Date Filed: October 07, 2026

Witness: Douglas P. Horton
Request from: CLF and Acadia Center

Question:

(Performance-based Regulation) Refer to Exhibit CLP-PBR-1 (Frayer Direct Testimony), page 60.

(a) Please confirm whether the Company's proposed Performance-Based Multi-Year Rate Plan ("PBMRP") differs from the mechanisms adopted in the Proposed Final Decision issued July 14, 2025 in Docket No. 21-05-15RE01 ("RE01 2025 PFD").

(b) Referencing the Company's answer to CLF-AC-1 (a), identify and describe each respect in which the PBMRP differs from the mechanisms adopted in the RE01 2025 PFD.

(c) For each identified mechanism difference provided under CLF-AC-1 (b), please identify confirm or deny that the whether the Company evaluated considered proposing the mechanism in its proposed PBMRP as originally adopted in the RE01 2025 PFD. If the Company did evaluate whether or not to propose the mechanism as originally set forth in RE01 2025 PFD, instead of as proposed in this Docket, please provide any written discussions, written analyses, workpapers, or other documentary materials used in making that determination.

Response:

(a) The Company's proposed Performance-Based Multi-Year Rate Plan ("PBMRP") has several similarities with the Proposed Final Decision ("PFD") of Docket No. 21-05-15RE01; however, it also has key differences. To make its proposal in this case, the Company started with the ratemaking framework under discussion in Docket No. 21-05-15RE01, while introducing certain modifications to remediate the flaws that would have ultimately hindered PURA's (draft) PBR model in terms of supporting the stay-out aspect of the PBR plan. The Company's perspective is, and has always been, that a comprehensive and cohesive PBR framework produces benefits for customers, while enabling investment by the Company in safe and reliable service, provided it is designed in a way that fairly balances interests. If the scales are tipped in either direction it introduces risk that rates will be set either too high or too low, diminishing (or eliminating) the incentives inherent in a properly constructed PBR framework.

The Company's analysis of the framework presented in Docket No. 21-05-15RE01 demonstrated that the draft framework was designed in a way that would programmatically

provide insufficient revenues to sustain the cost of ongoing electric service, which would mean that the Company would need to file more frequent rate cases to increase revenues, and therefore would not be able to commit to a rate case stay-out of any duration, thereby eliminating PBR entirely as an option. The response below and elsewhere in this docket compares the Company's proposed PBMRP against PURA's July 2025 proposed final decision in Docket No. 21-05-15RE01 ("RE01-PFD"), in its draft form.

(b) For this response the Company focuses on the most substantial differences of the PBMRP related to the revenue cap formula. This response is organized as follows:

1) Summary
2) Capital funding
3) Cost of capital
4) "I-X"
5) Consumer dividend, and
6) Exogenous cost recovery.

1) <u>Summary</u>

The objective of performance-based regulation is to establish a regulatory framework that promotes efficiency, innovation, accountability, and customer value while preserving a reasonable opportunity to recover the prudently incurred costs necessary to satisfy the utility's obligation to provide safe, adequate, reliable, and resilient service, including the cost of debt and equity capital.

Successful performance-based regulation may reduce reliance on traditional cost-of-service ratemaking, but it does not eliminate the expenditures, investments, financing requirements, and operational obligations necessary to provide utility service. Nor does it eliminate the economic realities associated with attracting the capital required to fund those obligations. Capital is a finite and scarce resource that is continuously allocated among competing investment opportunities across industries, sectors, and jurisdictions. Investors providing capital to utility infrastructure companies necessarily forego alternative investment opportunities and therefore require a return on their investment that is commensurate with the risks assumed. A framework that is disconnected from utility costs, investment requirements, and financing realities risks producing revenues that bear little relationship to the services customers require, the obligations the utility is expected to satisfy, or the capital necessary to support those obligations. Accordingly, a successful performance-based framework is one that remains informed by utility costs and capital requirements.

A successful performance-based framework must also recognize the operational realities of managing a dynamic electric distribution system. Equipment failures occur unexpectedly. Infrastructure conditions evolve. Reliability, resiliency, cybersecurity, and modernization needs change over time. Customer expectations and public-policy requirements continue to develop. A framework that ignores those realities cannot effectively support fulfillment of the utility's obligation to serve.

Sound regulatory design requires that revenue-adjustment mechanisms remain aligned with the costs and obligations they are intended to address. Operating-cost adjustments are appropriately informed by, for example, labor costs, contractor costs, materials costs, purchased services, and productivity trends. Capital-related revenue support is appropriately informed by the investments necessary to satisfy utility obligations, the financing required to support those investments, and the revenue requirements associated with obtaining and maintaining access to capital on reasonable terms.

The Company's goal in this proceeding is to establish a sustainable, cohesive ratemaking framework that advances electric utility service in the State of Connecticut in an affordable manner for customers over the long term. This is the Company's goal because the distribution system requires significant capital investment for reliability, resiliency, and modernization. For this investment to be affordable for customers, a coherent ratemaking plan needs to be instituted that balances customer interests, both in terms of the rates that customers pay and the services (and quality of service) received in exchange. Such a framework should recognize that maintaining access to capital at reasonable cost is itself a critical component of customer affordability. When investors perceive a stable, predictable, and sustainable regulatory environment, capital can be raised at a lower cost, reducing financing expenses borne by customers over time. Conversely, a framework that fails to provide reasonable revenue support for necessary investments risks increasing financing costs, constraining access to capital, delaying infrastructure improvements, and ultimately risks increasing long-term costs for customers while degrading quality of service.

Therefore, the framework must balance: (1) the reliability and performance requirements of the Company's customers and the broader State of Connecticut; (2) customer rate stability and affordability; (3) incentives for cost efficiency in utility operations; and (4) implementation of a revenue support mechanism sufficient to attract and maintain the capital necessary to deliver these objectives and support the safe, reliable, resilient, and modern electric distribution system that customers expect and require.

2) <u>Capital Funding</u>

Please also refer to the Company's responses to interrogatories OCC-423[i], OCC-859[ii], and EOE-156,[iii] all of which compare and contrast the Company's F-Factor proposal with the CT-bar outlined in the RE01-PFD. In summary, the CT-bar has several features that, in the Company's view, are appropriate for a PBR framework, and have been retained in the design of the Company's proposed PBRMP, inclusive of the F-Factor component. The Company's proposal excludes or augments only those negative aspects of the CT-bar as outlined in the PFD that, in the Company's analysis, all but guarantee that a utility operating under that framework would have revenues that, by design, were insufficient to sustain the business. The following is an excerpt of the Company's response to interrogatory EOE-156 at pages 6-9:

1. **Like the CT-Bar, the Company's F-Factor would take effect the first day of the first Rate Year coming out of the rate case, which eliminates the need for Rate Year capital to be embedded in base rates, subject to later downward only reconciliation.** To the extent capital investment currently factored into the Company's proposed revenue requirement for Rate Year 1 is "rolled back" to an earlier date (for example, to a capital investment cutoff date of February 28, 2027 for inclusion in base rates), the F-Factor revenue-requirement calculation would inherently adjust to reflect capital investment as of that cutoff date.

2. **Like the CT-Bar, the Company's F-Factor does not pre-emptively or categorically exclude any type of capital investment.** The Company regularly makes capital investments that do not directly affect the performance of the electric grid the way utility poles, transformers, lines, substations, etc. clearly do, but are nonetheless essential capital investments in the provision of service to customers. Capital investments for facilities safeguarding equipment, information technology enabling self-service customer portals, and vehicles needed for transporting materials to work sites are but a few examples of core capital investments that are necessary and, therefore, inform the F-Factor allowance.

3. **Like the CT-Bar, the Company's F-Factor aligns the capital investment necessary for the target performance of the electric grid outlined in the Company's Targeted System Plan, with the revenues required to support those investments.** In developing the F-Factor, the Company sought to establish a means of tying the F-

Factor revenue allowances to the capital investment forecast that would be discussed extensively in this docket. This allows the focus of the TSP to remain on the system needs and plan objectives while simultaneously acknowledging that those needs and objectives, whatever they may be, require some measure of revenue support. The F-Factor serves as a necessary link between the system needs evaluated in this docket and necessary revenues.

4. **The Company's F-Factor properly includes the cost of capital.** If CT-Bar is evaluated separately from going-in revenue requirements, no single design factor would guarantee its failure more so than the absence of the cost of capital from its revenue requirement calculations. Though the cost of capital is not visible the way other costs of service are, such as the maintenance cost that keeps an older piece of equipment online or the cost of gasoline in a line truck, it is just as real a cost of service.

   The Company regularly operates with a cash deficit. That is, the cash necessary to support ongoing operations exceeds the cash received from customers through bills. The direct result is the Company must secure funds through some other means. Those other means are debt and equity investors: the individuals, banks, corporations and other institutions supplying funds to capital markets. Those entities have choice in terms of the entities to whom they provide their funds, choices that weigh other utility companies, industries, countries and continents, type of security, duration, expected return, the presence (or absence) of dividends, environmental, social, and governance characteristics, and countless other variables against the investor's tolerance for risk. Not surprisingly, the Company cannot expect that investors, facing the choice between the Company and essentially all other investment opportunities, would or should accept zero return in exchange for their funds. Thus, the cost to acquire the funds necessary to perform the ongoing capital investments required of the system is real, fundamentally non-zero, and more specifically the Company's cost of capital filed in this proceeding.

5. **The Company's F-Factor captures all elements of the Company's capital investment base, including plant additions, plant retirements, accumulated depreciation, cost of removal, and accumulated deferred income taxes.** The Company's F-Factor calculation fundamentally captures the impact of ongoing

depreciation accumulating in rate base, which has the effect of reducing overall revenue requirements. Additionally, the Company's F-Factor calculation inherently captures the reduced revenue requirement resulting from plant retirements and accumulated deferred income taxes, while also incorporating the effect of cost of removal on rate base.

Like the CT-Bar, annual reconciliation of the revenue requirement ensures customers ultimately pay only for prudent capital investment while balancing the utility's need to cover the ongoing costs of providing ongoing service. Critically, the Company's F-Factor proposal does not circumvent prudence reviews, essential pillars of properly functioning regulatory frameworks, nor undermine the value that effective prudence reviews bring customers. Ultimately, the Company is acutely aware that any capital investment must successfully withstand the scrutiny of a prudence review. Whether that review happens next year, three years from now, or at any other interval, the Company knows the decisions made today must withstand a prudence examination. Any eventual findings of imprudence regarding capital investments made today have significant, negative financial implications, regardless of when those findings are made. Thus, the very expectation of future prudence reviews reinforces the prudence ingrained in decision-making today. Further, the risk of a future finding of imprudence and the negative financial implications thereof eliminates any perceived financial benefit for the Company to "over invest" today.

Annual reconciliation, including the prudence reviews involved, is a critical element of the Company's PBMRP proposal. As part of each annual PBMRP adjustment effective July 1 each year of the PBMRP,[2] the Company's actual capital additions for the Prior Year are allowed for inclusion in the calculation of the F-Factor to the extent that the actual capital additions do not exceed the Forecasted Budget (referred to as the F-Factor allowance).

To the extent that the cumulative actual capital costs in-service through the Prior Year, in aggregate, exceeds the Forecasted Budget through the Prior Year, then the F-Factor allowance is capped at the cumulative Forecasted Budget. This downward-only reconciliation will ensure that, in the end upon reconciliation, customer bills reflect the costs associated only with projects that are in service to customers and no more, and that if the Company invests more than the

Forecasted Budget, customer bills will not reflect amounts above the Forecasted Budget until such time as those capital investments are allowed into rates at the time of the Company's next rate case.The prior-period reconciliation will be reflected in the F-Factor, in addition to the revenue requirement associated with the Forecasted Budget for the upcoming rate year, effective July 1 annually. The F-Factor allowance will be calculated to determine the revenue requirement (inclusive of depreciation expense, property tax expense, return on rate base, and income tax) on actual plant additions (including plant additions, cost of removal, plant retirements, accumulated depreciation, and plant-related accumulated deferred income taxes ("ADIT")) up to the Forecasted Budget amount, and to reflect the revenue requirement for the Prior Year and through the Rate Year on in-service capital additions placed in service in the Prior Year, provided that those in-service capital additions are not reflected in base rates or in another rate mechanism. In addition, the F-Factor allowance will reflect the revenue requirement for rate year capital, established at the Forecasted Budget, subject to downward-only reconciliation in the subsequent F-Factor filing.

As noted above, annual reconciliation will consider plant-related ADIT on the Company's books through the end of the calendar year prior to a given annual filing. To the extent the Company has recorded cumulative plant additions in excess of the capital expenditure forecast provided in this docket or supported by a mechanism other than the F-Factor, the plant-related ADIT will be adjusted in the Company's annual reconciliation to avoid overstating the ADIT relevant to the F-Factor.

In total, the Company's proposed F-Factor will provide revenue support for, and ultimately reconcile, the capital investment placed into service from the cutoff date for inclusion in base rates through the effective date of the Company's subsequent rate case at the conclusion of the proposed PBMRP term. Per the Company's proposal, and as depicted in the illustrative attachments for this response, the F-Factor would ultimately reconcile capital investments made up to July 1, 2031 (the effective date of the subsequent rate case). Should the subsequent rate case be effective later than the July 1, 2031 illustrative date, the F-Factor would continue to reconcile capital investments placed into service until such time as that rate case does take effect.

Footnote 2: In this proceeding the Company is proposing that the first F-Factor take effect commensurate with new base rates authorized in this proceeding, for effect July 1, 2027, and annually thereafter for the duration of the PBMRP. However, the Company has reflected rate year capital in the revenue requirement proposed in this proceeding, such that the Rate Year 1 F-Factor is set to 0, since rate year capital that would otherwise be reflected in the F-Factor on a forecasted basis is reflected in base rates. If PURA declines to include rate year capital in base rates, the F-Factor would be calculated to reflect the revenue requirement on capital through the rate year, subject to later reconciliation.

3) <u>Cost of Capital</u>

Please also refer to the Company's response to interrogatory OCC-758,[iv] which discusses the role of equity capital in the Company's operations.

As described in its discussion in that response as well as its discussion above comparing the F-Factor and CT-bar, the exclusion from the CT-bar of the cost of capital on incremental capital investment is a fatal flaw that all but guarantees no utility would have sufficient revenues to cover its cost of service during the PBR term, and therefore would not be in a position to commit to a stay-out of any duration. In an environment in which significant increases in the level of system investment is needed on the distribution system, purposefully excluding the cost of capital from any revenue support mechanism ensures the utility has no realistic opportunity on a regular basis to earn its authorized return on equity, which is a necessary component of any regulatory framework so that the utility is in a position to cover its cost of service and be able to attract ongoing capital necessary to support needed and ongoing system investment.

