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

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.

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.