufficient operating capital or by impeding their ability to raise future capital. Nor has it been demonstrated that these rates are inadequate to compensate current equity holders for the risk associated with their investments under a modified prudent investment scheme." *Duquesne* at 618. Thus, having concluded that the overall economic impact on the utilities' had virtually no impact on the financial status of the utilities, the Court affirmed the lower court decision denying recovery for the abandoned plant.

In the instant docket, the Commission is considering whether PSNH's 2012 rates are just and reasonable given the reconciliation of PSNH's costs and revenues associated with its stranded cost recovery charge and its energy service rate. The record demonstrates PSNH's fossil-fueled generation plant was in service and used and useful in 2012, and available to produce energy almost 100% of the time. Hearing Exhibit 5, at 33-34.

In its prefiled testimony and at hearing, the OCA maintained that PSNH's fossil-fueled plants were only partially used and useful for calendar year 2012 and that investors should not

[4] The Court calculated that the approximate $3.4 million reduction in revenues resulting from the disallowance represents less than one-half of one percent of total revenues.

expect a return on plant that is not "fully" used and useful. Furthermore, upon questioning, the OCA appeared to be indifferent and, actually, had not considered, as to whether, should its concept by adopted by the Commission, the Company would have less access to capital markets, higher costs of borrowing or that investments in the Company would appear riskier to investors with the resulting additional costs. In addition, the OCA said it was "possible" that PSNH would have to request an increase in its return on equity but it didn't offer an opinion whether the OCA would support such a request.

Staff, however, believes that the adoption of OCA's proposed recovery methodology would create market uncertainty and affect utility earnings and financial stability for any New Hampshire utility to which the theory may be applied. As posited by the OCA, the "fractional" used and useful test would impose asymmetric risk on utilities and would impede the ability of utilities to account for future contingencies when there is uncertainty as to whether the costs of planning for such contingencies would be recoverable. Further, according to the model proposed by the OCA, a utility could face the prospect of being disallowed recovery if it costs were above market, but would also be disallowed to profit if its costs were below market prices. In other words, the model would operate to disadvantage utility investors even in those years where the utility plants operated economically as compared with the market.

The OCA's witness and counsel could not agree as to whether such a "fully used and useful" concept would generally apply to utilities in all regulated industries. While the witness stated that it would be applicable to other industries, OCA's counsel, in closing arguments, stated that it would only be applicable to PSNH and its generating assets due to the situation where approximately 50 percent of customers are paying 100 percent of the costs of the plants. Such a

position was not put forward by Mr. Eckberg either in his prefiled testimony or during the hearing.

The Commission is charged with balancing the interests of ratepayers and shareholders. The OCA's proposal is replete with examples of how the required balance does not exist. For instance, PSNH's Schiller Unit 5 was converted in 2006 to burn biomass rather than coal, and the plant current operates significantly more than during the OCA's 1993-2001 baseline period.[5] However, as shown in Mr. Eckberg's testimony, PSNH's shareholders receive no benefit whatsoever from the above-baseline operation. As another example, the use of a four-year period for purposes of determining whether a disallowance under OCA's proposal is warranted when performing a single-year reconciliation and assessment of plant operations is quite unbalanced and arbitrary. No matter how much PSNH's plants generate electricity over that period, the most PSNH shareholders can expect is 100 percent recovery. However, PSNH's plants can operate above the baseline level in the year being reconciled, but shareholders could still be subject to potential disallowances due to below-baseline operation in any of the other three years. That process would also disassociate the actual operation of the plant(s) in the year of reconciliation from the actual costs to be recovered. Suffice it to say that the OCA's proposal suffers from fatal flaws and from not being well thought out.

The facts in this case are substantially different than those in *Duquesne* and other rulings which denied utilities recovery for abandoned nuclear plants or huge costs over-runs incurred in the construction of nuclear plants. See, e.g. Public Service Co. of N.H. (125 N.H. 46) 1984. Further, unlike the Court in Duquesne, the OCA has expressed indifference as to whether its proposal would impair the financial integrity of PSNH in any respect.

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[5] It certainly is questionable why such changes in fuel source and operational characteristics were not taken into account in OCA's proposal.

Rather than examine the changes inherent in a restructured electric utility industry and PSNH's related adaptations to its operation and maintenance of the facilities, the OCA's proposal sends a message that unless PSNH operates its generating plants in the same manner and to the same extent that it did prior to restructuring, then the plants cannot be considered fully used and useful. That is overly simplistic, arbitrary and out of touch with the current status of the New England electricity and fuel markets. The OCA's proposal appears to be intertwined with its long-standing position on the merits of PSNH's continued ownership of generation. As Staff noted in its closing, the Commission has opened a Docket to investigation just that issue (IR 13-020) and believes that the investigation should continue unimpeded. In the meantime, however, the Commission must evaluate this docket and other proceedings regarding PSNH in accordance with applicable law and deny the OCA's requested relief as it is inconsistent with applicable New Hampshire law and the process of regulatory rate setting as enunciated by the Court in *Conservation Law Foundation.*

Respectfully Submitted on behalf of Commission Staff on February 4, 2014

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I certify that a copy on the date written below, I have served an electronic copy of this filing on the parties to the docket.

Date: February 4, 2014

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