THE STATE OF NEW HAMPSHIRE

CHAIRMAN
Amy L. Ignatius

COMMISSIONERS
Michael D. Harrington
Robert R. Scott

EXECUTIVE DIRECTOR
Debra A. Howland

PUBLIC UTILITIES COMMISSION
21 S. Fruit Street, Suite 10
Concord, N.H. 03301-2429

TDD Access: Relay NH
1-800-735-2964

Tel. (603) 271-2431

FAX (603) 271-3878

Website:
www.puc.nh.gov

November 5, 2013

Debra A. Howland, Executive Director
New Hampshire Public Utilities Commission
21 South Fruit St., Suite 10
Concord, NH 03301

Re: Sen. Forrester Inquiries re: Public Service Company of New Hampshire and Northern Pass Transmission LLC

Dear Ms. Howland:

By this letter I submit the report of my investigation into the issues raised in Senator Forrester's letters regarding the relationship between Public Service Company of New Hampshire (PSNH) and Northern Pass Transmission LLC (Northern Pass). It is important to note that this investigation should not be viewed as an audit of the Northern Pass project. Rather, the purpose of this investigation was to review costs originating at the PSNH level that in one way or another may have supported the Northern Pass project. As a summary of the text to follow, I can report that I did not find any evidence that PSNH or its customers are subsidizing or otherwise financing the activities of the Northern Pass project. The conclusions reached in this report are my own and are based on my review of discovery responses and other supporting documentation. To the extent additional information exists that I did not review that could alter my conclusions, I have no such knowledge.

Organization of Report

This report begins by reciting the series of correspondence that led to the investigation. That is followed by a summary of the steps taken in the investigation. Next, I describe in detail the types of costs reviewed and the results of my analysis, including analysis of the relationship between PSNH and Northern Pass. The report concludes with answers to each of the questions posed by Senator Forrester along with some general observations.

Background/Chronology of Correspondence

On August 2, 2013, Senator Jeanie Forrester filed a letter with the Executive Director of the New Hampshire Public Utilities Commission (Commission) inquiring into the relationship between

PSNH and Northern Pass. Senator Forrester's questions focused on whether or not PSNH resources were being used to support the Northern Pass project and, therefore, whether PSNH ratepayers were subsidizing the Northern Pass project. Since that initial letter was received, the following correspondence has taken place:

- Upon receipt of that letter, the Commission treated it as a complaint pursuant to RSA 365:1 and forwarded a copy of the letter to PSNH on August 7, 2013 for its response.
- On August 15, 2013, PSNH provided its response which, in summary, stated that no costs incurred by or on behalf of Northern Pass have been paid for using funds derived from rates paid by customers of PSNH.
- On September 5, 2013, Senator Forrester filed a second letter with the Commission reiterating her prior questions supplemented by two additional questions.
- On September 12, 2013, the Commission's General Counsel, F. Anne Ross, sent a letter to Senator Forrester outlining the Commission's activities in investigating the issues raised in her letters and providing preliminary responses to certain of the questions. In addition, Ms. Ross explained that Staff's investigation was ongoing and that at the conclusion of the investigation, Staff would provide a report to the Commission following which the Commission would be in a position to address Senator Forrester's questions in full and determine what, if any, further action would be appropriate.

In her letters, Senator Forrester posed the following questions:

1. Are PSNH ratepayer funds being used to support Northern Pass project expenses, including project development, lobbying, real estate acquisitions and public relations costs? Northern Pass claims to have spent $52 million through June 30, 2012; they claim they will have spent over $70 million by the end of the calendar year. Ratepayers should have a right to know who is fronting these dollars, to assure that the money is not coming from their pockets. At the moment, ratepayers are easily confused as to who is paying for what services by the use of PSNH staff to manage and staff the Northern Pass project.

2. Is there some relationship between PSNH and Northern Pass Transmission LLC that is governed by a contract that spells out the terms by which PSNH is reimbursed for the time and expenses invested by PSNH and its employees in advancing the Northern Pass project? If so, who are the parties to these contracts, what are the terms and conditions of the contracts, and who is paying whom for which expenses incurred? And, is there a sufficient accounting that clearly documents that these contracts are in fact being closely monitored and adhered to?