As the Company stated in its response to OCC-423 (at pages 7-8):

> *As discussed in the Company's response to OCC-435, based on the Company's current assessment of system investment needs in the near future, the revenue requirement associated exclusively with the cost of capital pertaining to future capital additions (excluding GET and Uncollectible) would amount to an incremental $15.6 million for Rate Year 1; an incremental $32.8 million for Rate Year 2; an incremental $36.4 million for Rate Year 3; and an incremental $39.5 million for Rate Year 4, or $124.1 million in total.*

This means that -- even if 100% of [the future incremental capital investment was] only partially supported with CT-Bar revenues (i.e. revenue covering depreciation expense and property taxes only); and even if the Company's future cost of service otherwise was 100% supported with rates; and even with perfect operational decision making -- the Company would still need to find $124.1 million of annual savings by Rate Year 4 in order to offset the loss of revenue associated with carrying costs on incremental investment over the term of the PBMRP, which would be necessary to commit to a stay-out term.

For perspective, the total O&M expense included in the Company's cost of service filed in this proceeding is $547.5 million. Thus, to earn its authorized ROE, all else equal, the Company would have to generate cost savings amounting to $124.1 million, or nearly 23%, of its Rate Year O&M level by Year 4, to offset the impact of the accumulating carrying costs on the incremental capital additions completed on the system after base rates are set in this case. This is nearly 34% of operating expense, excluding vegetation management and storm restoration costs, which is a very substantial proportion of the cost of service. For example, the amount of $124M is nearly two-thirds of the Company's labor and labor-related operating expense, or 60% more than the entire vegetation management program. It simply is not possible for the Company to cut this level of O&M expense without grossly debilitating the Company's ability to provide service to customers. In fact, it is not plausible to expect that the Company could generate even 10% in annual incremental O&M savings in the face of 2-3% annual inflation and, as a result, the Company could not agree to a stay out under circumstances where there is no recovery of the cost of capital on incremental investment over the PBMRP term.

Moreover, even if the Company were somehow able to find such remarkable cost savings, the going-in revenue requirement of the subsequent multi-year rate plan would capture those cost savings. Assuming continuation of the same PBR framework and required system investment, the Company would again be in the position of having to find an additional 34% of O&M savings (i.e. more than 60% cumulatively from Rate Year 1) in order to sustain itself over the next PBR term. Clearly, a framework that does not provide revenue supporting the full cost of incremental investment over a four-year period, as well as the next four-year period, is not a plausible or lasting framework. Thus, exclusion of the cost of capital from a capital support mechanism in an environment in which significant increases in capital investments are expected all but ensures the Company has no realistic opportunity to survive the PBR term without a critical need for a rate case to realign costs and rates.

> *Consequently, the overall framework as outlined in the REO1-PFD had no practical chance of sustaining the Company financially for the four-year term, nor would the Company have been able to even agree to a stay-out.*

The Company fully embraces the notion of incentivizing the utility to strive for cost efficiency under a PBR framework. However, excluding the cost of the capital, which is a fundamental and necessary cost associated with the infrastructure investment necessary to achieve the objectives outlined in the PBR plan is not a tool capable of delivering that outcome. Based on its current assessment of the substantial distribution system needs, the Company expects that it would need to file rate cases every 18 months or sooner, if possible, if the CT-bar were to be implemented as contemplated in the RE01-PFD. Please refer to the Company's response to interrogatory EOE-156 for additional discussion of the alternatives available to the Company in the absence of a viable, sustainable multi-year rate plan.

Thus, this critical deficiency of CT-bar is not a design feature of a sustainable multi-year framework and as such is not included in the Company's proposed F-Factor.

4) <u>"I-X"</u>

Both the RE01-PFD and the Company's proposed PBMRP include an inflation-based component within the revenue cap formula. However, the two approaches differ fundamentally with respect to both (1) the revenue base to which inflation is applied and (2) the economic purpose the inflation mechanism is intended to serve.

Under the RE01-PFD, the I-Factor would be applied broadly to the utility's revenue requirement, including capital funding mechanisms. As the RE01-PFD states:

> [t]he Authority will apply the I-Factor to all variables within the Revenue Cap Formula, capital funding mechanisms (i.e., CT-Bar and any potential Capital Cost Trackers), PIMs, SSMs, and regulatory assets and liabilities." (PFD Appendix A, page vi).

In contrast, the Company's PBMRP proposal intentionally limits application of the I-X mechanism to operating and maintenance ("O&M") costs, excluding catastrophic storm expense. The Company does so because the proposed PBMRP separately addresses capital-investment-related revenue requirements through the F-Factor, which directly reflects the revenue requirement associated with incremental capital investment, including plant additions, cost of removal, depreciation, taxes, and the cost of capital.

This distinction reflects an important economic principle. Inflation measures are reasonably suited to address changes in operating costs such as labor, contractor services, materials, and other routine expenditures that are consumed in providing service. Capital-investment requirements, however, are not determined by general inflation. Rather, they are determined by the actual infrastructure needs of the electric distribution system, including reliability, resiliency, modernization, asset replacement, cybersecurity, and other system requirements. The revenue support necessary for those investments is further determined by the financing required to attract capital from investors in competitive capital markets.

Accordingly, the Company's PBMRP separates the revenue support necessary for operating expenses from revenue support adjustment associated with capital infrastructure investment. The I-X mechanism addresses changes in operating costs while the F-Factor addresses changes in capital-related revenue requirements. Each mechanism is therefore aligned with the category of costs it is intended to support.

The RE01-PFD framework did not make this distinction. Because the RE01- PFD would apply the I-Factor to revenue streams associated with capital-support mechanisms while also maintaining separate capital-recovery mechanisms such as CT-Bar, the inflation adjustment and capital-funding mechanisms become interrelated rather than functionally distinct. By contrast, the Company's proposal establishes a clearer allocation of responsibility between mechanisms: operating-cost changes are addressed through I-X, while capital-investment requirements are addressed through the F-Factor.

Consistent with this approach, the Company proposes an inflation measure based on Gross Domestic Product Price Index ("GDPPI") and Employment Cost Index ("ECI"), indices that are more closely associated with the underlying drivers of utility operating costs. Because capital-investment-related revenue requirements are separately addressed through the F-Factor, there is no need for the inflation mechanism to provide additional revenue support for capital additions.

The result is a more transparent and internally consistent framework in which each component of the revenue cap formula serves a distinct purpose. The I-X mechanism addresses operating-cost pressures and efficiency incentives, while the F-Factor provides revenue support for prudent capital investment necessary to maintain a safe, reliable, resilient, and modern electric distribution system.

5) Consumer Dividend

While the Company's proposed S-Factor includes a benchmarking-based tiered approach that adjusts based on the Company's core O&M performance per customer relative to a benchmark, it does not align with the methodology described in the RE01-PFD in Docket No. 21-05-15RE01, under which highly efficient utilities would have an S-Factor of zero. Under the Company's proposal, the S-Factor has a floor of 30 basis points, meaning customers receive a 30-basis-point reduction relative to inflation even when the Company is classified in the highest performance tier. By contrast, the PFD described a framework under which highly efficient utilities would have an S-Factor of zero, resulting in no reduction relative to inflation.

Further, the PFD's discussion of the S-Factor was conceptual in nature. The PFD described potential benchmarking and tiering concepts and provided illustrative examples, but it did not establish the specific benchmarks, indices, thresholds, tiers, or other parameters that would be necessary to implement such a mechanism. Accordingly, while the Company's proposal incorporates benchmarking and tiering concepts similar to those discussed in the PFD, it does not adopt the specific zero-floor approach described therein.

6) Exogenous Cost Recovery

The Company provided comparison of its exogenous cost recovery proposal to the RE01-PFD in response to interrogatory OCC-430[v]. In summary, the RE01-PFD's setting of the exogenous cost recovery threshold at 0.75% is considerably higher than the thresholds established in other jurisdictions. The Company's proposed 0.5% is more closely to those other jurisdictions, as shown in the footnote the RE01-PFD references. The Company's complete response to OCC-430 is provided here:

> *The 0.75% materiality threshold proposed in the Docket No. 21-05-15RE01 Proposed Final Decision is unnecessarily high, and inconsistent with other jurisdictions. Although the Company supports the intention of establishing a materiality threshold as a means of balancing administrative burden with the Company's need to cover the costs of service, including those over which it has no control, a materiality threshold set too high actually renders the mechanism increasingly ineffective, raising the likelihood that the utility cannot commit to the PBR stay-out because it will be unable to obtain a fair or reasonable level of recovery of its operating costs, also barring customers from benefitting from the efficiency gains that come from an extended stay-out.*

In the extreme, a materiality threshold of 10%, for example, would indicate that for an event to qualify as exogenous in terms of its materiality, it must be at least $192.19 million ($1,921.9 million revenue requirement x 10%, using the Company's cost of service filed in this proceeding). The likelihood of a single event meeting this criteria is exceedingly rare, meaning the Z-factor, in practice, would be effectively rendered moot.

Additionally, PURA provided no basis for how it determined a threshold of 0.75% was appropriate. In fact, in its proposed final decision, PURA stated, "[t]he threshold [of 0.75%] better aligns with the thresholds established in other PBR jurisdictions," and then provided the following footnote referencing those other jurisdictions, each one of which is substantially below the 0.75% it proposed:

> ***"Hawaii set thresholds equivalent to 0.2%, 0.25%, and 0.28%; Ontario set a threshold equivalent to 0.5%; Massachusetts set a threshold equivalent to 0.37%; and Alberta Utilities Commission set a threshold equivalent to 0.25%."***

*The Company's proposed Z-Factor of 0.5% is more closely aligned to those other jurisdictions. (**emphasis added**)*

(c) As discussed in the Company's response to (a) above, the Company's proposal intentionally tracks with the developing framework outlined in the RE01-PFD, yet reflects the modifications necessary for the overall function of the plan to be a sustainable, lasting framework for the state of Connecticut, one capable of delivering on the promise of PBR. As discussed extensively in the Company's responses above as well as in its written comments in response to the RE01-PFD, the draft framework outlined in the RE01-PFD had fatal flaws that all but guaranteed failure as a ratemaking construct for the state of Connecticut. The Company's own extensive involvement throughout that docket, including participation in technical sessions, data requests, and analysis provided on the record, informed the conclusions stated above. Consequently, the Company did not perform additional analysis to (again) confirm that the framework outlined in the RE01-PFD was deficient, without modification, as a long-term ratemaking solution and incapable of realizing the essential benefits to Connecticut and its customers that a successful PBR plan offers.

Prior Referenced Responses:

[i] OCC-423 Question:

Exhibit CLP-ELP-1 Please explain in detail why the Company believes its proposed treatment of capital expenditures under the PBMRP, including the use of forecasted capital expenditures and the F-Factor, is preferable to including capital expenditures within the Revenue Cap Formula framework as proposed in the Docket No. 21-05-15RE01 Proposed Final Decision. In your response,

a. Please explain why the Company believes O&M expenses are appropriately subject to an externally indexed revenue cap, while capital expenditures require separate recovery through an F-Factor based on a fixed annual capital investment forecast.
b. Please explain how the Company's proposed treatment of capital expenditures is expected to produce customer cost savings or otherwise improve customer affordability relative to including capital expenditures within a revenue cap formula.
c. Please explain how the proposed F-Factor mitigates or avoids any incentive to favor capital expenditures over O&M solutions, including in circumstances where either a capital or O&M solution could be used to address the same system need.

OCC-423 Response:

The Company appreciates OCC's thoughtful and analytical questions on the Company's proposed performance based multi-year rate plan ("PBMRP") and looks forward to further discussion on the development of a workable PBR framework for the Company's customers.

To cover the issues raised in the question, the Company's response is organized as follows:

1. Review of relevant aspects of the Company's PBMRP.
2. Considerations on the design of capital-driven revenue support.
3. Specific responses to parts (a), (b) and (c), above.

1. Review of the Relevant Aspects of the Company's PBMRP

Ultimately, the Company's goal in this proceeding is to establish a sustainable, cohesive ratemaking framework that advances electric utility service in the State of Connecticut in an affordable manner for customers, over a long term. This is the Company's goal because the CL&P system needs investment for reliability, resiliency and modernization. For this investment to be affordable for customers, a coherent ratemaking plan needs to be instituted that will consider the interests of customers over a longer term than just the next rate case. That framework needs to balance: (1) the reliability and performance requirements of the Company's customers and the broader State of Connecticut; (2) customer rate stability and affordability; (3) incentives for cost efficiency in utility operations; and (4) implementation of a revenue support mechanism sufficient to cover the cost of delivering these objectives to customers.

The Company's PBMRP is designed to address these objectives in a holistic, balanced way. To do this, the Company started with the ratemaking framework under discussion in PURA's PBR docket (Docket No. 21-05-15RE01), while also introducing certain new elements to remediate the flaws that would ultimately hinder PURA's (draft) PBR model from supporting the necessary stay-out terms.

For any multi-year rate plan to be successful, it needs to be grounded in the reality of the utility's costs, while also incorporating features that innately push the utility to be more efficient. That is not to say every dollar of the utility's costs will be (or should be) recovered. Rather, the allowed revenues need to be sufficient to afford the utility a reasonable opportunity to cover its cost of service to customers, including a reasonable rate of return on equity ("ROE") where the utility is operating prudently and efficiently, as required by state law. A framework in which the utility has *no* reasonable opportunity to earn its ROE, regardless of how hard it strives for efficiency, simply becomes

self-defeating because the utility will exercise its statutory rights to a distribution rate proceeding, thereby muting the most powerful efficiency feature of a multi-year rate plan, which is the stay-out term.

A framework that underestimates the actual cost to run the system and/or affords the utility no reasonable chance to earn its allowed ROE, year after year, also results in under-investment and a system that not only lacks innovation, but falls further and further behind at a significant – albeit potentially unseen – cost to customers. As a result, a lasting, productive framework is one that is soundly informed by – not detached from – the drivers of the utility's real cost of service, including its cost of capital.

In this context, the two most critical features of the Company's PBMRP are as follows:

- A going-in revenue requirement that reasonably reflects the Company's actual operating expenses and cost of investment in the Rate Year, so that through effective management and prudent decision making, the Company can achieve the true efficiency gains that will be needed to stretch the approved revenue requirement over the stay-out term. Without a reasonable opportunity to maintain financial integrity over a stay-out period, as measured by the authorized ROE, the utility cannot focus on innovation and efficiency gains – and will instead file for the next rate case to make up ground. To accomplish this goal, the overall paradigm must "hang" together, making the base revenue requirement a pivotal element. The many components of a PBR plan, including going-in rates, as well as the subsequent rate adjustments, must work in concert with performance objectives and the capital investment requirements expected of the Company – for the benefit of customers, i.e., the entire framework must work to the benefit of customers, not only in relation to the price they will pay, but also in relation to supporting the level of service that they need and expect.

