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Witness: Donald J. Scacco Jr., Digaunto Chatterjee, Douglas P. Horton and Julia Frayer
Request from: CLF and Acadia Center

Question:

(Productivity Factor) Please refer to the Company's cost-of-service/rate-base-driven earnings model.

a) Explain why a capital-expense-based productivity factor calculated against customer growth is an appropriate basis for setting the revenue cap, given that the Company earns a return on capital additions to rate base regardless of whether customer count increases.
b) State whether the Company agrees that it has a financial incentive to increase capital spending independent of customer growth. If not, please explain the basis for disagreement.

Response:

a) Although LEI's Industry TFP Study calculates both a total factor productivity ("TFP") trend and capital and OM&A partial factor productivity ("PFP") trends, the Company is not proposing to use the TFP, nor the capital PFP, under its proposed revenue adjustment mechanism. The Company's proposed X Factor is based on the industry OM&A PFP and applies only to the OM&A component of the Company's revenue requirement. Capital costs are addressed separately through the Company's proposed capital funding mechanism.

   LEI uses customer count as the output measure in calculating OM&A PFP because it provides an objective, consistently defined, and comparable measure of physical output of electric distribution utilities over time. Please refer to the Company's response to CLF-AC-018[i]. The use of customer count as the output metric does not mean that customer growth is a prerequisite for recovery of costs or that capital investment must be directly caused by customer-count growth. Rather, the OM&A PFP measures how the quantity of operating inputs required to provide distribution service has changed over time relative to the quantity of outputs (customer count).

b) The Company does not agree it has an incentive to increase capital spending irrespective of system needs or customer growth. Capital investment is required for myriad reasons other than growth in customer count, including replacement of aging infrastructure, reliability, resiliency, safety, and public policy (for example, electrification, integration of distributed resources, and other evolving system and regulatory requirements). The Company has no financial incentive to invest capital that is not necessary in its obligation to safely and reliably serve its customers.

Prior Referenced Response

[i] CLF-AC-018 Question

(Productivity Factor) Refer to Exhibit CLP-PBR-2, p. 12, and the Study's use of "number of customers" as the output metric in the index method. Explain why the Study uses number of customers as the output metric, and state whether the Company agrees that growth in customer count is not a goal the Company can materially influence, depend upon, or utilize as a justification for seeking an increased revenue requirement.

CLF-AC-018 Response

Exhibit CLP-PBR-1, pp. 34–36 discusses the reasons for using the number of customers served as the output metric in LEI's Industry TFP Study. Customers served are commonly used as the output metric in TFP studies of the electric distribution industry. The goal of a TFP study is to identify output in physical unit terms. The use of Customer count fits this requirement. Customer counts are objective, consistently defined, and readily available across EDCs, allowing for meaningful comparison over time and aggregation across utilities. In contrast, electricity sales can be materially affected by factors largely outside a utility's control, including weather, economic activity, changes in customer usage, electrification, and the addition of large loads. Changes in electricity sales therefore do not necessarily reflect changes in an EDC's underlying productivity. In addition, EDCs invest in and maintain distribution infrastructure to provide customers with safe and reliable access to electricity and sufficient capacity to meet system demand, rather than to deliver a specific volume of electricity over the course of a year. Accordingly, LEI determined that the number of customers served provides a stable and comparable measure of the scale of distribution service for purposes of measuring industry productivity.

The Company agrees that growth in customer count is largely driven by factors outside the Company's control and that customer count growth, by itself, is not a justification for seeking an increased revenue requirement. The use of customer count in LEI's Industry TFP Study is intended to measure productivity trends; it is not intended to be interpreted as a business objective, where increasing the number of customers is a Company goal or, standing alone, a basis for increasing the Company's revenue requirement.