

State of New Hampshire
Supreme Court

NO. 98-114

2000 TERM

AUGUST SESSION

IN RE

NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION
STATEWIDE ELECTRIC UTILITY RESTRUCTURING PLAN

INTERLOCUTORY TRANSFER WITHOUT RULING
FROM THE PUBLIC UTILITIES COMMISSION

BRIEF OF CAMPAIGN FOR RATEPAYERS RIGHTS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

STATEMENT OF FACTS AND STATEMENT OF THE CASE 1

ARGUMENT 1

 I. Introduction 1

 II. The Rate Agreement Is a Rate Agreement, Not a Revenue Agreement 2

 A. People Can Leave the System 4

 B. PSNH Accepted the Risk That People Would Leave the System 5

 C. The Riddle of the Last Ratepayer 7

 III. PSNH Expressly Took the Risk That Revenues Would Fall Short 7

 IV. PSNH’s Remedy Is Against its Attorneys, Not Against its Customers 9

 V. PSNH’s Efforts for “Securitization” Belies its Claim of
 Rate Agreement Entitlement 9

CONCLUSION 10

REQUEST FOR ORAL ARGUMENT AND CERTIFICATION 10

TABLE OF AUTHORITIES

STATEMENT OF FACTS AND STATEMENT OF THE CASE

Because this case involves the construction of a document, and is before this Court from the PUC without ruling, there are few facts necessary for review. Those that are relevant are adequately covered by this Court in *Appeal of Richards*, 134 N.H. 148 (1991), *cert denied*, 502 U.S. 889 (1991). Otherwise, this Court only need be aware of the enactment of RSA 374-F.

ARGUMENT

I. Introduction

The heart of Public Service Company of New Hampshire's (PSNH) case is contained in its brief at page 26. There, the company writes,

“PSNH agrees that the Rate Agreement contemplated a return to ‘traditional ratemaking after the seven years of prescribed rate increases had been implemented. That statement, however, means only that after the fixed rate period,¹ the PUC must set rates in accordance with traditional rate making procedures and law. When it does so, the plain language of the Rate Agreement requires the PUC to include the specified unrecovered assets and expenses in PSNH's rate base, and it requires the PUC to provide for the amortization through rates of those rate base items during the periods specified in the Rate Agreement.”

PSNH Br. at 26. So it does. The Campaign for Ratepayers Rights (CRR) is prepared to assume, without conceding, that the Rate Agreement is enforceable as a contract, *Appeal of Richards*, 134 N.H. 148 (1991), *cert denied*, 502 U.S. 889 (1991), and that it guarantees that after the escalating rate period there is a return to traditional ratemaking and that the acquisition premium must be included in the ratebase. RATE AGREEMENT § 5(b), *Vol. I Appendix to Interlocutory Appeal* at 23.

¹The seven-year period is more accurately called the *escalating* rate period, because the rates, from the view of PSNH ratepayers, were anything but “fixed.”

II. The Rate Agreement Is a Rate Agreement, Not a Revenue Agreement

The Rate Agreement says that

“The acquisition premium . . . shall be included in [PSNH’s] rate base. \$425 million of the acquisition premium (or the full amount of the acquisition premium, if less than \$425 million) will be amortized on a straight line basis and recovered with a return [over the seven year escalating rate period]. The recovery of that portion, if any, of the acquisition premium in excess of \$425 million will be amortized on a straight line basis and recovered with a return over a [20-year] period.

RATE AGREEMENT § 5(b), *Vol. I Appendix to Interlocutory Appeal* at 23.

Before the PSNH bankruptcy and the advent of the Rate Agreement, PSNH’s rates were set, like other utilities, using the process known as traditional ratemaking. Rates were based on the cost of the utility’s assets plus a “return,” which is the regulated monopoly surrogate for a profit. *See, Appeal of Conservation Law Foundation*, 127 N.H. 606 (1986). The Rate Agreement was a hiatus from that tradition, which is now to resume. *Richards*, 134 N.H. at 162. Traditional ratemaking still sets rates according to the same method.

Traditional ratemaking guarantees that for each unit of electricity sold, the utility will collect a portion of the cost of the utility’s assets used by the consumer to generate and deliver that unit of electricity, plus a commensurate return on its investment. If the consumer doubles the size of her/his home or business, or otherwise doubles the electricity usage, the recovery of the cost of the utility’s assets and the commensurate return on investment will likewise be doubled. If, however, the consumer decreases the size of her/his electricity purchase, the utility will collect proportionally less. If the consumer decides to buy none at all, the utility collects nothing.