- Revenue support for incremental capital investment to support long-term system goals. The Company operates in a capital-intensive industry and has a substantial need to acquire cash on a systematic basis to operate its business. As annual capital investments regularly exceed net cash from operations (i.e. cash receipts from customers net of operating cash outflows), the Company must look to other capital sources to fund those investments. Those sources are the debt and equity investors supplying the cash to capital markets. This means the Company must compete with all other entities participating in those markets to attract capital. It is simply not possible for the Company to go to those markets and demand cash for free, or at below-market rates relative to the investor's risk when other entities participating in the same capital markets offer compensation for the use of funds over time.

  The Company provided extensive analysis and discussion on the cost of capital throughout Docket No. 21-05-15RE01, including specifically as it relates to CT-Bar. PURA's treatment with respect to going-in revenue requirements as well as any ongoing capital-driven revenue support mechanism, such as CT-Bar, is paramount to whether the Company, with effective management and sound decision-making, can responsibly cede its right to file for a rate amendment, whereas that is otherwise the only tool the utility has to align its revenues and costs and have a reasonable chance at earning its authorized ROE, which, over time, is necessary in order to attract the capital necessary to meet the standards of service expected of the Company's customers.

  The lack of a valid revenue requirement component within the CT-Bar that would allow recovery of the cost of capital associated with incremental capital investment over the term of the PBMRP is a non-starter from a policy perspective, creating an obstacle that would block a utility from giving up its right to file for rate modifications over the multi-year period in question. This is particularly accurate in the present environment in which significant increases in the level of necessary system investments are expected (and planned). Simply put, the CT-Bar, as previously envisioned in PURA's draft PBR decision, fully prevented the

Company from having any practical chance at staying out of a rate case, and therefore, would never work to create a reasonable PBR framework.

The Company's proposed PBMRP in this docket is designed to track the design of the CT-Bar as closely as possible, given that this was PURA's developing framework. However, the Company's PBMRP addresses the two primary faults in PURA's RE01 framework that would prevent the implementation of a workable PBR framework, which are (1) the deviations from ratemaking fundamentals that grossly understate the "going in" revenue requirement; and (2) modification of the CT-Bar to reflect the revenue requirement applicable to capital investment, which would include recovery of the cost of capital and the cost of removal over the course of the PBMRP term. The Company's F-Factor also corrects for the mechanical error of deducting depreciation expense from new plant additions, rather than from rate base.

In particular, the Company's proposed F-Factor is designed to recover no more than the revenue necessary to support a discrete amount of ongoing system investment, recognizing that the cost of capital is a lawful and factual cost of service that must be incorporated into the revenue requirement calculation for the Company, as it is for any utility.

2. Considerations on the Design of Capital Driven Revenue Support

CT-Bar, as defined in PURA's Proposed Final Decision, issued in Docket No. 21-05-15RE01, on July 14, 2025 (the "RE01-PFD"), had several sensible qualities that the Company supported. However, those "sensible" qualities were overcome by certain critically flawed concepts that would need to be modified or eliminated in order for the Company to consider committing to a stay-out. The positive and negative CT-Bar qualities are outlined briefly here and discussed in greater detail below, including with respect to similarities or differences to the Company's proposed F-Factor.

Summary of constructive features of PURA's RE01-PFD:

1) Acknowledgement that current revenue support for ongoing investment is essential;
2) No category of capital investment was summarily or preemptively excluded from CT-Bar;
3) CT-Bar takes effect with Rate Year 1; and
4) CT-Bar aligns capital revenue support with the capital investments of the DSP.

Summary of unworkable features of PURA's RE01-PFD:

1) Exclusion of the recognition in the CT-Bar of the cost of capital between rate cases.
2) Exclusion of cost of removal in the CT-Bar.
3) Application of depreciation expense as a reduction to plant additions rather than rate base.

Constructive features of PURA's RE01-PFD:

1) Positive #1: Acknowledgement that current revenue support for *ongoing* investment is essential to the integrity of the PBR framework.

First, that the CT-Bar even existed in PURA's RE01-PFD is genuine acknowledgement that some form of revenue support for rate year investment is essential to support a PBR framework. As discussed at length in that docket, the Company anticipates significant system investment over the next five years to advance the state's clean energy and reliability goals. Revenue support for *ongoing* system investment is crucial for any multi-year rate plan, whether in the form of the Company's proposed PBMRP, step increases, or any other ratemaking framework. CT-Bar's inclusion in RE01-PFD is a clear indication that incremental revenue support for ongoing system investments is a necessity.

2) <u>Positive #2</u>: No category of capital investment was summarily or preemptively excluded from CT-Bar.

Second, the RE01-PFD did not exclude particular categories of capital investment. For example, capital investments in facilities, fleet and information technology are viewed as permissible categories for revenue support in the CT-Bar framework. This is consistent with the Company's proposed F-Factor in this proceeding.

3) <u>Positive #3</u>: CT-Bar takes effect as of Month 1 of Rate Year 1.

The Company provided extensive discussion and analysis throughout Docket No. 21-05-15RE01 technical sessions and data responses regarding the "going-in" revenue requirement and the detrimental financial consequences of limiting capital investments to a period of time removed from the rate year. Ignoring for a moment the CT-Bar's deficiencies, having the mechanism take effect Month 1 of Rate Year 1 minimizes or eliminates those detrimental timing consequences, particularly in light of the fact that PURA has in recent years moved away from its prior practice of implementing future-test years in base rate proceedings, instead favoring a strict historical test year practice as it relates to plant additions.

Revenue decoupling is a factor to consider here because the revenue decoupling mechanism ("RDM") subsumes all sales growth to the extent that it is occurring, funneling incremental sales revenues back to customers. RDM is supported by valid policy reasons; however, the fact is that there are capital costs associated with adding new customers. Historically, when consistent and steady levels in the range of ~3$ per year of annual growth in sales and revenues was available to a utility to help offset the cost of incremental capital additions between rate cases, the pressing need for incremental revenue support was mitigated. Without the ability to capture that sales growth, and combined with the absence of an ongoing revenue support mechanism such as an F Factor taking effect on Month 1 of Rate Year 1, the Company would not be in a position to commit to a stay-out of any duration. This is because the Company would never be in a position to cover its cost of service (inclusive of its authorized cost of capital) because its rates would be set on a historical level of plant additions, despite the fact that its capital expenditures are higher than historical levels of depreciation, and because revenue decoupling ensures that even if load growth exists (and even if such load growth is enabled by the Company's increased level of capital expenditures) the Company is unable to retain additional revenues contributed by new customers, or new load.

4) <u>Positive #4</u>: CT-Bar was designed to align capital revenue support with the DSP.

Ignoring its deficiencies, the CT-Bar's connection to the Distribution System Plan ("DSP") constituted an essential link between ongoing system investments necessary to meet the objectives of the DSP with the revenues necessary to support those investments. Throughout Docket No. 21-05-15RE01, the Company advocated strongly for clearly defined linkages across all three tracks (RE01, RE02 and RE03), including proposing what would be the final technical session touching upon revenue requirements, in which those linkages were discussed. The Company's F-Factor is similarly aligned with the capital investment forecast provided in this proceeding for the DSP. The Company's capital investment forecast serves as the basis for a cap on the level of investment for the F-Factor.

<u>Unworkable Features of PURA's RE01-PFD:</u>

1) <u>Negative #1</u>: No recovery of cost of capital in the revenue requirement for capital investment between rate cases.

The single-most problematic feature of the CT-Bar was its intentional exclusion of the cost of capital associated with completing capital plant additions to the benefit of customers. Costs of capital are real costs of providing electric distribution service to customers in the State of Connecticut (or anywhere) and are recognized in statute. Although the cost of capital may be a more challenging cost to conceptualize, it is nonetheless as real as vegetation management, insurance, customer service, or any other cost of service. Cash is not free, a fact arising from its scarcity. Fundamentally, capital markets are where people, banks, corporations and other institutions provide their surplus of cash -- which is limited, to those entities that have cash needs -- which are generally unlimited. Consequently, and unsurprisingly, those entities providing the cash for some period of time expect to be compensated for providing it, thus establishing real cost to acquire capital.

The Company, operating in the capital-intensive industry of regulated utilities, is one of those entities that needs to acquire cash to operate its business. As annual capital investments regularly exceed its net cash from operations (i.e. cash from customers), the Company must look to other sources to fund those investments. Those sources are the debt and equity investors supplying the cash to capital markets. This means the Company must compete with ALL other entities participating in those markets. It is simply not possible for the Company to go to those markets and demand cash for free (or for below-market rates, relative to market expectations of risk and reward) when other entities participating in those capital markets offer adequate compensation for the use of funds over time. Therefore, there is a real and tangible cost to acquiring that capital. Please refer to the Company's pre-filed cost of capital testimony for in-depth discussion of the cost of capital.

The Company provided extensive analysis and discussion on the cost of capital throughout Docket No. 21-05-15RE01, including specifically as it relates to CT-Bar. PURA's treatment with respect to going-in revenue requirements as well as any ongoing capital revenue support mechanism, such as CT-Bar, is paramount to whether the Company, with effective management and sound decision-making, has the opportunity, but not a guarantee, to cover its cost of service to customers, and to earn its allowed return. The absence of the cost of capital from the CT-Bar, particularly in the present environment where significant increases in the level of necessary system investments are expected, prevents the Company from having any practical opportunity to commit to a stay-out to avoid the next rate case.

As discussed in the Company's response to OCC-435, based on the Company's current assessment of system investment needs in the near future, the revenue requirement associated exclusively with the cost of capital pertaining to future capital additions (*excluding* GET and Uncollectible) would amount to an incremental $15.6 million for Rate Year 1; an incremental $32.8 million for Rate Year 2; an incremental $36.4 million for Rate Year 3; and an incremental $39.5 million for Rate Year 4, or $124.1 million in total.

This means that -- even if 100% of those future plant additions were only partially supported with CT-Bar revenues (i.e. revenue covering depreciation expense and property taxes only); and even if the Company's future cost of service otherwise was 100% supported with rates; and even with perfect operational decision making -- the Company would still need to find $124.1 million of *annual* savings by Rate Year 4 in order to offset the loss of revenue associated with carrying costs on incremental investment over the term of the PBMRP, which would be necessary to commit to a stay-out term.

For perspective, the total O&M expense included in the Company's cost of service filed in this proceeding is $547.5 million. Thus, to earn its authorized ROE, all else equal, the Company would have to generate cost savings amounting to $124.1 million, or nearly 23%, of its Rate Year O&M level by Year 4, to offset the impact of the accumulating carrying costs on the incremental capital additions completed on the

system *after* base rates are set in this case. This is nearly 34% of operating expense, excluding vegetation management and storm restoration costs, which is a very substantial proportion of the cost of service.

For example, the amount of $124M is nearly two-thirds of the Company's labor and labor-related operating expense, or 60% more than the entire vegetation management program. It simply is not possible for the Company to cut this level of O&M expense without grossly debilitating the Company's ability to provide service to customers. In fact, it is not plausible to expect that the Company could generate even 10% in annual incremental O&M savings in the face of 2-3% annual inflation and, as a result, the Company could not agree to a stay out under circumstances where there is no recovery of the cost of capital on incremental investment over the PBMRP term.

Moreover, even if the Company were somehow able to find such remarkable cost savings, the going-in revenue requirement of the subsequent multi-year rate plan would capture those cost savings. Assuming continuation of the same PBR framework and required system investment, the Company would again be in the position of having to find an additional 34% of O&M savings (i.e. more than 60% cumulatively from Rate Year 1) in order to sustain itself over the next PBR term. Clearly, a framework that does not provide revenue supporting the full cost of incremental investment over a four-year period, as well as the next four-year period, is not a plausible or lasting framework. Thus, exclusion of the cost of capital from a capital support mechanism in an environment in which significant increases in capital investments are expected all but ensures the Company has no realistic opportunity to survive the PBR term without a critical need for a rate case to realign costs and rates. Consequently, the overall framework as outlined in the REO1-PFD had no practical chance of sustaining the Company financially for the four-year term, nor would the Company have been able to even agree to a stay-out.

To address this indelible flaw, the Company's proposed PBMRP in this docket is designed to produce the revenue necessary to support ongoing system investment through the F-Factor, which calculates a revenue requirement inclusive of the costs of capital unlike the CT-Bar, while preserving the customer benefits and inherent incentives of a PBR plan.

2) <u>Negative #2</u>: Exclusion of cost of removal from the revenue requirement on capital investment between rate cases.

CT-Bar excluded the cost of removal, which is a real cost for all utilities. As a simple example, to install a new utility pole where there is an existing one that needs replacement, the Company must first remove the existing utility pole. That cost is separate and distinct from the cost of the utility pole itself; yet, similarly recovered (as an estimate) over the life a utility pole. The Company's capital investment forecast in the present docket includes approximately $136 million of cost of removal for January 1, 2026 through June 30, 2028, and approximately $60-70 million per year thereafter. A total of $60-70 million in annual investment equates to pre-tax cost of capital of $6-7 million annual *incremental* revenue requirement (e.g. $6 million year 1, $12 million year 2, $18 million year 3, etc.). The CT-Bar revenue requirement intentionally excluded this component of the capital investment revenue requirement. The Company's proposed F-Factor calculation properly restores this component to the rate base computation.

3) <u>Negative #3</u>: Depreciation expense is used as a reduction to plant additions rather than to total rate base, consistent with fundamental ratemaking principles.

