Date Filed: September 15, 2026

Witness: Douglas P. Horton, Julia Frayer, Matthew Nelson and Michael Goldman
Request from: Office of Consumer Counsel

Question:

Performance Based Ratemaking Panel Exhibit CLP-PBR-1
Please explain the relationship, under the Company's proposed framework, between a utility's relative cost efficiency and the appropriate level of the Consumer Dividend.

a. Specifically, all else equal, would a utility whose OM&A costs are materially above its peer benchmark warrant a higher, lower, or unchanged Consumer Dividend relative to a utility whose OM&A costs are below its benchmark?

b. Please explain the economic rationale for the Company's answer and how that rationale was applied to the Company's proposal.

Response:

a. All else equal, a utility whose OM&A costs are materially above the benchmark would generally warrant a higher Consumer Dividend than a utility whose costs are below benchmark, because the former has greater potential for catch-up efficiency improvements. As explained in Section 2 of Exhibit CLP-PBR-3 and illustrated in Figure 4, a relatively less efficient utility may have greater opportunities to "catch up" to the industry's efficiency trajectory by adopting technologies or practices already implemented by more efficient peers. The Consumer Dividend reflects the potential for such improvements beyond the industry productivity trend.

   However, the "benchmark gap" or the percentage difference between CL&P's actual costs and the applicable benchmark cost, does not mechanically determine the annual Consumer Dividend. As explained in Section 5 of Exhibit CLP-PBR-3, benchmarking identifies relative cost performance and potential opportunities for improvement; it does not establish the annual rate at which those improvements can reasonably be achieved or that the entire gap can be eliminated within a single PBR term.

   For CL&P, the above-benchmark OM&A results support a modest Consumer Dividend in its OM&A-only revenue adjustment mechanism, as discussed in Exhibit CLP-PBR-3. In determining the appropriate magnitude, LEI also considered CL&P's favorable overall cost performance and relevant regulatory precedents. Please refer also to the Company's responses to OCC-431[i] and OCC-443[ii].

b. The economic rationale for this response is that benchmarking identifies relative cost performance and potential opportunities for improvement, but the actual Consumer Dividend earned is based on measured results. The Company applied this rationale in two steps, because the proposed Consumer Dividend is not a fixed number. The Company's relative cost position determined where the dividend starts, as described in part (a) and in the Company's responses to OCC-431 and OCC-443. The Company's actual performance as part of a performance-based rate determines whether it increases or stays at the floor.

   The dividend begins at 0.30 percent and moves each year based on measured results: up 0.10 percentage points in a year when the Company's Core Operating Expense per customer is below the inflation-adjusted benchmark, down 0.05 percentage points when it is not, and never below the 0.30 percent floor. The steps are deliberately asymmetric in customers' favor: the dividend rises twice as fast on demonstrated efficiency as it declines otherwise, and it can never fall below its starting level. The level customers receive therefore reflects how the Company actually performs, not a one-time judgment made before the period begins. An illustration of the mechanism's operation is provided in the Company's response to OCC-423[iii], and a historical illustration in the Company's response to OCC-432[iv].

The efficiency incentive in the Revenue Cap Formula is the I minus X structure, combined with the power of the stay-out requirement. The Consumer Dividend supplements that structure and is deliberately sized small enough to preserve the incentive that produces the gains to be shared. The design shares efficiency -- as it is demonstrated -- rather than assuming it in advance. If the Company outperforms the benchmark, the dividend rises automatically during the term, up to the top of the approved range; if it does not, customers keep the guaranteed minimum every year. Because the rate at which efficiency gains can be sustainably achieved cannot responsibly be set in advance (please refer to OCC-443, parts (d) and (e)), the mechanism determines it from actual results, and an efficiently operating company returns more to customers than a fixed value would, both during the term and through the full rebasing of its relatively lower cost level at the next rate case. The design protects customers on the downside, and any reduction in Core Operating Expense per customer that improved near-term earnings would register against the benchmark and increase the dividend, converting that reduction into an automatic, growing customer credit.

