

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

IR 22-048

ELECTRIC AND GAS UTILITIES

Investigation of Step Adjustment Methodology and Process

Initial Comments of Unitol Energy Systems, Inc. and Northern Utilities, Inc.

I. INTRODUCTION

On August 26, 2022, the New Hampshire Public Utilities Commission (the “Commission”), issued an Order of Notice in the instant proceeding explaining that the Commission had recently “made findings regarding the necessity for an investigation to examine the accounting and calculation methodologies for step adjustments presented by New Hampshire’s electric and gas utilities.” Order of Notice at 1 (citing *Unitol Energy Systems, Inc.*, DE 22-026, Order No. 26,656 (July 28, 2022) and *Unitol Energy Systems, Inc.*, DE 21-030, Order No. 26,657 (July 28, 2022)). The Commission further noted that step adjustment filings have become a frequent feature of ratemaking in New Hampshire, and described what it viewed as “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.” *Id.* In light of these observations, the Commission opened this investigatory proceeding to “examine all pertinent aspects of step adjustments” by utilities in New Hampshire. *Id.* at 2.

In framing the investigation, the Commission stated that it will review questions related to, among other things, the necessity for ongoing step adjustments for utilities and the ratemaking and calculation methodologies used. The Order of Notice sets forth a non-exclusive list of seven issues that it will consider in this proceeding:

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.

Id. at 3. The Commission invited the New Hampshire utilities and other interested parties to submit comments on the procedural schedule and scope of this investigation in advance of the Prehearing Conference on October 13, 2022.

II. SCOPE OF THE INVESTIGATION - SPECIFIC TOPICS

Unitil Energy Systems, Inc. ("UES") and Northern Utilities, Inc. ("Northern") (collectively, "Unitil" or the "Company") offer the below observations on the issues identified in the Commission's Order of Notice. The following comments are intended only as Unitil's initial considerations on these issues; the Company intends to provide additional information and briefing on these issues as the investigation progresses.

a. Issue 1: The advisability for continuing the step adjustment ratemaking paradigm in the current regulatory and economic environment in New Hampshire

Unitil strongly supports the continued use of step adjustments between rate cases to recover costs associated with certain capital investments that are placed in service after the test year. The Commission has acknowledged step adjustments to be a reasonable method to allow

for the timely recovery of assets in service without resorting to a full rate proceeding. Such adjustments, which are typically limited in number,¹ are effective at mitigating the effects of earnings attrition and therefore enabling utilities to defer costly rate cases, which can strain the resources not only of the utilities, but also the Commission and interested parties such as the Department of Energy and the Office of the Consumer Advocate. Step adjustments also allow for gradual, incremental increases in rates and can mitigate the effect of rate shock. Until welcomes the opportunity to discuss the merits of step adjustments as an essential regulatory tool.

Step adjustments have long been recognized as an appropriate component of utility rate plans, and the Commission has consistently allowed such adjustments for gas and electric utilities, including Northern and UES. The Commission has found that implementing annual step adjustments to recover certain capital costs “is a reasonable method to allow for a more timely recovery of assets in service without resort to a full rate proceeding.” *Unitil Energy Systems, Inc.*, DE 10-055, Order No. 25,214 at 27 (April 26, 2011) (approving four step adjustments to recover, *inter alia*, certain changes to distribution utility plant); *Public Service Co. of N.H.*, Order No. 25,123 at 32 (June 28, 2010) (approving multi-step rate plan); *see also Northern Utilities, Inc.*, DG 13-086, Order No. 25,653 at 10 (April 21, 2014) (approving a settlement agreement including multiple step adjustments as “representing an appropriate balancing of the interests of the Company and its customers.”). “Step adjustments to rates are employed as a means of ensuring that a regulated utility retains its ability to earn a reasonable rate of return after implementing large capital projects, and to avoid placing a utility in an earnings deficiency immediately after a rate case in which a revenue requirement was based on a historical test year.” *Lakeland Management Co., Inc.*, DW 10-306; DW 11-269; Order No. 25,357 at 13 (May 1,

¹ For example, the Commission allowed two steps for UES in DE 21-030, two steps for Northern in DG 17-070, and three steps for UES in DE 16-384.