CT-Bar's calculation treats depreciation expense as a net against plant additions. Although the Company appreciated that PURA found it important to capture ongoing depreciation expense in the annual revenue

requirement calculations, the overall execution of the computation was not correct. The Company's F-Factor corrects for this methodological error. Please refer to the example below outlining the mathematical problem:

($ Millions)

1	Correct treatment of depreciation's accumulation in rate base					
2		Rate Base			RevReq	
3		Year 1	Year 2		Year 1	Year 2
4	Plant Additions	$1,000	$1,000			
5	Cumulative Gross Plant	$1,000	$2,000	x 3.6% Depreciation	$36.0	$72.0
6	Accumulated Depreciation	-$300	-$600			
7	Cumulative Rate Base	$700	$1,400	x 9.8% Cost of Capital	$68.6	$137.2
8				Total Revenue Requirement	$104.6	
$209.2						
9						
10		CT			Bar	
11		Rate Base			RevReq	
12		Year 1	Year 2		Year 1	Year 2
13	Plant Additions	$1,000	$1,000			
14	Depreciation Expense	-$300	-$300			
15	Net Plant Additions	$700	$700			
16	Cumulative Depreciable Base	$700	$1,400	x 3.6% Depreciation	$25.2	$50.4
17	Cumulative Rate Base	$700	$1,400	x 9.8% Cost of Capital	$68.6	$137.2
18				Total Revenue Requirement	$93.8	$187.6
18				Error	-$10.8	-$21.6

The table above is a simplified example of CT-Bar's improper incorporation of ongoing depreciation in a revenue-requirement calculation. Effectively, the CT-Bar reduces plant additions by depreciation expense, which improperly reduces the total amount of plant to be depreciated, thereby reducing the incremental depreciation expense to be supported by the rate mechanism. The correct approach is to handle the plant additions separately from accumulated depreciation (see lines 4 and 6 in the table above). Note that both methods result in the same return on rate base, demonstrating that both calculations reflect the reduction to return on rate base resulting from ongoing/accumulating depreciation. The error is limited to the resulting new depreciation expense reflected in the revenue requirement, which is understated in the above example by $10.8 million in Year 1 and $21.6 million in Year 2 under the CT-Bar as compared to the Company's proposal in this proceeding, which mirrors in concept to how the Company records depreciation expense on gross plant additions (not on net plant additions, as in the CT-Bar).

Characteristics of the Company's Proposed F-Factor (same as CT-Bar, except for three features).

The Company is proposing a capital support mechanism (the "F" factor in the formula) that tracks as close as possible to PURA's CT-Bar, except that it addresses the three major impairments described above, which would prevent the Company from being able to agree to a stay-out. These three items are the exclusion of the cost of capital in the revenue-requirement computation for incremental plant additions, the cost of removal and the

mechanical deduction of depreciation expense from plant additions instead of rate base. In the Company's F-Factor, these first two items are included in the formula and the third mechanical process is addressed.

Beyond that, the F Factor would operate from a fixed annual capital investment level for each year of the PBMRP, with reconciliation through PURA's annual RAM proceedings. The fixed annual investment level would be set at the Company's capital forecast, as approved in this proceeding. As described previously, the Company has presented different investment trajectories in the Company's 5-Year TSP and is proposing to establish the capital support mechanism of the PBR adjustment consistent with the annual capital funding requirements presented in Figure 7 of Exhibit CLP-ELP-1.

Consistent with the structure of the CT-Bar in the RE01-PFD, the F-Factor would commence on July 1, 2027, coincident with new base rates, collecting an allowance developed from the Company's capital forecast presented in Exhibit CLP-TSP-3. In this proceeding, the Company has proposed base rates that include capital additions through the Rate Year. This means that the F-Factor implemented on July 1, 2027 (commensurate with new rates in this proceeding) would be set to zero at that time, since base rates would be set to collect the revenue requirement on capital placed into service in the rate year.

However, if PURA declines to incorporate rate-year capital additions into base rates in this proceeding, the F-Factor taking effect on July 1, 2027, would reflect the revenue requirement for the period July 1, 2027 through June 30, 2028 on capital additions placed in service (or estimated to be placed in service) from the point in time where PURA cuts off capital for inclusion in base rates and through June 30, 2028.[1] In the next year, as part of the Company's annual RAM compliance filing, actual plant additions placed in service during the applicable plan year would be reconciled against the F-Factor allowance put into rates on July 1, 2027. In that reconciliation, the Company would present its project document for a prudence review and, based on PURA's findings in that prudence review, the cost of actual plant additions for calendar year 2027, less whatever PURA has already included in rates for capital additions in 2027, would be actually incorporated into rate base at that point. Following PURA's determination that the Company's actual plant additions are prudent, used and useful, the Company's rate base would be adjusted and associated revenue requirement allowed for recovery that would be limited to the lesser of:

1. The total revenue requirement for the forecasted capital approved in this proceeding for the first implementation of the F Factor; or

2. The total revenue requirement for the actual plant in service.

If the cost of the Company's actual capital additions were to exceed the forecasted amount approved in this proceeding, the Company would not be permitted to obtain recovery of the incremental investment during the initial four-year PBMRP Term. Instead, any such investment would remain subject to review and consideration in a subsequent base rate proceeding or successor PBMRP Term.

This Company's proposed capital funding mechanism sets a defined cap on capital recovery during the plan term, providing customers with greater rate certainty and placing the risk of excess capital spending requirements on the Company. The annual reconciliation further protects customers by blocking recovery of investments that are delayed, deferred, canceled, or not placed in service, since those costs would not be reflected in the F factor, which is based on plant in service. For these reasons, the proposal aligns cost recovery with prudent investment, promotes accurate capital forecasting, and incentivizes efficient execution of the capital program, all while preventing customer over-collection.

III. Specific Responses to Parts (a), (b) and (c), above.

(a) Why are O&M expenses appropriately subject to an externally indexed revenue cap, while capital expenditures require separate recovery through an F-Factor based on a fixed annual capital investment forecast?

The capital investments the Company must make to provide electric service to customers in the State of Connecticut is a "local" concept. Those investments are driven by the circumstances and objectives of the State of Connecticut and the history and current status of the distribution grid in Connecticut. Those circumstances and objectives, which require long-term system planning and appropriate capital resources, are not encapsulated by a single index. O&M, though it is similarly influenced by local circumstances, does not change at the same rate as capital investment. For example, the Company's annual capital investment is expected to increase nearly 40% from $549 million in 2025 to $758 million by 2028, or more than 11% annually, on average. In contrast, over the same timeframe O&M (excluding storm funding and vegetation management) is projected to increase approximately 3-4% annually. The Company's proposed PBMRP aligns revenues with drivers of cost while maintaining the incentive to control costs.

In addition, under PBR theory, where capital inputs are contemplated in the indexed formula, then the X factor is negative, implying that the annual adjustment is inflation plus an additional factor. The testimony of London Economics in Exhibit CLP-PBR-1 reviews the results of their total factor productivity study producing this result. In this case, the Company elected to adhere as closely as possible to PURA's (draft) CT-Bar in order to remain synched with PURA's policy direction.

(b) How will the Company's proposed treatment of capital expenditures be expected to produce customer cost savings or otherwise improve customer affordability relative to including capital expenditures within a revenue cap formula.

There are three main opportunities for customer benefit in the PBR framework, which are: (1) the opportunity to leverage the stay-out term to drive operational efficiency and cost savings; (2) the opportunity to spread rate changes out over time to smooth impacts for customers and employ the concept of gradualism rather than promoting the cost and inefficiency of a traditional rate-case cycle; and (2) the opportunity to develop a systematic investment plan that promotes operational efficiency and cost-saving procurement strategies, while taking advantage of the smoothing impacts of the PBR framework to mitigate cost impacts.

The Company has submitted substantial testimony and documentation in this proceeding to provide insight into the level of capital investment that is needed on the system to provide adequate service to customers and to support the economic vitality of the State of Connecticut. Customers benefit directly when investment can be undertaken on a planned, systematic and consistent basis over time because (1) it is consistently more expensive to complete infrastructure projects tomorrow rather than today due to price inflation and other factors; and (2) the Company's process inputs (i.e., primarily labor and materials) cost less when procured on a planned and systematic basis rather than on an emergent basis.

Although difficult to define in terms of the overall cost trends, there are significant benefits for customers in an operating approach that is consistent, systematic, planned and carefully managed, which is an outcome that the Company is hoping to promote with its proposals in this proceeding. Bottomline – the Company is looking to establish a ratemaking framework that will promote efficiency of operations for the benefit of customers and the F-Factor is the optimal mechanism for that purpose.

Assuming that OCC's referenced alternative for a capital-cost mechanism "within a revenue cap

formula," means that the PBMRP would rely exclusively on an "I-X" revenue cap formula, with or without X defined with a negative factor, the Company's experience is that it is not adequate to support necessary capital investment, while raising issues for stakeholders. With the negative X factor, there is no direct link between the actual cost of capital plant additions and the revenue collection through customer rates, leaving it to be insufficient to support necessary capital investments and unsatisfactory for stakeholders that want transparency between the costs collected in rates and the rates that customers pay. As a result, achieving the efficiency needed to support a cost-effective capital plan is illusory in this model.

(c) How does the proposed F-Factor mitigate or avoid any incentive to favor capital expenditures over O&M solutions, including in circumstances where either a capital or O&M solution could be used to address the same system need?

In the Company's experience, implementation of the X factor mechanism (with a negative X factor) to cover capital investment was thought to be a mechanism that would promote efficient solutions between capital and O&M because the revenue allowance was not predicated on actual plant additions; rather, was simply formulaic. In 2017, the Massachusetts Department of Public Utilities ("MDPU") approved a negative X factor within a revenue cap for NSTAR Electric Company d/b/a Eversource Energy – and it remained operative for the five-year term of the plan. However, the fact is that – during an extended stay-out period, there is no incentive to incur any greater level of expense than is absolutely necessary to run the business. Therefore, there is no greater impetus than would exist in any event to make the optimal choice between expense and capitalization, where such a choice exists. And again, with the negative X factor, the MDPU felt it had no line of sight as to whether funds allowed to NSTAR Electric through the annual PBR allowance were, indeed, being leveraged for system investment.

Therefore, in 2022, the MDPU instituted the K-Bar providing an allowance for system infrastructure projects, coupled with reporting requirements on investment levels. The MDPU maintained the I-X formula to cover the O&M portion of the approved revenue requirement, which is what the Company is proposing in this case.

In reality, there are very few instances when system needs can be easily transitioned between a capital-work solution or a work solution that can be expense. The prudence review is the primary and most effective tool that regulators possess for evaluating these situations.

[ii] OCC-859 Question:

(Capital support mechanism) PURA defined six calculation steps for the CT-Bar as outlined in the 2021-05-15RE01 Proposed Final Decision. Compare the Company's proposed F-factor with each of the six steps of the CT-Bar calculation methodology, indicating where and when the proposed step has or will occur in the Company's approach to the present proceeding. For each of the six CT-Bar calculation steps, explicitly name the different approach that the Company plans to employ in calculating going-in rates and the proposed F-Factor. In the response, specifically include the following:

a. Identify when and how the amount of total depreciation expense associated with capital projects placed in service as of the end of the evidentiary record will be included in going-in rates (i.e., step 3);
b. Identify when and how the forecasted capital additions will be reduced by the value of the depreciation expense in Step 3; and,

c. Identify all CT-Bar calculation steps that are absent from or inconsistent with the Company's proposed F-factor approach.

OCC-859 Response:

Please refer to the Company's PBR model filed in its response to interrogatory EOE-156 as Attachment 1. For the F-Factor calculations specifically, see worksheets "PBR-4 F-Factor," which includes the development of F-Factor rate base as well as the corresponding calculations of depreciation expense and required pre-tax return on rate base, and "PBR-5 F-Factor Property Tax."

As an initial matter, the Company notes that, aside from *its own* analyses and models filed throughout the technical sessions of Docket No. 21-05-15RE01, there is no publicly available working CT-bar model with which the Company, or any other party, can estimate CT-bar outputs with precision. Put differently, no publicly available working model demonstrates the calculations contemplated by the PFD for CT-bar *other than those developed by the Company*. The only calculations available are those developed by the Company to advance discussion in Docket No. 21-05-15RE01, as well as the highly simplified, non-working "Hypothetical Representation" presented in Table 2 of the PFD (pp. 38-39). Accordingly, the Company's response to this interrogatory is based on its extensive involvement in Docket No. 21-05-15RE01, including the Company's K-bar calculations that preceded the CT-bar, and the Company's good-faith efforts to translate the narrative description of CT-bar in the Revised Straw Proposal dated February 27, 2025 into working calculations, such as those filed in response to interrogatory UPA-076 in that proceeding. The Company genuinely evaluated the CT-bar as initially outlined in the Revised Straw Proposal and provided a baseline model (UPA-076 in that proceeding) that captured CT-bar concepts and served as the foundation for discussion during subsequent technical sessions.

In the discussion below, "Steps 1-6" refer to the CT-bar methodology as outlined in the PFD. Step 1 also encompasses the broader discussion of the "Capital Plan" and "Non-Capital Plan" distinction described in the PFD.

Step 1

Step 1 of CT-bar is a historical review of actual investment placed in service, separated into two categories: "Capital Plan" and "Non-Capital Plan." The purpose of this step is to establish an average level of plant additions that were not anticipated in the Capital Plan for possible inclusion in subsequent revenue requirement calculations. The example provided in the PFD for "Non-Capital Plan" additions is "unplanned storm." Because the "Capital Plan" contemplated by CT-bar is a project-by-project listing of anticipated capital investment, "Non-Capital Plan" additions necessarily relate to investments not identified by project.

The Company's F-Factor proposal does not make this distinction. As the Company explained in Docket No. 21-05-15RE01, some projects cannot be planned with precision. For example, it would be impossible for the Company to perfectly predict Emergent Failures. The Company cannot predict which specific pole or cross-arm will fail. It can, however, reasonably forecast a volume and severity of such failures based on system conditions and recent experience. The Company views the distinction between "Capital Plan" and "Non-Capital Plan" as unnecessary for two reasons.

First, all capital investments, whether planned, unplanned, "Capital Plan," or "Non-Capital Plan," ultimately must pass a prudence review. This critical gate, successfully demonstrating prudence, is and should remain the ultimate determinant of recovery regardless of whether a particular investment was forecast in advance.

Second, the Company is proposing a hard cap on core capital investment eligible for the F-Factor based on the capital forecast presented in this proceeding. By doing so, the Company can provide upfront, during this proceeding, indicative revenue increases necessary to support those investments while committing to cap resulting revenue

increases during the PBMRP even if actual capital investment exceeds the forecast. This approach reflects the reality that system needs are dynamic. Rather than distinguishing between "Capital Plan" and "Non-Capital Plan," the Company's F-Factor considers capital investment in the aggregate, allowing the Company to deploy resources as efficiently as possible, respond to emergent system conditions which are inevitable for any utility operation, while balancing affordability and other considerations for customers.

Step 2

Step 2 of CT-bar is to determine the amount of capital investment expected to be placed in service during a given period. The Company's model filed in response to EOE-156 reflects the capital investment forecast presented in this proceeding. For purposes of this response, the Company refers to its discussion of the TSP for details regarding those investments. Here, the Company is addressing the mechanics of the capital forecast rather than the forecast itself.

Specifically, in EOE-156, Attachment 1, worksheet "COS-2 Capital," the sum of Lines 19 and 26 for a given calendar year equals the total capital investment shown in Exhibit CLP-ELP-1, Figure 7.

