STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DG 08-009

ENERGYNORTH NATURAL GAS, INC. D/B/A NATIONAL GRID NH

Notice of Intent to File Rate Schedules

Order Denying Motion for Rehearing

O R D E R N O. 25,044

November 13, 2009

I. PROCEDURAL HISTORY

On June 29, 2009, EnergyNorth Natural Gas, Inc. d/b/a National Grid NH (National Grid NH or the Company) filed a motion for rehearing and/or reconsideration of *EnergyNorth Natural Gas, Inc. d/b/a National Grid NH*, Order No. 24,972 (May 29, 2009) (Motion). The order granted a delivery rate increase for the Company based upon the terms of a partial settlement agreement approved by the Commission and upon an allowed rate of return on common equity (referred to herein as ROE) of 9.54%.

The ROE was established by the Commission after a contested hearing on the level of the return. Expert witnesses for the Company as well as the Commission staff (Staff) presented testimony concerning several methods of determining an appropriate ROE for National Grid NH. In the Order the Commission determined an appropriate ROE using methods that have been applied in determining utility ROEs for more than 20 years in New Hampshire**.** *See Pennichuck Water Works, Inc.,* Order No. 17,911, 70 NH PUC 850 (1985); *Pennichuck Water Works, Inc.,* Order No. 21,026, 78 NH PUC 621, 627 (1993); and *Public Service Company of New Hampshire,* Order No. 24,473, 90 NH PUC 230 (2005).

The Company's Motion is limited to challenging the Commission's determination that an ROE of 9.54% is reasonable given the risks faced by National Grid NH and is sufficient to "attract capital from the investment community generally." Order at 54-55. On July 7, 2009, the Office of Consumer Advocate (OCA) filed an objection to the Motion.

II. POSITIONS OF THE PARTIES

A. National Grid NH

1. Policy and Public Interest

The Company first argued that the Commission's ROE decision is contrary to the public interest. According to the Company, customers' needs require the Commission to create an environment that encourages sustainable long term infrastructure investment going beyond merely meeting franchise obligations, including replacing aging infrastructure, bringing innovative energy efficiency practices to New Hampshire, and implementing other forward-looking programs. The Company contended that the Commission's order fails to adequately consider the policy implications of the ROE it set for the Company when compared to that of other utilities in other jurisdictions where the Company claims an investor can earn a higher return. The Company asserted that the Commission appears to have reached this result in part because the Commission mistakenly relied on the Company's legal obligation to invest sufficient capital to maintain a safe and reliable system no matter what return it is able to earn.

The Company further maintained that the Company's management will be obligated to pursue investments on behalf of shareholders in jurisdictions more attractive to investors. According to the Company, the Commission's decision signals to investors that the Company is operating in a jurisdiction where it is not possible to earn an "industry standard" return unless the Company makes cost reductions to expense levels below what was allowed in the partial settlement agreement. The Company argued that not only will the Commission's decision discourage investment in the Company, but also will likely discourage other utilities from committing capital to the state.

2. Analytical Methods to Determine Return on Equity

Second, the Company argued that the Commission relied on a single analytical model without serious reference to other important indicators of the opportunity cost of capital, which caused the Commission to establish an ROE that is too low. The Company urged the Commission to factor in the results of multiple analytical models and other real world data to compensate for the claimed infirmities of the discounted cash flow model (DCF) relied upon by Staff, particularly in the current economic environment. In the Company's view, the Staff's ROE recommendation and the Commission's order are based almost entirely on a rote mathematical calculation.

3. Constitutional Constraints on ROE

Third, the Company argued that the ROE is unconstitutionally confiscatory. According to the Company, the ROE is too low to attract the capital necessary for it to meet increased demands for improvement and extension of its services, including the significant capital required to replace aging infrastructure.

In particular, the Company asserted that the Commission misconstrued the standard to be applied in balancing the interests of investors and consumers, which led it to disregard evidence that an ROE of 9.54% is considerably lower than the returns authorized for other gas utilities. The Company predicted that, as a result, rational investors will direct capital to other investments affording them an opportunity for a more favorable return with comparable risk.