Prior Referenced Responses:

[i] OCC-431 Question:

Exhibit CLP-ELP-1 Please explain in detail how the Company determined that a minimum of 30 basis points for the S Factor (Customer Dividend) is appropriate, including all analyses, assumptions, benchmarks, or other considerations relied upon in selecting 30 basis points. Please identify and compare the stretch factors adopted in other jurisdictions

that the Company considered in developing its proposed 30-basis-point minimum, including the jurisdiction, utility, applicable percentage or basis-point adjustment, and date and docket of adoption.

OCC-431 Response:

Please refer to Exhibit CLP-PBR-3, particularly Section 5, at pages 36-37, Figure 16 at page 38, and page 58, of Exhibit CLP-PBR 1. As discussed there, LEI concluded that the proposed 0.30% Consumer Dividend is reasonable in light of CL&P's benchmarking results. Moreover, LEI reviewed the other jurisdictions in Figure 16 of Exhibit CLP-PBR-3, as a reasonableness check and CL&P's proposed 0.30% falls within the range of Consumer Dividends or stretch factors adopted in other North American PBR frameworks.

[ii] OCC-443 Question:

Exhibit CLP-PBR-1 PBR Testimony Please explain quantitatively how LEI's benchmarking results support a 0.30% Consumer Dividend. Please explain how the Company's proposed 0.30% Consumer Dividend was derived from or otherwise informed by:

a. The Company's 22.9% average OM&A cost gap under the unit cost benchmarking analysis;
b. The Company's 11.9% average OM&A cost gap under the 2015–2024 econometric benchmarking analysis; and
c. The Company's 16.4% average OM&A cost gap under the 2021–2024 econometric benchmarking analysis.
d. Please provide any calculations, assumptions, analyses, or methodologies used to translate the identified efficiency gap into an annual achievable improvement.
e. Please explain why the widening gap does not support a Consumer Dividend greater than 0.30%, and provide all analyses relied upon in reaching that conclusion.

OCC-443 Response:

LEI did not derive the proposed 0.30% Consumer Dividend by applying a mathematical formula to any of the benchmarking gaps identified in parts (a) through (c). LEI's quantitative analysis was focused on the benchmarking itself. As explained in Exhibit CLP-PBR-3, LEI performed a unit cost analysis followed by an econometric analysis of the Company and the other 88 peers nationally. The benchmarking results measure CL&P's relative cost position compared with the average of all utilities (for the unit cost benchmarking) or a model-predicted benchmark for the Company's costs (for the econometrics benchmarking). A benchmarking study will report out relative efficiency, but it cannot measure the amount of cost reduction that can reasonably and sustainably be achieved in any particular year of the PBMRP, as explained in Exhibit CLP-PBR-1. Therefore, LEI examined what other jurisdictions have approved for stretch factor/consumer dividend, especially when the target utility is an average performer like CL&P. Please see Section 5 of Exhibit CLP-PBR-3.

The 22.9% result represents the average amount by which CL&P's OM&A cost per customer exceeded that of the national industry average under the unit cost benchmarking analysis. As LEI explains in Section 1.1 of Exhibit CLP-PBR-3, the unit cost analysis is an initial step in benchmarking analysis. Unit cost benchmarking does not control for differences in operating conditions and important business factors among utilities that will impact costs, such as the scale of business, the network composition, local costs of labor, etc. For that reason, the unit cost benchmarking results are not directly informative of a stretch factor for a utility, especially if the data allows for more rigorous econometric analysis.

