

**STATE OF NEW HAMPSHIRE
BEFORE THE
NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION**

DOCKET NO. IR 22-048

Electric, Gas and Water Utilities

Investigation of Step Adjustment Methodology and Process

**PRELIMINARY COMMENTS OF PUBLIC SERVICE COMPANY OF NEW
HAMPSHIRE D/B/A EVERSOURCE ENERGY AND
AQUARION WATER COMPANY OF NEW HAMPSHIRE**

I. Introduction

On August 26, 2022, the Public Utilities Commission (the “Commission”) issued an Order of Notice opening an investigation to examine the accounting and calculation methodologies for step adjustments. The Commission stated that step adjustments “have become a frequent feature of ratemaking in our State before this Commission,” and that the issue of step adjustments is “ripe for review, given the differences regarding the calculation methodologies used in developing step adjustment schedules, as well as the administrative challenges of adjudicating multiple step adjustment petitions each year with an abbreviated review schedule.” Order of Notice at 1. The Commission determined it would “examine all pertinent aspects of step adjustments by electric, gas, and certain water utilities in New Hampshire,” which would “aid the Commission in its role of examining step adjustment petitions to ensure just, reasonable, and accurate rates, and may serve as a starting point for reconciliations of recent step adjustment calculations and modifications of future proposals.” Order of Notice at 2. The Commission requested the utilities and interested stakeholders to pre-file comments on the procedural schedule and scope of this investigation by October 4, 2022. Order of Notice at 4-5.

Public Service Company of New Hampshire d/b/a Eversource Energy (“PSNH”) and Aquarion Water Company of New Hampshire (“AWC-NH”) (together, the “Eversource Companies”) are grateful for the opportunity to submit these preliminary comments in response to

the Order of Notice and to participate in this important investigation.¹ Specifically, this filing provides the preliminary comments of the Eversource Companies on the scope of the investigation and addresses each of the issues identified by the Commission in Order of Notice.

II. Comments of the Eversource Companies

A. Issues Presented

In its Notice, the Commission listed several issues for discussion, including but not limited to the following:

1. The advisability for continuing the step adjustment ratemaking paradigm in the current regulatory and economic environment in New Hampshire;
2. The calculation methodologies used to develop step adjustments, including the treatment of depreciation and other categories of expense, rate of return, etc.;
3. The role of the DOE's Audit Division in step adjustment review proceedings;
4. Potential enhancements to review proceedings, including timing of step adjustment filings and proposed rate effective dates;
5. The role of settlement agreements in full rate case proceedings in guiding step adjustment filings and criteria, including criteria related to project qualification;
6. The qualification criteria for step adjustments in general; and
7. The appropriateness of reconciliation adjustments.

Order of Notice at 3.

The Eversource Companies appreciate the Commission's willingness to take on these issues because, in today's environment, utilities are confronting increasing capital requirements that are not adequately addressed by the traditional base-rate construct, particularly with the implementation of revenue decoupling, which generally deprives the utility of the benefit of sales

¹ The Order of Notice states that as to water utilities, this investigation is limited to water utilities defined as "Class A utilities," having annual water operating revenues of \$750,000 or more. AWC-NH is a Class A utility as defined in N.H. Code Admin. R. Puc 602.01. AWC-NH and PSNH are affiliated entities within the Eversource Energy organization.

growth between rate cases unless a revenue-per-customer method is used. Even with a revenue-per-customer method, or alternatively, in the absence of revenue decoupling, the current sales growth trends are not correlated to the level of investment and its associated costs that are necessary for the utilities to undertake in order to provide the level of safe and reliable electric and water that is expected of them by their customers. Below, the Company addresses each of the issues presented in sequence.

