

**S T A T E O F
C O N N E C T I C
U T**

**DEPARTMENT OF PUBLIC UTILITY CONTROL
TEN FRANKLIN SQUARE
NEW BRITAIN, CT 06051**

**DOCKET No. 97-01-1597- DPUC REVIEW OF ELECTRIC COMPANIES COST OF SERVICE AND
01-15 UNBUNDLED TARIFFS DPUC REVIEW OF ELECTRIC COMPANIES COST
OF SERVICE AND UNBUNDLED TARIFFS**

July 29, 1998

By the following Commissioners:

Glenn Arthur
John W. Betkoski, III
Donald W. Downes

DECISION

I. INTRODUCTION

A. SUMMARY

This Decision assigns the costs of The Connecticut Light and Power Company and The United Illuminating Company to one of three functions; production (generation), transmission or distribution.

In this Decision the Department isolates each utilities' fully embedded cost for generation and generation-related services from all other utility costs. The generation costs identified herein do not reflect future competitive generation offerings and should not be used as a benchmark for comparing such offerings. Competitive generation pricing is a component of each utility's fully embedded costs and will be identified and broken out in subsequent proceedings. Therefore, this Decision should be viewed as the first step toward calculating competitive generation services rates.

A summary of proposed and approved allocators is contained in Appendix A.

B. CONDUCT OF THE PROCEEDING

By letter dated October 29, 1996, the Department of Public Utility Control (Department) notified The Connecticut Light and Power Company (CL&P) and The United Illuminating Company (UI; jointly, Companies) of the Department's intent to initiate a proceeding to review the functionalization of costs for the Companies. The proceeding was described as a follow-up to Docket No. 93-09-29, DPUC Investigation into Retail Electric Transmission Service, and Docket No. 94-12-13, DPUC Investigation into the Restructuring of the Electric Industry.

Pursuant to a Notice of Technical Meeting dated November 14, 1996, a Technical Meeting was held on November 26, 1996, at the offices of the Department, Ten Franklin Square, New Britain Connecticut to discuss the filing requirements of the instant proceeding. Pursuant to a Notice of Technical Meeting dated May 9, 1997, a Technical Meeting was held on May 27, 1997, at the offices of the Department to discuss the functional allocations presented by CL&P and UI. Pursuant to a Notice of Technical Meeting dated July 23, 1997, a Technical Meeting was scheduled at the offices of the Department on August 7, 1997. Pursuant to a Notice of Cancellation of Technical Meeting dated July 31, 1997, the August 7, 1997 Technical Meeting was canceled.

Pursuant to a Notice of Hearing dated July 25, 1997, a public hearing was held at the offices of the Department on August 14, 1997, and continued without date. Pursuant to a Notice of Continued Hearing dated August 28, 1997, the hearing was continued to September 29, 1997. Pursuant to a Notice of Continued Hearing dated May 20, 1998, an additional hearing was held at the offices of the Department on June 10, 1999, to examine the effect of Public Act 98-28, An Act Concerning Electric Restructuring (Act), on the instant proceeding.

C. PARTIES AND INTERVENORS

The Department recognized the following as parties to this proceeding: The United Illuminating Company, 157 Church Street, New Haven, Connecticut 06506-0901; the Office of Consumer Counsel (OCC), Ten Franklin Square, New Britain, Connecticut 06051; and The Connecticut Light and Power Company, P.O. Box 279, Hartford, Connecticut 06141-0270. The Department designated the Connecticut Business & Industry Association, the Manufacturing Alliance of Connecticut Inc., Connecticut Industrial Energy Consumers and the Office of the Attorney General (AG) as intervenors to this proceeding.

II. DEPARTMENT ANALYSIS

A. GENERAL

Under electric utility industry restructuring, generation will be competitive while distribution and transmission will continue to be regulated. To implement this change, rates must be unbundled and separate charges developed for each function. Fair cost assignment to each function is necessary to minimize cross subsidization and provide equal treatment for all competitors.

The Decision that follows functionalizes costs to generation, transmission and distribution. However, transmission and distribution costs can be grouped together, essentially resulting in an assignment of costs to generation and 'all other costs'.

CL&P states that although a debate on the functionalization of costs under today's vertically integrated utility structure may be healthy, that debate does not matter. Instead, the functionalization of costs must consider the future electric environment because where the costs are assigned leads to where the costs will be collected. Tr. 8/14/97, p. 61. UI also indicates that an unregulated environment must be considered in the instant proceeding. Tr. 9/29/97, pp. 272-274. However, the AG believes that costs should be assigned under today's industry structure. Then, if in a competitive environment a cost is determined to be unrecoverable, legislative policy should guide the assignment or recovery of that cost. Tr. 8/14/97, p. 62.

The Department stated that this proceeding was intended to functionalize costs based on today's electric industry structure. Tr. 9/29/97, pp. 52, 274, 299 and 372. This Decision addresses costs in the current vertically integrated utility structure and does not speculate as to cost recovery or the responsibilities for revenue collection assigned to the utilities in the future electric industry environment. The initial evidentiary phase of this proceeding concluded with the September 29, 1997 hearing. Subsequent to that the Act was signed into law. Passage of the Act provides all participants with a better understanding of how restructuring of the electric industry will unfold in Connecticut. However, as discussed below, although the Act assigns the responsibility for collecting certain costs to the distribution function, the Act does not quantify cost recovery. The Act instead requires the Department to determine the portion of existing utility costs that will be collected by the distribution function. Further, the Department did not base its conclusions regarding functionalization on the magnitude of the cost to be recovered.

In the past, electric companies generally submitted cost-of-service studies with a rate application. These studies were reviewed by the Department and interested parties, including the participants in the instant proceeding, at that time. Although costs were assigned to functions as part of those studies, the focus of past analysis and controversy was the allocation of costs to customer classes, not cost assignment by function. Due to the heightened importance of functionalization, a fresh look at this issue is warranted. Therefore, as it relates to functionalization, the Department will not be bound by our previous Decisions or former rulings by the Federal Energy Regulatory Commission (FERC).

The Uniform System of Accounts provides a good starting point for functionalization by clearly defining most accounts. As a result, there is consensus on the functionalization of most accounts including the majority of overall costs. OCC states that direct allocation is preferable

to the use of general allocators. Tr. 9/29/97, p. 483. The Department agrees. Direct assignment is the ideal way to allocate costs and therefore the preferred method in any cost study. The Department's goal is to functionalize as many costs as possible on a direct basis. However, not all employee, equipment or plant costs are dedicated to a single function; some costs are common to multiple functions and as such cannot be directly assigned. Therefore, it is necessary to use indirect or 'blanket' allocators to functionalize these 'general' costs. This Decision determines appropriate allocators for these general costs. Accounts not specifically addressed herein will be allocated based on the allocators presented by CL&P and UI.

Indirect assignment involves a great deal of judgment. The parties generally agree that although the National Association of Regulatory Utility Commissioners (NARUC) suggests alternative methods for allocating costs, NARUC does not recommend or require the use of any single method. Tr. 8/14/97, pp. 89-95. Reasonable arguments can be made for alternative allocations. In this proceeding, there was mild disagreement regarding assigning certain costs to the transmission function. However, there is significant disagreement regarding assignment of some costs to generation and/or distribution. Indirect assignment is the area of most of the controversy in this proceeding and therefore the focus of this Decision.

The primary indirect allocators proposed in this case for assigning costs are plant and overhead/labor (Plant or Labor Allocator).¹ OCC ALSO PROPOSED THAT SOME COSTS BE ASSIGNED EQUALLY AMONG ALL FUNCTIONS (ONE-THIRD ALLOCATOR). ANOTHER COMMON ALLOCATOR FOR INDIRECT COSTS IS REVENUES (REVENUE ALLOCATOR). THE CHOICE OF ALLOCATOR CAN HAVE A SIGNIFICANT IMPACT ON THE LEVEL OF COSTS ASSIGNED TO EACH FUNCTION. OCC AND AG GENERALLY USED THE PLANT OR ONE-THIRD ALLOCATORS, WHICH ASSIGN A GREATER PROPORTION OF COSTS TO GENERATION THAN TO DISTRIBUTION. UI AND CL&P GENERALLY USED THE LABOR ALLOCATOR TO ASSIGN INDIRECT COSTS. THIS RESULTS IN A LARGE SHARE OF COSTS ASSIGNED TO DISTRIBUTION AND LESS TO GENERATION. THE REASON FOR DISCORD REGARDING THE USE OF DIFFERENT ALLOCATORS APPEARS TO BE THE BELIEF THAT IN A FUTURE RESTRUCTURED ELECTRIC ENVIRONMENT THERE IS REASONABLE CERTAINTY THAT DISTRIBUTION COSTS WILL BE RECOVERED THROUGH THE CONTINUATION OF COST OF SERVICE RATE MAKING. CONVERSELY, COSTS THAT ARE FUNCTIONALIZED TO A FUTURE UNREGULATED GENERATION FUNCTION RISK BECOMING 'STRANDED' AND THEIR RECOVERY BECOMES LESS CERTAIN. OCC SCHEDULE 1 AND 2; RESPONSE TO INTERROGATORY UI-EL-14; RESPONSE TO INTERROGATORY CL&P-EL-12 REVISED; TR. 8/14/97, PP. 56-58. THE CHART BELOW ILLUSTRATES HOW THE ASSIGNMENT OF COSTS VARIES BASED ON THE ALLOCATOR SELECTED.²

¹ Overhead and labor are essentially the same allocator. CL&P identifies this allocator as overhead; UI identifies it as labor. The term Labor will be used in this Decision to reference these allocators.