2012); *see also Pittsfield Aqueduct Co., Inc.*, DW 10-090, Order No. 25,229 at 12 (June 8, 2011) (“Step adjustments can avoid placing a utility in an earnings deficiency immediately after a rate case in which the revenue requirement was based on a historic test year and a smaller rate base.”); *Unitil Energy Systems, Inc.*, DE 10-055, Order No. 25,214 at 25 (April 26, 2011). The Commission should continue to recognize this firmly-established precedent.

As Unitil has explained in recent UES and Northern rate cases, non-growth plant additions represent a significant portion of each company’s historic and forecasted investments. See DE 21-030, Hearing Exhibit 6 at Bates 000466-67, 000469 (showing that UES’s non-growth investments comprised, on average, 80% of capital spending from 2016 – 2020 and are projected to average 84.3% of capital spending through the end of 2023); DG 21-104, Hearing Exhibit 3 at Bates 000410, 000416 (showing 66% average non-growth spending From 2017 – 2020 and 76.6% average through 2023). Critical non-growth projects include, among other things, reliability investments, infrastructure replacement, and system improvements. The Company is mindful of concerns recently expressed by the Commission regarding growth in utility rate base relative to customer growth, *see Unitil Energy Systems, Inc.*, DE 20-002, Order No. 26,666 at 6, 11 (Aug. 15, 2022), but stresses that there is no reason to expect a direct, proportional relationship between system investment and customer additions, and that the Company must continue to invest in and maintain its aging equipment and facilities to assure the delivery of safe and reliable service irrespective of customer growth. Even if the customer count increases and the Company’s operating costs are well-managed, revenue may not keep pace with the increase in fixed costs associated with non-growth system investments, resulting in earnings attrition. DG 21-104, Hearing Exhibit 3 at 000099; DG 21-030, Hearing Exhibit 6 at 000119.

Step increases are also essential for maintaining the financial health of a utility, which

ultimately accrues to the benefit of customers. For example, Unitil's ability to finance capital investments relies heavily on internally generated funds (i.e., operating cash flows). Those cash flows are supplemented by short-term borrowings which in turn, are rolled into long-term debt and common equity. That financing cycle is subject to market risk, which is magnified when cash flows are diluted, requiring expanded access to external financing. Rating agencies focus on cash flows in their credit rating determinations; financing risk and the risk of a credit downgrade both are mitigated by the timely recovery of investments and strengthened cash flows from operations. Mitigating these risks benefits ratepayers in the form of lower costs of capital, and more efficient access to both debt and equity capital. Step increases support the cash flows needed to fund the non-growth investments that support system reliability, and to support the Company's credit profile.

As noted above, step adjustments also reduce the cost and administrative burden of frequent rate cases before the Commission. By allowing for the timely recovery of non-growth investments, step adjustments enable utilities to defer the filing of full rate cases, which necessarily require the significant expenditure of time and resources. Utilities and other parties to rate cases, including the Department of Energy and the Office of the Consumer Advocate, must engage the services of outside consultants to support their respective positions. It may also be necessary for utilities to engage the services of outside counsel, particularly if the frequency of rate cases places a strain on internal resources. These costs are ultimately recovered from customers. Restricting or eliminating step adjustments (which are limited in scope and take several months to adjudicate) would increase the frequency of full rate cases (which can take up to twelve months to adjudicate) and likely result in a significant strain upon Commission resources. Step adjustments also allow for gradual, incremental increases in rates and can not

only defer rate cases but mitigate the effect of rate shock when a utility ultimately does file a full case. *See Hampstead Area Water Company*, DW 05-112/05-177, Order No. 24,626 at 8 (May 26, 2006) (“The Commission has long recognized the principles of gradualism and avoidance of rate shock.”); *Development of New Alternative Net Metering Tariffs*, DE 16-576, Order No. 26,029 at 53 (June 23, 2017) (“[G]radualism’ is an important principle in sound ratemaking.”).

The necessity of maintaining the step adjustment ratemaking paradigm in New Hampshire is further underscored by the existence of RSA 378:7, which states: “The commission shall be under no obligation to investigate or hear any rate matter which it has investigated within a period of 2 years, but may do so within said period at its discretion.” While the New Hampshire Supreme Court has held that RSA 378:7 cannot be applied to bar consideration of a rate case when a utility makes a supported claim that its earnings deficiency is unconstitutionally confiscatory, *see Appeal of Gas Serv.*, 121 NH 602, 603 (1981), the statute nevertheless injects a degree of uncertainty and risk into the preparation of a rate case within the two year period. Step adjustments are an efficient method of bridging the potential gap between rate cases described in RSA 378:7.

b. Issue 2: The calculation methodologies used to develop step adjustments, including the treatment of depreciation and other categories of expense, rate of return, etc.