Thus, traditional ratemaking does not guarantee the utility will recover its costs or earn a

return; it merely guarantees that the utility has an opportunity to do so, if the consumer buys its product. *See* J. Bonbight, A. Danielson, & D. Kamerschen, PRINCIPLES OF PUBLIC UTILITY RATES 96 (2nd ed. 1988). No consumer is required to buy a utility's product. If none (or an inadequate number) buy the product, the utility will find itself unable to cover the costs of its assets and also unable to earn a return. Ratemaking for monopoly items is a surrogate pricing mechanism that is designed to mimic the market. It is not a guarantee that people will buy the product or that the monopolist will make money. No amount of intelligent or creative ratemaking, for example, could save the railroads after the interstate highway system decreased demand for their service.

PSNH is correct in saying that rates must be high enough, for a period of 20 years, to cover the acquisition premium. But the Rate Agreement nowhere says the state must guarantee enough people will buy PSNH's product at the specified rate levels so that PSNH will in fact recover the acquisition premium. The Rate Agreement nowhere holds the State responsible for paying the acquisition premium if demand for PSNH's product is not sufficient to allow PSNH to recover its costs.

In 1974, when the PUC granted PSNH the first of a string of rate increases, it told PSNH:

“We point out that the revenues which we allow do not comprise a guaranteed profit to the Company or to its stockholders. As the merchant prices the goods upon his shelves at a level which he calculates as sufficient to meet his operating expenses together with a reasonable return upon his investment, so we, in the exercise of the public right to fix charges for the service rendered by this public utility and having regard to the same factors taken into account by the private merchant, have set the level of rates which the Company will be allowed to charge. We have exercised our best judgment and believe that we are correct -- but if due to future eventualities over which we have no control the goals which our order is intended to achieve are not met, there will be no restoration, either to the Company or to its stockholders, of earnings and profits which were not

realized. In this respect the Company and its stockholders stand in no different position than that of the unregulated enterprise.”

In re Public Service Company of New Hampshire, 59 NHPUC 334, 338 (1974). The leading hornbook of utility ratemaking concurs:

“Under prevailing methods of rate regulation . . . private companies receive no guaranty of their ability to enjoy a fair rate of return, with the result that they may be under more or less severe pressure to practice operating economies and to stimulate growth of demand for service in order to earn the officially sanctioned rate.”

J. Bonbight, A. Danielson, & D. Kamerschen, *PRINCIPLES OF PUBLIC UTILITY RATES* 96 (2nd ed. 1988). PSNH’s claim that the Rate Agreement guarantees a return is based on the mistaken assumption that people will still want, or can be compelled, to purchase its product. While that may have been a good assumption, *Appendix to PSNH Brief* at 41 (testimony of John Noyes), it is only an assumption. Time did not bear out PSNH’s optimism.

A. People Can Leave the System

There are many ways people can leave PSNH’s system. A municipality may declare itself a utility and buy power from anyone it wishes. RSA 38:1 *et seq.* Currently the towns of Ashland, Littleton, New Hampton, Wolfeboro, and Woodsville, do precisely that. Dover and Claremont may now be on the brink of municipalizing.

Industrial facilities may build co-generation plants, whereby they burn gas to generate steam for their industrial process and use the waste heat to generate electricity. Innumerable co-generation plants currently exist in New Hampshire. For instance, eleven of the thirteen Hannaford Brothers Supermarkets (Shop ‘n Save) now self-generate. Dover City Hall has two gas turbine generators, and is off the grid. It was lit up when the rest of the state lost its power during last winter’s ice storm. More self-generation facilities are in the planning stages.

Any electricity consumer can generate their own power, using solar technology, windmills, gas generators, or any other method. There are numerous such facilities in New Hampshire now. A business in Northwood keeps itself busy installing solar panels; there are dozens of private windmills operating in the state. People can conceivably run an extension cord to their neighbor's house in another utility's franchise area, thereby effectively leaving PSNH's system. CRR has heard these anecdotes and believes it probably happens. People may simply conserve power by using less (e.g., replace electric heat with kerosene, or light bulbs with fluorescents), or go off the grid if they chose.

By doing these things, each of these former PSNH ratepayers currently provide the utility with a proportionately lesser share of the cost of PSNH's assets and its return on the assets. Nothing in the Rate Agreement prevents this. PSNH did not contract against this when it entered the Rate Agreement, and the State provided no guarantee it would not happen.