² The OCC and AG did not develop Plant or Labor percentage allocators, they relied on the percentages developed by the utilities.

THE DEPARTMENT VIEWS THE INSTANT PROCEEDING AS THE FIRST STEP IN A MULTI-STEP PROCESS THAT WILL ULTIMATELY RESULT IN UNBUNDLED ELECTRIC RATES. THE FOCUS OF THIS PHASE OF THE PROCEEDING IS FUNCTIONAL UNBUNDLING. THE FIRST STEP IS TO CATEGORIZE (I.E., FUNCTIONALLY UNBUNDLE) ALL COSTS INTO ONE OF THREE MAJOR FUNCTIONS; GENERATION, TRANSMISSION OR DISTRIBUTION. AFTER COSTS HAVE BEEN FUNCTIONALLY UNBUNDLED, THEY MUST BE FURTHER BROKEN OUT OVER THE NEXT YEAR TO DEVELOP RATES THAT WILL APPEAR ON CUSTOMERS BILLS AS REQUIRED BY THE ACT. DETERMINATION OF STRANDED COST, EXAMINATION OF THE STANDARD OFFER AND IDENTIFICATION OF SYSTEMS BENEFIT COSTS IS NEEDED BEFORE THE TRANSITION CHARGE, SYSTEMS BENEFIT CHARGE AND THE COMPETITIVE GENERATION CHARGE CAN BE DEVELOPED. PREVIOUSLY APPROVED CLASS ALLOCATION METHODOLOGIES WILL GUIDE THE RATE DESIGN PROCESS ONCE FUNCTIONAL UNBUNDLING IS COMPLETED. TR. 8/14/97, PP. 6-9.

ALL PARTIES MUST RECOGNIZE THAT THIS IS ONLY THE FIRST STEP. THE DEPARTMENT WILL NEED TO REVISIT THIS ISSUE AFTER THE COMPANY'S DIVEST THEIR GENERATING ASSETS. IF THE COMPANIES CONTINUE TO HOLD GENERATION AND DISTRIBUTION ASSETS INTO THE FUTURE, THE DEPARTMENT WILL CONTINUE TO EXAMINE THE ASSIGNMENT OF COSTS BETWEEN FUNCTIONS IN APPROPRIATE FORUMS. NEW ALLOCATIONS MAY EMERGE OR CONSENSUS MAY BE REACHED FOR CERTAIN ACCOUNTS AS THIS ISSUE IS EXAMINED FURTHER IN CONNECTICUT AND THROUGHOUT THE COUNTRY. UNFORESEEN CHANGES TO ELECTRIC UTILITIES COULD ALSO RESULT IN A NEED TO MODIFY THE ASSIGNMENT OF COSTS.

UI AND CL&P ARE CURRENTLY EXAMINING EACH ACCOUNT TO DEVELOP WAYS TO ASSIGN COSTS ACCURATELY TO FUNCTIONS IN THE FUTURE. THE DEPARTMENT ENCOURAGES THE COMPANIES TO EXAMINE COST CAUSATION IN MORE DETAIL. IT IS CRITICAL THAT COSTS ARE ASSIGNED TO THE FUNCTIONS THAT INCUR THEM. THE DEPARTMENT MUST ENSURE THAT COSTS ARE NOT SHIFTED FROM UNREGULATED TO REGULATED FUNCTIONS. THE ISSUE OF RECOVERY IS NOT A CONSIDERATION WHEN ASSIGNING COSTS AND STRANDED COST RECOVERY WILL BE CONSIDERED AT ANOTHER TIME.

1. PUBLIC ACT 98-28

PUBLIC ACT 98-28 WAS SIGNED INTO LAW ON APRIL 29, 1998. SECTION 5(B) OF THE ACT REQUIRES THE DEPARTMENT TO ISSUE AN ORDER THAT UNBUNDLES THE PRICE OR RATE FOR GENERATION SERVICES BY AUGUST 1, 1998. THE ACT PROVIDES GUIDANCE AS TO HOW DEREGULATION OF THE ELECTRIC INDUSTRY IN CONNECTICUT WILL PROCEED. AS NOTED IN THE MAY 20, 1998, NOTICE OF CONTINUED HEARING, THE PURPOSE OF THE JUNE 10, 1998, HEARING WAS TO EXAMINE THE EFFECT OF THE ACT ON THE INSTANT PROCEEDING.

OCC BELIEVES THE ACT SHOULD HAVE NO BEARING ON THE UNBUNDLING OF ELECTRIC GENERATION SERVICES FROM ALL OTHER UTILITY COSTS, STATING THAT IN THIS PROCEEDING THE DEPARTMENT SHOULD DEVELOP THE VALUE OF GENERATION SERVICES AS BEING THE CURRENT FULLY EMBEDDED COST OF GENERATION. THEN, IN SUBSEQUENT PROCEEDINGS REQUIRED UNDER THE ACT, THE UNBUNDLED COST OF GENERATION CAN BE EXAMINED TO DETERMINE COSTS TO BE RECOVERED THROUGH THE COMPETITIVE TRANSITION ASSESSMENT (CTA) OR SYSTEM BENEFITS CHARGE (SBC). OCC NOTES THAT CALCULATING COMPETITIVE GENERATION PRICING WILL BE COMPLEX AND CANNOT BE ACCOMPLISHED IN THE TIME FRAME OF THE INSTANT PROCEEDING. TR. 6/10/98, PP. 287-288, 319 AND 331; RESPONSES TO INTERROGATORIES OCC-EL-4, 6 AND 7.

CL&P AND UI BELIEVE THAT SECTION 5(B) OF THE ACT DOES NOT REQUIRE THE DEPARTMENT TO UNBUNDLE THE FULLY EMBEDDED COST OF GENERATION. THE COMPANIES STATE THAT CUSTOMERS WILL BE CONFUSED IF THE CURRENT FULLY EMBEDDED COST OF GENERATION IS UNBUNDLED AND ISOLATED ON CUSTOMER BILLS IN 1999 BECAUSE FUTURE COMPETITIVE GENERATION OFFERINGS WILL LIKELY BE SIGNIFICANTLY LESS THAN THE CURRENT FULLY EMBEDDED COST OF PRODUCTION³. FURTHER, THE COMPANIES ARE CONCERNED THAT MARKETERS MAY MISREPRESENT THE POTENTIAL SAVINGS ASSOCIATED WITH SWITCHING ENERGY SUPPLIERS BY USING THE EMBEDDED GENERATION COST VALUE AS THE BENCHMARK FOR COMPARING CURRENT RATES TO COMPETITIVE OFFERINGS. CL&P SUGGESTS THAT THE DEPARTMENT SET A VALUE FOR GENERATION SERVICES THAT REFLECTS A FUTURE MARKET PRICE OF GENERATION. THAT VALUE WOULD BE PROVIDED ON CUSTOMER BILLS IN 1999 AND COULD BE USED TO EDUCATE CUSTOMERS REGARDING FUTURE COMPETITIVE GENERATION OFFERINGS. UI BELIEVES THAT THIS PROCEEDING SHOULD ESTABLISH THE PROCESS BY WHICH THE PRICE OR RATE FOR ELECTRIC GENERATION SERVICES WILL BE DETERMINED. THEREFORE, UI PROPOSES TO DEFER A DETERMINATION OF THE VALUE OF GENERATION SERVICES TO A FUTURE PROCEEDING. ALTHOUGH NEITHER UTILITY KNOWS WHAT THE VALUE OF FUTURE GENERATION OFFERINGS WILL BE, THEY AGREE THAT IT IS NOT TODAY'S FULLY EMBEDDED COST. IN ADDITION, UI BELIEVES THAT THE LEGISLATURE INTENDED SECTION 5(B) TO BE INTERPRETED IN THE CONTEXT OF THE ENTIRE ACT, AND AS SUCH, GENERATION SERVICES CAN ONLY MEAN THE COMPETITIVE MARKET PRICE FOR THIS SERVICE. TR. 6/10/98, PP. 295-299, 298-315, 324-327 AND 329-330; LATE FILED EXHIBIT No. 10; RESPONSES TO INTERROGATORIES CL&P-EL-14 AND UI-EL-27, 28, 30 AND 31; UI LETTER 5/6/98.