According to the Company, the Commission's discretion to determine an appropriate ROE is limited by the principle that a low rate of return that discourages outside investment of necessary capital is unconstitutionally confiscatory and not within the "zone of reasonableness." The Company stated that a just and reasonable rate reflects, among other things, a rate of return commensurate with returns on investments on other enterprises having corresponding risks. As evidence that an ROE of 9.54% is too low, the Company referred to a survey of ROEs granted by other states for gas utilities and an award of 10.5% given to the Company's Rhode Island affiliate. The Company further argued that the allowed returns on equity for Staff's proxy group are all at 10% or higher, even before taking account of subsequent declines in stock prices and increases in the cost of equity. The Company concluded that any ROE less than 10% would not be commensurate with returns for similar investment opportunities.

The Company contended that the Commission incorrectly construed the Company's argument to be that an inappropriately low ROE would discourage the *parent company* from investing capital in National Grid NH. The Company reiterated that the legal principle it was arguing for was the capital attraction standard articulated in New Hampshire cases such as *Appeal of Conservation Law Foundation*, 127 N.H. 606 (1986) requiring the Commission to establish an ROE that will attract capital from the investment community generally. According to the Company, the Commission overlooked the principle that the ROE must be sufficient to attract *outside* investment capital and provide an ROE commensurate with those allowed for comparable entities, and further, the Commission has failed to authorize a reasonable return, which will ultimately devalue the investment of existing shareholders.

The Company asserted that the Commission cannot rely on the Company's obligation to expend a certain level of capital regardless of the return it earns if the goal is for the Company to make the ambitious investments needed to meet the State's and the Company's long term goals and serve customers' long term interests. In the Company's view, sound policy and basic constitutional principles require regulators to set a return that ensures that investors – whether they be investors in a public company or a holding company that owns the stock of a subsidiary – have an opportunity to earn a reasonable return despite the fact that they are obligated to provide safe and reliable service.

According to the Company, the Commission wrongly premised its decision on the fact that the Company's immediate source of capital is a large utility holding company, assuming incorrectly that because the *Company* has a minimum obligation to invest its own earnings so that its distribution system is maintained in a particular manner, the Company's *parent* has a corresponding obligation to invest its capital when needed. The Company maintained that it faces the same reality it would face as a stand-alone entity, namely, the loss of access to required capital, if its earnings are insufficient. The Company stated that such a result is not in the public interest, whether viewed from a customer or an investor perspective. The Company concluded that reconsideration or rehearing is appropriate because the Commission may have misconstrued the Company's argument and thus failed to properly analyze whether or not the ROE was too low to attract investment capital in light of returns available from other investment opportunities.

B. OCA

The OCA objected to the Company's Motion on grounds that the Commission already considered and rejected the issues raised by the Company and the Company has presented no good reason for the Commission to alter its prior determination. The OCA maintained that the Company simply repeated the facts and arguments it previously raised in its post-hearing brief. In support, the OCA cited the Company's arguments regarding: (1) the importance of ROE in attracting investor capital, the Company’s investment in other jurisdictions if the ROE is set too low, and the appropriateness of ROEs set at higher levels in other jurisdictions; and (2) the flaws in the discounted cash flow method and the necessity of considering the results of other methods in determining ROE.

OCA also argued that the Company’s claims of mistake and misunderstanding in Order No. 24,972 are insufficient to provide the Commission with a basis to rehear or reconsider its order. OCA asserted that the Company’s allegations of mistake are another version of an argument previously made and considered by the Commission, namely, that a certain level of ROE is necessary to attract investment capital.

In addition, the OCA argued that the Commission’s comments about the Company’s obligation to invest in its system and the Company’s access to capital from its parent did not form the basis of the Commission’s analysis or determination. The OCA stated that the Commission made its observations in the context of an evidentiary ruling on the Company’s survey data concerning ROE’s awarded to utilities in other states, which the Commission rejected on other grounds as unsupported and unreliable. OCA further pointed out that the Commission’s evidentiary ruling on the survey data was based on Commission precedent.

