

**DE 04-177**

**PUBLIC SERVICE COMPANY OF NEW HAMPSHIRE**

**Transition and Default Service Rates**

**Order on Second Motion for Rehearing**

**ORDER NO. 24,588**

**February 10, 2006**

**I. BACKGROUND**

This docket was originally initiated for the purpose of determining certain energy service rates of Public Service Company of New Hampshire (PSNH) for the period of February 1, 2005 through January 31, 2006. It remains open for the purpose of deciding what allowed Return on Equity (ROE) the New Hampshire Public Utilities Commission (Commission) should apply to the generation facilities owned by the Company when such rates are calculated and ultimately reconciled through the Company's stranded cost recovery mechanism. On June 8, 2005, following a hearing, the Commission issued Order No. 24,473, fixing the ROE at 9.63 percent. PSNH sought rehearing pursuant to RSA 541:3. On December 2, 2005, by Order No. 24,552, the Commission granted the PSNH motion in part and denied it in part, adjusting the allowed ROE to 9.62 percent.

PSNH took two steps on January 3, 2006. It filed an RSA 541:6 Notice of Appeal with the New Hampshire Supreme Court, to which the Court assigned Docket No. 2006-0002. It also filed a second rehearing motion, taking the position that two significant changes to the original ROE determination made by the Commission in Order No. 24,552 should be corrected by the Commission notwithstanding the pendency of appellate proceedings. No party filed a responsive pleading.

## II. PSNH MOTION FOR REHEARING

The Second Rehearing Motion reprises the arguments made by PSNH in its initial request for rehearing. Broadly stated, those arguments are that the Commission's ROE decision is unreasonable, erroneous, arbitrary and unconstitutional because it fails to consider adequately the level of risk incurred by PSNH's owners in connection with the Company's generation portfolio.

In addition, PSNH complains that Order No. 24,552 is "procedurally incorrect" because, according to PSNH, the Commission acted *sua sponte* to revise certain calculations from the original ROE order that were the result of a mathematical error. Second Rehearing Motion at 2. In Order No. 24,473, the Commission calculated the allowed ROE by, first, determining an ROE that would apply to a vertically integrated electric utility like PSNH (*i.e.*, one owning both a transmission and distribution system as well as generation facilities) and then applying a premium to account for the fact that the generation portion of the business involves greater risk to investors than the transmission and distribution business. The correction at issue involves the initial calculation of the so-called "Base" ROE. Order No. 24,552 revised the figure downward, from 9.42 percent to 9.30 percent. According to PSNH, the Company never sought a reduction in the Base ROE and Order No. 24,552 incorrectly suggests that it did.<sup>1</sup>

PSNH also challenges the steps taken by the Commission on rehearing after revising the Base ROE. The Commission indicated in Order No. 24,552 that it had incorrectly

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<sup>1</sup> PSNH makes an additional argument about the Base ROE calculation that it acknowledges is not new to the instant motion. In the First Rehearing Motion, PSNH argued at considerable length that the Commission erred by using a "mathematically precise" calculation to determine the Base ROE. According to PSNH, the fact that a mathematical error caused the Commission to change the Base ROE makes clear that the Commission established the Base ROE by formulaically applying the calculations derived from a particular methodology – the so-called Three Stage DCF (Discounted Cash Flow) methodology, and belies the Commission's contention in Order No. 24,552 that it was only using the Three-Stage DCF model as its "basic tool."

calculated the risk differential (*i.e.*, the difference, in basis points, of allowed return) between the two segments of PSNH's business. The Commission decided that the correct calculation, based on the record adduced in this case, required an upward adjustment of 32 basis points to the Base ROE. The original order applied a smaller adjustment, 21 basis points.

The 32 basis-point adjustment of which PSNH complains here arises out of the testimony of the Company's expert witness, Dr. Roger Morin. As noted in the two prior orders, Dr. Morin stated on the record that 64 basis points is an appropriate reflection of the "spread" between the investor risk associated with the transmission and distribution business and the investor risk associated with the generation assets.<sup>2</sup> It thus is necessary to decide how to allocate the 64 basis-point spread between the risk applicable to the vertically integrated company (*i.e.*, a combination of both business lines) and that applicable to the generation assets. In Order No. 24,473, the Commission made that decision based upon the actual mix of PSNH's corporate assets. On rehearing, the Commission abandoned that approach in favor of applying half of the 64 basis-point spread, as originally proposed by the PSNH witness, reasoning that it had erred in deeming the actual asset mix to be relevant to the task of deriving a return from proxy data that would then be applied to PSNH.