THE DEPARTMENT AGREES THAT COMPETITIVE GENERATION PRICING WILL BE LESS THAN THE CURRENT FULLY EMBEDDED COST OF GENERATION BUT THE RATES FOR COMPETITIVE OFFERINGS ARE UNKNOWN AT THIS TIME. HOWEVER, THE ACT DOES NOT DIRECT THE DEPARTMENT TO MAKE A DETERMINATION REGARDING COMPETITIVE GENERATION PRICING AT THIS TIME. THE DEPARTMENT BELIEVES THAT IT IS NECESSARY AND CONSISTENT WITH THE ACT TO DETERMINE THE FULLY EMBEDDED COST OF GENERATION AS THE FIRST STEP TOWARD DETERMINING COMPETITIVE GENERATION PRICING AND THE CTA. THE ACT IDENTIFIES COMPONENTS OF THE FULLY EMBEDDED COSTS OF GENERATION THAT WILL NOT BE SUBJECT TO COMPETITION AND PROVIDES A TIME FRAME FOR DETERMINING THE VALUE OF EACH OF THOSE COMPONENTS.

IN A LETTER DATED MAY 6, 1998, UI IDENTIFIED SIX COSTS THAT ARE ADDRESSED IN THE ACT: METERING AND BILLING SERVICES, GROSS EARNINGS TAX, CONSERVATION, RENEWABLE ENERGY, PURCHASED AND INDEPENDENT POWER CONTRACTS AND THE COSTS TO BE INCLUDED IN THE SYSTEMS BENEFIT CHARGE. UI STATES THAT THE ACT RESOLVES PRIOR UNCERTAINTIES RELATED TO THE ASSIGNMENT OF THESE COSTS AND IN SO DOING PROVIDES THE DEPARTMENT WITH CLEAR DIRECTION AS TO THEIR FUNCTIONALIZATION. UI NOW RECOMMENDS THAT EACH OF THESE COSTS BE ASSIGNED TO DISTRIBUTION. Id.

³ Public Act 98-28, Section 5(b) requires CL&P and UI to separate and itemize on customer bills electric generation services and all other utility costs beginning July 1, 1999.

THE DEPARTMENT AGREES THAT THE ACT PROVIDES GUIDANCE AS TO THE RESPONSIBILITY FOR COLLECTING CERTAIN COSTS, BUT DOES NOT AGREE THAT IT IS APPROPRIATE TO ASSIGN COSTS TO DISTRIBUTION SIMPLY BECAUSE THE DISTRIBUTION FUNCTION IS RESPONSIBLE FOR COLLECTING THE COST OR PROVIDING THE SERVICE. UI MIXES COST CAUSATION WITH COST RESPONSIBILITY. IN PARTICULAR, THE DEPARTMENT DOES NOT AGREE THAT IT IS APPROPRIATE TO ASSIGN PURCHASED POWER AND INDEPENDENT POWER COSTS TO DISTRIBUTION. THESE COSTS ARE CLEARLY GENERATION RELATED. USING UI'S REASONING, ALL NUCLEAR COSTS SHOULD ALSO BE ASSIGNED TO DISTRIBUTION SINCE THESE FACILITIES WILL NOT BE SOLD UNTIL 2004. THIS WOULD SEND THE WRONG PRICE SIGNAL TO CUSTOMERS AND PROVIDE A COMPETITIVE ADVANTAGE TO THE EXISTING UTILITIES THAT RETAIN GENERATION BY UNDERSTATING ITS COST. IN ADDITION, THE ACT DOES NOT SPECIFY THE AMOUNT OF THOSE COSTS TO BE RECOVERED. INSTEAD, THROUGH THE PROCEEDINGS REQUIRED UNDER THE ACT, IT PROVIDES A TIME LINE FOR CALCULATING THOSE VALUES. THE INSTANT PROCEEDING IS SIMPLY THE FIRST STEP IN THAT PROCESS.

THE DEPARTMENT CONCLUDES THAT THE PURPOSE OF THIS PROCEEDING IS TO SEPARATE GENERATION COSTS FROM ALL OTHER ELECTRIC COMPANY COSTS, NOT TO SPECIFY FUTURE DISTRIBUTION COMPANY FUNCTIONS OR RESPONSIBILITIES. THE RESOLUTION OF QUESTIONS CONCERNING DISTRIBUTION COMPANY FUNCTIONS AND COSTS AWAITS FUTURE RESTRUCTURING TRANSITION DOCKETS, NOTABLY THE REVIEW OF UTILITY CORPORATE UNBUNDLING PLANS TO BE FILED BY OCTOBER 1, 1998,⁴ AND OTHER INVESTIGATIONS REQUIRED BY THE ACT.

THE DEPARTMENT UNDERSTANDS THE CONCERNS EXPRESSED BY THE UTILITIES REGARDING THE POTENTIAL MISUSE OF A FULLY EMBEDDED GENERATION COST VALUE. THE DEPARTMENT AGREES THAT ONLY THE COMPETITIVE PRICE OF GENERATION SHOULD APPEAR ON CUSTOMER BILLS. SECTION 17 OF THE ACT REQUIRES THE DEPARTMENT TO ESTABLISH A CONSUMER EDUCATION ADVISORY COUNCIL (COUNCIL) TO DEVELOP AN OUTREACH PROGRAM TO EDUCATE CUSTOMERS ABOUT THE IMPLEMENTATION OF RETAIL COMPETITION. PURSUANT TO THE ACT THE COUNCIL MUST INCLUDE REPRESENTATIVES OF CL&P AND UI AND THE PROGRAM MUST ADDRESS ELECTRIC GENERATION SERVICE OPTIONS. PUBLIC ACT 98-28, P. 45. THE UTILITIES SHOULD USE THAT FORUM TO EDUCATE CONSUMERS REGARDING THIS ISSUE. IN ADDITION TO THE OUTREACH PROGRAM THERE WILL BE SEVERAL FORUMS IN WHICH THIS ISSUE CAN BE RAISED. THESE INCLUDE THE PROCEEDING TO ESTABLISH CODES OF CONDUCT AS REQUIRED BY SECTION 15, REVIEW PROCEDURES FOR CUSTOMER COMPLAINTS AS REQUIRED BY SECTION 31, AND DEVELOPING DEPARTMENT OVERSIGHT PROCEDURES OF UNFAIR TRADE PRACTICES AS REQUIRED UNDER SECTION 32.

B. CL&P ACCOUNTING AND COST MANAGEMENT SYSTEMS

CL&P employs a detailed accounting system. In Docket No. 97-05-12, DPUC Financial and Operations Review of The Connecticut Light and Power Company, CL&P submitted the Northeast Utilities (NU) Accounting Manual (NU Accounting Manual), dated May 28, 1997, and a comparative trial balance for the period ending April 30, 1996. Docket No. 97-05-12, Late Filed Exhibit No. 1. CL&P's management, information and budgeting system (MIB) allows it to manage costs by identifying expenses relative to the activities performed. This system allows CL&P to charge its costs more directly. Docket No. 97-05-12, Late Filed Exhibit No. 2; Tr. 8/15/97, pp. 147-162.

CL&P's accounting system uses the Uniform System of Accounts prescribed for Electric Utilities (FERC Accounts). The FERC Accounts provide broad categories for assigning costs. Under CL&P's accounting system, many FERC Accounts are broken down into detailed subaccounts. The definition of each subaccount appears to provide a basis for direct functionalization of costs. In addition to individual subaccounts, many CL&P Accounts include a general cost subaccount, the "99" account, for costs that are not readily assigned to a specific subaccount. These general costs are identified by cost control center (CCC), further defining the cost by function.

⁴ Public Act 98-23, Section 5(a) requires CL&P and UI to submit unbundling plans to the Department by October 1, 1998.

It appears that CL&P's current accounting system provides a level of detail sufficient to functionalize many costs on a direct basis. As noted above, direct functionalization of costs is the preferred method. Therefore, the Department believes that CL&P accounting system should guide the functionalization of costs. Costs that cannot be assigned directly will be functionalized on the basis of the general allocators discussed below. The Department will require CL&P to submit unbundled costs based on its FERC Accounts, subaccounts and the allocators developed herein.

The functionalizations developed herein are applicable to FERC accounts, not to CL&P's MIB. The Department views the MIB as an internal CL&P document that has no relevance for this Decision.

C. UI ACCOUNTING AND COST MANAGEMENT SYSTEMS

UI also relies on FERC Accounts but its accounting system does not provide the same level of detail as CL&P's. Essentially, UI does not separate its accounts into subaccounts. However, prompted by electric industry restructuring and the need to identify generation-related costs, UI initiated its Business Unit Financials (BUF) project. UI Late Filed Exhibit No. 1; Tr. 8/14/97, pp. 105-110; 147-153; 334 and 349; Tr. 6/10/98, pp. 395-423; Response to Interrogatory UI-EL-32; UI letter dated May 6, 1998. This project involves the analysis, identification and assignment of all costs incurred by UI into business unit and corporate or shared services categories, with the ultimate goal of establishing a financial reporting system that can track all direct and indirect costs by business unit. UI will conclude BUF in 1998 and will have a better understanding of cost functionalization at that time. *Id.* UI's efforts to date have identified several areas where it believes direct charging is superior to the use of historical general allocators. *Id.*

As UI assigns costs directly, the pool of 'general' dollars that would otherwise be functionalized by the use of the blanket allocators developed herein, will decline. The Department must insure that UI's BUF project develops appropriate and reasonable cost assignment. For example, a witness for UI testified that under BUF, the labor costs associated with his position were assigned directly to the distribution function. Tr. 8/14/97, pp. 131-138. However, based on the duties performed by this individual, which include sales, pricing and marketing, it is clear that functionalizing 100% of his labor and associated costs to distribution is not reasonable. *Id.* In light of testimony by UI, the Department is concerned that some of the direct assignments that UI has already made may not be appropriate. Therefore, a complete review of UI's BUF project is warranted.