OCA stated that the Commission reviewed the various analytical methods advocated by the parties and exercised its judgment and discretion in applying certain of these methods to determine ROE. OCA pointed out that the Company itself recognizes the Commission’s authority in this area.

OCA argued that the contested assumptions and alleged mistakes of the Commission do not speak directly to the legal issues determined by the Commission, including the reliability of the survey data, the selection of an appropriate analytical method and the application of these methods. In OCA's view, the Commission's statements are in the nature of *dicta*, the unreasonableness or unlawfulness of which the Company failed to demonstrate in its Motion. Moreover, according to the OCA, the Commission's statements represent a proper exercise of judgment and discretion by the Commission in balancing the competing interest of the Company and its investors.

III. COMMISSION ANALYSIS

Pursuant to RSA 541:3, the Commission may grant rehearing when a party states good reason for such relief. Good reason may be shown by identifying new evidence that could not have been presented in the underlying proceeding, *see O'Loughlin v. N.H. Personnel Comm'n*, 117 N.H. 999, 1004 (1977) or by identifying specific matters that were either "overlooked or mistakenly conceived" by the deciding tribunal. *Dumais v. State*, 118 N.H. 309, 311 (1978). A successful motion for rehearing does not merely reassert prior arguments and request a different outcome. *See Connecticut Valley Electric Co.*, Order No. 24,189, 88 NH PUC 355, 356 (2003) and *Comcast Phone of New Hampshire*, Order No. 24,958 (April 21, 2009).

In this proceeding, the Company seeks a 12.25% ROE. The Company characterizes its request as a reasonable representation of the average of its discounted cash flow (DCF) model result of 10.55%, capital asset pricing model (CAPM) result of 13.91% and a risk premium (RP) result of 12.71%. The Company's estimates incorporate adjustments for flotation cost, leverage premium and firm size. Without such upward adjustments, the Company's DCF estimate is 9.77%, the CAPM estimate is 12.78%, and the RP estimate is 12.50%. See Exhibit 33, Attachment PRM -21.

In Order No. 24, 972, the flotation, leverage and size premiums were rejected in accordance with many years of Commission precedent. In addition, also consistent with extensive Commission precedent, the express averaging of CAPM with DCF (as opposed to using it as a check on the DCF) was rejected. The Company simply did not make a persuasive case for overturning longstanding precedent.

After stripping out those upward adjustments, the direct comparison in this case focused on a fairly narrow range of estimates determined by the expert witnesses, consisting of Dr. Moul's 9.77% DCF calculation for the Company and Dr. Chattopadhyay's 9.33% DCF calculation for Staff. Order No. 24,972 sets forth a rigorous review of the elements of the two calculations and makes certain adjustments based on the record evidence to conclude that a 9.54% ROE is reasonable.

The Company's Motion does not proffer any new evidence. We thus consider whether the Motion identifies specific matters that were overlooked or mistakenly conceived and/or whether the Company's Motion merely reasserts prior unsuccessful arguments. We consider the Company's arguments in the order presented in the Company's Motion.

A. Policy and the Public Interest

The Company's first argument, that the Commission's decision on ROE is contrary to the public interest, was also made in the Company's post-hearing brief at pages 2- 4. The Commission described that argument in Order No. 24,972 at 23-24 but did not accept it. *See Id*. at 55. Underlying this argument is the Company's essential complaint that the ROE method the Commission has applied to cost of capital cases coming before this Commission for a number of years is flawed in that it does not properly measure investor expectations. *See Pennichuck Water Works, Inc.*, 70 NH PUC 850 (1985), *supra*; *Pennichuck Water Works, Inc.*, 78 NH PUC 621, 627 (1993), *supra*; and *Public Service Company of New Hampshire,* 90 NH PUC 230 (2005), *supra*. Moreover, the Company complains that since regulators in other jurisdictions have awarded higher ROEs than the ROE awarded in this docket, those higher ROEs must better reflect investor expectations.

