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**VIA ELECTRONIC DELIVERY and
BY HAND DELIVERY**

Mark D. Marini, Secretary
Massachusetts Department of Public Utilities
One South Station, 5th Floor
Boston, MA 02110

RE: Request of the Office of Attorney General, Office of Ratepayer Advocacy for Investigation into Ways to Increase Transparency, Efficiency and Customer Awareness Regarding the Level of Profits Earned by Massachusetts Electric and Gas Distribution Companies

Dear Secretary Marini:

The Office of the Attorney General (“AGO”) hereby requests that the Department of Public Utilities (“Department”) open an investigation into ways to increase transparency, efficiency, and public awareness and confidence regarding the profits that electric and gas companies are allowed to earn in Massachusetts. Among other issues, this investigation should consider means to:

- Increase transparency regarding the Department’s determination of the allowed rate of return on common equity (“ROE”)¹ for electric and gas companies within the context of rate cases conducted pursuant to G.L. c. 164, § 94;
- Decrease the cost, time, and complexity associated with reviewing ROE proposals; and
- Educate and provide further information to the public regarding earned and authorized ROE.

¹ Stated simply, a company’s return on equity is the dollar amount left over after the company has paid all of its expenses—essentially the company’s allowed profit.

I. Background

Of all the decisions the Department makes in a base distribution rate case, a company's allowed annual ROE typically has the greatest financial impact on Massachusetts utilities and their customers. Small changes to a company's allowed ROE can be worth millions of dollars. For instance, in the recent electric rate case brought by Massachusetts Electric Company d/b/a National Grid ("National Grid"), a one percent difference in the allowed ROE was worth over \$15 million in annual revenues.

Given the significant monetary impact that allowed ROE has on ratepayers and electric and gas company shareholders, the Department should conduct under its general supervisory authority under G.L. c. 164, §§ 76 and 94 a comprehensive, open, public review of ROE-related issues. Doing so will ensure that the Department is using regulatory best practices when setting electric and gas companies' allowed ROE and that the process is transparent and understandable to the public.

II. Allowed Return on Common Equity Trending Downward

Across the country, public utility commissions have been decreasing utility companies' allowed ROE. Between 2010 and 2016, the average allowed ROE set in rate cases for distribution companies decreased from 10.0% to 9.4%. The reasons cited for the downward trend include:

- The utility industry has been and remains at the lowest level of risk for equity investment;
- Capital costs for utilities, as indicated by long-term bond yields and interest rates have been and remain at historically low levels;
- Although economic conditions have recovered significantly over the past five years from the Great Recession, the annual growth of the United States economy remains tepid at 2.0 to 2.5 percent;
- The forecast for growth in the United States and World economies is expected to remain low compared to historical averages; and
- Revenue decoupling and cost reconciling rate adjustment mechanisms have greatly reduced investment risk in utilities.

Although Massachusetts faces these same economic conditions as the rest of the United States, Massachusetts electric and gas companies' allowed ROE currently are trending up, not down. Indeed, since the Department's decision in Fitchburg Gas and Electric Light Company d/b/a Unitil, D.P.U. 11-01 (2011) ("Unitil 2011"), the Department's allowed ROE has either stayed the same or increased in every litigated rate case. The Department's most recent allowed ROE for electric and gas companies are:

Company ²	Industry	Year	Allowed ROE
Fitchburg/Unitil	Electric and Gas	2011	9.20%
Bay State/Columbia	Gas	2012	9.45%
Bay State/Columbia	Gas	2013	9.55%
Fitchburg/Unitil	Electric	2014	9.70%
NSTAR	Gas	2014	9.80%
Fitchburg/Unitil	Electric and Gas	2016	9.80%
National Grid	Electric	2016	9.90%

In the rest of New England, since the Department’s decision in Unitil 2011, there have been four electric and gas adjudicated³ rate cases, all in Connecticut.⁴ The allowed ROE in these cases was significantly lower than the allowed ROE in Massachusetts:

Company	Year	Allowed ROE
United Illuminating	2013	9.15%
Connecticut Light & Power	2014	9.17%
Connecticut Natural Gas Corporation	2014	9.18%
United Illuminating	2016	9.10%

