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NH PUBLIC UTILITIES COMMISSION

April 24, 2013

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

Re: DE 11-250 – Public Service Company of New Hampshire, Request for Accounting Statement Clarification

Dear Ms. Howland:

On January 15, 2013, Public Service Company of New Hampshire (PSNH) filed a Request for Accounting Statement Clarification with respect to Order No. 25,246 issued April 10, 2012 regarding PSNH's petition for temporary rate recovery of the cost of the wet flue gas desulphurization system (Scrubber) installed at Merrimack Station. That request was followed by a supplemental filing by PSNH on February 20, 2013 and an objection filed by the Office of Consumer Advocate (OCA) on February 22, 2013. By this letter, Staff offers its comments with respect to the pending request for accounting statement clarification.

***Background***

In its January 15 request, PSNH summarized the temporary rate calculations used in the order but cited what it termed a "lack of specificity" regarding what particular costs would be recovered. PSNH stated that the calculation which resulted in a Temporary Rate Cost Percentage of 66% involved the use of "a simple ratio of two separate capital expenditure estimates for the entire Scrubber project and was not based on any current, ongoing or previously deferred costs that are being recovered today through temporary rates." According to PSNH, because of this lack of specificity, accounting rules[1] prohibit PSNH from currently recognizing the full equity return on the Scrubber asset which results in a mismatch in the deferral recorded for rate purposes versus the deferral recorded for financial reporting purposes. As a result, PSNH stated that while it is

[1] PSNH cited paragraph 9 of Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation," and stated that equity return is not defined as an "incurred cost" and, therefore, cannot be included in a regulatory asset for financial statement reporting.

currently recovering 66% of the equity return in temporary rates, the remaining 34% of the equity return, as it does not qualify as an "incurred cost" for SFAS No. 71 purposes, is ineligible for inclusion in a regulatory (deferred) asset although the remainder of the other cost components are eligible to be deferred. That mismatch, PSNH said, is creating a negative financial impact on PSNH's generation earnings due to PSNH's inability to currently recognize the full equity return on the Scrubber. PSNH further stated that its filing was in part spurred by the procedural delays that have taken place in the docket and noted that future additional delays would exacerbate the negative impacts.

On February 20, 2013, PSNH filed a "Supplemental Technical Statement of Stephen R. Hall and Michael L. Shelnitz" to provide additional information regarding the financial impact of the lack of recognition of the full equity return on the Scrubber. In that filing, PSNH mentioned the most recent suspension of the procedural schedule pursuant to a January 29, 2013 secretarial letter which stated that the Commission would be undertaking further consideration of issues contained in PSNH's January 23, 2013 Motion for Rehearing of Order No. 25,445. PSNH also stated that as of December 31, 2012, the total unrecognized equity return (comprising amounts from 2011 and 2012) was $19.4 million, with that amount expected to grow to $22.8 million by the end of 2013. According to PSNH, its inability to recognize the full equity return resulted in its 2012 before-tax generation earnings being reduced by $19.4 million and its earnings will continue to erode unless the Commission clarifies the accounting treatment of the equity return for financial reporting purposes. PSNH further stated that if the Commission does not issue an order to clarify the accounting, PSNH will be required to wait until the Commission issues a final order in this docket. Only at that time, PSNH said, would it be allowed to recognize the return for financial reporting purposes over the same period of time allowed for recovery of any other remaining previously deferred costs. Such an outcome would result in lower generation earnings in years prior to recovery, with higher earnings in the years over which such recovery would be allowed.