The Company's argument that ROEs set for other companies in other states establish a basis on which the ROE for the Company should be set in New Hampshire is flawed. The various analytical models presented by the expert witnesses and considered in this case measure investor expectations by analyzing risks, returns and growth forecasts for a group of companies similar in risk and business activity to the Company. Were we to adopt the comparison to other jurisdictions as a direct measure of an appropriate ROE, we would depart substantially from an objective consideration of investor expectations and introduce a self-referential circularity to the process based upon other regulators' ROEs, who presumably would then rely on our calculation. We decline, as we have done in the past, to adopt such an approach. *See Public Service Company of New Hampshire*, Order No. 24, 552, 90 NH PUC 542 at 556-557 (2005)

The Commission's approach to setting the ROE took into consideration the interests of investors and ratepayers, *see Id*. at 54-55, and obtained a different result than the Company's requested ROE of 12.25%. *See also* OCA's objection. Since we did not overlook the argument, the question becomes whether we misconceived the public interest and the appropriate ROE for serving the public interest. For the reasons set forth below, we conclude that we correctly determined the policy implications of the ROE of 9.54% established in Order No. 24,972.

In addition, the Company asserts that as a matter of policy the Commission should create an environment that encourages sustainable long term infrastructure investment going beyond merely meeting franchise obligations, including replacing aging infrastructure, bringing innovative energy efficiency practices to New Hampshire, and implementing other forward-looking programs. The Company bases its case for a higher ROE on general ideas such as encouraging an "aggressive capital program" and a "progressive energy policy," *see* Motion at 2, as well as the holding company's vision for the future in its 2007 Corporate Responsibility Report, (Exhibit 6) much of which applies to the electric industry. *See* Motion at 4. The Company did not specify what discretionary investments it had in mind nor did it commit to implement any of them in New Hampshire.

We are not persuaded that it would be appropriate in these circumstances for the Commission as a matter of policy to increase the ROE, beyond what is determined sufficient to meet investor expectations, in the hope that the Company would pursue vaguely described policies and programs more aggressively. More important, the Company's framing of the issue raises some concern about the definition of terms insofar as it may reflect some confusion about the nature of its franchise obligation in relation to what it terms discretionary investment. To the extent the Company suggests that there are certain actions that it is clearly not required to undertake, which it would undertake if appropriately compensated, or that regulatory disincentives to investment may exist, those are issues that it should pursue in another forum.[1] At the same time, if there are obligations that the Company fails to undertake, then the Commission will likewise take action in an appropriate forum.

In a related vein, the Company further contends that Order No. 24,972 fails to adequately consider the policy implications of the ROE it set for the Company when compared to that of other utilities in other jurisdictions where an investor can earn a higher return. The Company

[1] For example, the Commission has approved the continuation of the Company's energy efficiency program proposal for the period May 1, 2009 to December 31, 2010. The program encourages the Company to invest in energy efficiency measures and includes an incentive mechanism under which the Company is entitled to collect an annual performance-based shareholder incentive award. *EnergyNorth Natural Gas, Inc. d/b/a National Grid NH*, Order No. 24,995 (July 31, 2009). Furthermore, the Commission has approved a special cast iron-bare steel (CIBS) program for removing from service distribution pipes most likely to endanger public safety by leaking or failing, while permitting the Company annually to recover the reasonable costs of replacing pipe through additions to base distribution rates without being subject to the degree of regulatory lag often associated with the replacement of such assets. *National Grid plc,* Order No. 24,777, 92 NH PUC 279 (July 12, 2007) and *EnergyNorth Natural Gas, Inc. d/b/a National Grid NH,* Order No. 24, 996 (July 31, 2009).

claims the Commission appears to have reached this result in part because the Commission mistakenly relied on the Company's legal obligation to invest sufficient capital to maintain a safe and reliable system no matter what return it is able to earn. Motion at 6. This claim is unsound. We did not rely upon the Company's obligations to invest sufficient capital in its utility systems in determining an appropriate ROE. Instead, we determined an appropriate ROE by examining investor expectations regarding similar utility companies. *See* Order No. 24,972 at 56 *et seq*. Accordingly, the Company's first argument does not present a sufficient basis for rehearing or reconsidering the ROE established in Order No. 24,972.