The 11.9% result provides a more refined measure of CL&P's relative OM&A cost performance. Indeed, the econometric analysis takes account of such factors such as input prices, scale, and network characteristics. As the 11.9% remains a measure of the level of CL&P's costs relative to the model-predicted benchmark over the historical

period (2015-2024), it does not provide guidance on future efficiency gains and must be interpreted cautiously. In addition, LEI considered the broader peer distribution in looking at the OM&A benchmarking results. CL&P ranked 54th out of 88 utilities based on its average result over the 10-year period, placing it within the broad middle of the group. Accordingly, its above-benchmark OM&A costs represent an area for potential improvement, but are not an unusually large or extreme result relative to its peers. Those observations support a positive but modest Consumer Dividend, which based on LEI's collation of data from other jurisdictions, would be 0.30% as discussed in Section 5 of Exhibit CLP-PBR-3.

The 16.4% result comes from the econometric analysis of CL&P's OM&A costs against model-predicted benchmark, but for a much shorter period (2021-2024). Importantly, the recent-period results continue to show favorable overall cost performance: capital costs averaged 16.5% below benchmark (see Figure 15 in Exhibit CLP-PBR-3) and total costs averaged 3.1% below benchmark. As discussed in the Company's testimony, recent O&M cost pressures may include labor and vegetation management, as well as storm-related expenditures. Nevertheless, these provide context for the more recent period but do not establish the extent to which any individual cost category contributed to the 16.4% econometric benchmarking result or whether the same conditions will persist during the PBMRP term. Thus, the 16.4% OM&A result implies that additional operating-efficiency opportunities may exist, but does not give us any direct indication for how to size the Consumer Dividend.

LEI did not perform a calculation that converts the 22.9%, 11.9%, or 16.4% benchmarking differences into an annual achievable productivity improvement, and therefore there are no such calculations to provide. Such a calculation would not be methodologically appropriate because the benchmarking analysis looks at various measures of productivity at a given point of time, and does not say anything about the prospective rate at which cost differences can reasonably and sustainably be eliminated over the next few years. LEI used the benchmarking results as empirical evidence of relative efficiency and confirmation that there is some room for improvement. LEI then considered regulatory precedent for Consumer Dividends and stretch factors, which suggested that regulators have used values ranging from 0.15% to 0.60% for other EDCs, with lower values for those that are more efficient and higher values for those that are very inefficient. LEI then finds the value of 0.30% as a reasonable starting point for the Company's proposed Consumer Dividend.

Two further points place the proposed 0.30 percent in context. First, as shown in Figure 16 of Exhibit CLP-PBR-3, the Consumer Dividends and stretch factors approved in other jurisdictions range from 0.15 percent to 0.60 percent. The Massachusetts consumer dividends in Figure 16 are also conditional on inflation: those mechanisms pay 0.25 to 0.40 percent only when inflation exceeds two percent, reduced amounts at lower inflation, and nothing in low-inflation years. The Company's proposed 0.30 percent applies in all inflation conditions, so the guaranteed minimum benefit to customers is at or above the effective minimum of every mechanism in the comparison.

Second, the comparison is most direct when each mechanism is measured against the base to which it applies. The Company's S-Factor applies to the Core Operating Expense revenue requirement only, because capital is recovered through the separate Capital Funding Mechanism (Exhibit CLP-IAP-1 at 73). The most directly similar plans — an apples-to-apples comparison — are those in which regulators approved an OM&A-only revenue cap: National Grid in Massachusetts, with a 0.40 percent consumer dividend payable only when inflation is at least two percent, and FortisBC in British Columbia, with a 0.25 percent stretch factor (Exhibit CLP-PBR-1 at 47; Exhibit CLP-PBR-3, Figure 16).

Finally, the proposed design bounds its own ceiling. Because the S-Factor begins the first rate year at 0.30 percent and each year's result adjusts the level applied in the following rate year, the level can adjust no more than three times over the four-year term, and the highest level the mechanism can reach is 0.60 percent.
The illustrative calculation of how the Consumer Dividend operates over the PBMRP term is provided in OCC-432, Attachment 1.

[e] Q: *Please explain why the widening gap does not support a Consumer Dividend greater than 0.30%, and provide all analyses relied upon in reaching that conclusion.*

As discussed above in a – d, a benchmarking difference represents a measure of relative cost performance and should not be translated directly into an annual Consumer Dividend.