Whether or not these steps are similar to CT-bar, three points are important. First, the capital investment forecast used for the F-Factor is the same forecast discussed elsewhere in this proceeding as necessary to achieve the objectives described in the TSP. Second, each annual F-Factor filing includes a reconciliation of cumulative capital investment placed in service through the calendar year-end preceding the filing, including a prudence review. Thus, regardless of any differences in methodology, customers ultimately pay only for investment found prudent through that review. Third, because the F-Factor includes a hard cap based on the current capital investment forecast, the annual reconciliation is necessarily downward-only. Accordingly, if the Company places more plant in service than currently forecast, the reconciliation will not adjust revenues upward even if those additional investments are ultimately found prudent.

Mechanically, the flow of eligible capital investment through the F-Factor can be seen in EOE-156, Attachment 1, worksheet "PBR-4 F-Factor," as the sum of Lines 28 and 36.

Step 3

Step 3 of CT-bar reduces the level of capital investment eligible for revenue support by depreciation expense reflected in base rates. CT-bar incorporates this effect as a reduction to gross plant, that is, the amount of new depreciable plant. The net effect of this treatment is understated incremental depreciation.

The Company's F-Factor incorporates the effect of depreciation on capital-driven revenue requirements consistent with standard accounting treatment, as shown in EOE-156, Attachment 1, worksheet "PBR-4 F-Factor," Lines 33 and 34. Line 33 specifically reflects the amount of depreciation accumulating in rate base and is responsive to subpart (b) of this interrogatory. This is where ongoing depreciation expense appropriately influences the cost of service, consistent with subpart (a) of this interrogatory. By contrast, the CT-bar approach effectively reduces incremental gross plant additions (i.e., the amounts shown on Line 28), which understates the resulting depreciation expense.

Stated differently, the Company's F-Factor proposal does not mirror CT-bar's application of depreciation expense because CT-bar applies depreciation as a reduction to gross plant. However, the Company's F-Factor proposal remains consistent with the *intent* underlying CT-bar Step 3, namely the incorporation of depreciation into capital-related revenue requirements.

Step 4

As described above, the Company makes no distinction between "Capital Plan" and "Non-Capital Plan" investments and already incorporates a downward-only annual reconciliation of plant placed in service. Accordingly, CT-bar Step 4 is not applicable to the F-Factor.

Step 5

Step 5 of CT-bar contains certain reconciliation concepts that also exist within the Company's F-Factor proposal, including downward-only adjustments. However, the F-Factor is conceptually simpler because it does not distinguish between "Capital Plan" and "Non-Capital Plan" investments.

Under the F-Factor, the downward-only reconciliation is based on a prudence review (or the reality that the Company were to spend less than forecasted, such that actual plant additions are lower than the amount initially included in setting the F Factor) and consists of a straightforward comparison between (1) cumulative capital investment determined to have been prudently incurred and (2) cumulative capital investment reflected in this proceeding. Accordingly, the reconciliation reaches two straightforward conclusions: (1) whether the capital investment was incurred prudently and (2) whether that prudent investment exceeds, in aggregate, the investment forecast presented in this docket. If prudent investment exceeds the forecast, the F-Factor remains capped at the forecast level even though the investment was determined to be prudent.

By contrast, CT-bar Step 5 requires comparison of "Capital Plan" and "Non-Capital Plan" investments, a distinction that does not fully reflect the dynamic nature of distribution system needs. Moreover, Step 5 includes vague references to downward-only adjustments for capital investment PURA may deem "non-essential" (as opposed to *imprudent*) or capital additions that "can be delayed." The Company's F-Factor proposal includes no comparable adjustments. Instead, it relies on the prudence review process and the hard cap discussed above. See also the Company's response to OCC-423 for additional discussion of the relationship between CT-bar and the F-Factor.

Step 6

Step 6 of CT-bar is the calculation of the resulting revenue requirement. Under the Company's proposal, these calculations are performed in EOE-156, Attachment 1, worksheet "PBR-4 F-Factor," Lines 48-53, and worksheet "PBR-5 F-Factor Property Tax," Line 42. The summarized results are presented in worksheet "PBR-3 F-Factor Summary," Lines 17-23.

With respect to subpart (c), as demonstrated in the model filed in EOE-156, the Company's F-Factor proposal provides a truer calculation of the revenue requirements associated with capital investment, that is, one more closely aligned with actual capital-driven costs of service. Unlike CT-bar, the F-Factor explicitly incorporates the effects of plant retirements, cost of removal, and accumulated deferred income taxes ("ADIT").

CT-Bar Step	F-Factor Treatment
Step 1	No distinction between Capital Plan and Non-Capital Plan investments.
Step 2	Comparable forecast of capital additions.
Step 3	Depreciation is not applied as a reduction to plant additions; depreciation is reflected through accumulated depreciation in rate base

Step 4	Not applicable because F-Factor does not distinguish between Capital Plan and Non-Capital Plan additions.
Step 5	Modified. Reconciliation is based on prudence review and hard cap rather than Capital Plan/Non-Capital Plan comparisons and "non-essential" investment determinations.
Step 6	Comparable revenue requirement calculation, although F-Factor incorporates plant retirements, cost of removal, and ADIT.

[iii] EOE-156 Question:

(PBMRP CAPITAL SUPPORT MECHANISM) Refer to Exhibit CLP-ELP-1, pp. 101-103. Provide a working, unlocked Excel spreadsheet that would serve as a representative tool used to calculate the Company's incremental revenue requirements resulting from the proposed capital support mechanism (F-Factor) for each year of the MRP. As part of the submission, discuss the calculations and separately identify and explain all critical assumptions, using cited information from the Company's rate case submission where relevant (e.g., depreciation rate from the Company's depreciation study). In support of the request, please use the Company's proposed 5 Year Targeted System Performance (TSP) Plan within the spreadsheet's initial inputs and apply an initial assumption that the Company incurred actual plant-in-service additions of 5% more than the proposed annual TSP funding. Additionally, please configure the spreadsheet to allow for the weighted average carrying costs (WACC) to be individually adjusted for both ROE and Cost of Debt.

EOE-156 Response:

The Company appreciates the opportunity to respond to EOE's thoughtful question regarding the operation of the PBMRP proposed in this proceeding, which the Company views as key to reaching a long-term reliability and resiliency plan for Connecticut, while meeting affordability needs for customers. The Company's response to this request is organized as follows:

A. Overview and Results
B. F-Factor Discussion
C. Impact of 5% Additional Capital Investment
D. Model overview

Attachments referenced in this response:
EOE-156, Attachment 1, provides the Company's working model, with projected capital investment as filed in this proceeding. See, e.g., Exhibit CLP-ELP-1, Figure 7.
EOE-156, Attachment 2, provides a second model that is identical in every respect to Attachment 1 except that capital investments are 5% greater than the forecast submitted to this proceeding in Exhibit CLP-ELP-1, Figure 7, as stipulated by EOE's data request.

A. Overview and Results

Ultimately, the Company's goal in this proceeding is to establish a sustainable, cohesive ratemaking framework that supports electric utility service in the State of Connecticut in an affordable manner for customers, over a long term. This is the Company's goal because the CL&P system needs investment for reliability, resiliency and modernization. For this infrastructure investment to be affordable for customers, a coherent ratemaking plan needs to be instituted that will consider the interests of customers over a longer term than just the next rate case. That framework needs to balance: (1) the reliability and performance requirements of the Company's customers and the broader State of Connecticut; (2) customer rate stability and affordability; (3) incentives for cost efficiency in utility operations; and

(4) implementation of a revenue support mechanism sufficient to cover the cost of delivering these objectives to customers, including the cost of capital.

The Company's PBMRP is designed to address these objectives in a holistic, balanced way. To do this, the Company started with the ratemaking framework under discussion in PURA's PBR docket (Docket No. 21-05-15RE01), while also introducing certain new elements to remediate the flaws that would ultimately hinder PURA's (draft) PBR model from supporting the necessary stay out terms. As discussed below, the stay-out term is the critical element of the PBMRP that creates the cost-efficiency incentive inherent in a performance based ratemaking plan.

This context is vital to understand both the design and mechanics of the Company's proposed PBMRP, including both the F-Factor and "I-X" components. To augment understanding of how the plan would work over the stay-out period, the Company has incorporated the projected costs of service set forth in EOE-156, Attachment 1, Worksheet, entitled "COS-1 Total," which is the Company's cost of service, as filed. The Company does not intend to imply that these dollar amounts are certain for the future and there will undoubtedly be changes in a litigated result. However, these figures serve as a reasonable basis for presenting this analysis to reflect the Company's PBMRP proposal. Moreover, assuming that there will be changes to the underlying cost of service that serves as the "going in revenue requirement," all of the projections made herein become highly optimistic, as discussed below.

Increasing capital investment on the Connecticut distribution system is a given for the reasons described in the testimony of the Company's Leadership Panel and Targeted System Plan ("TSP") Panel – the Connecticut distribution system needs additional investment to maintain service reliability to customers and even more investment to achieve a level of modernization. The Company will need to make this investment to meet the interests of customers, with or without a multi-year plan. However, without a multi-year rate plan, whether in the form of the Company's proposed PBMRP or another reasonable model, the Company's only viable course of action to support this level of needed investment will be to file traditional cost-of-service rate cases, as closely to annually as possible. Effectively, these sequential cases will "roll in" unrecovered capital investment into base rates to maintain a nexus between what the Company needs to invest in the system and what rates are reflecting for recovery of costs.

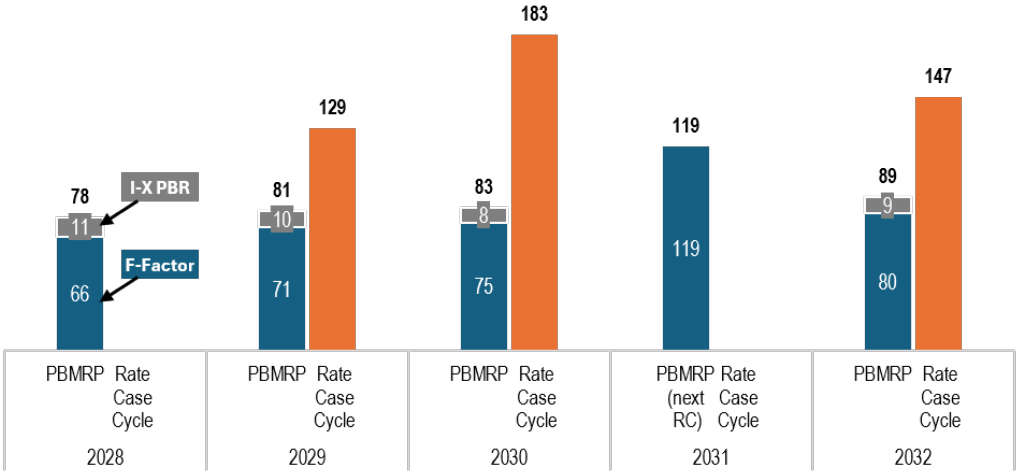
In a world in which system investment needs are relatively flat, economy-wide inflation is modest and predictable at 2% annually, and rates are fully coupled with growing sales revenues (and no revenue decoupling mechanism), it is conceivable that a utility could offset the cost increases it incurs with organic sales growth, as electric utilities could do in past decades. However, that is not the reality of today's operating environment. The distribution system investment needs are extensive and growing and the financial consequences of these circumstances are factors that need to be considered in determining a reasonable and workable regulatory plan. Establishment of a reasonable multi-year, performance-based ratemaking plan is the mechanism that can support the system needs in a manner that is wholly transparent and stable for customers, allowing for a smoother trajectory of rate changes than would otherwise occur.

Results of F-Factor Implementation Assuming Capped Forecast Investment

EOE-156, Chart 1, below, provides illustrative rate increases comparing circumstances where the Company is pursuing a traditional rate-case cycle with filings as close to annually as possible under Connecticut law, as compared to the proposed PBMRP. These amounts assume the Company's revenue requirement proposed in this docket is authorized without modification, except that the Company has used its existing weighted average cost of capital to perform the analysis, in order to isolate the functioning of the F-Factor operation - apart from changes in the cost of capital (i.e., the analysis uses a 9.25% return on equity and 47%/53% debt to equity capital structure). As noted above, the cost-of-service projections are shown in EOE-156, Attachment 1, Worksheet "COS-1 Total," Line 35.

In the absence of a multi-year rate plan, the Company anticipates filing rate cases on a rolling basis, with base rate changes effective January 1, 2029, July 1, 2030, and January 1, 2032. Chart 1, below, also spans the time period covering one year beyond the Company's proposed four-year plan. 2032 is shown for illustrative purposes.

EOE-156, Chart 1
Annual Incremental Revenue Increase, $ Millions



Note: Chart 1 assumes base-rate amendments effective 1/1/2029, 7/1/2030 and 1/1/2032.

In Chart 1, a rolling rate-case cycle is depicted as the orange series, with the Company estimating new rates effective January 1, 2029 (18 months after the present docket concludes), with additional revenues of $129 million; followed by another $183 million rate change effective July 1, 2030, and a further $147 million effective January 1, 2032. These rate adjustments arise primarily as a result of capital investment rather than O&M changes, which means that the associated rate changes are reasonably foreseeable and ultimately predictable.

In contrast, the Company's proposed PBMRP would yield revenue increases of $77.6 million for rates effect July 1, 2028, $81.1 million July 1, 2029, and $83 million July 1, 2030 (EOE-156, Attachment 1, worksheet "PBR-1 Total PBRA", Line 41). For purposes of discussion, the Company estimates that the subsequent rate case taking effect after the proposed PBMRP would be $119 million in 2031, followed by $89 million in 2032 assuming continuation of the proposed framework. Uncertainty grows as the timeframe of projections extends, as the Company will inevitably experience cost increases in relation to both operating expenses and capital investment, as time passes. Therefore, the later years (particularly 2031 and 2032) should be interpreted as illustrative for purposes of discussing the principles and conceptual impacts of the PBMRP and traditional rate case frameworks.

As Chart 1 illustrates, whether through a multi-year rate plan or sequential rate cases, ongoing revenue support is essential to the electric system. Revenue increases for the Company are rate increases for customers, so that a smoother and more predictable customer impact occurs through the Company's PBMRP, which is the fundamental

purpose of the PBMRP. The Company's proposal results in rate increases amounting to approximately 1.5-2.1% on a total bill basis, annually (Line 3). In contrast, a rolling rate-case cycle yields rate increases nearly double at 3.4% (Line 4). Essential to this discussion is that both frameworks are designed to roughly track with the cost of service, although the stay-out feature of the PBMRP forces the Company to absorb the risk of deviation from the cost of service given the likelihood that operating and investment costs will increase over the period. The difference is the gradualism of the Company's PBMRP, which results in smoother, more predictable bill changes for customers.