B. Analytical Methods to Determine Return on Equity

The Company's second major argument is that the Commission relied on a single analytical method, the discounted cash flow (DCF) method, for estimating the cost of equity, and such reliance resulted in an ROE that is too low. During the course of the proceedings, the Company argued that the results of the DCF, risk premium (RP) and capital asset pricing (CAPM) methods should be averaged in determining the cost of equity. Order No. 24,972 at 14.

Staff, on the other hand, relied primarily on the DCF method in presenting its recommendation, but used the CAPM method as a check on the reasonableness of the DCF result. *Id*. at 29. In its analysis, the Commission described the Company's argument, *Id*. at 56-57, but did not accept it based upon the weight of the evidence presented. *Id*. at 57-59. Thus, the Commission did not overlook the Company's analytic methods, which included the DCF method. Nor, as set forth below, did the Commission misconceive the issue of determining investor expectations. Accordingly, the Company's argument provides no basis for rehearing or reconsidering the ROE established in this case.

The Commission accepted Staff's recommendation that the Commission apply the approach described in *Public Service Company of New Hampshire*, Order No. 24,473, 90 NH PUC 230 (June 8, 2005), where the Commission reiterated that the DCF has been the primary method used in New Hampshire to determine the allowed ROE, though the Commission also recognized that other valid methods may be used as a test of reasonableness. Order No. 24,972 at 57-59. The Commission was not persuaded in Order No. 24,972, nor is it now persuaded, that averaging the results of the various methods leads to a more reliable cost of equity estimate than the Commission's traditional approach. The Commission found that 9.54% was an appropriate ROE based on a DCF analysis, *Id*. at 65, and that the CAPM method demonstrated that a 9.54% ROE is a reasonable estimate, *Id*. at 68-69. Staff's CAPM estimates were 7.08% and 8.48% while the Company's CAPM estimate, when corrected for an appropriate risk free rate and the latest Value Line average betas, was 9.92%. The Commission found that these CAPM estimates supported the DCF result. Thus, the Commission did not rely solely on a single analytical method as the Company charges. In addition, the Commission noted that the updated DCF estimate obtained by the Company's expert witness was 9.77% without the leverage and flotation cost adders rejected by the Commission, *see* Order No. 24,972 at 64. This estimate is comparable to the updated Staff recommendation of 9.33% and the Commission's finally approved figure of 9.54%. *See Id*. at 64. Accordingly, we conclude there is no basis in the record for rejecting the Commission's ROE determination resulting from application of the DCF method and use of the CAPM estimates as a check.

C. Constitutional Constraints on Return on Equity

The Company's third and final argument is that the 9.54% ROE is unconstitutionally confiscatory because the ROE is too low to attract the capital necessary for the Company to meet increased demands for improvement and extension of its services, including the significant capital required to replace aging infrastructure. *See* Motion at 10 et seq. Until now, the Company has not attached the "confiscation" label to its arguments, but the Company's primary evidentiary support for such a claim, i.e., the ROE survey data from other states, was argued at length and rejected by the Commission. *Id*. at 54. The Company asserts that the Commission misconstrued the standard to be applied in balancing the interests of investors and consumers, which led it to disregard evidence that an ROE of 9.54% is considerably lower than the returns authorized for other gas utilities.