The Commission has recently approved step adjustments for UES and Northern utilizing a “change in net plant” methodology to determine eligible capital investments for inclusion in the step adjustment revenue requirement calculation. DE 22-026, Order No. 26,656 at 6 (July 28, 2022); DE 22-020, Hearing Exhibit 2 at Bates 1, 10, 14, 15, 20; DE 22-020, Order No. 26,675 at 4 (Aug. 31, 2022). The Commission has expressed support for this approach as a general matter. *See* DG 22-020, Transcript at 93-94 (Aug. 25, 2022) (“I’m very happy that this, the ‘net plant

approach' was used. . . . I would commend Unitil for going in this direction.”). However, while the Commission approved step adjustments for Northern and UES utilizing the “change in net plant” methodology agreed to by settling parties in each docket, the Commission indicated that it would open this investigation for the purposes of determining a consistent methodology for future step increases. DE 22-026, Order No. 26,656 at 5-6.

Unitil anticipates that the treatment of depreciation expense in the “change in net plant” methodology is likely to be subject to examination in this investigation. As Unitil has explained in DE 22-020 and DE 22-026, the “change in non-growth net plant” methodology agreed to by the settling parties in those dockets and subsequently applied by the Company first calculates a year-end gross utility plant for the investment year by adding total plant additions and retirements for both growth and non-growth projects. The Company then calculates ending accumulated depreciation by netting depreciation expense against retirements, cost of removal, salvage, and transfers for both growth and non-growth categories of investment. “Depreciation Expense” is the annual depreciation expense booked in the investment year by the Company and includes investment year additions as they were placed into service as well as all vintages prior to the investment year. This method of determining depreciation expense for the purposes of calculating revenue requirement is consistent with commonly-applied ratemaking principles. An illustrative calculation setting forth the treatment of depreciation expense in the “change in non-growth net plant” methodology is attached hereto as Attachment A.

The Commission has suggested that the “change in non-growth net plant” can be determined by subtracting *actual* growth plant additions from the total change in net plant. DE 22-026, Order No. 26,656 at 6. Such a calculation, on its face, would not result in an accurate calculation of change in non-growth net plant, in that it entails the subtraction of a *gross* number (growth plant

additions) from a *net* number (total change in net plant). This has the effect of arbitrarily assigning all depreciation expense to non-growth plant additions, and thereby arbitrarily reducing the revenue requirement associated with such additions. Misallocating depreciation expense in this way is inconsistent with utility accounting practices and traditional ratemaking principles, which entail the allocation to each rate class its proportionate share of the cost of service for those customers. Assigning growth-related depreciation expense to non-growth investment strays from these principles.

Step adjustments will not be fully effective and achieve the purposes described in the previous section if the methodology for calculating the revenue requirement, including, *inter alia*, the treatment of depreciation expense, is not properly designed. Unitil appreciates the opportunity to discuss this critical issue with the Commission in the investigation.

c. Issue 3: The role of the DOE’s Audit Division in step adjustment review proceedings

It is not clear to Unitil what the Commission is contemplating when it references the role of the Audit Division in step adjustment review proceedings. To the extent that the Department of Energy, on its own initiative or at the direction of the Commission, offers an Audit Report into evidence to prove the truth of a matter discussed therein, then the Department must do so well in advance of a hearing and make a witness available to be cross examined on the contents of the Audit Report and the process employed to develop the conclusions contained in the Audit Report.

d. Issue 4: Potential enhancements to review proceedings, including timing of step adjustment filings and proposed rate effective dates

Unitil does not, in these comments, propose any enhancements to step adjustment review proceedings. As with any issue identified by the Commission in its Order of Notice, the Company reserves the right to propose such enhancements during the course of the investigation, or respond

to comments or proposals made by other participants in the investigation. As a general matter, it is important that step adjustment filings be reviewed in a timely and efficient manner.

e. Issue 5: The role of settlement agreements in full rate case proceedings in guiding step adjustment filings and criteria, including criteria related to project qualification