On February 22, 2012, the OCA filed an objection to PSNH's request. In its objection, the OCA said that it understood PSNH's request to mean that PSNH would under-report the proportion of costs (such as depreciation and debt costs) it is currently collecting in temporary rates (less than 66%), but fully report the amount of equity return on the Scrubber project investment. Further, the OCA stated that while PSNH did not specify if the requested accounting treatment would benefit its shareholders, executives or officers, it is reasonable to speculate that higher earnings may increase incentive compensation that is dependent on earnings. In addition, the OCA pointed out that PSNH has not claimed that any harm such as the violation of a loan covenant is imminent if the Commission does not authorize the special accounting treatment sought. With respect to the delays in the procedural schedule cited by PSNH, the OCA stated that those delays are partly due to PSNH's actions, including the pending motion for rehearing of Order No. 25,445. Moreover, if PSNH is ultimately not allowed to recover all of its Scrubber costs, the OCA said that the subsequent increase in earnings that PSNH seeks to avoid may not come to fruition. The OCA concluded by stating that PSNH has not demonstrated any extraordinary circumstances that would justify a deviation from normal accounting procedures.

***Analysis***

PSNH's Request for Accounting Statement Clarification raises a number of issues and questions. Among them are the following:

- Is the situation in this case any different than from any other temporary rate decision? If so, in what way(s)?
- If the Commission were to approve PSNH's request, would it be giving priority to a certain category of costs for a) recovery or b) financial statement recognition? If so, would such priority be appropriate?
- What are the potential implications of a decision in this proceeding with respect to future decisions by the Commission on requests by utilities for approval of temporary rates?

Analysis of the above questions starts with the enabling statute, RSA 378:7 which reads as follows:

> In any proceeding involving the rates of a public utility brought either upon motion of the commission or upon complaint, the commission may, after reasonable notice and hearing, if it be of the opinion that the public interest so requires, immediately fix, determine, and prescribe for the duration of said proceeding reasonable temporary rates; provided, however, that such temporary rates shall be sufficient to yield not less than a reasonable return on the cost of the property of the utility used and useful in the public service less accrued depreciation, as shown by the reports of the utility filed with the commission, unless there appears to be reasonable ground for questioning the figures in such reports.

Another component of the analysis is paragraph 9 of SFAS No. 71:

> 9. Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost[5] that would otherwise be charged to expense if both of the following criteria are met:
>
> a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.
>
> b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

SFAS No. 71, Footnote #5 gives this definition of an incurred cost:

> FAS71, Footnote 5--An *incurred cost* is "a cost arising from cash paid out or obligation to pay for an acquired asset or service, a loss from any cause that has been sustained and has been or must be paid for" (Eric L. Kohler, *A Dictionary for Accountants,* 5th ed. [Englewood Cliffs, N.J.:Prentice-Hall, Inc., 1975], p. 253).

In its Order No. 25,346 granting temporary rates, the Commission found that the methodology used to determine the Temporary Rate Cost Percentage of 66%, among other things, "…balances the interests of the Company and the ratepayers…" and that PSNH "…will achieve a reasonable return on the property, based on its current cost of capital." (Order No. 25,346 at 25-26.) While PSNH did not request rehearing of that order with respect to those specific findings, it appears that now, due to the passage of time and scheduling delays, it is taking the position that those findings are subject to question.

Temporary rates have historically been approved by the Commission with respect to what are commonly referred to as "base rate cases," or in the now unbundled retail electric industry, "distribution rate cases." The implementation of temporary rates in this proceeding with respect to the costs of owning and operating the Scrubber project is the first case of which I am aware that the Commission approved temporary rates with respect to the recovery of costs associated with an individual capital project. Temporary rate levels are reconcilable back to the initial date of rate effectiveness, meaning that if the permanent level of rates associated with Scrubber cost recovery is higher or lower than the temporary rate level, PSNH will either be allowed to recover from or be required to refund to customers the difference in the amounts ultimately allowed for recovery. In a base rate case, the same type of reconciliation applies, it just is not tied to one particular project. Requests for temporary rates in a base rate case involve calculations of revenue requirements that are derived using a utility's operating expenses and a return on rate base using a utility's cost of capital based on the books and records on file with the Commission. One could certainly argue that the Commission's decision to approve temporary rates for Scrubber cost recovery at a level below what would be considered "full" recovery is no different than rulings it has made in other cases where it approved temporary rates at a less than "full" level. That is, as the revenue requirements include a return on rate base using a utility's overall cost of capital—which has an equity component—a temporary rate level at less than "full" recovery would have the effect of a utility not recovering its full equity return for some period of time. Granted, that period of time will be somewhat longer in the instant proceeding, but the concept is still the same.