3. If PSNH has the staff time to allocate significant resources to the non-regulated side of their business, and specifically to Northern Pass, how can ratepayers be assured that the regulated side of the business is not overpaying for resources allocated to the regulated side of the ledger? Does the Public Utilities Commission oversee this set of

issues under current state law? If so, are there any documents or reports that explain how PSNH manages this that are available to the public?

4. Who decides if and when the resources of the regulated part of PSNH are being improperly used for non-regulated activity? How is information gathered and assessed to document that ratepayer interests are being monitored and protected?

5. Since my letter, dated August 2, to you, PSNH customers statewide have received the enclosed insert in their utility bills. Are ratepayers paying for the printing and distribution of this document, or does Northern Pass pay? How is a ratepayer to know for certain?

6. Finally, how is the PUC monitoring these transactions so that it can assure ratepayers that their pocketbooks are being properly and fully protected? Is it the PUC's responsibility to maintain a current and accurate information file of PSNH's activities?

Summary of Investigation Process and Procedures

Upon receipt of PSNH's response to Senator Forrester's August 2nd letter, Staff made a verbal request to PSNH for certain financial information relevant to the inquiries. That request was supplemented and followed up in writing on September 17th. Responses to those questions were received from PSNH on September 25, 2013 with a follow-up question sent back to PSNH on that same date. In addition, arrangements were made for an October 8, 2013 on-site visit to PSNH headquarters (a/k/a Energy Park) to review payroll records and other Northern Pass-related supporting documentation in response to my questions. Following that on-site visit, I sent another list of questions to PSNH to which I received responses on October 17th and 22nd. A final set of questions was sent to PSNH on October 31st and responses were received on November 5th. Areas of inquiry involved payroll and other costs originating at PSNH in support of Northern Pass as well as questions posed to directly address specific questions of Senator Forrester. For examination and sampling purposes, I requested all such costs incurred for the periods of October 1, 2012 through December 31, 2012 and April 1, 2013 through June 30, 2013.

During the on-site visit, I met with Northeast Utilities (NU) and PSNH personnel and reviewed detailed supporting documentation and confidential payroll information. My meetings with NU and PSNH personnel involved in-depth discussion of the nature and types of costs. I can report that throughout my investigation the PSNH and NU personnel I dealt with were very cooperative and forthcoming with the information I requested.

Cost Detail for Selected Calendar Quarters

This section of the report describes in detail the various types of costs that were charged to Northern Pass by PSNH. Total costs as reported for the two calendar quarters by PSNH that I reviewed were as follows:

	Oct - Dec 2012	Apr - Jun 2013
Payroll-related costs directly charged to Northern Pass:		
Payroll	$ 81,253.63	$ 88,052.34
Employee Benefits	54,025.54	52,754.93
Employee Expenses	4,901.44	3,325.42
Total payroll-related costs	140,180.61	144,132.69
Costs directly charged to Northern Pass using existing PSNH purchase orders:		
External Contract Labor	43,331.21	44,697.81
Air Travel to Canada	4,586.88	4,934.05
Office Supplies & Copier Expenses	2,217.40	2,281.31
Photoshop Services & Printing Fees	-	1,248.00
Other	2,684.45	3,366.08
	52,819.94	56,527.25
Costs for use of office space at Energy Park	13,081.74	14,812.87
	$ 206,082.29	$ 215,472.81

All costs that were reviewed were charged to the following specific codes in NU's accounting system, all of which are particular to Northern Pass Transmission LLC and the Northern Pass project:

Accounting Unit (i.e, the company code):	H2
Cost Control Center:	T29
Work Order #:	NPTNON11

Further, on the books of Northern Pass, all costs were recorded in FERC account #107, Construction Work in Progress, consistent with the process described in the Transmission Service Agreement (TSA) filed with the FERC in 2010 and approved by the FERC in 2011. Further discussion of the accounting for costs incurred by Northern Pass prior to commercial operation is included later in this report.

Payroll-Related Costs Directly Charged to Northern Pass

Payroll costs originated from either the PSNH payroll journal or from the payroll journal specific to PSNH's transmission segment. In other words, all payroll costs related to PSNH employees and did not include employees from any other affiliated company.