EOE-156, Table 1

Line	Description	2028	2029	2030	2031	2032
	Incremental Revenues ($ Millions)					
1	Company Proposal	77.6	81.1	83.0	118.6	89.0
2	Rate Case Cycle	0.0	129.0	183.0	0.0	147.0
	Annual Increase, % Total Bill					
3	Company Proposal	1.5%	1.5%	1.5%	2.1%	1.6%
4	Rate Case Cycle	0.0%	2.4%	3.4%	0.0%	2.6%

The rolling rate-case cycle is characterized by larger changes that are more disruptive to customers, in addition to being administratively burdensome for all Connecticut stakeholders. Importantly, the Company's PBMRP does not undermine the applicability or efficacy of prudence reviews in terms of establishing a strong incentive for cost control. Under the Company's proposal, prudence reviews can occur annually, preserving accountability and cost-control incentives with increased transparency, as well.

B. F-Factor Operation

At its core, the Company's proposed F-Factor mechanism is designed to provide a revenue allowance sufficient to support the level of capital investment needed by the system, including the cost of capital. Several essential characteristics of the F-Factor mechanism mutually contribute to its viability and potential longevity:

1. **Like the CT-Bar1 the Company's F-Factor would take effect the first day of the first Rate Year coming out of the rate case, which eliminates the need for Rate Year capital to be embedded in base rates, subject to later downward only reconciliation.** To the extent capital investment currently factored into the Company's proposed revenue requirement for Rate Year 1 is "rolled back" to an earlier date (for example, to a capital investment cutoff date of February 28, 2027 for inclusion in base rates), the F-Factor revenue-requirement calculation would inherently adjust to reflect capital investment as of that cutoff date.

2. **Like the CT-Bar, the Company's F-Factor does not pre-emptively or categorically exclude any type of capital investment.** The Company regularly makes capital investments that do not directly affect the performance of the electric grid the way utility poles, transformers, lines, substations, etc. clearly do, but are nonetheless essential capital investments in the provision of service to customers. Capital investments for facilities safeguarding equipment, information technology enabling self-service customer portals, and vehicles needed for transporting materials to work sites are but a few examples of core capital investments that are necessary and, therefore, inform the F-Factor allowance.

3. **Like the CT-Bar, the Company's F-Factor aligns the capital investment necessary for the target performance of the electric grid outlined in the Company's Targeted System Plan, with the revenues required to support those investments.** In developing the F-Factor the Company sought to establish a means of tying the F-Factor revenue allowances to the capital investment forecast that would be discussed extensively in this docket. This allows the focus of the TSP to remain on the system needs and plan objectives while simultaneously acknowledging that those needs and objectives, whatever they may be, require some measure of revenue support. The F-Factor serves as a necessary link between the system needs evaluated in this docket and necessary revenues.

4. **The Company's F-Factor properly includes the cost of capital**. If CT-bar is evaluated separately from going-in revenue requirements, no single design factor would guarantee its failure more so than the absence of the cost of capital from its revenue requirement calculations. Though the cost of capital is not visible the way other costs of service are, such as the maintenance cost that keeps an older piece of equipment online or the cost of gasoline in a line truck, it is just as real a cost of service.

   The Company regularly operates with a cash deficit. That is, the cash necessary to support ongoing operations exceeds the cash received from customers through bills. The direct result is the Company must secure funds through some other means. Those other means are debt and equity investors: the individuals, banks, corporations and other institutions supplying funds to capital markets. Those entities have choice in terms of the entities to whom they provide their funds, choices that weigh other utility companies, industries, countries and continents, type of security, duration, expected return, the presence (or absence) of dividends, environmental, social, and governance characteristics, and countless other variables against the investor's tolerance for risk. Not surprisingly, the Company cannot expect that investors, facing the choice between the Company and essentially all other investment opportunities, would or should accept zero return in exchange for their funds. Thus, the cost to acquire the funds necessary to perform the ongoing capital investments required of the system is real, fundamentally non-zero, and more specifically the Company's cost of capital filed in this proceeding.

5. **The Company's F-Factor captures all elements of the Company's capital investment base, including plant additions, plant retirements, accumulated depreciation, cost of removal, and accumulated deferred income taxes.** The Company's F-Factor calculation fundamentally captures the impact of ongoing depreciation accumulating in rate base, which has the effect of reducing overall revenue requirements. Additionally, the Company's F-Factor calculation inherently captures the reduced revenue requirement resulting from plant retirements and accumulated deferred income taxes, while also incorporating the effect of cost of removal on rate base.

6. **Like the CT-Bar, annual reconciliation of the revenue requirement ensures customers ultimately pay only for prudent capital investment while balancing the utility's need to cover the ongoing costs of providing ongoing service.** Critically, the Company's F-Factor proposal does not circumvent prudence reviews – essential pillars of properly-functioning regulatory frameworks – nor undermine the value that effective prudence reviews bring customers. Ultimately, the Company is acutely aware that any capital investment must successfully withstand the scrutiny of a prudence review. Whether that review happens next year, three years from now, or at any other interval, the Company knows the decisions made today must withstand a prudence examination. Any eventual findings of imprudence regarding capital investments made today have significant, negative financial implications, regardless of when those findings are made. Thus, the very expectation of future prudence reviews reinforces the prudence ingrained in decision-making today. Further, the risk of a future finding of imprudence and the negative financial implications thereof eliminates any perceived financial benefit for the Company to "over invest" today.

Annual reconciliation, including the prudence reviews involved, is a critical element of the Company's PBMRP proposal. As part of each annual PBMRP adjustment effective July 1 each year of the PBMRP2, the Company's actual capital additions for the Prior Year are allowed for inclusion in the calculation of the F factor to the extent that the actual capital additions do not exceed the Forecasted Budget (referred to as the F-factor allowance). To the extent that the cumulative actual capital costs in-service through the Prior Year, in aggregate, exceeds the Forecasted Budget through the Prior Year, then the F Factor allowance is capped at the cumulative Forecasted Budget. This downward-only reconciliation will ensure that, in the end upon reconciliation, customer bills reflect the costs associated only with projects that are in service to customers and no more, and that if the Company invests more than the Forecasted Budget, customer bills will not reflect amounts above the Forecasted Budget, until such time as those capital investments are allowed into rates at the time of the Company's next rate case. The prior-period reconciliation will be reflected in the F-Factor, in addition to the revenue requirement associated with the Forecasted Budget for the upcoming rate year, effective July 1 annually. The F Factor allowance will be calculated to determine the revenue requirement (inclusive of depreciation expense, property tax expense, return on rate base, and income tax) on actual plant additions (including plant additions, cost of removal, plant retirements, accumulated depreciation, and plant related accumulated deferred income taxes ("ADIT")) up to the Forecasted Budget amount, and to reflect the revenue requirement for the Prior Year and through the Rate Year on in service capital additions placed in service in the Prior Year, provided that those in service capital additions are not reflected in base rates or in another rate mechanism. In addition, the F Factor allowance will reflect the revenue requirement for rate year capital, established at the Forecasted Budget, subject to downward-only reconciliation in the subsequent F Factor filing.

As noted above, annual reconciliation will consider plant-related ADIT on the Company's books through the end of the calendar year, prior to a given annual filing. To the extent the Company has recorded cumulative plant additions in excess of the capital expenditure forecast provided in this docket or supported by a mechanism other than the F-Factor, the plant-related ADIT will be adjusted in the Company's annual reconciliation to avoid overstating the ADIT relevant to the F Factor.

In total, the Company's proposed F-Factor will provide revenue support for, and ultimately reconcile, the capital investment placed into service from the cutoff date for inclusion in base rates through the effective date of the Company's subsequent rate case at the conclusion of the proposed PBMRP term. Per the Company's proposal, and as depicted in the illustrative attachments for this response, the F Factor would ultimately reconcile capital investments made up to July 1, 2031 (the effective date of the subsequent rate case). Should the subsequent rate case be effective later than the July 1, 2031 illustrative date, the F-Factor would continue to reconcile capital investments placed into service until such time as that rate case does take effect.

C. Impact of 5% additional capital investment

EOE-156, Attachment 2 is the same working model as Attachment 1, except that the Company's actual capital investments are assumed to be 5% greater than the current forecast. These increases are reflected on the worksheet "COS-2 Capital," at Lines 19 and 26.

As shown in EOE-156, Table 2, below, in the event that the Company's actual capital investments over the period 2027-2031 were 5% greater than current projections, which is a realistic scenario, the Company's proposed F-Factor revenue would not increase, highlighting two crucial design characteristics.

First, the core capital investment forecast provided in this docket is proposed to be a hard cap on the capital plant additions eligible for recovery through the F-Factor. That means the Company, PURA and stakeholders will be adequately informed of the maximum future revenues as calculated today.

Second, where core plant additions greater than forecast will not be supported through the F-Factor mechanism, there is pressure on the Company to stretch to find efficiencies to maintain a viable rate of return. As Table 1 demonstrates, investing beyond the current forecast provides no benefit in the form of greater revenue during the PBMRP, while putting downward pressure on the Company's earned rate of return. Consequently, over the term of the PBMRP, the Company's financial interest is to operate within its budgets and with a high rate of efficiency in order to achieve a viable rate of return.

EOE-156, Table 2

	Rate Year 1	Rate Year 2	Rate Year 3	Rate Year 4
Base Capital Investment Forecast				
(As Filed, Docket No. 26-05-10)				
Annual Incremental F-Factor Revenue ($ millions)		$66.2	$71.4	$74.5
Return on Equity	9.10%	8.98%	8.87%	8.75%
Savings required to earn allowed ROE ($ millions)	**$7.6**	**$14.3**	**$21.2**	**$29.0**
5% Additional Capital Investment				
Annual Incremental F-Factor Revenue ($ millions)		$66.2	$71.4	$74.5
Return on Equity	9.01%	8.80%	8.61%	8.42%
Savings required to earn allowed ROE ($ millions)	**$11.9**	**$23.8**	**$36.1**	**$49.3**

As shown in Chart 1 and discussed previously the sequential rate cases have a larger impact for customers and are more disruptive, while also creating administrative burden for all Connecticut regulatory stakeholders. Conversely, the Company's PBMRP produces smoother changes in revenues/rates without undermining the importance or efficacy of prudence reviews that would occur in the traditional cost-of-service ratemaking context. Under the Company's proposal, prudence reviews would happen annually. Thus, accountability and cost-control incentives are preserved in the Company's proposal, with an improvement in ratemaking transparency.

However, the larger point illustrated in Table 2 is the powerful impact of the stay-out term.

Under PBR, a benefit for the Company is the line of sight it has on a predictable revenue stream that will replace the loss of sales growth associated with the revenue decoupling mechanism, while providing a level of support for the ongoing operation of the system, including needed investment. However, a significant risk for the Company is that its costs will deviate from the "going in revenue requirement" from the minute rates are set through the end of the stay-out term. These cost changes will impact operating expenses, as well as the drivers of investment costs.

The power of the stay-out term, therefore, arises in relation to the Company's impetus to offset the earnings attrition it will inevitably experience as a result of these cost changes, through efficiency initiatives that will reduce costs on a going forward basis, to the benefit of customers. That is, to maintain a viable rate of return, the Company will be pressed to seek out and achieve cost efficiencies somewhere in the business. Those efficiencies achieved during the stay-out period unavoidably inure to the benefit of customers when base-rates are next set on

a cost-of-service basis. This is the fundamental power of a PBR framework, which the Company is experiencing in its Massachusetts companies.

In this case, Table 2 (above) and the working model included as part of this response, each show that it would be necessary for the Company to realize cost savings of approximately $29 million annually, by the end of the PBR term, in order to be able to offset the downward pressures on the (currently) authorized return on equity ("ROE") of 9.25%, all else equal. (See, EOE-156, Attachment 1, worksheet "Financial Summary", Line 24). "Downward pressures" mean increased costs, whether operating expense or the cost of carrying unrecovered capital investment.

For context, the Company's O&M reflected in this docket (per Exhibit CLP-REVREQ-2, Schedule C-3.0), excluding vegetation management, storm restoration and uncollectible expense, is $352 million, annually. Cost efficiency gains of $29 million therefore equate to a reduction on total O&M of approximately 8 percent, which is a significant reduction in the normal course of business.

At the same time, Table 2 further highlights that this $29 million annual gap is almost doubled to a gap of $49.3 million with only a five percent increase in capital investment as compared to the capped F-Factor. This computation highlights the extreme sensitivity that exists within the cost-of-service ratemaking model when operating expenses and investment costs are increasing and the point at which base rates will be reset and realigned with actual costs is extended to a future point in time.

For example, recall that this analysis is founded on a "going in revenue requirement" that is equal to the Company's filed, proposed revenue requirement – and assumes only one change in the modelling over the entire PBR term, which is the 5% increase in capital investment. However, in reality, there is a virtual certainty of operating cost increases and investment additions that well exceed the 5% shown here, which would only further suppress the rate of return. Accordingly, this analysis highlights the inherent power of the stay-out term associated with a multi-year rate plan that provides revenue support, but without any guarantee of aligning with the actual cost of service along the way. The growing gap is the pressure that is created for efficiency gains that will then be passed on to customers at the next rate-setting interval.

D. Model Overview

Please refer to EOE-156, Attachment 1, for the Company's illustrative PBR model. The model incorporates the Company's proposal with respect to inflation measurement, revenue increases related to operating expenses, F-Factor, and combined effect on the financial results of the Company.

Key assumptions include:

i. The base rate increase, PBMRP, and catastrophic storm cost recovery authorized in this docket are all assumed at the level filed by the Company in this proceeding, with the only exception being the Company used the return on equity and equity capitalization as currently allowed, which is 9.25% and 53.0%, respectively.

ii. The sum of plant additions and cost of removal each year are equal to the capital investment forecast provided in this proceeding, as shown in Exhibit CLP-ELP-1, Figure 7.

iii. Capital and O&M costs related to AMI are excluded from the projected cost of service and illustrative F-Factor revenue requirement calculations. Should the F Factor be approved as the

mechanism enabling revenue support for AMI, the cap on capital investment would need to be increased to accommodate the costs for that program.

iv. Catastrophic storm costs, both the recovery of existing deferred costs as well as the costs related to future events, have no bearing on the model. Importantly, this implies the catastrophic storm and pre-staging costs in base rates perfectly match future costs (i.e. future revenue equals future cost for each and every year).

v. O&M cost pressure is assumed to be 1% greater than inflation, annually.