UI was given the opportunity to update its cost assignments to incorporate findings from its BUF analysis at the time of the June 10, 1998 hearing. However, it is unclear if UI proposed any modifications because the FERC accounts and the Company's BUF accounts are not comparable. Therefore, the functionalizations developed herein are applicable to UI's FERC accounts, not to the BUF. The Department views the BUF as an internal UI document that has no relevance for this Decision.

It is apparent that a major consideration to UI is whether costs may be stranded in the future. This concern should not drive functionalization; cost causation is the appropriate basis for functional assignment. The Department encourages UI to identify costs and assign them more directly, however, UI must change the basis for its assignment to reflect cost causation. The Department recognizes that it may be necessary to reexamine the functional assignment of costs if assets are sold in the future. But it does not follow that the total cost of departments that are not sold would be shifted to distribution. The Department would have to evaluate budgets to determine the prudent level of expenditures for efficient operations.

D. ADMINISTRATIVE AND GENERAL, ACCOUNTS 920-935

Administrative and General expenses (A&G) include FERC Accounts 920 through 935 and represent costs that are not directly assignable to production, transmission or distribution. These accounts include salaries, office supplies, outside services, property insurance, injury and damage claims, pensions and benefits franchise costs and regulatory expenses. CL&P and UI functionalized the majority of these costs on the basis of a labor allocator, while the OCC and AG used a net plant allocator. OCC Schedules 1 and 2; Response to Interrogatory UI-EL-14; Revised Response to Interrogatory CL&P-EL-12; Tr. 8/14/97, p. 114. Individual accounts are discussed below.

UI states that A&G support all functions and because many are labor related, it is reasonable to use a Labor Allocator to functionalize them. In addition, a Labor Allocator is consistent with NARUC and FERC guidelines for allocating these costs. Tr. 8/14/97, pp. 102-104. CL&P concurs stating that a Plant Allocator bears no relation to general overhead-related costs because it is clear that the vast majority of A&G does not support production. Tr. 8/14/97, pp. 118-121.

AG and OCC believe that these costs support a company's overall investment and should be functionalized on the basis of that investment. Therefore, AG and OCC support the use of a Plant Allocator. Tr. 8/14/97, p. 121.

The Parties functionalized virtually all A&G accounts using the same allocator, Labor or Plant. The Department agrees that these costs are general, and as such, difficult to assign. However, because each account is distinct costs should be functionalized by account. Therefore, functionalization of A&G will be based on a combination of direct assignment and the allocators approved herein.

1. Administrative and General Salaries Account 920

This account includes the compensation (salaries, bonuses and other consideration for services, but not including directors' fees) of officers, executives and other employees of the utility properly chargeable to utility operations and not chargeable directly to a particular operating function. This account may be subdivided in accordance with a classification appropriate to the department or other functional organization of the utility. Uniform Systems of Accounts.

Account 920 includes the cost of payroll for personnel providing services that generally support all functions of the company's business. Late Filed Exhibit No. 7 identifies 13 departments included in UI's corporate headquarters with a total cost in 1995 of \$26.7 million. UI has assigned \$13.4 million or approximately 50% directly to functions. Of this, over 90% was assigned to distribution either directly, or first to "customer accounts," "customer service" or "other" which UI also allocated to distribution. Supplement to Late Filed Exhibit No. 7. The remaining \$13.3 million is included in Account 920, which UI functionalized by use of the Labor Allocator. The result is that over 75% of UI's personnel cost for its corporate headquarters are assigned to distribution.

During the hearings, the Department examined the assignment of executive salaries, load forecasting and research and development. These are discussed below.

a. Executive Salaries

UI states that work performed by its executives changes regularly and although electric industry restructuring has made generation the current subject, transmission, distribution and labor issues occupy considerable amounts of time for these individuals. Although a Plant Allocator is simple, there is no relation between plant costs and the duties performed by executives. Further, although a Labor Allocator may not be "perfect," it is far superior to a Plant Allocator. Tr. 8/14/97, pp. 115-117. CL&P concurs, stating that the vast majority of executives salaries do not support production. Tr. 8/14/97, pp. 117-120.

OCC states that profits, from properly managed assets, is the primary focus of corporate executives and since plant assets comprise the majority of utility investment, use of the Plant Allocator is reasonable. Tr. 8/14/97, 118. AG concurs stating that executives are supported by the level of the company's investment. Tr. 8/14/97, p. 121.

The Department believes that the time spent by corporate executives does relate to the overall investment of each function. Although each function requires the attention of upper management, it appears that the majority of significant strategic, regulatory and legislative issues have been generation related. The Department therefore rejects the assignment of executive salaries to functions by the Labor Allocator as proposed by UI and CL&P.

b. Load Forecasting

UI and CL&P include load forecasting in Account 920. UI states that although generation may establish load forecasting on its own, the distribution company will continue to require this service. CL&P states that its load forecasting is actually revenue forecasting and that it is used for budgeting. Tr. 8/14/97, p. 166.

All functions require load and/or revenue forecasting to plan capacity additions. Production uses this information for budgeting and to schedule plant maintenance, transmission needs this information to schedule loads and to avoid constraints on the grid, and distribution uses this information to establish rates and revenue requirements. Load forecasting is not related to labor. The Department therefore rejects the assignment of load forecasting to functions by the Labor Allocator as proposed by UI and CL&P.

c. Research and Development

CL&P functionalizes research and development (R&D) directly based on the type of project being done. UI assigns R&D to Accounts 920, 921 and 923 and uses a Labor Allocator to functionalize these costs. Tr. 9/14/97, p. 163; Response to Interrogatory UI-EL-5. UI also includes dues to the Electric Power Research Institute in Account 921. Id.

R&D should be assigned directly based on the type of research being conducted. The Department will therefore approve CL&P's methodology as proposed. UI provided no evidence to support its proposed assignment. The Department will therefore require UI to functionalize R&D based on the same allocator as Account 920 approved below. UI should examine this area in more detail so that costs can be directly assigned or a more appropriate allocator can be chosen. UI shall report the breakdown of projects over the past three years if it requests a change to this allocator.

d. Conclusion

The Department concludes that executive salaries, load forecasting and research and development are not related to personnel and therefore rejects the assignments as proposed by the Companies. While it may be appropriate to assign some departments by Labor, such as Administration, Customer Services and Information Resources, many do not relate to Labor. Areas such as Audit, Controller, Corporate Affairs, Materials Management, Strategic Analysis and Treasury benefit all functions and would be more properly assigned based on Plant or Revenues.

It may be appropriate to assign each department to functions in the future. However, since this level of detail has not been examined, the Department will assign all costs in Account 920 50% by Labor and 50% by Net Plant. The Department will review this area in more detail in the future.

CL&P was not asked to provide a breakdown of departments as provided by UI. The Department may review CL&P's assignments in more detail in the future. The Department will require that CL&P make the same assignment of costs for Account 920 as ordered above.

2. Office Supplies and Expenses, Account 921

Account 921 includes office supplies and expenses incurred in connection with the general administration of a utility's operations that are assignable to specific administrative or general departments and are not specifically provided for in other accounts.

UI's review of Account 921 finds that many of these costs are clearly related to distribution. They include such items as data processing costs (which are primarily related to customer information systems) and outsource services such as bill collection and shareholder services. Therefore, a Labor Allocator is appropriate. Tr. 8/14/97, p. 108. CL&P also used a Labor Allocator for these costs.

The Department agrees that office supplies and expense are labor related and therefore approves the use of a Labor Allocator as proposed by CL&P and UI.

3. Administrative Expenses Transferred, Account 922.

Account 922 is credited with administrative expenses recorded in Accounts 920 and 921 that are subsequently transferred to construction costs or to nonutility accounts. Uniform System of Accounts. This account should be functionalized in the same manner as Accounts 920.

4. Outside Services, Account 923

Account 923 includes the fees and expenses of professional consultants and others for general services that are not applicable to a particular operating function or to other accounts. It includes the expenses of persons engaged for a special or temporary purpose in circumstances where the person so engaged is not considered an employee of the utility. Uniform System of Accounts.