B. The Eversource Companies Advise Continuation of the Step Adjustment Ratemaking Paradigm.

The Eversource Companies recommend continuing the step adjustment ratemaking paradigm given the current regulatory and economic conditions facing utilities in New Hampshire. Step adjustments support essential capital investment on the system and delay the need for filing a base-rate petition that effectuates the update of all of a utility's costs. For the reasons discussed below, maintaining adequate capital investment *is an imperative* for maintaining and improving the safety, reliability and resiliency of electric service and the reliability, safety and quality of water service. Adequate capital investment cannot be maintained without timely and adequate cost recovery. At the same time, avoidance of base-rate proceedings is to the benefit of customers. As a result, the step adjustment paradigm is a valuable tool for balancing the competing objectives of a safe and reliable system, and customer impact.

For electric distribution companies, the need for increasing investment stems from numerous factors, including age and condition of distribution infrastructure; increasing expectations of customers for more reliable and resilient service due to our modern-day dependence on electricity; the benefits of installing modernized technology for reliability, resiliency and environmental control; and the need to accommodate clean energy facilities with two-way power flows. For water companies, there is an equally compelling need for increased

investment. To assure access to safe, high-quality drinking water, it is necessary to make substantial capital investments in the installation and replacement of new water infrastructure. For both electric and water companies, the need for these investments arises primarily from infrastructure age and the correlating deterioration, and increasing customer expectations.

At the same time, the cost of running the system is increasing, including in relation to the cost of capital projects. For example, the majority of PSNH and approximately half of AWC-NH workforces are employed under collective bargaining agreements that provide for annual wage increases. Similarly, contractors working on the electric distribution system and water systems are becoming harder to source due to high demand for their services across the country, which drives higher costs. For PSNH, labor cost increases are driving increases in the cost of vegetation management and electric line crews, which are fully labor dependent. For AWC-NH, this includes skilled crews for water main construction and replacement. These crews can go where the money is, leaving fewer crews available to the Eversource Companies. This is coupled with a higher demand locally for their services due to increasing system demands facing all utilities in the region, diseased trees and an increased need for vegetation management services due to persistent drought conditions, and related factors.

Conversely, customer expectations for reliability are at an all-time high, and tolerance for service outages are at an all-time low. The availability of safe and reliable public necessities, like electricity and water, is critical for everyday life and dependence on the reliability of these necessities has been underscored and amplified by the pandemic with a persistent shift to a remote or hybrid workplace. For the electric grid and water systems, much of the infrastructure that exists today to serve customers was installed following a post-WWII economic boom and buildout of the electric and water systems to support economic growth in suburban and rural areas. This infrastructure is reaching the end of its useful life *in bulk* making it critical that the Eversource

Companies maintain and increase the level of capital investment needed annually to replace it.

In addition, today's electric distribution system was not designed to enable the seamless integration of distributed energy resources ("DER") with two-way power flows. Instead, the system was designed to allow power to flow one-way from the generating source to the customer. As the adoption of new and emerging technologies, including but not limited to electric vehicles, battery storage and solar panels on customer homes increase in popularity and adoption in New Hampshire, these system dynamics will increase variability and add risk to the system without proper integration and management, driving the need for more capital investment to accommodate and control the integration of this technology.

With water systems, there are ongoing environmental regulatory developments and remediation efforts that drive the need for capital investment and uniquely increase operating costs. A recent example is the effort to remediate the contamination of per- and polyfluoroalkyl substances ("PFAS"), which is present in high concentrations in areas in the Aquarion service territory. Aquarion has been awarded a Drinking Water and Groundwater Trust Fund ("DWGTF") for the amount of \$428,250 and a grant from Department of Environmental Services ("NHDES") for \$1,341,259 to treat PFAS in a well critical for the Hampton and North Hampton water supply, and to mitigate the potential for further PFAS impacts to other wells. But this is likely an issue that will arise elsewhere in the service territory, as well, and is only one example of how environmental regulation and compliance directly impact capital planning for water utilities. Aquarion also faces aging infrastructure that will need replacing as it reaches the end of its useful life.