Finally, 0.30% is the floor, not the ceiling, under CL&P's proposed mechanism. As explained in Exhibit CLP-PBR-1 at page 64, the Consumer Dividend can increase during the PBMRP term if the Company outperforms the applicable controllable O&M benchmark. Thus, the proposed design provides customers with additional benefits if CL&P achieves greater operating efficiencies than assumed in establishing the initial Consumer Dividend.

The Consumer Dividend is an affordability mechanism. As such, it must be evaluated for both providing a benefit to customers, as well as for sustainability. A dividend set too low forgoes customer benefit, while a dividend set beyond sustainably achievable efficiency would function as a rate reduction unsupported by actual cost performance. The proposed design addresses the scale question through movement rather than starting magnitude. The level begins at 0.30 percent, can never fall below that level or become a surcharge (Exhibit CLP-PBR-1 at 64), rises automatically as the Company demonstrates efficiency, and is applied against the Company's O&M revenue requirement under the PBMRP. Unlike an earning sharing mechanism, which provides customer benefits only when earnings exceed the allowed return on equity, this mechanism will share the costs the Company controls, even when under its allowed rate of return. The consumer dividend design provides customers with efficiency gains during the plan term without waiting for the next rate case, and at the next rate case all achieved efficiencies are reflected in rebased rates in full.

[iii] 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) **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) **Positive #4: 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.

Unworkable Features of PURA's RE01-PFD:

1) **Negative #1: 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 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.

[iv] OCC-432 Question:

Exhibit CLP-ELP-1 Please provide a historical calculation of the S-Factor for each of the last 20 years using the methodology proposed by the Company. For each year, provide (a) the Company's Core Operating Expense per customer; (b) the applicable inflation-adjusted benchmark; (c) the percentage by which Core Operating Expense per customer was above or below the benchmark; and (d) the resulting S-Factor that would have applied under the Company's proposed methodology. Please provide all calculations in an unlocked Excel workbook with formulas intact.

OCC-432 Response:

Please refer to OCC-432, Attachment 1. This Attachment provides a historical calculation of the S-Factor for each of the years 2018 through 2025 using the methodology proposed by the Company in this rate case. Any hypothetical calculations going back beyond 2018, the time of the last rate case, would not provide reliable data and would be difficult to create. Financial definitions and systems change over time, as well as base assumptions. The methodology to derive an S factor for O&M needs to be anchored to a rate-case-approved Core Operating Expense level. It can only be built consistently from the current chart of accounts and current tracker structure (i.e., cost categories cannot accurately be compared if cost categories have changed). Since the recovery mechanism and accounting treatment of

various costs changed materially over the prior decade (e.g., storm reserve, vegetation management program), a pre-2018 Core Operating Expense would be based on a different set of assumptions and could not be compared.

The hypothetical calculation assumes two 4-year PBMRP plan terms during the 8-year period. The benchmark for the consumer dividend uses the Company's Core Operating Expense and customer count based on the data from the most recent rate case in Docket No. 17-10-46. The benchmark is then reset in 2022 for the next four years based on actual 2022 data.

In the attached spreadsheet, a floor of 0.30% is set for each PBR term as proposed in the Company's filing.

There are three sheets in the Excel version of OCC-432, Attachment 1, that provide:

- At Page 1, INPUTS: For each year 2018 through 2025: the historical customer count, core operating Expense, and inflation adjustments. In addition, this section provides a list of any other assumptions used.
- At Page 2, O&M TRIGGER: Calculates the applicable inflation-adjusted benchmark, the annual Core Operating Expense per customer for each year 2018 through 2025, and determines whether the Core Operating Expense is above or below the benchmark.
- At Page 3, RACHET ENGINE: Illustrative calculation of the S Factor for each year of the two hypothetical rate plan terms and the $/customer incurred each year.