

**STATE OF NEW HAMPSHIRE**

**BEFORE THE**

**PUBLIC UTILITIES COMMISSION**

Public Service Company of New Hampshire

Annual Reconciliation of Energy Service and Stranded Cost for 2012

Docket No. DE 13-108

**LEGAL BRIEF OF THE OFFICE OF THE CONSUMER ADVOCATE  
ON APPLICATION OF THE USED AND USEFUL CONCEPT**

A. INTRODUCTION

The Public Utilities Commission (PUC or Commission) opened Docket No. DE 13-108 *In Re: Public Service Company of New Hampshire, Annual Reconciliation of Energy Service and Stranded Cost for Calendar Year 2012* (Reconciliation Docket) to consider PSNH proposed reconciliation of revenues and costs associated with its energy service charge and stranded cost recovery charge (SCRC) for calendar year 2012. The Commission issued an order of scope, stating that the Commission will review PSNH “2012 plant performance, plant outages, replacement power purchases, and other purchases of power and capacity...Also, the prudence and reasonableness of PSNH’s incurred capital costs, and whether PSNH has otherwise appropriately accounted for and reconciled its energy service and stranded costs and any offsetting revenues...” Order Defining Scope of the Proceeding and Granting Motion to Intervene. (July 9, 2013)(Order No 25,540) Review of the economics of plant performance, including the capacity factors of PSNH owned fossil units, is included within the scope of this proceeding.

At the conclusion of the presentation of evidence on January 27, 2014, the Commission allowed the parties to brief legal issues related to the Office of the Consumer Advocate (OCA)

recommendation that the Commission disallow a portion of shareholder return for PSNH's fossil plants based on reduced plant capacity factor. The OCA's recommendation raises the following legal questions:

1. Does The Commission Have The Authority To Reduce Shareholder Returns by Applying the Regulatory Concept of Used and Useful When Utility Assets Demonstrate Reduced Economic Value?
2. Should The Commission Apply That Authority In This Reconciliation Docket?
3. Should The Commission Use The Methodology Based On Capacity Factor Proposed By The OCA to Proportionately Reduce Shareholder Return In This Reconciliation Docket?

B. ARGUMENT

The New Hampshire Supreme Court describes "two broad principles" which govern the development of utility ratebase: prudence and what is used and useful. *Appeal of Conservation Law Foundation of New England, Inc.*, 127 N.H. 606 (1986). The Court holds that:

"[t]he second principle of rate base inclusion or exclusion derives directly from the statutory description of allowable rate base property as "used and useful." RSA 378:27, :28. ... While prudence judges an investment or expenditure in the light of what due care required at the time an investment or expenditure was planned and made, usefulness judges its value at the time its reflection in the rate base is under consideration. Under the "used and useful" principle, the commission is not asked to second-guess what was reasonable at some time in the past, but rather to determine what can reasonably be done now with the fruits of investment.

*Appeal of CLF* at 674.

Simply stated, "The prudence test determines whether cost recovery is allowed at all, while the used and useful analysis determines the portion of prudently incurred costs on which the utility is entitled to a return." *Western Massachusetts Electric Company*, D.P.U. 85-270 at 25-27 (1986). The Commission has the authority to deny a portion of shareholder return to better balance ratepayer and shareholder interests. *Re Iowa Pub. Service Co.*, 46 PUR4th 339, 370-71 (1982). ("Finding of Fact #29. It is appropriate to deny company a percentage of return on

investment in capacity that cannot be considered necessary to provide adequate service in Iowa.”).

1. The Commission Has The Authority To Reduce Shareholder Returns by Applying the Regulatory Concept of Used and Useful When Utility Assets Demonstrate Reduced Economic Value.

The Commission has regulatory tools to address conflicts which arise between shareholders and ratepayers due to changes in market conditions and plant economics. The used and useful rate recovery principle is flexible. The New Hampshire Supreme Court describes it in this way:

There is no simple formulation that describes the standard of usefulness. Prior case law has invested the commission with flexibility in determining what may qualify as used and useful, thus necessarily providing scope for policy judgments.