Payroll and Employee Benefits

Regarding payroll and employee benefit costs, I was initially provided with a list of PSNH employees who directly charged time to Northern Pass during the requested periods, along with the respective number of hours for each employee and the related payroll costs. As a level of further detail, I requested and was provided with the weekly time totals and costs for each employee. From there, I sat with a PSNH employee and reviewed the online daily payroll records for PSNH personnel (selected by me) from various departments. As part of that review of daily time records,

I observed that days in a particular week had anywhere from zero to eight hours charged to Northern Pass. Any Northern Pass-related hours in excess of eight on any day were tracked, but the employees did not receive additional pay nor did the extra hours get included in the cost totals. Based on that review, I did not observe any issues indicating any improper time recording by PSNH employees with respect to the Northern Pass project.

For the two calendar quarters selected, PSNH employees from various departments charged a total of 1452 hours (12 employees - 4th quarter 2012) and 1562 hours (15 employees - 2nd quarter 2013) to the Northern Pass project. The total costs, including benefits, associated with that payroll were $135,279.17 and $140,807.27 for the respective quarters. The employees who charged time to Northern Pass were from a variety of departments at PSNH and whose work activities included corporate communications, community relations, transmission engineering, governmental affairs, media relations, real estate, building services and property management.

Payroll costs for the periods reviewed did not include the payroll of the former President of PSNH, Gary Long. When PSNH was asked how Mr. Long's pay was allocated or otherwise charged to Northern Pass, the response was as follows:

> *Until 2013, Gary Long's activities relating to the Northern Pass project primarily involved negotiations regarding an economic power purchase agreement that would benefit PSNH's customer base. Therefore, that time was not charged to Northern Pass. In 2013, through the end of Mr. Long's term as President of PSNH, ten percent of Mr. Long's time is deemed to be on behalf of Northern Pass. The allocation of costs of Mr. Long's salary will be accomplished via appropriate accounting journal entries which have not yet occurred.*

As I understand that response, PSNH viewed Mr. Long's Northern Pass-related activities prior to 2013 as being done in the interests of PSNH and its customers through the attempts to negotiate a power purchase agreement. Although not stated in the response, it appears to indicate that beginning in 2013 Mr. Long's activities were more directly related to promotion of the Northern Pass transmission project. Considering the response was received in October 2013 and Mr. Long was no longer the President of PSNH, one would expect that the appropriate accounting entries would have already been recorded. However, regardless of when the accounting entries are eventually posted,[1] it is important to understand the related cost and rate implications which are discussed in the "Determination of Electric Distribution Revenue Requirements" section of this report.

Employee Expenses

Employee expenses incurred by PSNH employees and charged to Northern Pass included reimbursements for mileage, meals, cell phone costs, registration fees, hotel overnight stays and tolls. Employee costs such as mileage are included in in employee's daily time reporting, and

[1] I have requested PSNH to provide me with the accounting entries when they are recorded. It is my understanding that the entries are scheduled to posted in early November.

coded to the particular activity. With respect to Northern Pass, as part of my review of payroll, employee expenses were observed to be included and properly coded to the activity.

Costs Incurred Utilizing Existing PSNH Purchase Orders

For these categories of costs, it is important to understand the distinction of "utilizing existing PSNH purchase orders." Within the NU family of companies, certain of those companies will have open purchase orders with vendors that have been vetted through the bidding and approval process. By using those purchase orders rather than issuing new purchase orders, there is a level of administrative efficiency gained. As relates to this PSNH/Northern Pass investigation, the costs listed as "utilizing existing PSNH purchase orders" are costs that would not have otherwise been incurred and appeared as originating on PSNH's books but for the existence of those open purchase orders. Said another way, if Northern Pass had issued its own purchase orders, none of these costs would have appeared on PSNH's books at all.

External Contract Labor

All costs in this category were provided by Comensura (now known as The Guidant Group). As explained by PSNH,

> *The Guidant Group (previously Comensura) provides temporary employment services across the Northeast Utilities System (NU) including administrative functions, information technology, engineering, professional services and any other business functions within the company with a need for temporary employment service. The Northern Pass project specifically contracts for a Communications Manager (Russell Kelly) and occasionally for Engineering Support (Lorraine Shottes).*

In my review of cost information, all such Comensura costs referenced time charged by the above two referenced individuals. In addition, invoices from Comensura for Northern Pass-related work all included the particular cost center and work order codes mentioned earlier in this report. In my sampling, I did not observe any instances where costs for the Northern Pass project were charged to PSNH.