Unitil's last seven rate cases have been resolved by settlement,² and all have included step adjustments as components of a comprehensive stipulation among the settling parties. The Commission has long "encourage[d] parties to settle issues through negotiation and compromise, because it is an opportunity for creative problem solving, allows the parties to reach a result in line with their expectations, and is often a better alternative to litigation." *Unitil Energy Systems, Inc.*, DE 16-384, Order No. 26,007 at 15 (April 20, 2017) (citing *Granite State Electric Co.*, Order No. 23,966 at 10 (May 8, 2002) and RSA 541-A:31, V(a)). Step adjustment are an essential tool in the negotiation of comprehensive rate case settlements. In addition to the basic components of the step adjustment framework – for example, the number of steps, timing of the filing, eligible plant, and the method of calculation – parties may also negotiate, as they did in DE 21-030, certain customer protections such as a cap on the incremental revenue requirement. This allows the parties additional flexibility in the negotiation of other components that comprise a potential settlement.

Unitil agrees with the Commission's oft-repeated encouragement in favor of compromise and settlement. Settlement is an efficient and reasonable means of resolving a rate case and ensuring that all parties' interests are represented, a result that ultimately benefits customers. The Commission should preserve the step adjustment ratemaking paradigm and continue to allow parties the freedom and flexibility to negotiate the terms of a step adjustment program, including

² DG 21-103; DE 21-030; DG 17-070; DE 16-384; DG 13-086; DG 11-069; DE 10-055.

criteria related to project qualification, in future rate cases.

f. Issue 6: The qualification criteria for step adjustments in general

As discussed above in response to Issue 1, non-growth plant additions represent a significant portion of each Unitil company's historic and forecasted investments. The Company has proposed non-growth investments because the revenue requirements associated with these projects are not otherwise offset with new revenues from new customers. The settlement agreements submitted to the Commission in DE 21-030 and DG 21-104 incorporate a "change in non-growth net plant" approach to determining eligible investments for inclusion in the step adjustment, and Unitil has committed to providing comprehensive documentation, including but not limited to construction work orders. For the reasons discussed above, it is imperative that the Commission continue to approve step adjustments to recover non-growth investments between rate cases, and the Company believes that the "change in non-growth net plant" methodology is an appropriate means for identifying qualifying investments.

g. Issue 7: The appropriateness of reconciliation adjustments

In the Order of Notice, the Commission states: "This 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.*" Order of Notice at 2 (emphasis added); see also Order No. 26,656 at 7 (suggesting that "[t]his investigation could be used to inform future reconciliations for this and other step adjustments."); Order No. 26,657 at 2-3 (noting that the Commission "approved [UES's] preferred methodology subject to reconciliation pending the outcome of [the Commission's] upcoming investigation."). In Order No. 26,656 (DE 21-030), the Commission accepted the Company's "change in non-growth net plant" methodology for the purposes of calculating

UES's 2022 step adjustment revenue requirement, "subject to reconciliation." Order No. 26,656 at 6, 7.

It appears, based on the language in the Order of Notice and the above-cited Orders, that the Commission contemplates using this investigation to potentially determine a different methodology for calculating a step adjustment revenue requirement, and then retroactively apply that calculation to adjust previously fixed rates. Doing so – regardless of whether the methodology would result in a higher or lower rate than was previously fixed – would violate the well-established rule against retroactive ratemaking. Any such reconciliation would be unsupportable as a matter of law, as well as manifestly unfair to the utilities and their customers. Moreover, the Commission has expressly stated that this investigation will not conclude with a final order that is binding upon the participants in this or future dockets. As such, no reconciliation adjustment can be ordered in this docket. "Reconciliation adjustments" are inappropriate for consideration as a general matter, and are outside the scope of this investigation. Simply put, the Commission should not consider such adjustments in this or any other docket.

The rule against retroactive ratemaking is, in addition to being a well-entrenched regulatory principle, recognized by the New Hampshire Supreme Court, which has held "it is a basic legal principle that a rate is made to operate in the future and cannot be made to apply retroactively." *Appeal of Pennichuck Water Works*, 120 NH 562, 566 (1980). Tariffs have the force and effect of law and also state the terms of the contract between utility and customer; because of these dual attributes, retroactively altering the terms of a tariff contravenes both Part 1, Article 23 of the New Hampshire Constitution (enjoining "[r]etrospective laws") and the Contract Clause of the U.S. Constitution (precluding laws that have the effect of "impairing the obligation of contracts"). *Id.* at 566; see also *Freedom Ring Communications, LLC d/b/a BayRing*

Communications, DT 06-067, Order No. 24,886 at 10 (August 8, 2008). Just as a utility Company cannot retroactively adjust upward rates previously fixed and charged to customers, the Company cannot be made to retroactively adjust its rates downwards and, one or more years in the future, refund some portion of previously collected rates to customers. If that were allowable, a utility company and its shareholders would have no certainty or stability in rates, as they would constantly be open to attack, second-guessing, and “reconciliation” even after the Commission issues a final order.

