Date Filed: November 03, 2026

Witness: Matthew P. Fallon
Request from: Public Utilities Regulatory Authority

Question:

(REGULATION) Explain whether the Company has raised any capital (debt at the company level or equity at the corporate holding company level) since its last rate case and at what rates. Provide all amounts, issuance dates, the purpose for the capital, the provider of the capital, etc.

a. Does the company have any indication that its recent cost of capital is higher (a premium) or lower (a discount) compared to similar offerings by other electric utilities?
b. Do revenue stabilizing and cost-tracking mechanisms (e.g., RAM, decoupling, capital trackers) affect investor's interest in investing in the Company and the required rate of compensation? Explain.

Response:

a. Please refer to the ALLCO-143, Attachment 1, and ALLCO-143, Attachment 2, for details on the CL&P long-term debt issuances since January 1, 2018. For each of these issuances, the Company engaged investment banks to issue the long-term debt to institutional investors in the public market. The long-term debt was issued at rates consistent with market rates for instruments of similar maturity and risk. Within the ranges of coupon rates obtained by the Company, the Company does not have the necessary information available for peer companies to be able to assess whether the Company's recent cost of capital is higher or lower than other electric utilities making similar solicitations to the marketplace.

b. This question encompasses two distinct concepts. With respect to the first concept, the answer is yes – the existence of stabilizing and cost-tracking mechanisms has a strong nexus to investor interest. Investors are putting their money (and money they maybe managing for others) into Eversource Energy and its operating affiliates and the lack of timely and adequate recovery of capital investment makes that investment riskier (or even too risky) than investing with other utilities that have that have sufficient recovery paths in place. As a result, without those mechanisms, investor interest in Eversource Energy would be severely diminished in favor of utility holding companies that have mechanisms in place that do track investment on a timely and adequate basis. This is a very real dynamic for Eversource Energy and its utility operations. Investors have a strong interest in understanding and have a line of sight into the ability of the operating companies to recover their capital investment on a timely and adequate basis (and at a fair rate of return) and substantial dialogue with investors and *potential* investors focuses on that specific topic.

The second concept raised in the question is related but distinct. This concept is whether the existence of revenue stabilizing and cost-tracking mechanisms (such as RAM, decoupling and capital cost recovery mechanisms) affect the "required rate of compensation." Please refer to the Company's response to RRU-123[i], for a detailed discussion of this concept. On this point, the answer is multi-part. Yes, having mechanisms in place that, collectively, function well to allow the utility to recover its costs on a timely and adequate basis should be considered in setting the "compensation" due to investors, given that investors are being compensated for the risk of their investment in the utility companies.

That said, constitutional law principles require that the evaluation of investor risk must be undertaken in relation to "similarly situated" companies operating with a similar risk profile. Thus, the methodological approach to setting ROE in a base-rate proceeding is to base the economic and financial analysis driving the ROE estimation on a proxy group of similarly situated utility companies. Where those companies have similar mechanisms in place, the risk profile is similar and thus, "compensation" of risk associated with those mechanisms is embedded in the proxy group data.

Prior Referenced Response:

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[i] RRU-123 Question:

(CAPITAL MARKETS) Explain how the Earning Sharing Mechanism (ESM), Revenue Adjustment Mechanism (RAM), revenue decoupling, and capital trackers each individually, and also collectively, impact the Company's revenue risk and the cost of capital? Explain.

RRU-123 Response:

This question indicates a fundamental conceptual error, which is that the Company's "risk" with and without a mechanism can be discretely evaluated and keyed to a specific increment on the return on equity ("ROE"), which it would not be appropriate, for the following reasons.

Cost of equity analyses rely on market data for the proxy group companies and the evaluation of a change in the Company's risk (and ultimately its ROE) is properly derived as a comparison with the proxy group. To the extent that the proxy group companies have similar mechanisms as the Company, the effects of those mechanisms are reflected in the market data that has been used in the analysis.

As shown in Exhibit CLP-ROE-9, Ms. Bulkley conducted an analysis to determine whether the operating subsidiaries of the companies in her proxy group have one or more of three specific ratemaking mechanism in place, which are: (1) either a partially forecast or fully forecast test year; (2) a revenue decoupling mechanism or other clause mitigating volumetric risk; and/or (3) a form of capital cost recovery between rate cases. As discussed on page 67 of Ms. Bulkley's direct testimony, Ms. Bulkley concluded that the timeliness of CL&P's cost recovery through regulatory adjustment mechanisms is similar to the proxy group. Therefore, the existence of these mechanisms cannot be

considered in isolation as evidence of lower risk or a lower cost of capital because comparable risk-mitigating mechanisms are already prevalent in the proxy-group market data used to estimate the Company's cost of equity.