RSA 374-F did not create the phenomena of people using less power or leaving PSNH's system. PSNH itself is responsible for this. It was PSNH's ever-higher rates that led to depressed sales. The legislation merely directed the PUC to allow more people to find alternative sources by permitting consumer choice in electric supply. Consumer choice has the exact same effect for PSNH as consumers leaving its system any other way. And the risk of it happening rests with PSNH just as fully as the risk of lost sales from self-generation or municipalization – risks which PSNH explicitly accepted.

B. PSNH Accepted the Risk That People Would Leave the System

PSNH knew that people could and might leave its system.

Wilbur Ross was the financial advisor to the equity holders in the bankruptcy. He was

PSNH's witness in this case concerning the bankruptcy, its resolution, and the terms of the Rate Agreement. He testified that the utility "accepted the risk that the increase in rates might drive large customers to self-generation or might cause some towns to municipalize their electric systems." *Appendix to PSNH's Brief* at 76.

David Kleinschmidt testified during the bankruptcy proceedings. As a senior consultant of engineering science for Arthur D. Little, he conducted a study to gauge the effects of the Rate Agreement on the likelihood that people would leave the system. The Bankruptcy Court wrote that "[h]e testified that significant self-generation is already occurring in New Hampshire and that it would be a serious threat with greatly increased electric rates." He further testified that PSNH's largest customers would be able to go off the utility's system rapidly, and that this could lead to a significant decrease in demand for PSNH's product. *In re Public Service Co. of New Hampshire*, 114 B.R. 820, 832 (Bkrcty. D.N.H. 1990). The Bankruptcy Court also cited the testimony of William Moss, an NU consultant. According to the Court, Moss concluded that municipalization "was a viable option in New Hampshire but probably would not occur during the" period of the Rate Agreement. Thus, it is clear that PSNH evaluated the risk of customer loss by municipalization and concluded it was not worthy of including in the Rate Agreement. *Id.* at 833.

PSNH admitted that it bore this risk. In the PUC case that approved the Rate Agreement, the agency quoted the company as saying that "NU and its investors, not New Hampshire ratepayers, bear the risk of optimistic sales projections over the Fixed Rate Period." *Northeast Utilities/Public Service Company of New Hampshire*, 75 NHPUC 396, 434 (1990).

C. The Riddle of the Last Ratepayer

If we suppose that the acquisition premium is \$400 million and that PSNH has 1 million ratepayers, PSNH's recovery of the acquisition premium is \$400 per ratepayer over 20 years. If we suppose that one half of the ratepayers leave the system, each customer's share doubles to \$800. As each ratepayer leaves the system, those that are left are responsible for a commensurately higher portion.

PSNH's arguments make one wonder whether, if everybody leaves the system, what happens to the one person who is left. Is there a \$400 million bag? Is that person alone responsible for paying it? While this outcome is absurd, it is the logical result of PSNH's argument.

III. PSNH Expressly Took the Risk That Revenues Would Fall Short

As shown above, PSNH expressly took the risk that its customers would leave its system. If the company wanted to protect itself against that, it should have included that in the Rate Agreement. PSNH put many provisions into the Rate Agreement, but it did not include a clause such as: "PSNH's monopoly status is guaranteed by the state of New Hampshire until such time as all its costs are recovered," or "At no time shall the State of New Hampshire permit customer choice until NU's cost of acquisition has been recovered," or "During the full term of all obligations under this agreement, PSNH's monopoly franchise shall not be impaired."

Out of thin air, however, PSNH is now pretending that it did not take the risk that its costs would not be recovered. It instead alleges that the State assumed that risk. *Appendix to PSNH Brief* at 42 (testimony of John Noyes). PSNH points to no provision of the Rate Agreement to support the allegation, and it is a fiction.

When it entered the Rate Agreement, PSNH was fully aware that it had no guarantee that it would recover the acquisition premium. PSNH readily admits that the acquisition premium is roughly one-half the cost of Seabrook. In its brief in *Appeal of Richards*, the Company wrote,

“PSNH, as a co-proponent of the Reorganization Plan, voluntarily accepted and sought the Commission’s approval of the Rate Agreement which, in effect, permits recovery of \$1.5 billion of PSNH’s investment in Seabrook (\$700 million assigned Seabrook value plus the \$800 million “Acquisition Premium”).

PSNH Brief in Appeal of Richards, N.H. Sup. Ct. No. 97-406, November Session, 1990 Term at 25. The cost of Seabrook was split in half for accounting and tax purposes. *Appendix to PSNH Brief* at 20 (testimony of John Noyes).