UI functionalizes some of its Account 923 costs on a direct basis with the remainder assigned by the Labor Allocator. These general costs include legal, reengineering and training-related expenses. Tr. 8/14/97, pp. 126-128. UI notes that some of its legal costs can be identified by function but that the total amount of these costs is small. *Id.* CL&P assigned these costs on the basis of a Labor Allocator. OCC and AG endorse the use of the Plant Allocator for these costs. OCC Schedules 1 and 2; Response to Interrogatory UI-EL-14; Revised Response to Interrogatory CL&P-EL-12.

CL&P's accounting system for Account 923 includes several specific subaccounts and a single general subaccount, Account 923.99. Costs included in Account 923.99 are identified by CCC. Although assignment by subaccount appears to be available to CL&P, it used the Labor Allocator to functionalize these costs. Response to Interrogatory EL-12 RV-01.

It appears that many of these costs can be identified by function. Therefore, to the extent possible, they should be assigned on a direct basis. If there is a wide fluctuation between functions on an annual basis, it may be appropriate to average several years. Costs for outside services that cannot be functionalized directly should be allocated using the same proportions as the direct assignments.

5. Property Insurance, Account 924

Account 924 includes the cost of insurance or reserve accruals to protect the utility against losses and damages to owned or leased property used in its utility operations. It also includes the cost of labor and related supplies and expenses incurred in property insurance activities.

To be consistent with FERC guidelines, UI allocated property insurance on the basis of a Labor Allocator. However, UI states that this is one of the A&G costs that can be functionalized based on a Plant Allocator. Tr. 8/14/97, pp. 109-111 and 322. Based on its accounting system, CL&P assigned property insurance directly by function and used a Plant Allocator for its general property insurance subaccount. Id.; Response to Interrogatory CL&P-EL-12-RV-01; Northeast Utilities Accounting Manual.

Property insurance relates to the value of property therefore net plant is a good proxy for functional assignment. The Department will approve CL&P's assignments and direct UI to assign the cost of property insurance on the basis of a Plant Allocator.

6. Injuries and Damages, Account 925

Account 925 includes the cost of insurance or reserve accruals to protect the utility against injury and damage claims of employees or others, losses not covered by insurance, and expenses incurred in settlement of injuries and damages claims. It also includes the cost of labor-related supplies and expenses incurred in injuries and damages activities. Uniform System of Accounts.

CL&P's subaccounts 925.05, Injuries/Damages - Millstone, and 925.1A, Seabrook Charges, are directly functionalized as generation. All other costs in this account for CL&P and all UI's costs are functionalized on the basis of a Labor Allocator. Responses to Interrogatories UI-EL-14 and Revised CL&P-EL-12. OCC and AG used a net plant allocator. OCC Schedule 2; Tr. 9/29/97, p. 431.

The Department believes the cost of injuries and damages relates to the number of employees, therefore, the use of a Labor Allocator is appropriate. The Department will approve the assignment of costs in Account 925 as proposed by CL&P and UI.

7. Employee Pensions and Benefits, Account 926

Account 926 includes pensions paid to or on behalf of retired employees, or accruals to provide for pensions, or payments for the purchase of annuities for this purpose, when the utility has committed itself to a pension plan under which the pension funds are irrevocably devoted to pension purposes, and payments for employee accident, sickness, hospital, and death benefits or insurance therefor. Also included are expenses incurred in medical, educational or recreational activities for the benefit of employees and administrative expenses in connection with employee pensions and benefits. Uniform System of Accounts.

These costs are labor related; therefore, they should be functionalized using a Labor Allocator.

8. Regulatory Commission Expense, Account 928

Account 928 includes all expenses (except the pay of regular employees only incidentally engaged in such work) incurred by the utility in connection with formal cases before regulatory commissions, or other regulatory bodies, or cases in which such a body is a party, including payments made to a regulatory commission for fees assessed against the utility for pay and expenses of such commission, its offices, agents and employees. It also includes payments made for the administration of the Federal Power Act. Uniform System of Accounts.

CL&P used direct, Labor and Plant Allocators for these costs. UI believes that these costs will be supported 100% by the distribution function in the future; therefore; UI assigned them directly to the distribution function. UI stated that in previous cost studies these costs

were assigned on the basis of Labor. OCC assigned these costs on the basis of a Plant Allocator. Responses to Interrogatories CL&P-EL-12-RV-01 and UI-EL-14; OCC Schedules 1 and 2; Tr. 9/29/97, pp. 330-335; Id.

FERC costs should be assigned equally to transmission and generation since FERC has jurisdiction over transmission rates and wholesale generation transactions. The Department believes that CL&P's assignments are appropriate for all remaining costs.

The Department does not agree with the assignment of regulatory costs to distribution as proposed by UI. Regulatory agencies have responsibilities in all areas of utility operations. It is therefore appropriate for all functions to share these costs. The Department will require UI to break out its regulatory costs and assign them as follows: FERC costs should be assigned to generation and transmission. Regulatory costs for environmental protection should be assigned to generation, since the costs generally relate to environmental compliance at power plants. Costs for the Department and OCC should be allocated based on revenues of generation and distribution, since the Department currently regulates these functions and revenues are the basis for Department billing. The Connecticut Siting Council is responsible for the siting of generation plants and transmission lines. In addition, the Council requires each electric company to submit a forecast of loads and resources. The load forecast is useful to all functions to plan capacity additions and develop revenue requirements. Siting therefore should be assigned based on a Plant Allocator. Based on the forgoing analysis of regulatory agencies and their responsibilities, it is clear that all functions related to the provision of electric service are currently regulated and will remain regulated to some extent in the future. It appears that the regulation most often involves generation therefore the Department believes that all remaining general costs should be assigned on the basis of a Plant Allocator. In addition, if UI cannot breakout regulatory costs by regulatory agency, all costs should be assigned by a Plant Allocator. The Department recognizes that it may be appropriate to modify these allocations in the future as regulatory roles and billing charges are more clearly defined as a result of electric industry restructuring.

9. Miscellaneous General Expenses, Account 930

Account 930 includes the cost of labor and expenses incurred in connection with the general management of the utility that are not provided for elsewhere.

CL&P used direct and Labor Allocators for these costs; UI used the Labor Allocator only. OCC used a Plant Allocator. Response to Interrogatories CL&P-EL-12-RV-01, UI-EL-14, OCC Schedules 1 and 2.

Management relates to the number of employees; therefore, it is appropriate to assign Account 930 as proposed by CL&P and UI.

E. GENERAL PLANT, ACCOUNTS 389 THROUGH 399

General plant is that portion of plant assets that are not directly assigned to production, transmission or distribution accounts but which are necessary to provide electric service. General plant expenses include Accounts 389 through 399. These accounts include land rights, structures and improvements, office furniture, transportation equipment, stores equipment, tools and garage equipment, lab equipment, communication and miscellaneous equipment. Uniform System of Accounts.

UI functionalized these costs on the basis of a Labor Allocator, CL&P on the basis of direct and Labor Allocators and the OCC and AG used a Plant Allocator. Tr. 8/14/97, p. 76-96. The parties generally agreed that a detailed analysis of these costs would prove time consuming and costly and they question the merit of such a review. Responses to Interrogatories CL&P-EL-12-RV-01 and UI-EL-14; OCC Schedule 2; Id. Tr. 8/14/97, pp. 108 and 109.

As a result of the BUF project, UI has found that the use of a Labor Allocator understates certain distribution-related costs, such as A&G. UI states that although a detailed

breakdown of General Plant is not being done as part of BUF, it believes such an analysis would result in more costs allocated to distribution. Tr. 8/14/97, p. 84. Further, UI states that the use of a Plant Allocator distorts the functionalization of these costs because plant assets are capital intensive resulting in a higher allocation to generation. Plant Allocators, which are driven by costly nuclear facilities, do not need the same level of general plant support that the distribution function requires. Transportation equipment provides an example of this; generating plants require little in the way of transportation expense, while the distribution function relies heavily on these costs. Tr. 8/14/97, pp. 78-82.

CL&P views general plant as labor supportive and therefore believes the Labor Allocator is appropriate. Tr. 8/14/97, p. 92. The OCC and AG state that the Plant Allocator is simple, easily tracked and is consistent with NARUC guidelines. Tr. 8/14/97, pp. 89-95.

A review of these accounts finds that they bear no relation to net plant. For example, Account 395, lab equipment, comprises costs for equipment not assignable to specific plant accounts including, ammeters, galvanometers, and millivolt meters. The items included in this account do not support generation. Additional examples are Accounts 396, power operated equipment, and 397, communication equipment. Account 396 includes back filling machines, diggers, boring machines and pile drivers, while Account 397 includes cables, insulators and antennas. The Department agrees with UI and CL&P that a Labor Allocator more appropriately tracks general plant than does a Plant Allocator. Therefore, general plant will be functionalized on the basis of each company's Labor Allocator.

F. MISCELLANEOUS INTANGIBLE PLANT, ACCOUNT 303.

Account 303 includes the cost of patent rights, licenses, privileges and other intangible property necessary or valuable in the conduct of utility operations and not specifically chargeable to any other account.