*Appeal of CLF* at 637.

There is ample case law regarding the scope of the Commission’s authority in setting rates. Leading cases include *Bluefield v Public Service Comm* where the United States Supreme Court held:

There must be a fair return upon the reasonable value of the property at the time it is being used for the public... [T]he value of the property is to be determined as of the time when the inquiry is made regarding the rates. If the property... has increased in value since it was acquired, the company is entitled to the benefit of such increase.’ [cites omitted.]

*Bluefield v Public Service Comm*, 262 U.S. 679, 690-91 (1923),

Using the same principles, if the property in question has decreased in value, the company should bear a share of the burden from that decreased value. The *Bluefield* decision reflects market conditions experienced in the United States after World War I. The Supreme Court found that this change in market conditions was relevant in setting rates, holding as follows:

What annual rate will constitute just compensation depends upon many circumstances, and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public

equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding, risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures...A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.

*Bluefield* at 692-693.

Changes in electricity markets in 2012 affected the dispatch of PSNH fossil plants. Ex. 5

Cannatta Testimony at 33-35; Attach. MDC #2 at 43-54; Ex. 2 White Testimony Attach. FBW 2-5 at 59-62; Shelnitz Testimony Attach. MLS 3 at 12-13; Smagula Testimony Attach. WHS-3 at 142- 148. The Commission has the authority to consider those changes in this Reconciliation Docket.

An early New Hampshire case addressing Commission rate setting authority is *New England Tel & Tel v State* 98 NH 211 (1953) where the Commission had modified its methodology to respond to changes in telephone technology and law occurring in the 1950's. The Court held that "... certain of its [the Commission's] departures from methods of apportionment now in use elsewhere are justified by variables due to local conditions." The Court upheld the Commission's order stating, "Agencies to whom this legislative power of rate-making has been delegated are free, within the ambit of their statutory authority, to make pragmatic adjustments which may be called for by particular circumstances. *Id* citing *Federal Power Comm. v. Natural Gas Pipeline Co.* 315 U.S. 575, at page 587."

In the electricity field, the New Hampshire Supreme Court is periodically called upon to review Commission responses to changing local events. In *Re Legislative Utility Consumers Council v PSNH*, 119 NH 332 (1979), the market description from 1979 could have been written about 2012. "During the past several years, the issues involved in the ratemaking process of energy producing public utility companies have assumed unprecedented significance and

visibility.[cite omitted] ...The Legislature's creation of the LUCC indicates the public's heightened awareness of the importance of utility ratemaking. See RSA ch. 363-C (Supp.1977).” *Id.* at 332. Regarding the need for a flexible approach, the Court interpreted New Hampshire rate making authority, finding that:

The statutory scheme for public utility regulation mandated by the Legislature in RSA ch. 378 clearly expresses an intent that the Commission be afforded wide parameters within which to exercise its judgment. RSA ch. 378 is conspicuously devoid of any prescribed methodologies.

*Id.* at 352.

The Court again opined on the flexibility of the ratemaking principle of usefulness in *Appeal of Conservation Law Foundation of New England, Inc.*, 127 N.H. 606 (1986).

Similar to the courts’ descriptions of changing economic conditions in *Bluefield* in 1923, and *LUCC* in 1979, the Court in 1986 found:

In the face of rate issues that are unparalleled in the State's history, we should recall that the usefulness principle lends itself to development over time and under new conditions. See *Company v. State*, 95 N.H. at 358. We therefore attend seriously to the suggestions of the separate opinion, that the burden of excess capacity that may be created by such giant projects may appropriately be shared as between investors and customers, see Glicksman, *Allocating the Cost of Constructing Excess Capacity: "Who Will Have To Pay For It All?"*, 33 Kan.L.Rev. 429, 432 (1985) at 439-40, and that the usefulness principle may be applied to effect such a shared allocation.