Had PSNH not chosen to split off the acquisition premium, it would have been included as a cost in the Seabrook Power Contract, which the PUC itself described as a “bullet-proof obligation to pay.” *Northeast Utilities/Public Service Company of New Hampshire*, 75 NHPUC 396, 439 (1990). Because the Seabrook Power Contract is a FERC-approved wholesale contract, its cost cannot be disallowed by the PUC pursuant to the “filed-rate doctrine.” *See Appeal of Northern Utilities, Inc.*, 136 N.H. 449 (1992). By its choice, therefore, PSNH took on the very risk it now claims rests with ratepayers. Moreover, PSNH was on notice long before the bankruptcy that it wouldn’t necessarily recover Seabrook costs through ratebase. *Appeal of Public Service Company of New Hampshire*, 122 N.H. 1062, 1076 (1982).

The United States Supreme Court recently ruled on a similar matter. In *United States v. Winstar*, 518 U.S. ___, ___, 64 U.S.L.W. 4739, 4758 (1996), the Court wrote that “[i]f the [risk] was foreseeable, there should have been a provision for it in the contract, and the absence of such a provision gives rise to the inference that the risk was assumed.”

IV. PSNH's Remedy Is Against its Attorneys, Not Against its Customers

PSNH could have written into the Rate Agreement a guarantee that it would recover its costs regardless of events in the market. While the company may wish it had done so, it didn't.

It was clear to all watchers of the electric industry in 1989 and 1990, when the Rate Agreement was being negotiated, that restructuring was likely. At the time airlines, trucking, and telephones had been deregulated. Gas utilities were in the process. The trade press was full of the possibility for the electric industry.² PSNH had no basis on which to suppose that it was immune.

If PSNH has a remedy for these failures, it is for malpractice against Day, Berry & Howard, its attorneys in the Rate Agreement negotiations. But by the terms of the Rate Agreement document, there is no remedy against the ratepayers of the state of New Hampshire.

V. PSNH's Efforts for "Securitization" Belies its Claim of Rate Agreement Entitlement

Securitization is effectively a bond guarantee whereby a default caused by PSNH's failure to recover its costs would be guaranteed by ratepayers. Securitization is supposed to lower rates because it creates an absolute obligation to repay the bonds, allowing refinancing on better terms.

PSNH has been actively seeking in the legislature to have its assets securitized by New Hampshire ratepayers. *PSNH Brief* at 24, n 15.

²The number of articles in the trade press at the time belies any claim that a utility did not know that the days of monopoly electric utilities were numbered. *See e.g.*, Martha O. Hesse, *Market-Based Approach Can Work Well in Advancing Goals of Electric Industry*, OIL DAILY (Oct. 3, 1989); *[Senator] Johnston Sets October Hearings on PUHCA: Says He Has 'Open Mind,'* INDEP.POWER RPT.1 (Sept. 22, 1989); *NARUC: Fortifying for a Sea of Change*, 124 PUB.UTIL.FORT.40 (Sept. 14, 1989); *Utility Marketing Strategists Use Experience From Telephone Industry*, ELEC.UTIL.WK. 4 (June 6, 1989); *White House Urges Competition: Efficiency in Electric Industry*, ELEC.UTIL.WK. 2 (May 22, 1989); *Consumers Power CEO Sees More Diversification*, ELEC.UTIL.WK. 9 (Nov. 3, 1986).

If the acquisition premium is already guaranteed, as PSNH is here claiming, there would be no lowering of the rate, or in the alternative, PSNH would today be able to refinance at more advantageous terms without needing securitization.

PSNH's attempt to have ratepayers securitize the recovery of its costs belies its claim that the Rate Agreement is already a guarantee, and reveals that its position in this appeal is flawed.

CONCLUSION

For the foregoing reasons, CRR urges an answer of 'no' to question 1 as it pertains to any "stranded costs" created by the acquisition premium. To the extent that the acquisition premium may create "stranded costs" for PSNH, there is no requirement that the PUC recognize them in establishing stranded costs charges.

Respectfully submitted,
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Dated: August 8, 2000

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REQUEST FOR ORAL ARGUMENT AND CERTIFICATION

Counsel for the Campaign for Ratepayers Rights requests that Attorney Joshua L. Gordon be allowed 5 minutes for oral argument.

I hereby certify that on August 8, 2000, a copy of the foregoing will be forwarded to all those on the Court's April 1, 1998 order.

Dated: August 8, 2000

Joshua L. Gordon, Esq.