All of these factors drive the need for investment and the associated costs incurred, yet none arise as a result of a growing customer base that would provide incremental revenues to offset the capital investment or increasing O&M. Whether a feeder or well-field serves 1 or 1000

customers, it will need to be replaced if it is aging and in poor condition. There is no option that allows the Eversource Companies or other utilities to forego this investment or to allow reductions in the public safety. Moreover, a proactive approach to replacement is always more cost-effective than a reactive approach that waits for failure to occur. With a proactive approach, it is possible to plan and prepare for costs rather than incurring costs on an “emergency” basis. Capital investment is an imperative for customers and timely and adequate recovery is an imperative to make that happen consistent with credit-metric expectations.

Historically, utilities were able to rely on sales growth to provide revenue support between rate cases. With revenue decoupling in place, any changes in revenue are not made available to the utility but rather are provided to, or collected from, customers to make the utility neutral to reductions in sales volumes arising from energy efficiency and energy conservation measures. As a result, even if sales growth *is occurring*, it falls to the benefit of customers reducing the amounts that customers would otherwise owe to the utility through the revenue decoupling mechanism. However, even without decoupling in place, the level of sales growth currently being realized by the Eversource Companies is not aligned with the level of investment and costs necessary to maintain system safety, reliability, and resiliency. Without any possibility of having sufficient revenues associated with new sales growth to cover the cost of incremental capital investment and increased operating expenses experienced between rate cases, utilities have no other option than to constantly seek base-rate relief or to somehow hold back on investment, which is an ultimate detriment for customers. For water utilities, customer growth has not been a factor influencing base rates for quite some time: from 2012 to 2021, less than 500 customers were added to the Aquarion water system. Yet the many factors mentioned above require ongoing capital investments to ensure a safe and adequate supply of drinking water.

As a result of increased energy efficiency, conservation and reduced demand growth, utility regulators have recognized the need to pair the traditional rate-setting process with other supportive regulatory frameworks to provide incremental revenue between base-rate cases so that base-rate cases can be spaced out over longer time intervals to the benefit of customers. New Hampshire uses step adjustments, which typically recognize an increase in revenues for capital costs, but could also include an accommodation for isolated or larger-scale changes in O&M costs that would otherwise trigger the need for a base-rate case on their own (such as the cost of major IT installations that increase annual expense by an inordinate amount).

In New Hampshire, parties to rate cases and regulators have favored the implementation of one or more step adjustments to provide for an increment of cost recovery for investments not reflected in base rates. This is critical to enable utilities to extend the time between rate cases, saving customers money and fostering administrative efficiency. Without step adjustments, utilities will be compelled to file rate cases much more frequently thereby allowing all elements of the cost of service to be updated on a more frequent basis. Rising utility costs of service, without a commensurate adjustment of revenues generates the need for rate cases. Full-scale rate cases are costly for all involved and often impose larger and sharper rate adjustments on customers than would occur with sequenced step adjustments to roll larger costs into rates on a phased basis.

For these reasons, step adjustments are an important part of the ratemaking paradigm in New Hampshire. Step adjustments provide rate stability and a predictable rate path for customers. Step adjustments enable utilities to extend the period of time between base rate cases, which benefits customers through administrative efficiency and avoiding the costs, efforts and contested nature of a full rate case. Steps are also typically negotiated as part of a settlement agreement and are subject to future audit by the New Hampshire Department of Energy (“DOE”), ensuring that the rates are just and reasonable and in the public interest.

In recent rate proceedings, both Eversource Companies entered into settlement agreements, approved by the Commission, that included step adjustments. and those steps played an integral part in balancing the interests of all parties.² The steps were critical to the ability of the Eversource Companies to maintain sufficient revenue for a longer period, consequently avoiding the need to file a full rate case at the earliest possible opportunity and minimizing these resource-intensive administrative proceedings that last up to 12 months or longer.³ In addition, the Commission has no obligation to accept a rate case from a particular utility any more frequently than two years from the utility's previous rate case.⁴ This is not the case in neighboring jurisdictions like Massachusetts and Maine that do not employ step adjustments, utilities may file rate cases at any time. Therefore, step adjustments balance the interests of the utilities and customers by allowing utilities to collect sufficient revenue during the interim years to avoid rate filings well beyond the two-year threshold for the filing of a new rate case.