*Appeal of CLF* at 647.

These descriptions of economic and market conditions show that from time to time, the Commission exercises its authority in unique ways to set rates in response to changing circumstances. In 2012, the unique circumstances of New Hampshire’s utility market calls for the Commission to exercise its judgment in ratemaking. The Commission has the authority under case and statutory law to do so.

2. The Commission Should Apply That Authority In This Reconciliation Docket

For 2012 there are several circumstances which combine together and compel the Commission to use its regulatory flexibility in setting just and reasonable rates. These circumstances are:

- a. A hybrid electric market place of competition and monopoly for the PSNH service territory;
- b. About 60 percent of customer load is paying 100% of plant costs due to customer migration; and
- c. Fundamental changes to the price and availability of natural gas.

Ex. 11 Eckberg Testimony at 9-14 (as revised).

The combination of these three factors drives the misallocation of costs and benefits between ratepayers and shareholders. This drives the OCA's recommendation that the Commission apply the used and useful ratemaking standard in a way that better balances the costs and benefits of PSNH generation between ratepayers and shareholders.

Pursuant to RSA 363-17-a "the commission shall be the arbiter between the interests of the customer and the interests of the regulated utilities". It is the Commissions statutory responsibility to consider the relevant factors that have created an imbalance between the interests of utility customers and utility shareholders and devise a means for bringing those interests back into balance. "The determinations of reasonable rate of return, prudence, and usefulness alike require the exercise of judgment and discretion in determining the recognition that is appropriately due to the competing interests of the company and its investors and of the customers who must pay the rates to provide the revenue permitted." *Appeal of CLF* at 674.

3. The Commission Should Use The Methodology Based On Capacity Factor Proposed By The OCA to Proportionately Reduce Shareholder Return In This Reconciliation Docket

Fairness requires allocating some risk of obsolete plants to the shareholders. Where ratepayers pay 100% return on plants that self-schedule (Ex. #6 and 7) and have low to very low capacity factors, (Ex. #1 at 145-148 ) there's no incentive for the utility to make economic decisions that benefit consumers as well as shareholders.

By allocating all of the costs of the fossil fuel plants to PSNH default service customers, including a 100% shareholder return, shareholders are completely shielded from the competitive impact of their choice to continue to own and operate their fossil fuel plants regardless of economics. The majority of residential consumers, as default energy service customers, bear all of the cost burden of PSNH generation. Witness testimony for PSNH conceded that shareholders will earn 100% return whether the plants run zero days a year or 365 days a year. This is true as long as there was an initial Commission finding of "used and useful" at some point in the past. PSNH argues that 100% shareholder return is appropriate and mandated even if the used and useful finding: 1) was over 40 years ago, 2) is applied to plants in 2012 exhibiting capacity factors at historic lows; 3) was made under a different market structure and different market conditions; and 4) includes a 100% shareholder return for plants that operate through PSNH self-scheduling, regardless of economic merit.

Migration in 2012 was increasing, reducing the number of customers bearing the cost burden for PSNH generation. See *Public Service Company of New Hampshire Migration of Customers To and From the Competitive Energy Supply Market 2012 Report to the New Hampshire Public Utilities Commission*. PSNH's default energy service customers do not get the benefits of competition, even though the default service customers of other New Hampshire

utilities do, through the use of a competitively bid energy procurement process. This dissimilar allocation of risk and benefit among consumers in different service territories as well as between PSNH consumers and shareholders requires redress.

New Hampshire's restructuring law states:

A transition to competitive markets for electricity is consistent with the directives of part II, article 83 of the New Hampshire constitution which reads in part: "Free and fair competition in the trades and industries is an inherent and essential right of the people and should be protected against all monopolies and conspiracies which tend to hinder or destroy it." Competitive markets should provide electricity suppliers with incentives to operate efficiently and cleanly, open markets for new and improved technologies, provide electricity buyers and sellers with appropriate price signals, and improve public confidence in the electric utility industry.