III. Current Lack of Transparency Regarding Shareholder Profits

In Massachusetts distribution rate cases today, there is a plethora of evidence presented by expert witnesses sponsored by a company and the AGO regarding a just and reasonable allowed ROE. In its final order, the Department appropriately summarizes this evidence and discusses pros and cons of the testimony.⁵ However, the Department does not describe how it arrives at a final

² The Department set these companies’ ROE after a litigated rate case. Bay State/Columbia Gas’ and Liberty Utilities’ most recent ROEs are not included in the table because their ROEs were set as part of comprehensive settlements.

³ The ROE in the other New England electric company rate cases since Unitil 2011 were established through settlement:

Company	State	Year	ROE
Narragansett Electric	RI	2012	9.50%
Central Maine Power	Maine	2014	9.45%
Green Mountain Power	Vermont	2014	9.60%

⁴ See United Illuminating, Docket No. 13-01-19 (2013); Connecticut Light and Power, Docket No. 14-05-06 (2014); United Illuminating, Docket No. 16-06-04 (2016).

⁵ The Department’s standard for determining a company’s allowed return on equity is set forth in Bluefield Water Works and Improvement Company v. Public Service Commission of W. Virginia, 262 U.S. 679 (1923) and Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591 (1944); the allowed ROE should: (1) preserve a company’s financial integrity; (2) allow it to attract capital on reasonable terms; and (3) be comparable to returns on investments of similar risk.

allowed ROE number and the final result often appears inconsistent with the Department's summary subsidiary findings.

For instance, in the Department's recent order in the National Grid rate case (Massachusetts Electric Company and Nantucket Electric Company, D.P.U. 15-155), the Company's witness recommended a 10 to 10.5% ROE and the AGO's witness recommended a 8.5% ROE. In its Order, on eight occasions the Department favorably weighed the evidence supporting a lower ROE. Conversely, the Department favorably weighed the evidence supporting a higher allowed ROE only one time.⁶

Based on these subsidiary findings, the public and intervenors would expect an allowed ROE number closer to the AGO's 8.5% than the Company's recommended 10 to 10.5% return. At minimum, the Department's subsidiary findings would suggest a return no higher than 9.4% (the average of 8.5% and 10.25%, rounded up). However, despite these findings, the Department allowed an ROE of 9.9%, which is the highest rate of return on equity for an electric or gas utility in Massachusetts since 2009.⁷ The difference between 9.4% and 9.9% is significant—approximately \$7.5 million in added electricity costs for Massachusetts consumers and businesses annually until the Company's next rate case.

The Department's Order in the recent rate cases brought by Unitil for its electric and gas divisions included a similar disconnect between the Department's subsidiary findings on ROE and the Department's ultimate ROE determination.⁸ In its order in the 2016 Unitil rate case, all of the Department's findings were either neutral or favored a lower ROE.⁹ Nonetheless, the Department awarded Unitil a 9.8% ROE, which was much closer to Unitil's proposed 10.25% ROE than the 8.75% recommended by the AGO's expert witness.

⁶ The Department found the following factors weighed in favor of the Attorney General's analysis and a lower ROE: (1) the Attorney General's lesser emphasis on analyst forecasts of EPS growth rates; (2) the Attorney General's argument of upward biases by investors; (3) the Company overstated their DCF-derived ROE by minimizing the low-outlier estimates; (4) the Attorney General's CAPM analysis carried more weight due to "the magnitude of deficiencies within the Company's proposed CAPM" [p. 378]; (5) the Company's risk premium model was flawed and overstated their ROE; (6) the Company's CIRM reduces their risk; (7) the Company's decoupling mechanism reduces their risk; and (8) the Company's risk is reduced with the recovery of test year balance of protected hardship account receivables. The Department only found that the Company's storm fund mechanism increased the Company's risk. Massachusetts Electric Company, D.P.U. 15-155, pp. 354-83.

⁷ The Department granted National Grid a 10.35% return on equity. Massachusetts Electric Company & Nantucket Electric Company, D.P.U. 09-39, p. 400 (2009).

⁸ See Fitchburg Gas and Electric Light Company, D.P.U. 15-80/15-81, pp. 273-94 (2015).

⁹ Id. (making *no* findings favorably weighing the evidence supporting a higher ROE, while favorably weighing the evidence supporting a lower ROE seven times).

The Department's recent orders do not explain its judgment nor make clear the Department's line of reasoning for these seemingly anomalous results. Absent this clarity, the public is left to speculate the grounds for why the Department selected one ROE number instead of another, or even why the Department chose a ROE at the higher end of the range of reasonableness rather than the lower end. Providing a road map or guide describing how the Department reached its decision on the allowed ROE for a particular company would benefit the utilities, the public, reviewing courts and the Department by:

- Increasing transparency into the Department's decision-making;
- Serving as an "informative guide for future conduct" for all utilities;¹⁰
- Increasing case efficiency by narrowing the range of litigated issues;
- Promoting more consistency in the ratemaking process for all utilities;
- Streamlining evidence presentation by providing more clarity to witnesses regarding the Department's priorities and methodologies;
- Limiting appeals of Department orders; and
- Providing the Supreme Judicial Court with the information to determine "with confidence whether the reasoning in fact employed was factually supported and free from legal error."¹¹

IV. Proposed Investigation

The AGO recommends that the Department explore the following questions, each of which is discussed further below:

1. How can the Department modify its orders to provide more information regarding how the Department determines the allowed ROE?
2. How can the Department decrease the cost, time and complexity associated with reviewing ROE proposals?

¹⁰ Boston Gas Co. v. Dep't. of Pub. Utils., 368 Mass. 780, 803 (1975).

¹¹ NSTAR Elec. Co. v. Dep't of Pub. Utils., 462 Mass. 381, 389 (2012). See also Boston Gas Co. v. Dep't. of Pub. Utils., 368 Mass. 780, 803 (1975) ("The department would have performed a more useful service if it had explained with greater precision how it arrived at [the ROE]"); Hamilton v. Dep't. of Pub. Utils., 346 Mass. 130, 137 (1963) (citations omitted) (Supreme Judicial Court review is only feasible when the agency has provided "a guide to its reasons"); Ret. Bd. of Somerville v. Contributory Ret. Appeal Bd., 38 Mass. App. Ct. 673, 678-79 (1995) (quoting Maryland Cas. Co. v. Comm'r of Ins., 372 Mass. 554, 566-67 (1977)) (The requirement to provide a statement of reasons is necessary for a reviewing court to "exercise its appellate function to determine whether the findings of the agency are supported by the evidence and whether given these findings, the agency correctly applied the law to the facts so found").

3. How can the Department increase customer access, education and confidence regarding companies' earned and authorized ROEs?

V. Proposed Questions to Investigate

1. *How can the Department modify its orders to provide more information regarding how it reaches its ROE decision?*

Because establishing a fair allowed ROE is not an exact science and involves judgment,¹² there is no single correct way to modify the Department's orders to increase transparency. Rather, the investigation should explore a range of options. Some options to explore might include:

- The Department explicitly stating in its order the Department's determination of what constitutes the base range of reasonableness for the allowed ROE;¹³
- The Department stating in its order the Department's determination as to whether the allowed ROE should be set at the lower, middle or upper end of the range, and why;
- The Department providing more explicit information regarding how investor risk or other factors impact the final decision (this could include the bases point reductions or additions);
- Establishing greater additional uniformity in the methodology for determining the allowed ROE;¹⁴ and/or

¹² Boston Edison Co. v. Dep't of Pub. Utils., 375 Mass 1, 11 (1978) ("The rate of return is not an immutable number, but rather one chosen from a range of reasonable rates and determined by the Department to be appropriate under the circumstances").

¹³ Many state commissions provide this information in their orders. See e.g., California, Decision on Test Year 2013 Cost of Capital, 12-12-034 (2012), p. 39; and Application of Virginia Electric & Power Co., PUE-2015-00060 (Feb. 29, 2016), pp. 9–12 (applying statutory range calculation defined in Va Code sec. 56-585.1(A)(2)).