C. The Eversource Companies Support the Use of a Uniform Methodology for Calculating Step Adjustments as part of Future Rate Cases.

As a general matter, the Eversource companies would favor a uniform methodology for calculating the revenue requirement change associated with the step adjustment. Standardization of the computation of the revenue requirement change to be included in rates would be informative to all parties; would facilitate settlement discussions; and would lead to greater administrative efficiency and regulatory certainty.

To the extent that step adjustments are structured to allow recovery of capital investments through base rates, the step adjustment constitutes a proxy for the change in rate base. To

² Order No. 26, 433; Order No. 26,659.

³ RSA 378:6, I(a); *See also* Exhibit D to Executive Order #29, pursuant to Executive Order 2020-04, as extended by Executive Order 2020-05, extending the Commission's ability to suspend rate schedules by six months, from 12 to 18 months.

⁴ RSA 378:7

incorporate incremental capital investments into rate base, the step adjustment should be calculated to essentially update all components of rate base, including accumulated depreciation, incremental depreciation expense, property tax expense, the weighted cost of capital and taxes. Essentially, the step adjustment would constitute a “roll forward” of rate base from the most recent rate case so that all elements of rate base maintain parity. To the extent that major O&M cost changes are allowed to be included in the step adjustment, those costs would also be included in a “roll forward” of the base revenue requirement establishing a new set of base rates.

D. The Eversource Companies Support the Participation of the DOE’s Audit Division in Step Adjustment Review Proceedings Subject to Due Process Considerations.

Historically, Commission audits were primarily an assessment of the accuracy of the utilities’ booked costs, meaning that the audit was essentially an accounting review. To the extent the DOE’s Audit Division conducts an audit of capital projects and calculation of costs within a proposed step adjustment, the resulting audit report should be subject to normal due process in a contested case. That is, during development of the report, the utilities should be provided an opportunity to exchange information with DOE’s Audit Division and provide input on the draft report. Should the Commission require that the final audit be entered into the record as an exhibit (and the Eversource Companies are not necessarily suggesting that this should occur), the final audit should be filed to the relevant docket and the author(s) of the report should be made available as a witness subject to cross-examination. As a party, DOE should have a burden of proof to support the audit report and should be required to answer discovery and present a witness for cross-examination at hearing as part of the adjudicatory process, consistent with RSA Chapter 541-A. Given that DOE is a party and to the extent that the audit does more than account for the accuracy of booked utility costs, the audit report should not be accepted as a fact in the record without allowing due process. Nor should the Commission take administrative notice of audit reports to

the extent that the reports make any recommendations for action, as that amounts to a contested party position. Absent these measures, the utilities would be deprived of basic due process in responding to the audit report.

E. The Eversource Companies Support Potential Enhancements to Step Adjustment Review Proceedings.

The Commission could determine it appropriate to evaluate potential enhancements to step-adjustment review proceedings, including timing of step adjustment filings and proposed rate effective dates. In terms of the timing of step adjustment filings and proposed rate-effective dates, one objective should be to start rates on the same date to avoid the need for multiple rate changes on customers' bills. However, the challenge that this approach raises is that, frequently, rate case settlement agreements result in the simultaneous setting of new base rates, adjusting temporary rates and, typically, implementing the first step adjustment agreed to in settlement. However, this does not allow the Commission to separately review the underlying elements of the step adjustment. Below, in relation to the potential for reconciling adjustments, the Company discusses a process that could alleviate this challenge and allow the simultaneous rate changes to go forward.

F. The Commission Should Continue to Encourage Settlement Agreements in Rate Cases.

The Commission should continue to encourage settlement agreements as a means to resolve contested rate case dockets. Settlement agreements reflect a balance of consideration and compromise on the key issues by the parties and facilitate administrative efficiency and are therefore in the public interest. Settlements are also subject to review and approval by the Commission as being just, reasonable and in the public interest.⁵ New Hampshire's laws and administrative rules favor settlements.⁶

⁵ N.H. Code of Administrative Rules Puc 203.15(b)

⁶ RSA 541-A:31; N.H. Code of Administrative Rules Puc 203.15, 203.20.