The Commission did not determine, in DG 22-020 or DE 22-026, that the “change in non-growth net plant” methodology was unjust or unreasonable. Moreover, it did not find that that the rates resulting from the application of the settling parties’ “change in non-growth net plant” approach in those cases to be unjust or unreasonable. In fact, the Commission can *only* allow rates that it deems to be just and reasonable or lawful. RSA 378:5, RSA 378:7. Thus, any attempt to retroactively amend the just, reasonable, and lawful rates approved in DG 22-020, DE 22-026, or any other docket in which the Commission has issued a final order fixing rates is inappropriate.

To the extent that the Commission were to arrive at a preferred methodology for calculating the step adjustment revenue requirement that would have resulted in a higher revenue requirement in DG 22-020 and DE 22-026, the Company would not then petition the Commission to retroactively collect an increase in rates. To do so would plainly violate the prohibition against retroactive ratemaking described above and contravene the terms of the settlement agreement that the Company knowingly and willingly entered into with its counterparties. Moreover, to do so would simply be unfair to the Company’s customers. Likewise, any conclusion by the Commission that a different calculation methodology could be

retroactively applied to change previously fixed rates would violate the rule against retroactive ratemaking and be patently unfair to Unitil and any other affected utility.

The “reconciliation adjustments” contemplated by the Commission would also, at least in the case of UES and Northern, upend the settled expectations of the parties. The settlement agreements in DE 21-030 and DG 21-104 were the product of many days of extensive negotiations among the settling parties; the provisions set forth in the settlement agreements reflect compromise by all of the settling parties. The Company agreed to rate case stay outs in both DE 21-030 and DG 21-104 because it anticipated recovering a revenue requirement related to non-growth plant additions based upon the calculation agreed to by the settling parties. Unitil may not have agreed to these stay out provisions or other concessions in the settlement agreements if the “change in non-growth net plant” calculation was to be changed at some time in the future. If the Commission were to materially and arbitrarily alter the terms of settlement agreements in separate and subsequent dockets, it would cast doubt upon the stability of any settlement agreement brought before it in the future. This will chill the long-established and encouraged practice of settling matters before the Commission and lead to inefficiency and unnecessary, costly litigation.

III. PROCEDURAL SCHEDULE

Unitil has conferred with counsel for the Eversource and Liberty companies and is supportive of the procedural framework proposed by Eversource. The Company looks forward to further discussing the procedural schedule with all interested parties.

IV. CONCLUSION

Unitil appreciates the opportunity to provide its perspective in these initial comments and stands ready to participate further in this proceeding.

	Rate	Total	Growth	Non-Growth
Plant Additions		\$ 19,929,755	\$ 3,332,692	\$ 16,597,063
		100.00%	16.72%	83.28%
Depreciation Expense		\$ 10,413,124	\$ 1,741,303	\$ 8,671,822
		100.00%	16.72%	83.28%
Cost of Removal		\$ (642,545)	\$ (40,873)	\$ (601,671)
		100.00%	6.36%	93.64%
Change in Net Plant		\$ 10,159,176	\$ 1,632,262	\$ 8,526,912
Pre-Tax Return	8.99%	\$ 913,455	\$ 146,764	\$ 766,691
Depreciation				
Plant Additions		\$ 19,929,755	\$ 3,332,692	\$ 16,597,063
Depreciation Expense	3.46%	\$ 689,570	\$ 115,311	\$ 574,258
Property Tax				
Change in Net Plant		\$ 10,159,176	\$ 1,632,262	\$ 8,526,912
Property Tax Expense	0.66%	\$ 67,051	\$ 10,773	\$ 56,278
Amortization on Post Test-Year Projects		\$ 157,739	\$ -	\$ 157,739
		100.00%	0.00%	100.00%
Revenue Requirement		<u>\$ 1,827,814</u>	<u>\$ 272,848</u>	<u>\$ 1,554,966</u>