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

Question:

(Total factor productivity) Refer to Exhibit CLP-ELP-2, Page 35, Foot note 52, LEI states that "*LEI also evaluated the Handy-Whitman Index (" HWI") of public utility construction costs as a potential capital price deflator. LEI ultimately selected the BLS Producer Price Index for two primary reasons. First, unlike the PPI, the HWI is proprietary, and its w1derlying methodology and data are not publicly disclosed, making it difficult to independently evaluate or replicate the resulting estimates. Second, sensitivity testing demonstrated that use of the HWI generated implausibly large real retirement values for certain utilities, resulting in negative estimates of real capital stock under the perpetual inventory method. These outcomes are not economically plausible ai1d would have necessitated the exclusion of affected utilities from the sample. The issue became more pronounced under assumptions of longer asset service lives (i.e., 40, 45, and 50 years).*" Please explain the Company's use of the Handy-Whitman Index ("HWI") in Exhibit CLP-IAP-7 with LEI's decision not to use HWI as a capital price deflator in Exhibit CLP-PBR-2. Specifically:

a. Please explain why the Company considers HWI to more accurately reflect how inflation impacts Distribution Companies within the region and to be the appropriate inflation factor for the Exhibit CLP-IAP-7 - RE08 affordability test, while LEI determined that HWI presented methodological and data limitations, including lack of transparency and replicability and, in certain applications, economically implausible estimates of real capital stock.
b. Please recalculate Tables 3 and 4 of Exhibit CLP-IAP-7 using a consistent inflation measure for both historical and forecast spending, including, at minimum, HWI and the BLS PPI used by LEI in Exhibit CLP-PBR-2, and provide the resulting affordability threshold and percentage of the threshold represented by the proposed LRP.

Response:

As stated in Exhibit CLP-IAP-1 and Exhibit CLP-IAP-7, the Company does not agree that the RE08 affordability test is a sound approach for determining whether utility service is affordable. The test is allegedly designed to account for "reasonable escalation factors," however, determining those "factors" is a difficult exercise and, in any event, would need to account for multiple externalities, such as inflation, infrastructure aging, exogenous grid stressors like weather events and electrification and standardized equipment sizes, among numerous other factors.

The Company's testimony in CLP-IAP-1 demonstrates that it seeks to balance affordability and reliability, with a recognition that these concepts are inter-related and move together over the relevant time horizon. As previously stated, a system that is allowed to degrade does not become more affordable; it becomes less reliable and, in time, more expensive to maintain and fix.

The Company applied the RE08 affordability test illustratively, as a condition of the Order and, as shown in Exhibit CLP-IAP-7, the proposed capital plan is within the resulting threshold. Although the Company complied with the RE08 affordability test requirements, the core premise of the affordability test is that historical spending dictates future spending adjusted for inflation. This does not account for the fact that maintaining historical performance, as the PBMRP performance framework requires, comes at an increasingly higher cost, for a multitude of reasons including inflation. However, even if adjusting inflation provided the Company with additional revenue support to do the same type of project each year as a theoretical matter -- what matters is the scale and magnitude of infrastructure investment or upgrades is needed each year, along with numerous other drivers of infrastructure cost that are not necessarily captured in inflation measures.

As infrastructure ages, significantly more assets need to be replaced either proactively or as emergent failures. Short-term underinvestment increases the age and the number of failures of the assets that then need to be replaced as emergent failures. Other important factors that drive costs up are regulatory, safety and environmental constraints and considerations. For example, new equipment and work method standards to promote customer and worker safety and resilience mean that, even if the Company were to perform the same project today as it did years ago, it would cost more today for these reasons, even if the costs were to be adjusted for inflation.

To illustrate this practicality, Eversource's ReBOT tool that determines the optimal reliability mitigation for each eligible zone and thereby constructs a cost-optimal reliability program, demonstrates that the same dollar spend results in progressively lower benefits to reliability metrics. This is because, as zones with multiple events or customers impacted and cheaper solutions are addressed, more costly solutions are the only ways remaining to retain or further improve reliability metrics. For example, the model will prioritize short zones of bare conductor with many events or customers impacted so that a less costly reconductoring project will improve reliability. Once all these opportune zones are addressed, what remains are longer zones, with less events and customers impacted, so cost per unit of reliability improvement will increase.

Instead of a singular affordability test, the Company submits that it is more appropriate to review affordability and reliability through a balancing lens, aiming to avoid both overinvestment (which can increase costs without commensurate benefits) and underinvestment (which can erode reliability, create future cost pressures, and ultimately harm customers). Ultimately, while the Company agrees with the overall emphasis on affordability stemming from RE08, as well as RE08's reliability framework, it does not agree that the inflation-based affordability test is a valid tool for determining the affordability of a capital plan.

With respect to inflation factors, LEI stated a specific concern with the HWI for estimating long term aspects of real capital stock. However, the Company continues to support HWI as the most reliable and appropriate set of inflation factors for the utility sector. The BLS PPI is a broad, national macroeconomic indicator tracking average price changes across thousands of products and industries, and the GDP Deflator Index considers economy-wide measures such as personal consumption expenditures, private domestic investment, exports of goods and services, and government expenditures and consumption. The HWI is a highly specialized index tailored exclusively to the public utility construction sector and to specific regions. Compared to other inflation indices, the HWI more accurately reflects how inflation impacts distribution companies within the region, and therefore, is the appropriate inflation factor for general utility use and any application of the RE08 affordability test.

PURA has previously noted that "the HW Index better reflects costs of utilities doing business..." Application of the United Illuminating Company to Amend its Rate Schedule, Docket No. 24-10-04, at 43 (October 28, 2025) ("UI 2025 Decision"). As PURA states, "The Handy-Whitman Index reflects escalation of utility costs over time and has an index specific to northeast utilities … the HW Index considers utility construction costs by FERC plant account (e.g., transformers, meters, overhead conductors, station equipment)." Id.

There is also no inconsistency between LEI's use of the BLS PPI in the TFP Study and the Company's use of HWI in the affordability analysis because the indices are used for entirely different analytical purposes. HWI is specifically designed to measure changes in utility construction costs and reflects cost trends for utility-specific inputs, including labor, materials, and equipment associated with distribution facilities such as station equipment, poles, conductors, conduit, transformers, and meters.

In the Industry TFP study, LEI required a capital price deflator to convert historical nominal capital additions and retirements into a consistent measure of real capital quantity for use in the perpetual inventory method. Because the reported gross book value of utility assets reflects assets acquired in different years and therefore at different historical price levels, the additions and retirements must be deflated before they can be incorporated into the real capital stock calculation. This application requires the price index to be applied over a relatively long historical period and is mathematically sensitive to the interaction among the price index, asset vintages, retirements, and assumed asset service lives. LEI had collected and tested using HWI but found it could result in mathematical irregularities because of the methodology, which would in turn impact the breadth of the industry TFP study (the number of EDCs that could be included).

As a consequence, balancing the availability of data with the constraints of the methodology, LEI determined that the BLS PPI was an appropriate index for the specific purpose of constructing a real capital-stock quantity under its TFP methodology. LEI's use of the BLS PPI, therefore supported expressing the resulting capital quantities in constant 1988 dollars. This is distinctly

different from the analysis being contemplated under RE08 affordability test, which is to inflate capital spending from 2015 to 2025 terms.

For most other purposes, including the RE08 affordability test, HWI is the most appropriate inflation index for the industry, as it takes into account utility-specific costs in the Northeast.