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Witness: Douglas P. Horton and Julia Frayer
Request from: Department of Energy and Environmental Protection

Question:

(PBR- K-bar) Refer to Exhibit CLP-PBR-1 p. 69. Describe what a "K-bar arrangement" is and provide more detail of K-bar arrangements approved in Massachusetts and Alberta. Compare and contrast this type of capital funding mechanism with the Company's proposal.

Response:

A K-bar mechanism is a formula-based capital funding mechanism used within a performance-based regulation ("PBR") plan as described in Exhibit CLP-PBR-1. The K-bar is designed to provide additional revenue to the utility to support capital investment, where the base PBR-indexing mechanism is insufficient to support the required level of support using only the selected I-factor and X-factor. A K-bar typically establishes a level of capital funding support using a notional amount pursuant to a benchmark (in some cases historical plant additions), relative to the revenue generated by the PBR formula and selected I-factor and X-factor.

For the 2024–2028 PBR term, the Alberta Utilities Commission ("AUC") approved K-bar funding mechanism based on the five-year average of 2018–2022 actual plant additions. The AUC explained that K-bar "is not intended to provide funding for projects on a line-by-line basis," but rather supplements the basic I-X mechanism by providing "an envelope of funding for the management of business-as-usual activities with a reasonable opportunity to earn the approved rate of return." See AUC Decision 27388-D01-2023, *2024-2028 Performance-Based Regulation Plan for Alberta Electric and Gas Distribution Utilities*, October 4, 2023.

As discussed in the final decision of the Massachusetts Department of Public Utilities in D.P.U. 22-22, the K-bar approach, originally developed by the Alberta Utilities Commission ("AUC"), is one under which "the I-X PBR formula escalates historical average capital additions not subject to recovery through capital trackers to form the basis of future approved capital recovery."[1] Supplemental recovery is determined by the difference between the utility's escalated historical capital needs and the capital-related revenue already provided through the I-X formula. For NSTAR Electric, under the MDPU-approved five-year PBR plan (2023–2027), the K-bar mechanism provides incremental capital revenue support based on a rolling average of historical plant additions. The initial K-bar adjustment, effective January 1, 2024, uses the average of actual

[1] Massachusetts Department of Public Utilities, NSTAR Electric Company d/b/a Eversource Energy, D.P.U. 22-22, November 30, 2022, at 20.

plant additions placed in service from 2018–2022, with the historical averaging period updated annually thereafter. The mechanism determines annual capital revenue support using the approved rate base associated with capital additions, subject to an annual constraint. Specifically, the MDPU implemented an annual capital spending constraint of up to ten percent from the annual capital spending forecasted in the rate case proceeding. The MDPU recognized the challenges in accurately forecasting capital spending, as well as the potential impacts on future capital spending from recent and anticipated changes in energy and climate policy in the region. Accordingly, the MDPU found it appropriate to allow a modest amount of flexibility from the Company's forecasted budget in setting the expenditure restraint.[2]

CL&P is proposing a capital support mechanism with certain difference, more closely correlated with the direction of PBR policy in Connecticut. The Company's proposed mechanism is referred to as the "F" factor and is based on a fixed annual capital investment level established from the Company's capital forecast presented in this proceeding. Actual plant additions placed in service would be reconciled against the forecasted in this proceeding through PURA's annual RAM proceedings, and the allowed rate base and associated revenue requirement would be limited to the lesser of the revenue requirement for the approved forecast or the revenue requirement for actual plant in service. Capital spending above the approved forecast would not be recoverable during the initial four-year PBMRP term. See Exhibit CLP-ELP-1, at 101-102.

The key difference between the MDPU K-bar and the Company's proposed F Factor is that K-bar determines supplemental capital funding formulaically from a historical capital-additions benchmark, whereas CL&P's F factor begins with a PURA-approved capital forecast and reconciles recovery to actual plant placed in service, subject to the approved forecast cap with such reconciliation available only on a downward basis, as appropriate.

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2 Id. at 61-62.