¹⁴ In Connecticut, the Connecticut Public Utilities Regulatory Authority ("Connecticut PURA") opened an investigative inquiry into the desirability, need and feasibility of establishing a uniform methodology for determining return on equity. Investigative Inquiry into the Desirability, Need and Feasibility of Establishing a Uniform Methodology for Determining Return of Equity, Docket No. 09-10-06. Although the Connecticut PURA never formally adopted a particular methodology, it used the comments and evidence submitted in the generic proceeding in subsequent rate cases. See Id., Letter to All Participants (May 9, 2012); see also Connecticut Light & Power, Docket No. 14-05-06 (Dec. 17, 2014). In Connecticut Light & Power, the Connecticut PURA found that the use of certain principles across rate cases resulted in methodologies that are "more transparent and less 'black box.'" Connecticut Light & Power, Docket No. 14-05-06, p. 145 (Dec. 17, 2014).

- Including any staff analysis formulating an allowed ROE into the record of the case¹⁵ or explaining in the decision the staff's analysis and modifications staff made to the assumptions and modeling contained in the record.

In considering options, the Department should review (1) its current practices; (2) the practices used by other states' public utility commissions; and (3) opportunities for improving or updating the Department's current practices.

2. How can the Department decrease the cost, time and complexity associated with reviewing ROE proposals?

All parties could benefit from an administratively more efficient ROE review process. One option to consider is revising the Department's filing requirements. The Department's filing requirements date to 1976. Regulations Governing the Filing of Requests for Rate Relief by Gas, Electric and Telephone Companies, D.P.U. 19019-A (1976).

For instance, the filing requirements could be revised to require companies to file testimony and exhibits concerning the effect of the various adjustment mechanisms on overall company risk. This testimony could include a quantification of the shareholder risk reduction that the various trackers provide. This specific record evidence would assist the Department in providing a more detailed explanation of its allowed ROE determination, as discussed above.

The Department also could consider updating its standard filing requirements for providing data to aid the Department and other parties in evaluating ROE proposals. The Department could specify the required financial data, calculations, workpapers and financial reports and studies that are to be filed as part of a rate application that support the requested ROE.

3. How can the Department increase customer access, education and confidence regarding earned and authorized ROE?

By opening this investigation, the Department will take a first step towards increasing customer access, education, confidence and acceptance regarding ROE-related issues. The investigation could consider additional ways to increase customer awareness and knowledge about the rate-making process and particularly provide information regarding company profits and how they are established. Suggestions include:

- Publishing an annual report for the public on the Department-authorized revenue requirement for all the investor owned utilities;¹⁶

¹⁵ Wannacomet Water Co. v. Dep't. of Pub. Utils., 346 Mass. 453, 469 (1963) (citing Salisbury Water Supply Co. v. Dep't. of Pub. Utils., 344 Mass. 716, 721–22 (1962)) (“If the department relied at all upon its own staff, their computations and opinions should have been introduced in evidence, and, if judicial notice was taken of any facts, there should have been compliance with G.L. c. 30A, sec. 11(5)”).

¹⁶ See, e.g., California Pub. Utils. Comm'n, Electric and Gas Utility Cost Report: Public Utilities Code Section 913 Report to the Governor and Legislature, April 2016, available at:

- Providing an annual report on allowed ROE for each of the utilities in the Commonwealth, along with a comparison to the commission determined allowed rates for other utilities in New England;
- Requiring companies to include earned and allowed ROE information with explanations on an easily accessible part of their websites; and/or
- Holding public information sessions.

VI. Conclusion

For the reasons stated above, the Attorney General's Office respectfully requests that the Department open an investigation into ways to increase transparency, efficiency, and public awareness and confidence regarding Massachusetts utilities' shareholder profits.

Respectfully submitted,

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Cc: Kevin F. Penders, General Counsel
Attached Service list

http://www.cpuc.ca.gov/uploadedfiles/cpuc_website/content/utilities_and_industries/energy/reports_and_white_papers/ab67_leg_report_3-28.pdf.

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