UI divides this account into miscellaneous and miscellaneous - Demand Side Management (DSM). The majority of UI's non-DSM miscellaneous intangible costs represent investment in customer service computer software. UI functionalized miscellaneous costs on the basis of a Labor Allocator and the miscellaneous-DSM costs on a direct basis to distribution. CL&P allocated these costs on the basis of a Labor Allocator. The OCC believes that non-DSM costs should be assigned using the One-Third Allocator. The AG concurs with OCC stating that because UI's non-DSM miscellaneous costs represent costs for the provision of a bundled service, they should be assigned equally to all functions. CL&P did not have any costs in this account. OCC Schedules 1 and 2; Responses to Interrogatories UI-EL-14 and Revised CL&P-EL-12; Tr. 8/14/97, pp. 190-194.

As discussed below, DSM costs will be allocated to generation. Therefore, UI's miscellaneous-DSM costs will be functionalized accordingly. As long as a company remains integrated, all functions will require customer service information and therefore will benefit from computer software. Thus, it is reasonable to assign these costs based on the Labor Allocator as proposed by CL&P and UI.

G. CUSTOMER ACCOUNTING AND RELATED COSTS, ACCOUNTS 901-905

1. Accounts 901, 902, 903 and 905

Customer accounting and related costs are contained in Accounts 901-905. These costs include meter reading, billing, uncollectibles and the administrative costs associated with revenue collection. CL&P and UI functionalized these costs directly to distribution, while OCC and AG functionalized them using the One-Third Allocator. Tr. 8/14/97, pp. 209-210 and 280; OCC Schedules 1 and 2; Responses to Interrogatories UI-EL-14 and Revised CL&P-EL-12.

UI states that if production were a separate business unit, UI's costs for meter reading and related services would not change significantly because UI, the distribution company, would continue to serve the same number of customers. UI further states that the current transmission function does not rely on end-use metering. In addition, whether under today's system or a future structure, generators will likely continue to provide power on a wholesale basis to the grid and therefore are not concerned with retail metering. UI's preference is to retain customer accounting as a distribution function and develop charges for providing this service. The revenue collected from the service would then reduce distribution costs. Tr. 8/14/97, pp. 216-222.

CL&P agrees that the transmission of energy has nothing to do with end-use metering; therefore, transmission should not be assigned any of these costs. Further, assuming that no costs are assigned to transmission and a decision is made to split the remaining costs 50/50 between generation and distribution, CL&P believes that a portion of the generation-related cost will likely become stranded. Tr. 8/14/97, pp. 225-228.

AG views the customer accounting as a separate business or a 'fourth' function, and believes that distribution, transmission and generation will rely equally on the services of this function. Because each function will require this service, it is reasonable to assign one-third of the cost to each function. Tr. 8/14/97, pp. 216-222.

At present, all generation-related costs are recovered on a kW and kWh basis, while distribution-related costs are recovered on a kW and kWh basis and through fixed monthly customer charges. Because revenue is recovered based on metered use, it is clear that both functions require retail end-use metering. End-use meters will also be needed by both functions in the future. If anything could change it appears there could be less need for end-use meters by the distribution function if distribution costs are more fully recovered through fixed customer service charge revenues. For example, assume a change in rate design such that all distribution costs are recovered through the monthly customer charge. Under this scenario, although the distribution function would continue to require billing services, it would no longer need end-use consumption information to recover its revenues and could eliminate meters and related costs. However, the generation function would continue to need consumption data to bill for energy sales.

The transmission system essentially deals in the movement of energy at high voltages and does not rely on retail end-use metering for revenue recovery. In addition, transmission meters are accounted for separately. Therefore, the Department finds that the transmission function should not be assigned any cost for Accounts 901, 902, 903 and 905. The issue then becomes how to functionalize these costs between distribution and production.

UI states that many generators sell directly to the power pool, not to individual customers. UI believes that marketers and load aggregators, not the owners of generation, will deal with end-use customers. Therefore, metering should not be assigned to generation. Tr. 8/14/97, pp. 210 and 211. The Department disagrees. It does not matter whether a generator or an aggregator sells to retail customers, all costs to generate power, aggregate load and marketing by competitors must be collected through the competitive generation component of rates. In either case, metering will be necessary to bill customers for generation. Section 16(c) of the Act requires each distribution company to provide metering, billing, and collection services, but it also requires the Department to determine cost-sharing allocations for these services between the distribution companies and electric suppliers.

The Department concludes that the production and generation functions require end-use metering. Since generation requires these costs it is inappropriate to assign costs solely to distribution unless and until charges are developed for these services. The Department believes that this is the preferred goal, however, since charges are not available at this time, it is appropriate to assign costs to each function.

Based on the above, it is reasonable to allocate these costs 50/50 to generation and distribution at this time. This allocation simply represents an assignment of the total cost of providing this service. UI stated that it prefers to retain customer accounting as a distribution function and develop charges for providing this service. UI's approach is reasonable and is essentially what this Decision attempts to do. If all costs were assigned to the distribution function, as UI and CL&P propose, and a charge is assessed to the provider of competitive generation services for metering and billing, net costs would decline for the distribution company and increase for generation.

As with many of the costs discussed herein, future treatment and recovery may change based on the implementation of the Act. The Department will modify the assignment ordered herein once rates are approved for assessing these costs to competitive generation service providers.

2. Uncollectibles, Account 904

Account 904 provides for losses from uncollectible utility revenues. These costs were functionalized by the Parties in the same manner as all other Customer Accounting and Related Costs. Tr. 8/14/97, pp. 209-210 and 229; OCC Schedules 1 and 2; Responses to Interrogatories UI-EL-14 and CL&P-EL-12. UI notes that its uncollectibles are driven by public policy decisions and that future policy decisions will have a direct bearing on these costs. Tr. 8/14/97, p. 230-232. UI and CL&P assigned these costs directly to distribution. The AG agrees that these costs are driven by public policy but believes that each function should share equally in these expenses.

Uncollectibles are a cost for all companies. When customers do not pay their electric bills, revenues to all functions are reduced. In fact, UI states that the allocation of these costs will likely be based on the billing, (i.e., revenue) of each function. *Id.* A difference between electric companies and other businesses is that there are regulations that require electric utilities to serve customers and limit disconnection to hardship customers. The Department believes that the allocation of these costs should be directly proportional to the revenues collected by each function. Therefore, uncollectibles will be functionalized on the basis of revenues except for those associated with hardship or moratorium customers, which will be functionalized to distribution.

H. METERS AND METER EXPENSE, ACCOUNTS 370 AND 586

Account 370 includes the cost of meters or devices and appurtenances thereto, for use in measuring the electricity delivered to end-use customers. This account does not include meters for recording output of a generating station or substation meters. Account 370 includes only those meters used to record energy delivered to customers. Account 586 includes the cost of labor, materials used and expenses incurred in the operation of customer meters and associated equipment. Uniform System of Accounts.

CL&P and UI functionalized these costs directly to distribution. OCC and AG assigned these costs using the One-Third Allocator as they did for meter reading and billing. OCC Schedules 1 and 2; Responses to Interrogatories UI-EL-14 and Revised CL&P-EL-12.

As noted above, revenue collection for the distribution and production functions requires end-use metering; therefore, it is reasonable to assign the cost of meters and related expenses to these functions until charges are developed for this service. The Department concludes that the costs of meters and related expenses should be assigned on the same basis as Accounts 901, 902, 903 and 905. Therefore, Accounts 370 and 586 will be functionalized 50/50 to distribution and generation.

I. CUSTOMER SERVICE AND INFORMATIONAL EXPENSES, ACCOUNTS 907-910

Account 907, supervision, includes the cost of labor and expenses incurred in the general direction and supervision of customer service activities. Account 908, customer assistance expense, includes the cost of labor and materials used and expenses incurred. Account 909, advertising expense, includes the cost incurred for advertising to foster conservation, improve the environment, improve the system load factor and provide other general information to customers. Account 910, miscellaneous customer service and information expense, includes the cost of labor and materials used and expenses incurred in connection with customer service and informational activities that are not included in other customer information expense accounts. Uniform System of Accounts.

CL&P and UI functionalized these costs to distribution while AG and OCC used the One-Third Allocator. Tr. 8/14/97, pp. 239-250; OCC Schedules 1 and 2; Responses to Interrogatories UI-EL-14 and Revised CL&P-EL-12.

CL&P states that the majority of these costs are related to conservation and load management programs (C&LM) and supervision of the people involved in these programs. Although there are some costs related to general customer assistance, the bulk are C&LM related. Tr. 8/14/97, p. 239. AG and OCC believe that assigning one-third of these costs to each function is appropriate because customers are buying a bundled service. AG and OCC further state that although the one-third assignment will likely change over time, it is a reasonable starting point. Tr. 8/14/97, pp. 249 and 250.

Although the Uniform System of Accounts defines these costs as C&LM related, it appears that there are general customer service related costs included in these accounts; therefore, the following analysis separates these costs into C&LM and other.