The Company argues that the applicable legal principle, articulated in New Hampshire cases such as *Appeal of Conservation Law Foundation*, 127 N.H. 606 (1986), requires the Commission to establish an ROE that will attract capital from the investment community generally. We agree that the capital attraction standard is an important part of the constitutional standard to be followed in connection with establishing an ROE. Indeed, in Order No. 24,972 the Commission quoted from *Appeal of Conservation Law Foundation*. *Id*. We also agree that the attraction of capital standard is to be applied to the investment community generally. Order No. 24,972 did exactly that. *Id*. at 54-55. Thus, we reject the Company's argument, *see* Motion at 14, that the Commission overlooked the principle that the ROE must be sufficient to attract *outside* investment capital and provide an ROE commensurate with those allowed for comparable entities. Applying this standard to the expert testimony presented in this docket led us to determine that an ROE of 9.54% for the Company was reasonable and was sufficient to attract outside investment.

The Company also conflates the allowed returns on equity in other jurisdictions with the market's expectation of what is a sufficient ROE to attract new investment by arguing that since the allowed ROE for all of the utilities in the Staff's proxy group are greater than 10%, any ROE less than 10% would not be commensurate with returns for similar investment opportunities – and thus are unconstitutional as outside of the "zone of reasonableness." This argument ignores the logical consequence of what happens when a company earns (or perhaps, as in this case, is allowed to earn) more than what the market requires for a given level of investment. If, for example, the market were to require a 10% return for stock or equity purchased on par – at face or book value – dollar for dollar – in a particular business, but the actual and expected return going forward was significantly greater, then the stock or equity in such a business could be expected to be valued at a premium over book value. In fact, the equity in the companies in the Staff proxy group for the DCF analysis – with allowed ROEs greater than 10% - on average reflected an approximately sixty percent premium over book value. See Exhibit 51, Attachment VIII. All other things being equal, it can be inferred from these premiums that the allowed ROEs greater than 10% are higher than required; not that ROEs less than 10% are too low. See Day 2 Transcript at page 152, line 21 through page 157, line 2; see also Exhibit 27 at page 6, line 18 through page 7, line 16.

The Company also complains that the Commission incorrectly construed the Company's argument to be that the Commission should not set too low an ROE because it would discourage the *parent company* from investing capital in National Grid NH, *see* Motion at 12, and that the Commission wrongly premised its decision on the fact that the Company's immediate source of capital is a large utility holding company, assuming incorrectly that because the *Company* has a minimum obligation to invest its own earnings so that its distribution system is maintained in a particular manner, the Company's *parent* has a corresponding obligation to invest its capital when needed, *see* Motion at 14-15.

As discussed above, these contentions are without merit. The Commission recognized that the capital attraction standard relates to an allowed ROE that will attract capital from the investment community generally. In fact, the Commission went further and stated that the capital attraction standard did *not* relate to motivating a holding company to invest its discretionary capital in a utility subsidiary. *Id*. at 55. That comment, as well as the comment that the Commission did "not consider that determining an ROE for the Company in New Hampshire is part of a competition among the states for National Grid's discretionary investment dollars," *Id*. at 54, were made in reference to the argument made by the Company in its post-hearing brief at 24 that:

> "relative levels of allowed returns in different jurisdictions matter because the various jurisdictions plainly compete for discretionary capital investments (*i.e.*, those that are not required to meet a utility's basic legal requirements) made by utility holding companies doing business in multiple jurisdictions."

The Company further complains that, in setting the ROE, the Commission mistakenly relied on the Company's legal obligation to invest sufficient capital to maintain a safe and reliable system no matter what return it is able to earn, see Motion at 6, and similarly that the Commission cannot rely on the Company's obligation to expend a certain level of capital regardless of the return it earns, see Motion at 14. The Commission did not establish a lower ROE based on the Company's unconditional duty to meet its franchise obligations. The Commission's ROE analysis was manifestly an objective one, *see Id*. at 54, 56-65, performed in accordance with the Commission's traditional approach and applicable constitutional standards.

In conclusion, the Company has not stated good cause for rehearing. Accordingly, its motion for rehearing is denied.

Based upon the foregoing, it is hereby

ORDERED, the Company's Motion for Rehearing is DENIED.

By order of the Public Utilities Commission of New Hampshire this thirteenth day of November, 2009.

Thomas B. Getz
Chairman

Clifton C. Below
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary