Date Filed: September 03, 2026

Witness: Douglas P. Horton
Request from: Office of Consumer Counsel

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.

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 <u>going-in revenue requirement</u> 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) **Positive #2: 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) **Positive #3: 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) **Negative #3: 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

[1] The Company is neutral to whether Rate Year capital is included as an adjustment to base rates or is contemplated by operation of the F-Factor, as it was under the CT-Bar construct. However, for evidentiary purposes, the Company needed to include both potential outcomes in its filing.

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.