C&LM and DSM are one-and-the-same. Therefore, as discussed below, conservation-related costs are identified separately and are allocated 100% to generation. The remaining costs are for general customer assistance inquiries such as power outage calls, service termination/restoration, billing or collection and termination. These costs bear no relation to the transmission function. Therefore, the issue is the functionalization of these costs to distribution and generation.

CL&P and UI submitted a breakdown of customer inquiries by type. Late Filed Exhibit No. 5. UI divides its calls into five categories while CL&P utilizes seven. Based on the nature of the categories it appears that the distribution and generation functions 'generate' customer assistance inquiries and both functions will need to respond to these inquiries in the future. For example, power outages will affect the revenues of both functions; billing inquiries, phone-in readings and termination/restoration also apply to both functions.

The Department believes it is appropriate to assign costs to the generation function as long as customer service representatives answer questions that relate to generation. Therefore, it is reasonable to assign these cost using the Labor Allocator.

J. SALES EXPENSE, ACCOUNTS 911-916

Sales Expense includes Account Nos. 911, Supervision; 912, Demonstrating and Selling; 913, Advertising; 914, Revenue from Merchandising and Jobbing; 915, Costs and Expenses of Merchandising and Jobbing; and 916, Miscellaneous Sales Expense.

These accounts generally include the cost of labor and expenses incurred in the general direction and supervision of sales activities, the cost of labor, materials used and expenses incurred in promotional, demonstrating and selling activities, except by merchandising, the object of which is to promote or retain the use of utility services by present and prospective customers. Uniform System of Accounts.

UI assigned these costs directly to distribution while OCC used the One-Third Allocator. CL&P did not demonstrate costs for these accounts in its exhibit. OCC Schedules 1 and 2; Responses to Interrogatories UI-EL-14 and Revised CL&P-EL-12

UI states that sales expense includes the costs of exhibitions, displays and advertising designed to promote electric service and only represents above-the-line costs. Advertising costs may be booked to Account 912 or to customer information, depending on the nature of the advertising being done. Response to Interrogatory EL-20; Tr. 9/29/97, pp. 363-365.

Although CL&P did not demonstrate costs in these accounts, the Department notes that in testimony presented in Docket No. 98-01-02, DPUC Review of The Connecticut Light and Power Company's Rates and Charges, CL&P indicated that costs that had previously been assigned to Account 920, A&G Salaries, are now being booked to Account 912. The accounting changed as a result of a shift within CL&P to activity based management. Docket No. 98-01-02, Roman PFT, 1/14/98, pp. 7-9. These costs, which support CL&P's Customer Support Organizational activities and include regulatory pricing, retail contracting, market research, economic and community development, field support, market planning and field personnel, total \$8.8 million. Id. CL&P believes its assignment of these costs to Account 912 is consistent with the intent of the Uniform System of Accounts. Id.

By definition these costs appear to support all functions; therefore use of the One-Third Allocator is reasonable.

K. TRANSMISSION BY OTHERS, ACCOUNT 565

This account will include amounts payable to others for transmission of the utility's electricity over transmission facilities owned by others. Uniform System of Accounts.

UI functionalized Account 565 directly to production, while CL&P and OCC functionalized it directly to transmission. OCC Schedules 1 and 2; Responses to Interrogatories UI-EL-14 and Revised CL&P-EL-12.

By definition Account 565 is appropriately functionalized to transmission.

L. DEMAND SIDE MANAGEMENT

DSM costs are related to the conservation activities of CL&P and UI and include past deferrals and future expenditures. UI believes that although all functions benefit from conservation, these costs should be allocated 100% to distribution. UI states that the benefit of past conservation expenditures remains with the customers for whom the costs were incurred; therefore, those customers (i.e., distribution customers) should bear the costs. In addition, UI believes that a generation company that is forced to bear these costs cannot be competitive. Tr. 8/14/97, p. 44.

CL&P also functionalized DSM to distribution stating that even under the current industry structure these costs are appropriately assigned to that segment of the vertically integrated utility charged with carrying out this type of social policy. However, CL&P believes that

regardless of how DSM is functionalized this cost will be identified and treated separately in the future. Tr. 8/14/97, pp. 47, 65 and 66.

OCC believes DSM should be functionalized to generation, stating that DSM has never been designed to reduce the size or capacity of transmission or distribution systems. The goal of DSM has always been to reduce peaks and shift consumption from one time period to another, goals that address the production of electricity. Tr. 8/14/97, p. 50. AG also functionalized DSM to generation, citing the goals mentioned by OCC. AG noted that assigning these costs to generation does not preclude their recovery, stating that generation costs will likely be further broken down and the recovery of each cost category treated separately, a decision that appropriately rests with a legislative body. Tr. 8/14/97, pp. 56 and 57.

The goal of DSM is to reduce peak demands, shift consumption to off-peak periods or otherwise control the need for additional generation. These programs were not designed for the benefit of the distribution or transmission systems; however, public policy had a large influence on the types of programs offered and overall budgets.

DSM costs are properly allocated 100% to generation. Recovery of future conservation assessments is addressed in Section 33 of the Act. Therefore, this issue will be addressed in subsequent proceedings.

M. ECONOMIC DEVELOPMENT

Economic development (ED) costs for UI and CL&P include two components: payroll for personnel whose primary duty is to attract business to the utility's service territory; and funding for the Connecticut Economic Resource Center. Tr. 8/14/97, pp. 167-180. CL&P functionalized these costs on the basis of a Labor Allocator, while UI functionalized the costs directly to distribution. OCC believes that these costs should be functionalized on the basis of a Plant Allocator. AG states that because all functions benefit from ED, costs should be divided equally among the functions. Id.

OCC believes that because ED is meant to attract and retain load to sell energy, a production-related allocator is appropriate. UI and CL&P state that production and distribution have different incentives regarding ED. The distribution function strives to attract and retain business in its service territory to utilize the distribution system more fully. This is done to benefit all distribution customers and the local economy. The production function is less concerned with growth in any particular area since energy can be sold from any location within a region. Therefore, UI and CL&P believe an allocator that assigns these costs more fully to distribution is appropriate.

The Department agrees that the incentives to continue ED in an unregulated environment will change from those that exist currently. However, at present, all functions benefit from ED efforts. Therefore, it is reasonable to allocate these costs to all functions based on revenues at this time.

N. TAXES

1. Income Taxes-Account 409

In general, income tax is assessed against each Company's gross income less various exclusions and deductions specified by statutes and administrative regulations. Utilities pay an income tax like other businesses, and these taxes represent the largest single operating expense (other than fuel) incurred by the utility. A corporate income tax is imposed on a utility's net income; therefore, the company's capital structure and rate of return have a strong impact on these taxes.

CL&P allocated income taxes by function on the basis of revenue requirements. UI functionalized income taxes on the basis of rate base. OCC functionalized by using the One-Third Allocator. However, OCC stated that although assigning income tax by revenue

requirement is more accurate, it does not object to the rate base allocator. Tr. 8/14/97, pp. 199-201.

Income taxes are based on the net income of the company, which is the excess of the revenue over the expenses incurred in earning the revenue. Conversely, a company can have a net loss if its expenses exceed revenue. The Department believes all functions, generation, transmission and distribution, will produce revenues and incur expenses that will result in either a net income or net loss. The Department concurs with CL&P that income taxes can be assigned by function on the basis of revenue requirements. However, rate base refers to the value of the utility's investment in its facilities. If a constant rate of return is assumed, the higher the rate base the more a utility will earn. The amount of tax paid by a utility rests not only on the value of the company's property, but on the equity return a company makes. This is what determines the company's taxable profits in the current regulatory setting. Therefore, the Department believes that using a rate base allocator is more appropriate.

2. Deferred Income Taxes, Accounts 410 and 411

The tax consequences of most events recognized in the financial statements for a year are included in determining income taxes currently payable. However, tax laws often differ from the recognition and measurement requirements of financial accounting standards, and differences can arise between (a) the amount of taxable income and pretax financial income for a year and (b) the tax bases of assets or liabilities and their reported amounts in financial statements.

Deferred taxes are produced when normalization is used to account for accelerated depreciation. The deferred tax reserve equals the total of extra taxes not yet paid to the government but included in current rates paid by customers. It represents funds held in reserve by the utility to pay the higher taxes that will fall due in future years as depreciation deductions shrink. The deferred tax expense represents cash collections from ratepayers for which there is no corresponding, immediate cash expenditure by the utility. The deferred tax reserve is subtracted from rate base.

Deferred taxes are also a result of any tax code changes. Such a change occurred in the Tax Reform Act of 1986 (TRA 1986), when Congress reduced the maximum corporate tax rate from 46% to 34%. Therefore, the reserves of deferred taxes that the utilities had accumulated to comply with the 46% rate were in excess of what they will have to pay under the 34% rate. The TRA 1986 required that excess reserves be reduced over the remaining life of the asset that gave rise to the reserve for deferred taxes.

Temporary differences (timing differences that create differences sometimes accumulating over more than one year between the tax basis of an asset or liability and its reported amount in financial statements) ordinarily become taxable or deductible when the related asset is recovered or the related liability is settled. A deferred tax liability or asset represents the increase or decrease in taxes payable or refundable in future years as a result of temporary differences and carryforwards at the end of the current year.