RSA 374-F (II).

The Commission must create incentives for PSNH as an electricity supplier, "to operate efficiently and cleanly...with appropriate price signals." *Id.* This can be done by tying shareholder return to plant operation metrics. Capacity factor is a reasonable measure of economic plant operation as the Independent System Operator of New England (ISO-NE) dispatches plants based on economics: the most efficient, least expensive plants are dispatched first (and most often) and the least efficient plants are dispatched only when necessary to meet peak energy needs. Therefore rewarding PSNH shareholders for high capacity factor operation and allocating a share of the burden for low plant capacity factors is a reasonable means of implementing New Hampshire state policy and reflecting the values of New Hampshire's constitution.

The parties and Staff agree on the underlying facts of the operation of PSNH generation units. The testimony from both PSNH and Staff witnesses is that the fossil plants, with the exception of Shiller Unit #5, are operating with capacity factors that do not reflect those seen historically. Ex. 5 Cannatta Testimony at 33-35; Attach. MDC #2 at 43-54; Ex. 1 White

Testimony 51-57. During much of 2012, PSNH self-scheduled units to accommodate their operating characteristics, in the hope that the market price would match their expectations and the plants would be economic to run. However, the Company provided no means to evaluate whether or not self-scheduled plant operation is economic. Particularly where PSNH does not have the dispatch information available to the ISO-NE, such as which regional units are off line for maintenance or which transmission lines may be out of service. PSNH attempted to adjust plant operations to make up for the reality that the plants are not designed for the market conditions which existed in 2012.

In 2012 the price of natural gas had declined from the highs experienced in 2005 and 2006. Ex. 5 at 54-56. The New England region continued a period of decreased reliance on coal-fired electricity generation which is reflected in the low capacity rates of the PSNH fossil fleet. *Id.* The rate of migration of PSNH's customers continued to grow, leaving a reduced energy service load from which to recover 100% of the costs of its fossil plants. *Id.* at 56. These significant market and operational changes create an imbalance between ratepayer and shareholder interests.

### C. CONCLUSION

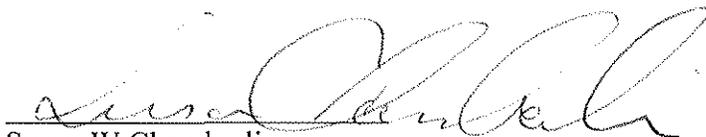
Similar concerns regarding the appropriate balance between ratepayer and shareholder interests prompted the Iowa State Commerce Commission to develop a formula for reflecting excess capacity in rate of return, rather than in rate base. See *Re Iowa Pub. Service*

In the real world of competitive enterprise, management officials must continuously rethink prior decisions as new events unfold. Those who fail to stay on top of current events lose out to their competition. Iowa utilities should also maintain surveillance over costs associated with a particular decision, and in the absence of the kind of incentive provided by a competitor, the responsibility falls upon us to provide the requisite incentive.

*Re Iowa Pub. Service Co.*, 46 PUR4th 339, 370-71 (1982).

The OCA's proposed methodology of reducing shareholder return based on average capacity factors takes into consideration changes in market structure and economics that have taken place since the Commission first found PSNH fossil generation plants used and useful many years ago. The methodology also respects the dictates of RSA 369-B:3(IV)(1)(A) by limiting shareholder return without reducing recovery of plant operating costs. ("The price of such default service shall be PSNH's actual, prudent, and reasonable costs of providing such power, as approved by the commission"). The Commission has the authority to provide incentives for shareholders to respond to the unique market conditions in New Hampshire in 2012 and in accepting the OCA's recommendation, better balance ratepayer interests with those of PSNH shareholders.

Respectfully submitted,



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Certificate of Service

I hereby certify that a copy of this brief was provided via electronic mail to the individuals included on the Commission's service list for this docket.

2/4/14  
Date



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