If this investigation produces a standardized recommendation on the method to calculate the revenue requirement comprising the annual step adjustments, then parties to a settlement agreement in a future rate could either choose to adopt that methodology or propose an alternate methodology. If the settling parties view an alternative methodology as warranted based on the facts and circumstances of a case, then it would be their burden to support the methodology as just, reasonable and in the public interest. The Commission then has the opportunity to review the settlement and the record of the docket to find that the settlement is just, reasonable and in the public interest and therefore warrants approval.

The Eversource Companies understand that the Commission is undertaking this investigation to receive information about the relative merits of step adjustments and how they are calculated, and whether adjustments or modifications should be considered in future adjudications. But no matter the result of this investigation or any adjudications that may follow it, the Eversource Companies would like to note that step adjustments are the only mechanism in place in New Hampshire that maintain sufficient utility revenue in lieu of a full rate case.⁷ If revenue is not sufficient for the utility to sustain the level of capital investment needed to uphold the system, the utility's only recourse is to file a full base-rate case, in which all utility costs are updated and incorporated to those rates, which is a process that is a considerably larger undertaking than even multiple step adjustments. Without step adjustments, this frequency is more likely to trend toward every two years⁸, which will have bill impacts to customers.

⁷ There is one additional interim rate mechanism for water utilities, the Water Infrastructure and Conservation Adjustment ("WICA") program that allows for recovery for eligible main replacements.

⁸ RSA 378:7 gives the Commission discretion to wait up to two years before it accepts a new rate case from a utility, unless there is a claim of an unconstitutional taking, in which case the Commission must take the case.

G. Qualification Criteria for Step Adjustments Would Help Limit Controversy in Step Adjustment Proceedings

Setting the qualification criteria for step adjustments would be informative to all parties; would facilitate settlement discussions; and would lead to greater administrative efficiency and regulatory certainty. The step adjustments incorporated into the settlement agreements approved in the recent rate cases of the Eversource Companies apply the standard qualification that capital projects must be in service to customers to qualify for inclusion in a step adjustment. New business projects are growth projects that are designed and undertaken for the purpose of serving new load and generating new, incremental revenues. To the extent that the incremental revenue is available to the utility to offset the capital cost of the customer addition, then these customer additions may not be appropriate for inclusion in the step adjustment. However, where a revenue decoupling mechanism is in place the incremental revenues will be subsumed into the mechanism, which means that the capital additions producing the revenue should be allowed in the step adjustment.

The Eversource Companies are open to discussion of process enhancements to facilitate the Commission's review of step adjustments. This could be accomplished by changes to the timing of review periods, capping how much may be included in a step, and subjecting all projects to a full prudence review among other measures.

H. Reconciliation Adjustments Are Appropriate, If Applied Outside of Base Rates.

The Order of Notice states that “[t]his investigation will aid the Commission in its role of examining step adjustment petitions to ensure just, reasonable, and accurate rates, and *may serve as a starting point for reconciliations of recent step adjustment calculations* and modifications of future proposals.” Order of Notice at 2, citing Order Nos. 26,623, 26,656, 26,657, and 26,661 (emphasis added). The orders cited by the Commission are recent approvals of step adjustments that include language stating that these approvals may be subject to reconciliation, including

reconciliation based on the outcome of this proceeding. If the Commission intends to implement the step adjustments as a reconciling mechanism, the mechanics would be different than what is undertaken today. Base rates cannot be adjusted on a retroactive basis, so to the extent that recently approved step adjustments have been incorporated into base rates, those steps cannot be reconciled.

