

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: ADOPTION OF PERFORMANCE INCENTIVES :
FOR NATIONAL GRID PURSUANT TO R.I. GEN. LAWS : DOCKET NO. 4857
§ 39-1-27.7.1(e)(3) TO APPLY TO THE ELECTRIC :
INFRASTRUCTURE, SAFETY, AND RELIABILITY PLANS :

DIVISION OF PUBLIC UTILITIES AND CARRIERS' RESPONSES
TO PUBLIC UTILITIES COMMISSION'S
FIRST SET OF DATA REQUESTS

- 1-1. What are the specific objectives of the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement?

The Capital Efficiency Mechanism as proposed in Docket 4770 was intended to incentivize National Grid (electric) to complete authorized capital construction projects at or below their projected costs.

In Docket 4770 the Division of Public Utilities and Carriers undertook to submit for regulatory consideration for the first time in Rhode Island a meaningful review of the incentive structure by which electric and gas utilities earn a return on equity. The Division undertook this mission based on significant consultation with Rhode Island stakeholders in the Docket 4600 and Power Sector Transformation processes. Stakeholder consensus was that the existing cost-of-service regulatory model creates an incentive for the utility to adopt capital-intense solutions and that the benefit-cost framework of Docket 4600 was explicitly not intended to address this regulatory deficiency. Based on this stakeholder feedback, the Division proposed as a part of a settlement agreement a broad suite of performance incentives which would in combination begin to move Rhode Island toward a less capital biased incentive structure. The Division specified in its testimony that the creation of alternative incentive mechanisms would require iteration, experimentation and learning. The Division is pleased that the Commission has opened a docket to examine these topics further and recommends additional work be undertaken among stakeholders with the mutual respect, transparency and broad engagement that has characterized successful regulatory advances in Rhode Island.

Severed from the other elements of the Docket 4770 Settlement Agreement, the Capital Efficiency Mechanism originally proposed in Docket 4770 no longer exists as a proposal. The Division has chosen not to submit it in this docket.

The Capital Efficiency Mechanism was the result of wide-ranging settlement negotiations among many parties. The Division and other parties had anticipated that in the course of

hearings on the Settlement Agreement there would have been an opportunity for additional refinement and negotiation of certain topics based on guidance from the Commission. As a result, certain details and implementation logistics of the Mechanism were deliberately left open for further refinement. The Commission opted to offer specific changes to the Settlement Agreement which made additional negotiation procedurally impracticable and the Capital Efficiency Mechanism never benefitted from the refined negotiation parties had anticipated.

- 1-2. Does the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement promote the realization of new consumer and societal benefits? Please explain.

The Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement attempted to promote the realization of more efficient execution of capital investment projects in the context of National Grid's annual electric Infrastructure, Safety and Reliability program. Achieving greater efficiency in the execution of these projects, in the Division's opinion, is a consumer and societal benefit.

- 1-3. Does the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement promote behavior that the utility otherwise would not take? Please explain.

The Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement imposed a modest penalty and awarded a modest incentive that National Grid (electric) would incur or receive if the Company executed capital investment projects over or below their authorized budgets. Without the mechanism, the utility would simply recover costs in a reconciliation proceeding. There was no natural incentive in place for this behavior. With such a structure in place, it was the Division's belief that National Grid would have been, incentivized to execute projects at or below budget.

- 1-4. Is there a clear nexus between the design of the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement and the expected benefits? Please explain.

The Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement was designed to place a three-year cumulative capital budget overlay on top of each annual reconciling budget with a potential incurrence/award of a penalty/incentive for achieving spending targets. This design was connected to the anticipated benefit identified above in response to PUC 1-1 because it sought to penalize/reward the over or underspend of multi-year projects, that is one of the major areas of focus of a reconciling capital tracker.

- 1-5. Is there a clear and stated reason why the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement is needed to achieve the specific objectives? Please explain.

See Response to 1-4.

- 1-6. Is the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement designed to promote superior utility performance and significantly advance the expected benefits as efficiently as possible? Please explain.

In general, absent a reasonable explanation, the Division believes that utilities should complete capital projects at or below budget. The Capital Efficiency Mechanism proposed in Docket No. 4770 was designed to attempt to achieve this goal, which would be an indicator of superior utility performance and efficiency.

- 1-7. Is the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement designed so that customers receive most of the benefit? Please explain.

In general, the mechanism was designed to incentivize National Grid (electric) to complete capital projects at or below budget. Assuming the mechanism achieves this objective, ratepayers would receive the majority of the benefits through a reduced revenue requirement arising from the Company's efficient spending.

- 1-8. Is the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement designed to grant increasing levels of rewards to the utility for higher levels of performance? Please explain.

In general, the incentive component was designed such that saving more yields a greater incentive.

- 1-9. Will the design and implementation of the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement be completely transparent and fully document and reveal inputs and methodologies to ensure no duplication of incentives across various ratepayer funded programs? Please explain.

There is no duplication of incentives of which the Division is aware. All inputs and calculations were proposed to be fully transparent and documented.

- 1-10. Is it possible to compare the cost of achieving the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement to the potential benefits? Please explain.

The Division does not understand what is meant by "cost of achieving". If by that term the Commission means costs to promulgate such a mechanism it may be possible to perform such a comparison but in the context of a capital budget process performing such an analysis, in the Division's opinion, is not material to assessing the merits of the mechanism.

- 1-11. Are there opportunities for National Grid to earn multiple incentives for attaining the objectives identified in the Division's response to PUC-1-1? Please explain.

Not that the Division is aware of.

- 1-12. Please explain how the baseline set in the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement was set.

The PUC sets the baseline in its approval of the ISR budget.

- 1-13. Please explain how the baseline set in the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement is objective and not easily influenced by the Company's own inputs.

The mechanism is objective by virtue of its numerical spending target and incentive/penalty structure. In the Division's opinion, Company inputs can influence almost any mechanism the Division may propose and the Commission may consider. In this case, the Company's inputs are reviewed and approved by the Commission after review by the Division.

- 1-14. Please explain how the baseline set in the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement is measurable where there are opportunities to change the baseline during the period over which the Capital Efficiency Mechanism operates.

This is an area the parties had anticipated they would refine.

- 1-15. Please explain how the baseline set in the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement accounts for deferral of projects/spending.

This is an area the parties had anticipated they would refine. However, the baseline would have been adjusted for overall project deferrals.

- 1-16. Please explain how the baseline set in the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement is impacted by mandatory spending fluctuations.

This is an area the parties had anticipated they would refine.

- 1-17. Please explain how the baseline set in the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement is impacted by discretionary spending fluctuations.

This is an area the parties had anticipated they would refine.

- 1-18. Please explain how the comparison of actual spending to the baseline set under the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement is impacted by deferrals of projects/spending.

This is an area the parties had anticipated they would refine.

- 1-19. Please explain how the comparison of actual spending to the baseline set under the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement is impacted by mandatory spending fluctuations.

This is an area the parties had anticipated they would refine.

- 1-20. Please explain how the comparison of actual spending to the baseline set under the Capital Efficiency Mechanism proposed in the Docket No. 4770 Settlement Agreement is impacted by discretionary spending fluctuations.

This is an area the parties had anticipated they would refine.

- 1-21. Please provide a detailed explanation of how the proposed incentives or penalties will be treated for purposes of the Company's electric earnings reports.

This is an area the parties had anticipated they would refine.