Thus, the relevant question is not whether an individual mechanism mitigates a particular risk, but whether the Company's overall risk, after considering the operation of these mechanisms and the risks that remain, is materially different from the risks reflected in the proxy group.

As it relates to how the Earning Sharing Mechanism (ESM), Revenue Adjustment Mechanism (RAM), revenue decoupling, and capital recovery mechanisms, individually, and also collectively, impact the Company's revenues, please note the following:

- **Earnings Sharing Mechanism (ESM):** As proposed by the Company, the ESM can only serve to lower revenues in the future versus what revenues would otherwise be, in the absence of the ESM. Under the Company's proposal, the ESM will only be triggered in situations where the Company earns above (not below) its authorized return on equity. In this way the ESM does not decrease or mitigate revenue risk to the Company, but instead serves as a customer protection during the course of the PBMRP to ensure that rates are not inadvertently set too high during the course of the plan. Because the ESM does not provide corresponding protection when the Company earns below its authorized ROE, it does not mitigate the Company's downside revenue or earnings risk and therefore does not provide a basis for concluding that the Company's cost of capital is lower.

- **Revenue Adjustment Mechanism (RAM):** The RAM annually reconciles a number of reconciling rate components including the Non-bypassable Federally Mandated Congestion Charge (NBFMCC), the transmission adjustment clause (TAC), the system benefits charge (SBC), competitive transition charge (CTA), electric system improvement charge (ESI), and the revenue decoupling mechanism (RDM), which is described below. The vast majority of costs collected through the RAM are costs necessary to support state mandated public policy programs. The RAM ensures that customers pay no more and no less than the cost of these programs by annually reconciling rates to reflect the cost of the programs. These programs would not be able to continue in the absence of the RAM, requiring the state to decide to either abandon them or to identify an alternate funding source other than through electric rates. Therefore, the RAM does not mitigate the Company's downside Revenue of earnings risk and does not provide a basis for concluding that the Company's cost of capital is lower.

Revenue decoupling (RDM): Revenue decoupling was enacted by the legislature in order to ensure that utilities as program administrators of Energy Efficiency programs do not have a financial disincentive to aggressively pursue energy efficiency programs. Without RDM, utility revenues would increase as customer usage increases-which means that the RDM is limiting upside and downside potential, symmetrically. The RDM serves to "decouple" the level of revenues from the level of underlying sales volumes so that -- in the end -- the utility recovers the level of revenues authorized by PURA, nor more and no less. The RDM provides a more predictable level of revenues annually than in the absence of decoupling for both the Company and its customers, but also means that revenue increases for any reason (weather, electrification, economic development, increased customer usage, or other factors) are subsumed by the RDM and returned to customers through operation of the mechanism, rather than being available to the Company as a revenue opportunity.

- Capital recovery mechanisms, like reconciling mechanisms for non-capital items, are utilized to provide support for the underlying capital program and are typically implemented in lieu of sequential rate case filings. In the absence of a capital recovery mechanism, if the level of authorized revenues are insufficient to support the costs of incremental necessary capital requirements, the utility's recourse is to file a full

distribution rate case in order to get the costs associated with the capital investment reflected in rates (i.e., depreciation, property taxes, and the cost of capital).

Collectively, these mechanisms reduce particular risks within the Company's regulatory framework, but these mechanisms do not convert the Company's operating revenues or earnings risk-free revenue streams. Instead, these mechanisms address different risks and operate differently than the base-rate construct. For example, the RDM mitigates volumetric revenue risk; the RAM reconciles imbalances between costs and revenues; capital recovery mechanisms account for the revenue requirement on capital investment between rate cases; and the proposed ESM limits the earnings available to the Company above its authorized ROE without providing corresponding protection against earnings below that level. The appropriate cost-of-capital question therefore is not whether these mechanisms provide any risk mitigation. Some clearly do. The question is -- after consideration of their design and operation together with the Company's remaining business, regulatory and financial risks – *whether the Company's overall risk is materially lower than the risks already reflected in the proxy-group market data.* Ms. Bulkley's analysis indicates that it is not, because comparable adjustment mechanisms and forms of timely cost recovery are prevalent among the proxy-group utilities.

The credit-rating agencies' reports and methodologies reinforce the importance of that distinction. Moody's recognizes revenue decoupling and timely capital recovery as credit supportive, but it also identifies the regulatory environment and financial performance as material credit considerations. Fitch likewise identifies the stability and predictability of earnings and cash flow, together with financial metrics, as relevant to CL&P's credit profile. Accordingly, these mechanisms should be evaluated as components of the Company's overall regulatory framework, not as isolated adjustments that can simply be translated adjustments to cost of capital.