I understand PSNH's request in this proceeding to be a request to give priority to the recovery of the equity return, as opposed to other costs, which would allow it to recognize the full equity return for financial statement purposes, thereby preserving and smoothing its earnings. I am not aware of any prior Commission rulings on temporary rates wherein the Commission gave priority to any particular category of costs for purposes of recovery or financial statement recognition. Those prior rulings are in the nature of granting a temporary rate level of X until such time as the implementation of permanent rates, with any recovery of the difference between the permanent and temporary rate levels taking place on a going-forward basis following the establishment of permanent rates. If the Commission were to give priority to the recovery of the equity return, it could be establishing a precedent that other utilities would seek to use in future requests for temporary rates. For instance, a utility could divide its return on rate base calculation into two components: one for the equity costs and one for the debt costs. In so doing, it could then request disparate treatment of the various components of the overall cost of capital. Given the potentially varying reasons why a utility might request such disparate treatment for purposes of temporary rates, it seems that such a request would veer from the relatively straightforward intent of RSA 378:27. Giving priority of full recovery to any cost component, whether it be equity return or not, could also lead to illogical results depending on the amount of the prioritized costs as compared to the level of temporary rates granted. For example, assume in this case that the Commission had approved a Temporary Rate Cost Percentage of 50%. If PSNH's request to recovery 100% of the equity return was granted, then you would have a situation where all of the other cost components would be currently recovered through temporary rates at a percentage much lower than 50%. The lower the temporary rate level approved by the Commission, the more illogical and unbalanced the recovery of the various costs components. I do not understand RSA 378:27 to provide for such unbalanced and targeted recovery.

It should also be noted that PSNH's requested accounting clarification of the temporary rate order differs from a request for an interpretation of accounting rules, so it is questionable as to whether the Commission has a basis to render a decision. In its filing, PSNH does not appear to be questioning the meaning of the cited section of SFAS No. 71.[2] Rather, recognizing the limitations of the "incurred cost" definition for regulatory asset purposes, PSNH seems to be requesting the Commission provide for accounting of costs in a way not specifically provided for in that accounting standard, something much different than requesting an interpretation of the standard. Although PSNH has identified the definition of an "incurred cost" pursuant to SFAS No. 71 as a determining factor in its request for accounting clarification, in Staff's view, giving such priority of recovery to one category of costs would be instituting policy that would be ripe for misuse in the future and could lead to a wide variety of arguments as to whether other types of costs, for whatever reason, should be given priority of recovery.

***Recommendation***

Having reviewed PSNH's filing and the relevant background materials, Staff recommends that the Commission decline to issue the requested accounting statement clarification. While Staff understands that PSNH states that it is currently experiencing earnings erosion for its generation business as a result of its inability to fully recognize the equity return on the Scrubber project, Staff notes that in PSNH's most recent NHPUC Form F-1 the reported earned return on equity for the generation segment is 8.39% for the twelve-month period ended December 31, 2012. While this is below the Commission-

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[2] Staff notes that PSNH has not presented a letter or opinion from its outside auditors regarding the requested accounting clarification.

allowed return on equity of 9.81% for PSNH's generation business, Staff does not believe that warrants the Commission amending or otherwise clarifying its ruling on temporary rates in this proceeding in any way that would allow PSNH to give priority of recovery to the equity return for the Scrubber project as opposed to other costs of the project.

Sincerely,

Steven E. Mullen
Assistant Director – Electric Division

cc: Service List