CL&P allocated deferred taxes by function on the basis of revenue requirements. UI functionalized deferred income taxes by the Plant Allocator and OCC functionalized by the One-Third Allocator. Tr. 8/14/97, pp. 199-201.

Deferred taxes are based upon the depreciation associated with Company assets (property), therefore, deferred income taxes that cannot be directly identified to generation, transmission and distribution should follow the related asset and be allocated based upon the Plant Allocator.

3. Payroll Taxes

A utility, as well as any other business, is by law a "tax collector" for the federal and state governments with respect to taxes withheld from employees' salaries and are themselves subject to federal and state taxes based on the amount of remuneration earned by their employees. Such taxes constitute an operating expense of the business and may amount to a relatively substantial sum.

The Federal Insurance Contributions Act provides for age and disability benefits, insurance benefits to survivors and health insurance for the aged (Medicare). These payroll taxes are levied against both the employer and the employee and are based upon the employees gross earnings. The Federal Unemployment Tax Act (FUTA) provides for a system of unemployment insurance established in cooperation with state governments and is levied on employers only. Unemployment insurance provides temporary relief to those who become unemployed as a result of economic forces beyond their control. A credit against the federal tax is allowed for contributions which an employer makes to a state plan. The state unemployment tax provides for a system of unemployment insurance. In addition, all employers are required to withhold an amount approximating employees' liability for the federal income tax due on those earnings.

The Department believes the remaining payroll taxes that cannot be identified by process should be allocated based on the Labor Allocation factor between generation and transmission and distribution, as proposed by CL&P and UI.

4. Property Tax, Account 408

The utility industry is capital-intensive. A utility's generating, transmission, and distribution plant creates a substantial tax base for property taxes, which are assessed based on the value of the property located within a given jurisdiction. From a business perspective, property taxes are a part of the cost of the services of such property.

CL&P directly allocated property taxes to generation, transmission and distribution. Areas that were in question, such as the central office buildings, which are not function specific, were allocated based upon the Labor Allocator. Tr. 8/14/97, p. 196. UI did not directly assign property taxes to functions, but allocated all property taxes by the Plant Allocator. Tr. 9/29/97, pp. 323 and 324. OCC's approach was to functionalize by using the One-Third Allocator.

The Department believes the assignments as proposed by CL&P and UI are appropriate. CL&P has directly assigned costs where possible consistent with the Department's goal. It is appropriate to assign property taxes for general plant by the Labor Allocator because these facilities support all functions. UI has not directly assigned costs. Property taxes are based on the value of plant and equipment, therefore, the Plant Allocator is appropriate in UI's case since all the plant and equipment are not separated.

5. Gross Earnings Tax Account 408

The gross earnings tax (GET) is applied to total revenues from a company's sales without the benefit of any deductions. The tax is imposed directly on the seller based upon total revenues and is considered a general business cost. It differs from a sales tax in that it is a tax on the selling company rather than on the purchaser. However, the GET generally is passed to the customer indirectly in the form of increased energy cost.

CL&P assigned the GET directly to each customer class (Residential, Commercial and Industrial) based upon the known revenue for that class. Tr. 8/14/97, pp. 196 and 197. UI functionalized the GET as being "other," that is, not being production, transmission, or distribution. However, "other" was allocated back to distribution. Response to Interrogatory EL-14; Tr. 8/14/97, pp. 198 and 199.

Prior to the Act, generation, transmission and distribution produced revenues subject to the GET. The Act provides that effective January 1, 2000, the GET will be raised from 4%

to 6.8% on residential customers and from 5% to 8.5% on non-manufacturing business customers. This tax will then only apply to the electric distribution company's services, including conservation funding, renewable energy funding, the systems benefit charge and the competition transition assessment. Competitive electric generation services are exempt from the tax.

The GET is a revenue tax and until such time as the Act states, it should continue to be allocated among generation, distribution and transmission based on the revenue generated by each function.

6. Sales Tax, Account 408

a. Sales Tax Energy

Commercial customers of all electricity providers are assessed a 6% sales tax on bills over \$150. All other classes are exempt. The Companies collect the tax as a part of the electric bill and remit the tax revenues to the State. All parties agree the 6% state sales tax is a pass-through and therefore it was not addressed. Tr. 8/14/97, pp. 202-204.

The assignment of the sales tax to functions based upon revenues is appropriate because the tax is imposed on total bills, which include the cost of all functions.

b. Sales and Use Tax

A sales tax is imposed on the sales price of tangible personal property that is purchased for use or consumption in the taxing state unless specifically exempted. Sales of services are not taxable unless specifically listed in the law. Under Connecticut law, electricity is tangible personal property. Sales and use taxes are counterparts. If a sale is subject to the state sales tax, it generally would not be subject to the state use tax and vice versa.

CL&P and UI agreed the sales tax on goods and services purchased by them to conduct their business would be included in the cost of goods and services purchased and therefore should be allocated directly to the functions of generation, transmission, and distribution. CL&P went one step further and stated that it would use the Labor Allocator to designate any remaining taxes that could not be directly identified. OCC's approach is to use the One-Third Allocator. Tr. 8/14/97, pp. 202-204.

The Department agrees that the sales tax on goods and services should be directly assigned where possible. Sales taxes that cannot be directly allocated should be assigned based upon the Labor Allocator. This is appropriate since any costs that cannot be identified are likely to be for general plant or operations, which the Department has determined shall be assigned to functions by Labor.

7. Investment Tax Credit, Account 411

Prior to 1986, tax legislation provided for a reduction of federal income taxes by an amount known as the investment tax credit (ITC). The ITC has been subject to a number of limitations and has been frequently amended and even suspended. The credit generally has ranged from 4 to 10 percent of new investment in plant and equipment, and was considered a source of cash flow for the company that could be used to finance operations and construction programs. In the TRA 1986, the ITC was retroactively repealed for property placed in service after December 31, 1985. However, there were various transitional rules for property placed in service after this date. ITC carryovers from years prior to 1986 and ITC on transition property will be reduced. In addition, there was a 100% reduction in the depreciable basis for

any transition ITC. Despite its repeal by the TRA 1986, the ITC continues to play a role in the computation of a utility's corporate federal income tax liability, because it represents a dollar-for-dollar reduction of income tax liability.

The Department has determined that the ITC associated with new investment in qualified plant/property should be directly assigned with any ITC for general plant being assigned by Labor. If ITCs cannot be directly assigned, they should be assigned based on the Plant Allocator.

O. NET INCOME

Net Income is the profit a company makes after all expenses and taxes. Currently, an allowed level of income is approved by the regulatory process based on the forecasted net rate base and capital structure during the rate year to produce a return commensurate with the risks of the company. The capital structure and return are bundled in that they are the same for all functions. CL&P and UI proposed to functionalize net income on the basis of net plant.

The Department believes that net income is developed to produce a return on assets, therefore rate base is the most appropriate allocator at this time. Although not addressed in this proceeding, the appropriate capital structure and required return could vary considerably between functions in the future. Therefore, it will likely be necessary to revisit this issue in the future. Such an evolution could have a significant impact on the assignment of costs to functions.

III. CONCLUSION AND ORDERS

A. CONCLUSION

The allocators developed herein are appropriate for unbundling generation costs from all other utility costs. However, as noted above, this is the first step toward calculating the competitive generation services component of rates. The cost allocations arrived at in this proceeding will be reexamined in future unbundling proceedings in light of the provisions of Public Act 98-28 concerning cost recovery and the functional separation of the operation of the existing electric companies.

B. ORDERS

For the following Orders, please submit an original and six (6) copies of the requested material, identified as order compliance by Docket Number, Title and Order Number to the Executive Secretary.

1. On or before September 1, 1998, UI shall submit unbundled costs based on the allocators developed herein and costs for the most recent 12-month period.
2. On or before September 1, 1998, CL&P shall submit unbundled costs based on the allocators developed herein and costs submitted to the Department on June 1, 1998, in Docket No. 98-02-01, DPUC Review of The Connecticut Light and Power Company's Rates and Charges-Phase 2.

DOCKET NO. 97-01-15 DPUC REVIEW OF ELECTRIC COMPANIES COST OF SERVICE AND UNBUNDLED TARIFFS

THIS DECISION IS ADOPTED BY THE FOLLOWING COMMISSIONERS:

GLENN ARTHUR

JOHN W. BETKOSKI, III

DONALD W. DOWNES

CERTIFICATE OF SERVICE

THE FOREGOING IS A TRUE AND CORRECT COPY OF THE DECISION ISSUED BY THE DEPARTMENT OF PUBLIC UTILITY CONTROL, STATE OF CONNECTICUT, AND WAS FORWARDED BY CERTIFIED MAIL TO ALL PARTIES OF RECORD IN THIS PROCEEDING ON THE DATE INDICATED.

ROBERT J. MURPHY
EXECUTIVE SECRETARY
DEPARTMENT OF PUBLIC UTILITY
CONTROL

DATE