The model is organized into three primary sections:

1) **Financial Summary**, which presents illustrative results of the combined effect of the Company's proposed rate increase, PBR framework, and cost projections

2) **PBR Model,** which covers "I – X – CD" and F-Factor

    a. Worksheet "PBR-1 Total PBRA"
    b. Worksheet "PBR-2 Inflation"
    c. Worksheet "PBR-3 F-Factor Summary"
    d. Worksheet "PBR-4 F-Factor"
    e. Worksheet "PBR-5 F-Factor Property Tax"
    f. Worksheet "PBR-6 Capital Forecast"
    g. Worksheet "PBR-7 Going-In Capital RR"
    h. Worksheet "PBR-8 GDP"
    i. Worksheet "PBR-9 ECI"

3) **Cost of service**, which consists of three worksheets, provides a forecast of the actual cost of providing electric service

1) Financial Summary

The "Financial Summary" provides the combined results of going-in revenues along with the rate increases determined through the Company's PBR proposal, the operating costs of service projected over the same timeframe, and the investment base that enables the Company's essential service to customers.

Lines 15-27 show the calculation of the Company's actual, earned return on equity over the four years of the Company's PBMRP term. Specifically, Line 22 provides the annual earned return on equity; Line 23 provides the cumulative average annual ROE; and Line 24 provides the revenue requirement (excluding GET and uncollectible) or cost savings necessary to achieve the allowed ROE.

Lines 28-44 provide a simplified Income Statement for the four years of the Company's PBMRP, including revenue projections as well as the operating costs of service. These costs represent the projected costs of doing business whether or not those costs are supported with rates.

Lines 46-61 provide a summary of the revenue increases calculated in the PBR model and the corresponding impacts on uncollectible expense and gross earnings tax.

2) PBR

The PBR worksheets are the working calculations that drive the illustrative distribution rate increases discussed above. Each one of which is discussed separately below:

a. Worksheet "PBR-1 Total PBRA"

This worksheet summarizes the results (i.e. rate increases) of the model's other "PBR" worksheets and is organized into four sections: (1) Going-In Revenue Requirements; (2) PBR-O Adjustment; (3) F-Factor Adjustment; and (4) Total Performance Base Revenue Adjustment. "Going-In Revenue Requirements" reflects the eventual revenues authorized as a result of this proceeding. For purposes of this response, this reflects revenues as proposed in this docket and adjusted, as discussed above. The purpose of this section is to orient the reader to the authorized levels of operating revenue (Line 17) and O&M (Line 21) established in this proceeding and, second, to perform calculations necessary to establish Rate Year 1 baselines for use with subsequent rate year revenue calculations. Line 19 is the resulting base distribution revenue requirement that represents the overall starting point for distribution revenues to which any and all PBMRP rate adjustments for Rate Year 2 would be added or subtracted as appropriate. Line 23 is the level of O&M to which the PBR-O percentage increase for Rate Year 2 would apply.

The PBR-O adjustment section (Lines 25-30) provides the calculations for inflation-driven rate increases, which are initially applied to line 23 discussed above. Line 27 is the combined percentage increase resulting from the Company's proposed composite inflation measure, -0.03% productivity ("x") factor, and consumer dividend. For this analysis, the Company has assumed a 30-basis point consumer dividend for all years. Line 28 provides the resulting annual incremental revenues.

The F-Factor adjustment section on this worksheet references the results determined on other worksheets of the model (discussed below). Here, Line 33 provides the resulting annual incremental revenues, while Line 34 provides the cumulative F-Factor revenue requirement.

Line 37 provides the total annual revenue increase, which is the sum of Lines 28 and 33.

Line 43 is the final resulting base distribution revenue requirement that begins with Rate Year 1 amounts and adjusts annually thereafter by the amounts described above.

For purposes of this analysis, there are no exogenous cost recovery assumptions reflected in the accompanying working model. If PURA were to authorize the Company's proposal, including mechanics related to exogenous cost provisions and the consumer dividend, the PBR model would need to be adapted from the attached to include additional worksheets as appropriate.

b. **Worksheet "PBR-2 Inflation"**

This worksheet first aggregates the relevant indices' data points from worksheets 10 and 11 (discussed below), which are shown on Lines 13-16 for GDP-PI and Lines 21-24 for ECI. Each index is then averaged for a given calendar year (Lines 17 and 25), which then form the basis for the annual growth calculations on Lines 18 and 26. As discussed in the Company's pre-filed testimony, the Company is proposing to weight the indices 66.9% for GDP-PI and 33.1% for ECI. The composite resulting inflation is shown on Line 32.

Line 33 provides the -0.03% productivity factor, while Line 34 shows the consumer dividend, which assumes 30 basis points for simplicity of this analysis. The combined result of inflation, productivity factor and consumer dividend is shown on Line 35, which is before the imposition of a 5% cap. To the extent line 35

exceeds the proposed 5% cap, Line 36 would provide the adjustment such that Line 37, the final result, is the lesser of the 5% cap and Line 35.

Note that projections of inflation are used for analytical purposes in this response and to assist with discussion pertaining to future rate increase implications. Actual calculations of PBR adjustments in future annual PBR filings would rely exclusively on published data available at the time of a given year's annual PBR filing.

c. Worksheet "PBR-3 F-Factor Summary"

Like the CT-Bar, the Company's proposed F-Factor is calculated on a monthly basis. The "F-Factor Summary" worksheet aggregates the results of those calculations on Lines 17-29 and presents in 6-month increments to enable both calendar-year and rate-year views of the same information. Property taxes (Line 19) are not calculated monthly, but rather on a fiscal year basis. Line 28 provides the resulting cumulative F-Factor revenue requirement, while Line 29 is the annual incremental amount shown on the worksheet "PBR-1 Total PBRA," line 33.

d. Worksheet "PBR-4 F-Factor"

This worksheet provides the monthly calculation of the F-Factor revenue allowance summarized on the previous worksheet and is the "engine" of the overall F-Factor model. Broadly, it aggregates the necessary inputs, including rate base activity assumptions (Lines 18-25) and relevant rates resulting from this proceeding, including depreciation expense as a function of gross plant (Line 49) and pre-tax return on rate base (Line 51).

Note also that this worksheet includes a "switch" (Line 16) that enables this model to adapt to the cutoff date of capital investment for inclusion in base rates. However, due to the large number of possibilities for a potential cut-off date and similarly large variation of resulting Going-In revenue requirements, the model is currently configured to use this line as an adjustment for Rate Year 1 only. That is, the model is not currently built such that the user can specify a cutoff date for capital investment inclusion in base rates and have that date adjust the going-in capital revenues, as well as the F-Factor. Conceptually, this switch is intended to affix the start of the F-Factor calculations to the last date capital investment is reflected in base rates.

As presently configured, the F-Factor revenue requirement assumes the capital investment reflected in base rates is per the Company's proposal, which is through June 30, 2028. However, the capital-driven rate year revenue requirement calculations reflected in the Company's filed cost of service are based on rate year averages. For example, the rate base referenced in the return on rate base calculations found on Exhibit CLP-REVREQ-2, Schedule A-1.0, Line 16 is average rate base, while Rate Year 1 depreciation expense is based on rate-year average plant in-service, as denoted on WP C-3.34, line 13 of the same exhibit. Consequently, the F-Factor calculation is currently configured to rely on 50% of Rate Year 1 capital investment to effectively build the proper ending balances as of 6/30/2028 upon which subsequent rate year calculations can grow. Note that the interaction between the F-Factor and the cut-off date for capital investment inclusion in base rates is a critical component to the longevity of the Company's proposal as it assures that the F-Factor starting point aligns with the endpoint for base rates, leaving no gap over the duration of the rate plan.

For purposes of this written response, the Company does not detail the calculations of this worksheet here. Instead, the Company refers to the line references provided on the last page of this worksheet (Model PDF, page 8) for both Attachments 1 and 2, which detail the calculations performed. For emphasis, note that Line 33 captures the accumulation of depreciation recovered in base rates. By design, the F-Factor intentionally reflects this to properly estimate a reasonably true capital driven revenue requirement.

The resulting F-Factor revenue requirement, excluding property tax, which is referenced by the preceding worksheet, is shown on line 53.

e. Worksheet "PBR-5 F-Factor Property Tax"

This worksheet provides the fiscal year calculations for incremental property tax expense based on capital investments made since 2024 and forecast through 2031. Line 12 references capital investment assumptions discussed elsewhere, while Lines 13-24 perform the calculations of depreciation expense pursuant to Conn. Gen. Stat. §12-63(b)(6), net book value, assessed value pursuant to Conn. Gen. Stat. §12-63(a), and the eventual property tax expense by applying the composite mill rate calculated in Exhibit CLP-REVREQ-2, Schedule WP C-3.37 p17 to 21, Page 20, Line 73. The result is shown on line 24.

Lines 28-32 then summarize that result by calendar year, while Lines 38-40 summarize by rate year. After adjusting for the extent to which base rates recover the property tax related to these same investments on Line 41, as discussed in previous sections, the final property tax amount reflected in the F-Factor allowance is shown on Line 42.

f. Worksheet "PBR-6 Capital Expense Forecast"

This worksheet is provided to create the necessary link between the F-Factor revenue allowance calculations and the capital investment forecast discussed in this docket. The capital investment forecast included aligns with the Company's filed capital investment forecast, as can be seen in Exhibit CLP-ELP-1, Figure 7. The F-Factor capital investment assumptions reflected in the revenue allowance calculations of "PBR-4 F-Factor" necessarily agree with this worksheet.

g. Worksheet "PBR-7 Going-In Capital RR"

This worksheet is a collection of select data points as approved in the Company's "Going-In" rates (or, in this case, as proposed in the Company's filed cost of service schedules, Exhibit CLP-REVREQ-2-A, B, C, D Schedules, adjusted to reflect the currently authorized return on equity (9.25%) and equity capitalization (53.0%), as stated previously:

- Lines 12-16 provide the dollar amounts related to capital-driven costs of services, which are depreciation, property taxes and costs of capital. Amounts shown are currently as proposed in this illustrative model (except where noted), but ultimately will reflect the amounts as approved in this docket.

- Lines 21-28 provide a summarized view of the Company's filed rate base for the test year, rate year beginning, rate year ending, and rate year average balances. These balances serve as the basis (denominators) for establishing the capital-driven costs above as a percentage of approved balances. Those percentages are used on the other "PBR" worksheets, as well as the cost of service worksheet to estimate future costs of service based on approved levels (Lines 30-32)

- Lines 47-81 provide rates for uncollectible expense, gross earnings tax, and the costs of capital as well as necessary calculation of gross-ups to those rates for use in the model's calculations.

- Additional details are shown in column (F) of this worksheet.

h. Worksheet "PBR-8 GDP"

This worksheet presents raw Gross Domestic Product-Price Index (GDP-PI) data obtained from the Bureau of Economic Analysis. For illustrative purposes only, this model also includes a projection of GDP-PI obtained from Moody's September 14, 2026. As noted above, actual calculations of PBR increases, if approved as filed, rely only on historical data available at the time of a given year's annual PBR filing.

i. Worksheet "PBR-9 ECI"

This worksheet contains raw Employment Cost Index (ECI) data obtained from the Bureau of Labor Statistics. Note that projections of inflation are used for analytical purposes and to assist with discussion pertaining to future rate increase implications. Calculations of PBR increases, if approved as filed, rely only on historical data available at the time of a given year's annual PBR filing.

3) Cost of Service

The cost of service included for analytical purposes in the Company's working model consists of three worksheets: "COS-1 Total," "COS-2 Capital," and "COS-3 Property Tax."

a. Worksheet "COS-1 Total"

This worksheet provides projections of the Company's actual costs through the end of the PBMRP term as a means of assessing the impact the capital investment forecast and O&M cost pressures have on the overall cost of service as well as the degree to which revenues align with the Company's cost of service (as reflected on the "Financial Summary" worksheet).

Lines 15-37 summarize the results of the cost drivers, including especially O&M (Lines 16-19), depreciation (Line 21), property taxes (Line 22), and costs of capital, including corresponding income taxes (Lines 24-27).

Gross earnings taxes and uncollectible expense are calculated on Lines 33 and 34 as if the full cost of service (Line 28) is in rates.

Non-storm O&M is shown on Lines 38-44, while storm O&M is shown on Lines 45-50, where non-catastrophic costs are identified separately from catastrophic storm / pre-staging funding.

Non-storm rate base is shown on Lines 52-59, which reflect the capital investment forecast (exclusive of AMI) filed in this docket.

Lastly, capital-driven costs of service are shown on Lines 61-67. Depreciation, property tax, uncollectible, gross earnings taxes, and costs of capital are based on the Company's filed cost of service in this docket, specifically Exhibit CLP REVREQ-2-A, B, C, D Schedules, except that the return on equity (9.25%) and equity capitalization (53%) are shown at currently authorized amounts.

b. Worksheet "COS-2 Capital"

This worksheet functions nearly identically to "PBR-4 F-Factor" except that it relies on actual capital investment projected over the term of the PBMRP. This is essential to understanding actual costs of service, whether or not those costs are supported by revenues. It forms the basis for evaluating the degree to which

the F-Factor is sufficient. For additional details pertaining to the mechanics, please see the line references found at the end of this worksheet (or model PDF page 19).

c. Worksheet "COS-3 Property Tax"

Similarly, this worksheet is included to assist with the calculation of actual costs of service. It operates mechanically identically to "PBR-5 F-Factor Property Tax" except that it relies on actual capital investment projections (Line 12).

[iv] OCC-758 Question:

(Retained Earnings) Referring to OCC-518 Response. Are ratepayers paying a cost of equity outlay for retained earnings?

OCC-758 Response:

The Company provides this comprehensive response to questions raised in OCC Interrogatories 758 through 766. Where this response references those interrogatories, footnotes have been provided for ease of reference.

1) Fundamental Ratemaking Principles

Two fundamental ratemaking principles apply here.

First, retained earnings are not "included in rate base." Only infrastructure assets are included in rate base and the only equity return that customers pay is the return on rate base. The largest components of a utility company's rate base is the net balance of infrastructure investments that the Company has had to finance via a combination of long-term debt and equity (meaning that it reflects the gross value of plant additions, less accumulated depreciation on those additions, less the accumulated deferred income tax ("ADIT" 1) benefit). The Company collects a return on rate base through rates equal to the weighted average cost of capital times rate base. The weighted average cost of capital ("WACC") in a rate case reflects the utility's cost of money associated with debt and equity capital used to fund rate base. In a rate case, utility rates are set to reflect the utility's cost of service including its WACC on rate base, such that rates are set to provide revenues that cover i) the utility's annual operating expenses (including taxes, depreciation, and other annually recurring expenses), ii) the utility's annual cost of debt service on rate base such that iii) deducting the level of O&M and debt service from PURA-approved revenues results in a level of net income that reflects the authorized cost of equity (return on equity) established by PURA in the rate case. Customers pay only the return on rate base. There is no separate or additional payment by customers associated with retained earnings.

Second, retained earnings reflects the net income that the utility has earned but has not distributed as dividends. Net income is either returned to shareholders as a dividend, or is retained in the Company as retained earnings. In this manner, retained earnings represent owner's equity in the utility business, becoming part of the permanent capital supporting the Company's operations and investment in utility infrastructure assets. Retained earnings help to alleviate the need for incremental equity issuances (or contributions from the parent company, in the case of a regulated subsidiary) in order to finance ongoing investments.

2) Retained earnings are no different than other cash resources that investors contribute as equity; Ratepayers are not paying a separate (or second) amount for retained earnings (OCC-759)

Customers pay rates designed to support the cost of providing utility service, including operating expenses, depreciation, taxes and the cost of capital (including the authorized return on equity) on the rate base invested in utility infrastructure. When earnings are retained in the Company rather than being distributed to investors as dividends those funds remain at risk to the investor and appropriately form part of the Company's equity capitalization, as "owner's equity."
Accordingly, equity derived from retained earnings is economically no different from other equity funds provided through direct investor contributions and, as such, its cost is the same authorized return on equity as all other sources of equity, when retained earnings are used to pay for utility infrastructure in lieu of other capital funding (OCC-759). In corporate finance, retained earnings come at the same cost, and thus have the same required return as externally supplied equity because investors retain ownership of those funds and continue to bear the same risks associated with the business. The source of the equity does not change the economic reality that investors have committed capital to the enterprise and could otherwise deploy that capital in competing investment opportunities were it not retained in the Company to fund additional infrastructure investments.

3) Retained earnings are not included in rate base; Retained earnings are invested capital that pays for rate base and must be repaid to investors, with a rate of return. (OCC-760)

Within the regulated utility ratemaking framework, retained earnings are not "included in rate base," as OCC-760 suggests. Rather, retained earnings are a source of investor-supplied capital, while rate base consists of prudently incurred assets that are used and useful in providing service to customers. Rate-base assets must be financed with a combination of long-term capital (long term debt and shareholder equity) and retained earnings are one, cost-effective source of that financing. To the extent retained earnings fund utility plant comprising rate base, the retained earnings become part of the capital structure supporting those investments. Regulatory ratemaking acknowledges the cost of equity capital and provides an opportunity to earn a return on invested capital regardless of whether the equity originated from stock issuances or accumulated retained earnings. From a financial perspective, utility assets are indifferent to the source of financing used to acquire them. A dollar of utility plant funded through retained earnings is economically identical to a dollar of utility plant funded through newly issued common stock. Both retained earnings, excluding issuance costs, and the funds from newly issued common stock represent investor dollars committed to utility operations which are exposed to investment risk and other forces that determine the cost equity investors demand in order to provide the utility with its capital to invest.

In addition, retained earnings differ fundamentally from items that reduce rate base, such as ADIT. As described previously, for utilities, ADIT arises primarily from timing differences between tax and book depreciation and represents taxes effectively paid for by customers in advance of the time that the Company pays out those taxes to appropriate governments. Because ADIT generated in this manner is generally viewed as cost-free capital supplied through the ratemaking process rather than by investors, it appropriately reduces rate base and correspondingly reduces the amount of investor-supplied capital upon which shareholders are permitted to earn a return. In this way, rate base is reduced by ADIT, such that the WACC applied to rate base reflects the cost of capital required to finance rate base, being sourced by long-term debt and shareholder equity.

By contrast, retained earnings ***belong to investors*** and represent earnings that have been reinvested in the business rather than distributed as dividends. In other words, retained earnings are investor capital that are used to fund new rate base assets rather than being distributed immediately as a dividend. This is economically equivalent to a circumstance where 100 percent of net income were to be distributed to shareholders as a dividend, and then reinvesting the portion that would otherwise have been retained as retained earnings back in the Company. Consequently, retained earnings are properly treated as investor-supplied equity capital and are eligible to earn the authorized return on equity when supporting utility investments.

The differing treatment of retained earnings and ADIT reflects a fundamental principle of utility ratemaking, which is that investor-supplied capital that remains at risk in the utility business comes at the cost of equity, and the utility is thus afforded an opportunity to earn a return on the balance of equity that is financing rate base, including retained earnings. Conversely, customer-supplied or cost-free sources of financing (such as ADIT) are generally used to reduce the amount of investor capital *upon which* a return may be earned. The regulatory ratemaking framework acknowledges that investors must be compensated for supplying capital and bearing financial risk and also that customers should not pay more than cost of capital that is required in order to finance rate base, by ensuring that cost-free funding sources, such as ADIT, lower rate base.

4) Ratepayers are not "double paying" for retained earnings (OCC-761).

For the same reason, ratepayers are not "double paying" for retained earnings, as contemplated by OCC-7614. The earnings that were "retained" in the utility were previously earned by investors through rates charges to customers and became investor property once earned. To articulate this point, it is important to point out that the amount of retained earnings in any given year has no impact on the value of rate base in that year. In general, utility rate base is a function of the net value of infrastructure (assets), whereas shareholder equity is a source of funds utilized to pay for those rate base assets. The dividend payout ratio (or the inverse being the retention ratio) has no direct bearing on rate base. As explained above, retained earnings as a source of capital to fund rate base is economically equivalent to an investor receiving a dividend and then choosing to purchase additional shares in the Company in the same amount. Both are shareholder equity used to finance rate base, and both come at the cost of equity.

Because investors continue to bear the risks associated with utility operations, retained earnings exist as investor-supplied capital supporting the rate base, on which the Company is entitled to earn a return on equity. The authorized return compensates investors for providing and maintaining that capital in the business, regardless of whether it originated from a stock issuance or retained earnings. Retained earnings are therefore properly treated as investor capital, unlike ADIT, which is generally considered customer-supplied, cost-free capital that reduces the amount of investor-supplied capital required to support utility operations. The use of retained earnings as opposed to new stock issuances is a slightly lower cost source of funds, as there are no issuance costs associated with the use of retained earnings to fund new investments.

Characterizing retained earnings as a second payment by would miss the fundamental point that the opportunity to earn a return on invested capital and the passage of time are inextricably linked because capital that remains invested continues to have value to investors. Investors could have received those earnings as dividends and invested those dollars elsewhere and had those funds not been reinvested in the Company. As a result, retained earnings continue to represent investor capital that is contributed to the business, is at risk, and carries an ongoing opportunity cost, thereby remaining subject to the authorized return on equity.

Similarly, rate base would not be reduced by retained earnings simply because customers previously paid rates that enabled the Company to generate those earnings, as OCC-762 suggests5. Once earned, retained earnings belong to investors. The fact that those funds were retained in the business rather than being distributed as dividends does not change the fact that those funds remain investor-supplied capital supporting utility operations – just the same as any other contribution –with the contributions subject to continuing exposure to business risk and coming at the cost of equity.

As an example, consider a prudent, used-and-useful substation costing $50 million that is financed at the capitalization ratio proposed in this proceeding comprised of 53.86% equity. If the Company raises the equity through new share issuances, the substation would be financed with approximately $23 million of debt and $27 million of newly issued equity. Alternatively, investors could reinvest $27 million of previously earned profits rather than receive those funds as dividends. Under OCC-762's proposition, the second scenario would result in a lower rate base simply because

those earnings were reinvested in the Company rather than being received first as a dividend and then reinvested through the purchase of newly issued shares. Yet, the underlying asset is identical; the service provided to customers is identical; and the investment decision facing investors is identical, i.e., ***choose*** to invest capital in the Company or ***choose*** to invest it elsewhere.

There is no economic or financial basis for treating these two financing sources differently (i.e., retained earnings versus investment in newly issued shared) for purposes of determining the financing costs associated with rate base assets providing service to customers. Relying on retained earnings is slightly lower cost since the use of these funds eliminates the need to go to market and the incremental costs associated with the issuance of new equity. Treating these two sources of funds differently would create a financing bias that favors externally raised equity over internally generated equity, even though both sources of capital reflect investment dollars provided by investors. Such a result would disconnect ratemaking outcomes from the financial principles used to set the return on equity. Establishing different returns for different sources of equity funding violates the basic financial principle that the return on an investment is based on the risk of the investment, not the source of the funding.

5) Retained earnings are an important source of internally generated capital (OCC-763).

Retained earnings are an important source of internally generated capital. Retained earnings strengthen the Company's financial position, support credit quality, reduce reliance on external financing, and help fund ongoing infrastructure investment. Recovery of financing costs does not eliminate the need for utilities to maintain adequate equity capital in the capital structure financing rate base. OCC-763 appears to imply that the Company merely serves as an intermediary between utility assets and the owners of those assets6. In reality, the owners of the Company and the owners of the utility assets are one and the same. Importantly, customers do not bear the risk of supplying capital to fund utility assets; investors do. Customers pay rates that include the cost of debt and equity capital; however, the capital itself is supplied by investors, not customers. Whether the source of equity capital is retained earnings or proceeds from newly issued shares does not alter this fundamental relationship and therefore does not change the cost of service because, in either case, investors have chosen to commit capital to utility operations and the return on that capital is based on the risk of the investment, not the source of the capital. Indeed, one purpose of maintaining a reasonable level of retained earnings is to preserve financial flexibility, support credit quality, and enhance access to capital markets. These attributes ultimately benefit both customers and investors by helping ensure that the utility can continue to attract capital at reasonable cost and provide safe and reliable service.

The Company does not distribute all earnings as dividends (OCC-764) because doing so would eliminate an important source of internally generated equity capital7. If retained earnings were fully distributed each year, the Company would need to replace that capital through additional common equity, debt, or both, in order to fund utility investments and maintain its target capital structure. This financing could be more costly and could expose both investors and customers to additional financing and market risks.

6) Retained earnings are a cost-effective financing resource.

Retained earnings provide financing benefits by avoiding flotation costs (OCC-766)8, including underwriting, legal, registration, and administrative expenses associated with issuing new securities. Although the Company can elect to distribute 100% of earnings to investors and can subsequently raise replacement capital in the financial markets (OCC-765), doing so presents several drawbacks9.

First, given the capital-intensive nature of the utility industry, replacement capital would likely be required almost immediately, exposing the Company to prevailing market conditions and unnecessary financing risk.

Second, retained earnings provide a financial cushion during adverse events, including market disruptions and broader economic downturns.

Third, if investors expected the Company to distribute all earnings as dividends, earnings volatility would translate directly into dividend volatility, including potential dividend reductions, which can be viewed negatively by capital markets.

Fourth, replacing retained earnings with externally raised equity would introduce flotation costs that could otherwise be avoided. From a capital formation perspective, retained earnings represent the most efficient source of common equity because they allow the utility to finance investment without incurring transaction costs, market issuance risk, or potential dilution associated with new share offerings.

By retaining earnings instead of issuing equivalent new equity, the Company obtains equity financing without incurring flotation costs. As a result, retained earnings are often a lower-cost source of equity capital than newly issued common stock.

7) Summary

In summary, retained earnings are investor-owned capital resources that remain invested in the utility business. The earnings constitute investor-supplied equity capital, are appropriately used to pay for utility infrastructure, while reducing the need for external financing and associated flotation costs.

In contrast, ADIT is generally treated as customer-supplied, cost-free capital and therefore serves to reduce the amount of investor-supplied capital upon which a return may be earned. This distinction reflects a foundational principle of utility ratemaking: customers should receive the benefit of cost-free sources of capital (ADIT), and only pay the cost of capital necessary to finance rate base assets that in service, used and useful, and prudently incurred. The flip side of this same coin is that utility investors should have the opportunity to earn a fair return on capital they supply and place at risk, whether or not that equity capital is contributed in the form of a purchase of newly issued stock or in the form of retained earnings by the company. The treatment of retained earnings reflects the fundamental principle that capital left invested in the business continues to have value and an opportunity cost to investors, even when that capital originated from previously earned income. Fundamentally, retained earnings are the result of investment retained in the business rather than being distributed as dividends, and utility ratemaking has long recognized such retained earnings as investor-supplied equity, no different in substance from newly invested common equity.

Accordingly, retained earnings are not a source of customer-supplied capital, nor do they represent a basis for reducing rate base. Rather, retained earnings are investor-owned funds that are reinvested in utility operations and continue to perform the same economic function as any other form of common equity.

[v] OCC-430 Question:

Exhibit CLP-ELP-1 Please explain in detail how the Company determined that a threshold significance of 0.5% of total distribution revenue is appropriate for Z-Factor eligibility. Please explain why the Company proposes a 0.5% threshold rather than the 0.75% threshold proposed in the Docket No. 21-05-15RE01, Proposed Final Decision, and provide all analyses, calculations, benchmarks, or other information relied upon in selecting the proposed 0.5% threshold.

OCC-430 Response:

The 0.75% materiality threshold proposed in the Docket No. 21-05-15RE01, Proposed Final Decision is unnecessarily high, and inconsistent with other jurisdictions. Although the Company supports the intention of establishing a materiality threshold as a means of balancing administrative burden with the Company's need to cover the costs of service, including those over which it has no control, a materiality threshold set too high actually renders the mechanism increasingly ineffective, raising the likelihood that the utility cannot commit to the PBR stay-out because it will be unable to obtain a fair or reasonable level of recovery of its operating costs, also barring customers from benefitting from the efficiency gains that come from an extended stay-out.1

In the extreme, a materiality threshold of 10%, for example, would indicate that for an event to qualify as exogenous in terms of its materiality, it must be at least $192.19 million ($1,921.9 million revenue requirement x 10%, using the Company's cost of service filed in this proceeding). The likelihood of a single event meeting this criteria is exceedingly rare, meaning the Z-factor, in practice, would be effectively rendered moot.

Additionally, PURA provided no basis for how it determined a threshold of 0.75% was appropriate. In fact, in its proposed final decision, PURA stated, "[t]he threshold [of 0.75%] better aligns with the thresholds established in other PBR jurisdictions," and then provided the following footnote referencing those other jurisdictions, each one of which is substantially below the 0.75% it proposed:

> "*Hawaii set thresholds equivalent to 0.2%, 0.25%, and 0.28%; Ontario set a threshold equivalent to 0.5%; Massachusetts set a threshold equivalent to 0.37%; and Alberta Utilities Commission set a threshold equivalent to 0.25*%."

The Company's proposed Z-Factor of 0.5% *is* more closely aligned to those other jurisdictions.