Air Travel to Canada

For each of the calendar quarters reviewed, the costs incurred involved a single round-trip flight to Canada for discussions related to the Northern Pass project. The cost totals included all taxes and fees associated with the flights. The vendor used, Wiggins Air, is a vendor that had previously been approved by NU and has been used for many years to transport employees between New Hampshire and Connecticut. All air travel costs related to the Northern Pass project were charged directly to Northern Pass.

Miscellaneous Costs – Office Supplies/Copier/Printing/Other

This variety of cost types are simply what the description implies. That is, these categories costs incurred by employees and consultants and included such things as binders, paper, pens, copier supplies and repairs, postage, printing, catering, teleconferences, etc. Again, all such costs were directly charged to Northern Pass.

Costs for Use of Office Space at Energy Park

Northern Pass currently uses office space at Energy Park that is physically separate from PSNH activities, and is charged by PSNH using a monthly calculation based on the number of full-time equivalent employees (FTEs). The monthly calculation starts with a summation of the operating costs and depreciation expense for Energy Park divided by the total number of FTEs at Energy Park in that particular month. That result is then multiplied by the number of FTEs for Northern Pass to derive the total charge to Northern Pass for use of the office space. For each of the months reviewed, the number of FTEs for Northern Pass was 10. The monthly charges are recorded on a one-month lag. For example, the monthly charge booked for October 2012 was based on total expenses for the month of September 2012. Upon review of the calculations, I did not find them to be inappropriate. As a further note, based on my discussions with NU personnel, the current plan is for Northern Pass to move out of Energy Park in the next couple of months and establish an office in a nearby non-PSNH building.

Other Subjects Addressed in Senator Forrester's Questions

Costs of Bill Insert Referred to in Question #5

PSNH was requested to provide an explanation of how the costs associated with an August 2013 bill stuffer (total of two pages, one of which discussed the Northern Pass project) were accounted for between PSNH and Northern Pass. In response, PSNH stated that 50% of the total costs, including design, paper and printing costs were charged to Northern Pass. While on-site, I requested and received copies of all invoices associated with the bill insert. The total costs consisted of two invoices: Design costs were $1,499.00 and the printing costs were $8,037.17. Upon review of the supporting documentation, I confirmed that the costs were, in fact, split 50/50 between PSNH and Northern Pass.

Relationship Between PSNH and Northern Pass

Ms. Ross' letter to Senator Forrester explained that the Commission's authority over transactions between a regulated utility and an affiliate is detailed in RSA Chapter 366, as well as in Chapter 2100 of the Commission's administrative rules (the "2100 rules"). With respect to RSA Chapter 366, the following question was posed to PSNH: "Please provide a written description of any agreements or other arrangements between PSNH and Northern Pass providing details of how the costs and any reimbursements are accounted for." PSNH responded as follows:

> *There are no written agreements between PSNH and Northern Pass responsive to this question. RSA 366:3 does not require a continuing contract or arrangement between a public utility and an affiliate. All services provided by PSNH to any affiliated entity, whether as part of general operations (such as storm assistance) or for Northern Pass, is (sic) charged directly to the affiliate and no charges occur for these costs to the originating company.*

Although there is no specific bilateral contract between PSNH and Northern Pass, on October 25, 2013 I received a copy of NU's time reporting policy which is used by all companies in the NU system. As part of the policy statement, it says,

> *The process for preparing accurate and reliable financial records begins with the proper charging of business transactions on source documents such as time reports. Each employee, and his or management, is responsible for ensuring that business activities are charged appropriately.*

The policy follows up those statements with a discussion of discipline (including discharge) for violation of the policy and further states that any deliberate violation or fraud could result in termination for the first violation. The time reporting policy describes the process for charging time appropriately, with particular emphasis on charging time directly to the individual NU companies.

> *Each subsidiary company should be charged directly, whenever possible, for employees' time. Direct charges are inherently more accurate than allocations as they reflect actual work and activities as they have occurred. Charges should be made to the subsidiary that will derive a benefit from that activity.*

As described earlier in this report, I reviewed individual PSNH employees' time records and found evidence of time directly charged to Northern Pass, consistent with the time reporting policy.