Specifically, if the Commission is seeking to have a longer time period to allow for a prudence review of the capital projects (and potential O&M expense) included in the steps, this could be accommodated through the implementation of a “reconciling” approach *outside of base rates*. In other words, the Commission could approve the simultaneous implementation of the new base rates, the adjustment to temporary rates and the step adjustment amount, with the step-adjustment amount collected *outside of base rates* and subject to later review and reconciliation. Then, the Commission could conduct a prudence review process that could take up to 12 months for a final decision, for example, while the reconcilable rates are collecting the filed revenue requirement for the respective step adjustment.

Of course, in this paradigm, adjustments made to the amounts included in the filed revenue requirement (i.e., if a project is deemed to be imprudent in whole or in part), would need to be refunded to customers, with appropriate carrying charges. In this paradigm, there would be no adjustment to base rates. Accordingly, “reconciliation” of filed amounts that are collected through rates can only occur with implementation of a reconciling mechanism with the purpose of the mechanism being to initiate recovery coincident with other rate changes, subject to further review and investigation of the prudence of the underlying projects.

If the objective is to conduct the prudence review prior to allowing recovery to commence in rates charged to customers, then the Commission could set a standard time period of no greater than six months from the filing of the step adjustment for the prudence review; conduct that review; and then put the amount allowed for recovery into base rates (without the need for a reconciling

mechanism). If the parties to a settlement agreement know ahead of time that a step adjustment will not take effect until six months subsequent to the effective date of new base rates from the settlement agreement, for example, then the settling parties will factor that delay into the economics of the deal, thereby allotting sufficient time to the Commission for a prudence review. One problem that has arisen in recent settlements is that this timeline is not known at the time of settlement and, as a result, utilities count on the timely implementation of the step adjustment in considering the balance of benefits and costs in the settlement deal.

If step adjustments are implemented in the future as adjustments to base rates, these adjustments cannot be subject to reconciliation. Once approved, customers and the utility have an expectation that the resulting rates create a binding agreement as set forth in the utility's tariff. *Appeal of Pennichuck Water Works*, 120 N.H. 562, 566 (1980) ("Pennichuck"). The prohibition against retroactive ratemaking is well established and the Commission has found that "the customers of a utility have a right to rely on the rates which are in effect at the time that they consume the services provided by the utility, at least until such time as the utility applies for a change." *Pennichuck*, at 566. The Commission has also held that "[o]nce customers consume a unit of those services, they are legally obligated to pay for it and in that sense the transaction has been completed and the charges are set in accordance with the rates then in effect and on file with the PUC." *Id.* In the same way, the utilities also have a right to rely on payments from its customers who have consumed services under the approved rates.

This need for certainty and finality with respect to the step adjustments is particularly important because step adjustments are designed to provide revenue support in between rate cases. For example, the Commission recognized that the settlement agreement approved for PSNH in Docket DE 19-057 included three step adjustments that resulted in "a negotiated amount that the [settling [p]arties agree will provide [PSNH] with the revenues necessary to provide safe and

reliable service.” Order No. 26,433, at 19. It is clear that the utilities rely on the revenues provided through these step adjustments to invest in their systems. Step adjustments allow the utilities to recover capital investments placed in service between rate cases, excluding new customer investments and typically subject to a capped amount. Therefore, even with step adjustments, utilities are not recovering the full amount of these investments.

Lastly, subjecting the utilities to further uncertainty through the possibility of reconciliation would exceed the Commission’s authority as contrary to law and undermine the very purpose of allowing step adjustments. Although the Order of Notice indicates that the Commission may examine the “appropriateness of reconciliation adjustments,” any changes to the step adjustment methodology resulting from this investigation should be forward-looking only and should not apply retroactively.

III. Suggested Procedural Schedule

Eversource Companies recommend the following illustrative procedural schedule:

- Commissioner-attended technical session with all participants and any resulting record requests from Commissioners
- Participant technical session
- Second Commissioner-attended technical session and record requests
- Participants file final comments/recommendations

IV. Conclusion

The Eversource Companies appreciate this opportunity to provide their preliminary comments and look forward to further participation in this docket.