According to PSNH, the problem with this calculation in Order No. 24,473 was *not* that it sought to apply the Company's actual asset mix but, rather, that the Commission did this by using the wrong asset mix and compounding the mistake with a mathematical miscalculation. In the view of PSNH, the allowed ROE calculated for a vertically integrated company (in this instance, 9.30 percent) must equal the sum of two figures: (1) the ROE

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<sup>2</sup> According to Dr. Morin, the spread could be anywhere from 64 to 86 basis points. The Commission has consistently opted for the low end of this range, for reasons explained in Order No. 24,473.

associated with the distribution business, multiplied by 0.72 to reflect that distribution is 72 percent of PSNH's assets, and (2) the ROE associated with the generation business, multiplied by 0.28 to reflect that generation is 28 percent of those assets. According to PSNH, using this formula and assuming that PSNH would be entitled to a 9.30 percent return as a vertically integrated entity, it would be necessary to fix the generation ROE at 9.76 percent. Alternatively, PSNH applies the same formula to argue that if the appropriate generation ROE is truly 9.42 percent then the vertically integrated return would be only 9.16 percent rather than the 9.30 percent calculated by the Commission on rehearing.

### **III. COMMISSION ANALYSIS**

PSNH's initial argument, concerning the Base ROE, has two prongs, one procedural and one substantive. To start with the latter, PSNH raises no arguments here, with respect to the methodology used by the Commission to determine the Base ROE, that were not fully addressed in Order No. 24,552. PSNH continues to argue that because the Base ROE is identical to the one yielded by the mathematical formulas used in the Three-Stage DCF model, we run afoul of court precedents warning that these determinations are not an exact science and are not subject to precise mathematical calculation. PSNH does not accept what the Commission has previously made clear: that it adopted the approach of Staff's expert witness, involving use of the DCF model to reach a result that was then measured against the results from another recognized economic model as a check on the reasonableness of the first result. That the result settled on was a specific number, determined to the basis point (*i.e.*, to the one-hundredth of a percentage point), does not suggest, as PSNH has now repeatedly argued, that we have somehow

reduced this task to mere calculation without the exercise of judgment about the reasonableness of that number.

The other argument PSNH makes about the Base ROE calculation in Order No. 24,442 is that it was “procedurally incorrect.” The allegedly incorrect procedure consisted of the Commission (1) learning via PSNH’s initial rehearing motion that there appeared to be a mathematical error in the Commission’s application of the Three-Stage DCF model, (2) asking Staff to work with the parties to explore this question, (3) learning via a written filing from Staff that the parties had conferred and agreed that a mathematical error was reflected in Order No. 24,442 that, when corrected, actually decreased the Base ROE by 12 basis points, a development PSNH would obviously not deem to be favorable, and (4) adopting the correction in the decision on the initial PSNH motion.

Issuance of an order correcting the ROE was not, as PSNH contends, a *sua sponte* action but rather a consequence of a motion for rehearing. In response to the PSNH motion, we explicitly adopted a corrected calculation that the Company actually *endorsed* (while preserving its right to challenge whether the calculation was a legally sufficient basis for an allowed ROE).

We are aware of no legal principle that suggests we should eschew a correction because it turns out to be unfavorable to the party that first brought the error to the Commission’s attention. PSNH labels this as “procedurally incorrect,” but does not suggest that its right to due process was compromised nor any other constitutional right implicated. Nor does PSNH cite any statute, rule or recognized legal principle that supports its position. Accordingly, we discern no basis for rehearing in connection with our revision of the Base ROE.

The remaining issue in the instant motion requires no analysis beyond that which is contained in Order No. 24,552. In that order, we determined we had erred in the method previously employed to calculate the risk premium added to the Base ROE to reach the ultimate result. We abandoned our initial approach, which involved calculating the premium based on the actual asset mix of the company, in favor of the approach urged in the testimony of Dr. Morin on behalf of PSNH, which involved the assignment of equal weight to the two business segments. *See, Morin Testimony Ex. 7, p. 80.*

The mathematical error in the risk premium calculation, as alleged by PSNH in its pending motion, rests on the assumption that it is correct to weight the calculation of the premium based on PSNH's actual asset mix. We confessed error, however, in taking the extraneous step of applying the Company's actual asset mix. To grant PSNH's motion would only compound that error. PSNH's mathematics may be correct in isolation but the result follows from the flawed premise that PSNH's actual asset mix should be employed at the last step of the calculation. Order No. 25,552 fully and adequately explains why we corrected course on that question.

**Based upon the foregoing, it is hereby**

**ORDERED**, that the motion of Public Service Company of New Hampshire for rehearing of Order No. 25,552 is DENIED.

By order of the Public Utilities Commission of New Hampshire this tenth day of  
February, 2006.

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Thomas B. Getz  
Chairman

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Graham J. Morrison  
Commissioner

Attested by:

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ChristiAne G. Mason  
Assistant Executive Director & Secretary