As further exploration of the relationship and any relevant agreements between the two entities, PSNH was also asked to provide its view as to whether and how Chapter 2100 of the Commission's administrative rules regarding affiliate transactions applies to the relationship between PSNH and Northern Pass. PSNH's response was that

> *Northern Pass and PSNH are affiliated entities under the definition of RSA 366:1, II and Rule Puc 2102.01. However, Northern Pass is not a "competitive affiliate" as defined in Rule Puc 2102.03, nor is it a "competitive energy affiliate" as defined in Rule Puc 2102.04. As a result, the following substantive portions of PUC Chapter 2100 appear to apply to the relationship between PSNH and Northern Pass: 2103.01, 2103.02, 2105.01 and 2105.09.*

As explained in Ms. Ross' September 15, 2013 letter, Chapter 2100 of the Commission's administrative rules (the "2100 rules")...were initially implemented in 2003 in connection with electric industry restructuring that allowed for competition with respect to electricity supply

services. The definitions of "competitive affiliate" and "competitive energy affiliate" referred to by PSNH in its response read as follows:

> Puc 2102.03 "Competitive affiliate" means any affiliate that is engaged in the sale or marketing of products or services on a competitive basis and includes any competitive energy affiliate.
>
> Puc 2102.04 "Competitive energy affiliate" means any competitive affiliate that is engaged in the sale or marketing of natural gas, electricity, or energy-related services on a competitive basis.

The types of entities intended to be captured by these two definitions can be illustrated by a simple example. Assume PSNH had two separate retail affiliates—one that was a competitive electricity supplier selling supply service to end use customers, and the other a company that sold electric hot water tanks. The supplier would be included under Puc 2102.04, and the seller of hot water tanks would be included under Puc 2012.03 as selling "products or services." The main focus of the rules was that if a regulated utility established a non-regulated competitive affiliate, that affiliate was not to have any preference with respect to things such as: access to customer information; cost/pricing advantages; and joint marketing opportunities. In other words, all competitive entities, whether affiliated or not, were to be treated the same. Major concerns about the applicability of the 2100 rules to Northern Pass involve a) whether costs charged to Northern Pass by PSNH are priced appropriately, and b) whether by allowing marketing through means such as PSNH bill inserts Northern Pass is given an unfair advantage over competitors who would not have access to such marketing mechanisms. Regarding the two definitions above, one must first understand what the entity "Northern Pass Transmission LLC" is and what it is not.

As described in the TSA, Northern Pass is an entity *"...created to develop, construct, own and maintain a 1,200 MW +/- 300 kV HVDC transmission line extending from the U.S. Border to a direct current ("DC") to alternating current ("AC") converter station to be located near the Webster substation in the City of Franklin..."* Using that description, Northern Pass does not appear to fit into either of the two definitions above. PSNH correctly points out that as an "affiliate" of PSNH, the pricing provisions of Puc 2105.09 "Transfer of Goods, Services, and Capital Assets" apply to transactions between PSNH and Northern Pass. Pursuant to that rule, services provided from a distribution company to an affiliate must be provided at the greater of the fully loaded cost or market value. Items involving joint or shared costs are required to be allocated and priced based on fully loaded costs. Having reviewed the costs involved in this investigation, I found the pricing to be in conformance with Puc 2105.09.

Of course, consistent with the TSA, the transmission line proposed to be constructed by Northern Pass will provide a means for HQ Hydro Renewable Energy, Inc (HQ), a non-affiliated contractual party, to transmit power it purchases from its parent and/or its affiliates into the New England market. While that power and its pricing would certainly compete with power produced by current wholesale generators and/or prospective project developers, it is difficult to say that because the <u>user</u> of the line would be a competitor of other entities means that the <u>owner/developer</u> of the line (who facilitates the sale of power by the user) is also a competitor. In addition, as discussed later in this report, the rate charged to HQ by Northern Pass for use of the line will be in accordance with a

formula approved by the FERC. The words "on a competitive basis" in the above definitions, however, presume the lack of such price regulation. Based on the information I reviewed, my conclusion is that Northern Pass, as currently described and based on its current status, is not a "competitive affiliate" or a "competitive energy affiliate" pursuant to the 2100 rules. I am cognizant, however, that this issue may be viewed differently by other parties. Thus, the Commission may wish to accept comment on this subject.

