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Witness: Donald J. Scacco Jr., Digaunto Chatterjee and Douglas P. Horton
Request from: Department of Energy and Environmental Protection

Question:

(PBR) Refer to CLP-PBR-1, p. 8 and 66) and CLP-ELP-1 pg. 115-116. In your testimony it states that the purpose of PBR implementation is to effectively "mimic the forces that would have been in play if there was competition" where firms "compete to provide the best service at the lowest cost through effective operations" (CLP-PBR-1, pg. 8). Please provide greater support for why the company feels these incentives/penalty levels will achieve the objective of PBR by mimicking competitive market forces to provide the best/lowest cost service.

Response:

The objective of performance-based regulation is to replicate the economic incentives that encourage firms in competitive markets to improve efficiency, control costs, and maintain high-quality service that their customers will want to purchase. CL&P's proposed Performance-Based Multi-Year Rate Plan ("PBMRP") seeks to achieve these objectives through an integrated framework of efficiency incentives, financial rewards and penalties for performance, and customer safeguards.

For example, the I–X revenue adjustment mechanism and cap on capital funding creates the same conditions that firms in a competitive industry face because they cannot themselves influence the price of their product and have to stay in line with industry trends. The PBMRP gives the Company a pre-set and externally indexed amount of budget to spend. That will discipline the Company in seeking out achievable efficiencies, as discussed on page 18 of CLP-PBR-1.

In addition, the Company has proposed a $10 million maximum penalty pool and $5 million maximum incentive pool for the performance incentives. These measures are intended to ensure quality of service and other performance objectives are top of mind for the Company, by virtue of the meaningful financial consequences that influence the Company's operational decisions. As discussed in CLP-ELP-1, the $10 million penalty pool represents approximately 0.5% of distribution revenues, and is tied to the exogenous cost threshold, which the Company considers financially significant without jeopardizing its financial stability. The smaller $5 million incentive pool is intended to encourage performance improvements while limiting additional costs to customers. This asymmetrical structure creates a stronger deterrent against service deterioration while also motivating improvements.

The allocation of the penalty structure reinforces the importance of reliability, with 70% ($3.5 million in potential penalties assigned to each of Blue-Sky SAIDI and SAIFI) and the rest (30% or $3 million) to customer service performance. The incentive pool also has greater amount allocated to reliability ($3 million), with remainder ($2 million) allocated to customer service improvements. Furthermore, the PIMs use a sliding-scale structure, which provides progressively greater financial consequences as performance deviates from established targets. This is discussed on page 116-117 of CLP-ELP-1.

Together with the overall revenue adjustment mechanism, and financial incentives and penalties seek to mimic competitive market pressures by rewarding operating efficiencies while deterring reliability or service quality degradation and encouraging improvements. The Company has proposed penalties and incentives at these levels in order to strike a reasonable balance between providing meaningful financial incentives, protecting customers, and maintaining financial stability so that the financial impact (positive or negative) does not have an out-sized impact on the Company's financial performance in either direction.