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Witness: Douglas P. Horton, Julia Frayer, Matthew Nelson and Michael Goldman
Request from: National Railroad Passenger Corp. (Amtrak)

Question:

Explain the basis for the proposed 0.30% consumer dividend.

a. Explain how the benchmarking results informed or influenced the proposed consumer dividend value of 0.30%.
b. Specifically identify the conclusions from the benchmarking study that were relied upon in selecting the proposed consumer dividend value of 0.30%.
c. Identify any factors beyond the benchmarking results that were considered in selecting the 0.30%.
d. Identify any alternative consumer dividend values considered and explain why those values were not selected.

Response:

LEI did not derive the proposed 0.30% Consumer Dividend by applying a mathematical formula to CL&P's benchmarking results. Rather, the benchmarking analysis provided evidence regarding CL&P's relative cost performance, which in turn suggests the potential for additional operating-efficiency improvements. In particular, CL&P's historical OM&A costs were modestly above the applicable benchmark, supporting the inclusion of a positive but moderate Consumer Dividend. As explained in OCC-443 and OCC-539, however, the percentage difference between actual and benchmark costs does not establish the annual rate at which those differences can reasonably and sustainably be eliminated and therefore was not translated mechanically into the Consumer Dividend.

LEI also considered regulatory precedent as a reasonableness check. As discussed in Section 5 of Exhibit CLP-PBR-3, approved positive Consumer Dividends and stretch factors reviewed by LEI generally ranged from 0.15% to 0.60%, and the proposed 0.30% falls within that range.

Please refer to the Company's responses to OCC-431[i], OCC-443[ii], OCC-539[iii], and OCC-543[iv], and Section 5 of Exhibit CLP-PBR-3.

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-539 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.

OCC-539 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-423iii, and a historical illustration in the Company's response to OCC-432iv.

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.

[iv] OCC-543 Question:

Performance Based Ratemaking Panel Exhibit CLP-PBR-1
Given that the proposed Consumer Dividend applies to the OM&A portion of the PBMRP, please explain why the Company's below-benchmark capital and total cost performance is relevant to determining the appropriate Consumer Dividend. In your response:

a. a.Explain the relative weight or consideration given to OM&A, capital, and total cost benchmarking results in supporting the proposed 0.30% Consumer Dividend
b. b.Explain why favorable capital performance should moderate the Consumer Dividend when capital costs are recovered outside the I-X OM&A revenue adjustment mechanism.

OCC-543 Response:

a. LEI's Benchmarking Study presented the results of three different cost models, which were individually estimated using the same econometric techniques, but in some cases different business drivers because of relevance and statistical significance. LEI did not use any weighting methodology to combine the OM&A, capital, and total cost benchmarking results, as implied in the question. Rather, the OM&A cost benchmarking results provide direct evidence regarding potential operating-efficiency improvement and support the inclusion of a Consumer Dividend for the Company's PBMRP. Capital cost and total cost benchmarking results were considered only as complementary context in assessing CL&P's overall cost performance, and reasonableness of the overall PBMRP (and not specifically the starting value of the Consumer Dividend). Please also refer to Section 5 of Exhibit CLP-PBR-3.

b. Favorable capital performance was not used as a mathematical offset, credit, or adjustment to the OM&A benchmarking result or to calculate the Consumer Dividend. As explained in response to part a), the capital benchmarking results were considered as complementary context regarding CL&P's overall cost performance. Please also refer to OCC-443[i].