As further comment on the relationship between PSNH and Northern Pass, I note that the 2100 rules contain prohibitions on a distribution company providing its "competitive affiliates" advertising space in billing envelopes or access to any other form of written communication unless such opportunity is also provided to "all similarly situated non-affiliated suppliers."[2] Having concluded that Northern Pass is not a competitive affiliate of PSNH, the restrictions would not apply for the purpose of my investigation. It is interesting to note, however, that in its on-file affiliate transaction compliance filing, PSNH indicated that "*PSNH uses its billing envelope space exclusively for utility purposes.*" PSNH was asked to explain how that statement applies to Northern Pass' use of PSNH's billing insert. In response, PSNH stated,

> *One of the initial tenets of the Northern Pass project has been creation of a power purchase agreement (PPA) that would specifically benefit New Hampshire customers. That remains a high priority. PSNH is proposing a PPA for a specific portion of the energy transmitted on the Northern Pass to be purchased from Hydro-Québec, in a manner similar to past purchases by PSNH, so that New Hampshire customers would receive additional, unique, long-term benefits from the project. These benefits, which would enure to the benefit of PSNH's customers, are deemed to reflect a reasonable utility purpose.*

PSNH's explanation describes a link between the two entities (i.e., a proposed power purchase agreement) as the "utility purpose" qualification. While that may be a legitimate utility purpose, there is no such agreement in place and it is not mentioned in the August 2013 bill insert. Although I do not conclude there to be a technical violation of the 2100 rules, given the significant interest in the project and the questions raised by the bill insert, I would advise that PSNH and Northern Pass refrain from future use of PSNH bill inserts to promote the Northern Pass project.

Description of How Northern Pass Costs get Recorded and Paid (and by Whom)

A fundamental question underlying the inquiries by Senator Forrester is: Are customers of PSNH, a regulated electric distribution utility, paying for any of the costs of the Northern Pass transmission project through the electric distribution rate paid to PSNH? If the answer is "yes," then is that appropriate? If the answer is "no," how can we be sure of that? These questions are reasonable questions and certainly arise when customers see representatives of PSNH at public events discussing and promoting Northern Pass or when they open their electric bills and see inserts touting the benefits of the project. The difficulty arises in explaining the difference between that public perception and the reality of following the actual cost accounting.

---

[2] See Puc 2105.08(d). The use of the words "similarly situated non-affiliated suppliers" is consistent with Ms. Ross' description of the 2100 rules being implemented with respect to competition for electricity supply service.

There are two main elements that are foundations to understanding the answer to that question. Those elements are a) how electric distribution revenue requirements and the resulting rates are determined, and b) which entity pays the costs of the Northern Pass project and the source of the funding to pay those costs.

Determination of Electric Distribution Revenue Requirements

When a Commission-regulated utility such as PSNH files for a change to its distribution rates, it does so by submitting a filing that includes, for a "test year" period, a rate base (i.e., plant, equipment and other assets offset by certain liabilities) and a calculation of its net operating income determined by subtracting its test year expenses from its test year revenues. A rate of return, calculated by combining the cost of a utility's debt with a return on equity, is applied to the rate base to determine what the required level of net operating income is to achieve that rate of return. The *required* level of net operating income is then compared to the *actual* level of net operating income to determine whether the rates should be increased or decreased in order to achieve the full level of revenue required to recover expenses and achieve the rate of return (i.e., the "revenue requirement"). The period of review is called a "test" year because the individual line items—assets, liabilities, equity, revenue and expenses—are, after any necessary adjustments, deemed to be representative of a typical year. In reality, all of the individual line items can and do change frequently. The main areas of focus in a rate case, however, are the amount of the revenue requirement and the overall rate of return established and whether they are set at just and reasonable levels. The amount of the revenue requirement is what customers pay in rates, not the exact amounts of the individual line items used to create that revenue requirement.

Following a rate case, the way to monitor those factors is through review of a utility's earnings. As revenues, expenses and rate base change, so will the resulting net operating income earned by the utility. If the net operating income results in the utility earning a rate of return on equity higher than what was authorized in the rate case, then an argument could be made that customers are paying too much and the utility's rates should be decreased. Conversely, if the net operating income earned results in a rate of return on equity below the level authorized in the rate case, a similar argument could be made that the customers aren't paying enough for the utility to recover its costs and earn a reasonable rate of return. These are fundamental to utility ratemaking. In an actual rate case, the issues are analyzed and discussed much more in depth. It is important to have this understanding, however, to understand the items at issue in this investigation.

