The Narragansett Electric Co. d/b/a National Grid—Application for Approval of a Change in Electric and Gas Base Distribution Rates (filed on November 27, 2017)

Docket 4770

Request for Information

Requesting Party: New Energy Rhode Island (NERI)
To: National Grid
Request No.: NERI Set 13 - 3-1
Date of Request: 3.9.18
Response Due Date: Rolling
Subject/Panel: Book 2—Hevert

3-1. Reference p. 70, l. 4 through p. 71, l. 18. Does the Company consider performance-based ratemaking to be a revenue stabilization mechanism? Could performance-based ratemaking, combined with decoupling or other revenue-stabilization mechanisms, minimize "risk" to the Company? Is the Company suggesting that no amount of reduction in "risk" due to revenue-stabilization mechanisms could ever lead to a reduction in ROE when the proxy companies have revenue stabilization mechanisms in place?

Response can be found on Bates page(s) 1.

NERI 13-1

Request:

Subject: Book 2 – Hevert

Reference p. 70, l. 4 through p. 71, l. 18. Does the Company consider performance-based ratemaking to be a revenue stabilization mechanism? Could performance-based ratemaking, combined with decoupling or other revenue-stabilization mechanisms, minimize "risk" to the Company? Is the Company suggesting that no amount of reduction in "risk" due to revenue-stabilization mechanisms could ever lead to a reduction in ROE when the proxy companies have revenue stabilization mechanisms in place?

Response:

Performance-Based Ratemaking (PBR) is a broad term used to define a form of ratemaking in which a utility's revenue is based, at least in part, on the utility's performance. There are various forms of PBR. For some utilities, PBR is implemented as a price-cap or revenue-cap formula with a productivity factor and inflation adjustment factor that is benchmarked to a peer group. If the utility can be more productive than the peer group, its revenue will be higher. Other types of PBR may provide for performance incentives in addition to an approved revenue requirement based on the utility meeting or exceeding a set of metrics approved by the regulator. Such performance incentives provide the opportunity to earn an incentive either in the form of a set dollar amount, or additional basis points to its authorized return on equity. Whether or not PBR "stabilizes" a company's revenue depends on the specifics of the mechanism and how much of the utility's revenue is at risk by virtue of PBR. It is conceivable that PBR could increase the volatility of a utility's revenue, and, therefore, its risk, because a utility's performance varies year to year.

Estimating the Cost of Equity is a comparative analysis; therefore, the principal analytical issue is whether the Company is less risky than its peers because of its cost recovery mechanisms to such a degree that investors would specifically and measurably reduce their return requirements. That the Company's existing recovery mechanisms may, to a degree, stabilize the Company's revenues does not affect its Cost of Equity because it cannot be demonstrated that: (1) the Company is materially less risky than the proxy group by virtue of those mechanisms; and (2) investors are likely to react to the incremental effect of those mechanisms.

Mr. Hevert's judgment is that, on balance, the breadth and scope of mechanisms in place among the proxy companies do not render the Company less risky than its peers.