As discussed in Ms. Ross' September 12, 2013 letter, PSNH is in the midst of a five-year rate settlement that provided PSNH with only limited opportunities to adjust its distribution rates, with any such adjustment having to meet specific criteria. That settlement included an overall cost of capital determined using a rate of return on equity of 9.67%. The settlement also included an earnings sharing agreement whereby if PSNH's earned return on equity exceeds 10%, it is required to return 75% of the difference to customers. On the low end, PSNH is not allowed to propose a change to its distribution rates during this five-year period unless its earned return on equity is less than 7% for two consecutive quarters. Throughout this rate settlement period, PSNH's earnings are continually reviewed through the periodic reports it is required to file with the Commission. To the extent that PSNH's earnings and cost levels are impacted by a shift to significant non-regulated

activities, such as a shift of costs to the Northern Pass project, such impacts would appear in those reports and, all else being equal, would result in higher reported earnings. Since the earnings sharing provision of rate settlement took effect in mid-2011, PSNH's earned return on equity for the distribution portion of its business has varied from a high of 9.01% to a low of 7.50%, with the most recent reported results being 8.57% for the twelve months ended June 30, 2013.[3] Since those results have all fallen within the earnings sharing bandwidth contained in the Commission-approved settlement agreement, that does not support an argument that customers have paid either too much or too little in their distribution rates since the implementation of the settlement agreement. Outside of the requirements of the settlement agreement, if the current year happened to be a test year, all changes in revenue and expenses would have to be taken into account to determine a new revenue requirement, and any revenues and costs associated with Northern Pass would be excluded from test year revenues and costs.

Further, it is helpful to have an understanding of how PSNH's distribution earnings change relative to the magnitude of change in net operating income. Based on the most recent reports, for each $1 million change in net operating income, PSNH's reported earnings would change by 0.21%. What that means is that if, in a twelve-month period, PSNH incurred $1 million of costs attributable to Northern Pass that, for whatever reason, had not been charged to Northern Pass, PSNH's distribution earnings would still be well within the earnings bandwidth contained in the settlement agreement. Moreover, as will be discussed in the next section, Northern Pass will receive recovery of all costs charged to it by PSNH, plus a return, from HQ regardless of whether the project goes forward,[4] so there is really no financial incentive for any Northern Pass-related costs to remain on PSNH's books.

Suffice it to say that no Northern Pass costs were included when PSNH's current distribution rates were established, and if those rates were to currently be reset, no Northern Pass costs would be included. So, money received by PSNH from customers is used to recover the amount of a Commission-approved revenue requirement determined through using only PSNH-related revenues and costs.

Funding and Payment of Northern Pass Costs

One of Senator Forrester's questions discussed the concept of cost reimbursement from Northern Pass to PSNH. Upon their incurrence, if costs that originated at PSNH were directly charged to Northern Pass and were never included as costs on PSNH's books, there is no need for reimbursement. For example, if Northern Pass used an open PSNH purchase order to obtain printing services and when the invoice is received the cost is directly charged to Northern Pass, there is no cost to reimburse. However, the situation does lead to the question of which entity

---

[3] It is important to acknowledge that PSNH's earnings have been impacted either positively or negatively by changes in <u>any</u> of the individual line items contained in the determination of revenue requirement in its last rate case. Some examples of other changes are variations in sales, employee retirements, new hires, changes in property tax rates, etc.

[4] Based on my review of documents filed with the TSA and the related FERC order, there are provisions that deal with Northern Pass' reimbursement of costs from HQ in the event of termination of the TSA prior to commercial operation.

actually pays these costs? Where does the money actually come from? In response to an inquiry regarding the source(s) of funding for Northern Pass costs as they arise, PSNH stated:

> *In October 2010, Northern Pass Transmission, LLC (NPT, LLC) and H.Q. Hydro Renewable Energy, Inc. (HQ) entered into a Transmission Service Agreement (TSA) which contains a FERC-approved formula rate that governs the recovery of costs incurred on the Northern Pass Project. Costs incurred by the project are recorded on the books of NPT, LLC in the Construction Work in Progress account (#107). NPT, LLC will fund all costs until the project's Commercial Operation Date (COD). Upon COD, the formula rate will be applied and HQ will provide a yearly payment for the recovery of all costs, plus an equity return, over a 40 year term.*

To verify this response, I reviewed relevant portions of the TSA and supporting testimony filed with the FERC.[5] Witness testimony that accompanies the TSA filing is consistent with the summarized explanation above, although the testimony goes into much further detail. As part of that detail, the witnesses explained that for purposes of funding, NU and NSTAR, which at the time of that filing owned 75 percent and 25 percent of Northern Pass, respectively,[6] would make equity contributions to Northern Pass which would be recorded on their books as investments in a subsidiary.

Responses to Senator Forrester's Questions

In her letter to Senator Forrester, Ms. Ross provided preliminary responses to some of the questions and stated that the remaining questions would be addressed following investigation by Staff. Below I provide responses to all of the questions, incorporating those preliminary responses as appropriate.

1. As described in detail above, based on my investigation, PSNH ratepayer funds are not being used to support Northern Pass development costs. While some costs, including payroll costs, may originate at PSNH, those costs are directly charged to Northern Pass and will eventually be paid by HQ. Northern Pass was formerly funded by capital contributions from NU and NSTAR, and since the merger of those two entities has been funded by NU.

2. There is no separate bilateral contract between PSNH and Northern Pass regarding the time and expenses spent by PSNH and its employees in promoting the Northern Pass project. However, the time and expenses charged by PSNH to Northern Pass are done so in accordance with NU's time reporting policy as well as the pricing provisions included in the Commission's administrative rules dealing with affiliate transactions.

---

[5] These documents can be accessed at: http://www.northernpass.us/assets/permits-and-approvals/FERCTransmissionServiceAgreementFiling.pdf.

[6] As a result of the NU/NSTAR merger, NU now owns 100 percent of Northern Pass.

3. The Commission has oversight of the level of PSNH's earnings from regulated operations and the underlying rate levels as well as the proper use of PSNH resources. In general, the Commission is responsible for ensuring that utilities provide safe and reliable service at just and reasonable rates. With respect to payroll, my review of PSNH's payroll records indicates that PSNH employees are following the proper procedures for charging time to Northern Pass. If, because of such charges of PSNH payroll to Northern Pass, a concern arose that PSNH customers are overpaying in their distribution rates, that would only be the case if all other costs and revenues were unchanged since the last time the distribution rates were set. That would be purely a theoretical result that does not represent real world operations. Review of PSNH's distribution earnings reveals that they remain within the reasonable range contained in the Commission-approved rate case settlement.

4. The Commission determines if resources of regulated PSNH are being improperly used for non-regulated activities. As explained by Ms. Ross in her letter, *"[t]he tools used by the Commission for gathering this information take the form of informal inquiries, financial reporting by the utility, audits of utility books and records, and more extensive review of all revenues and expenses during periodic rate cases."* The investigation I performed in this instance demonstrates Ms. Ross' explanation.

5. Following review of the relevant invoices, the costs of the two-page bill insert attached to Senator Forrester's September 5 letter were charged 50 percent to PSNH and 50 percent to Northern Pass. Such a division of costs was appropriate as one page of the insert discussed PSNH and the other page discussed Northern Pass. Other than through a review of the underlying documentation, ratepayers would be unaware of the cost allocation.

6. See response to question #4. Regarding the part of this question referring to the PUC "maintain[ing] a current and accurate information file of PSNH's activities," the PUC does not manage the day-to-day activities of any regulated utility. Utilities are required to keep appropriate books and records of their activities, file periodic reports and respond to inquiries and examinations as necessary.

Conclusion

Having conducted this investigation, I offer the following observations. While it appears that PSNH and Northern Pass are following appropriate procedures to ensure proper recording of costs associated with the Northern Pass project—resulting in PSNH customers not subsidizing the project—it is important that both companies remain mindful that what happens in the accounting books of record is not apparent to the general public. What is evident to the general public is what they see and hear on a daily basis with respect to the Northern Pass project. Although the Commission has no proceedings before it related to Northern Pass, the project undeniably carries with it strong opinions both for and against. As I'm sure both companies are fully aware, public concerns related to the project coupled with questions resulting from PSNH's involvement in supporting the project create lots of questions to be addressed. With that in mind, PSNH and

Northern Pass should consider reducing those questions by making it clear during public events that, if PSNH personnel are involved, all costs associated with PSNH's involvement are being charged to Northern Pass. In addition, I suggest that the companies refrain from the use of PSNH bill inserts to promote the Northern Pass project.

While my investigation answers questions dealing with the underlying costs of certain activities, by this report I do not attempt to influence anyone's views regarding the Northern Pass project. My task was to review any PSNH-originated costs related to the project as well as details of the relationship between PSNH and Northern Pass.

Please let me know if you have any questions regarding this report.

Sincerely,

Steven E. Mullen
Assistant Director – Electric Division