VERMONT DEPARTMENT OF PUBLIC SERVICE'S "RATEPAYER ADVOCACY" IN GREEN MOUNTAIN POWER'S 2016 RATE ADJUSTMENT FILING UNDER ALTERNATIVE REGULATION

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2016 REPORT ON THE "INDEPENDENCE" AND "EFFECTIVENESS" OF THE VERMONT DEPARTMENT OF PUBLIC SERVICE'S "RATEPAYER' ADVOCACY"

Summary of Findings and Recommendations

The 2016 Vermont Legislature directed the Vermont Attorney General (AGO) to review the independence and effectiveness of the Vermont Department of Public Service's (Department) advocacy on behalf of ratepayers in at least one proceeding conducted under Alternative Regulation (Alt. Reg.). The AGO chose to review the Department's efforts on behalf of ratepayers in reviewing and challenging Green Mountain Power's (GMP)'s 2016 request for a rate adjustment under the Company's Alt. Reg. Plan.

The review's most significant findings are:

1. There is no evidence that the "independence" of the Department lawyers and experts who reviewed Green Mountain Power's (GMP) 2016 Rate Adjustment[1] Filing was compromised due to an overly "cozy" relationship with GMP employees;
2. The current Alt. Reg. plan does not give Department experts enough time to review GMP's proposed rate base investments[2] which were authorized to grow by $188 million over the past two years (16%);
3. The current Alt. Reg plan discourages litigation. Instead, it encourages annual negotiated settlement of all disputes between the Department and GMP. Ratepayers would be better-served if the Department litigated and obtained a final judgment from the Vermont Public Service Board on such important issues as:
   - GMP's repeated failure to meet its obligation to prove why the rate base investments it proposes are in the best interests of ratepayers;
   - The appropriate rate of return on equity (ROE) for GMP in light of the fact that there is little risk under Alt. Reg that GMP will not earn its authorized ROE;
   - The appropriate capital structure for GMP in light of the fact that the Company is a wholly owned subsidiary;
   - The proper interpretation of important provisions of the current Alt. Reg plan such as the "Exogenous Change Adjustment."
4. There should be a three-year "pause" in alternative regulation when GMP's current Alt. Reg Plan expires on September 30, 2017. During that pause, the Department should advocate for the process proposed by George Sansoucy, P.E. LLC ("Sansoucy")[3] which would require GMP to file a "traditional rate case" with the Vermont Public Service Board (Board) no later than January 1, 2018. (Sansoucy's complete proposal is attached to this report.)

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[1] The 2016 proceedings set GMP's rates to serve its customers in the 2017 "rate year" (10/1/2016-9/30/2017). This process has been referred to by the parties as the "2017 Base Rate Filing", the "2017 Cost of Service Filing" or the "Plan Rate Adjustment Filing." Since the "filing" and the "process" took place in 2016, it is referred to in this report as the "2016 Rate Adjustment Filing" to avoid confusion.

[2] GMP's "rate base" is the total amount of the Company's investment in "plant" (generation facilities, distribution lines, trucks etc.) that serves ratepayers. Ratepayers pay for additions to rate base investment through electric rates. They pay a "return of" that investment (depreciation expense component in rates) and a "return on" that rate base investment (cost of capital component, including a return on equity component).

[3] George Sansoucy, is an expert in a variety of areas related to utilities and utility regulation. He has worked and testified as an expert before the New Hampshire Public Utilities Commission, the Michigan Public Service Commission and the San Francisco Public Service Commission.

Background

In its 2016 session, the Vermont Legislature amended 30 VSA § 3075 to require the Commissioner of the Department of Public Service (Department) to submit an annual report to the Legislature which:

> ". . . summarize (s) the Department's role and positions with respect to other significant topics addressed by the Department's Public Advocacy Division pursuant to alternative regulation or to litigation before the Public Service Board or other tribunal. The report specifically shall refer to the Department's duties and responsibilities under Title 30 and explain how the Department's positions and activities align with those statutory provisions." Sec. 5f (a)

The Legislature explained the "primary purpose" of the Commissioner's report:

> "(b) The primary purpose of the reporting requirement of this section is to help address concerns regarding any potential compromise of the effectiveness or independence of the Department's representation of ratepayers in rate proceedings, including base rate filings under an alternative regulation plan.

The Legislature directed the Vermont Attorney General (AGO) to assist the Commissioner by providing "findings and recommendations" which are to be included in the Commissioner's annual report:

> "(c) To assist with meeting the purpose stated in subsection (b) of this section, the Attorney General shall monitor and detail at least one rate proceeding annually and make findings and recommendations related to the effectiveness and independence of the Department's ratepayer advocacy. In performing his or her duties under this section, the Attorney General shall have full access to the work and work product of the Department as it relates to each proceeding he or she monitors. The Attorney General's findings and recommendations shall be included in the Department's annual report."

I. PROCESS ADOPTED TO COMPLY WITH THE LEGISLATURE'S DIRECTIVE

Green Mountain Power (GMP) is Vermont's largest electric utility. The AGO selected GMP's 2016 Rate Adjustment" Filing under the Company's Alt. Reg. Plan as the proceeding to follow in assessing the "effectiveness" and "independence" of the Department's advocacy on behalf of GMP ratepayers.

On June 29, 2016, the AGO retained the undersigned[4] to follow the process and draft the "findings and recommendations" mandated by the Legislature. At roughly the same time., the AGO

[4] Bob Simpson - I worked as a lawyer in the Public Advocacy Division of the Department of Public Service from 1990-94. During that time, I was involved in litigating two GMP rate cases before the Vermont Public Service Board (Board) under what is now called "traditional rate-making." Following my work for the Department of Public Service, I went to work in the Chittenden County State's Attorney's Office where I served as Chief Deputy from 1997-2001 and as State's Attorney from 2001-2006. During my time at the State's Attorney Office, I also served on

retained Sansoucy to provide technical advice, and later, to draft a proposal to replace the process for reviewing and approving proposed additions in GMP's annual Rate Adjustment Filing.

Under Alt. Reg, GMP files annually for adjustment of its rates. This annual rate adjustment process sets the rates ratepayers will pay to generate the revenue needed to cover GMP's costs to provide electric service to its customers ("Cost of Service") in the upcoming "rate year" – the twelve -month period running from October 1 through September 30.

By the time Sansoucy and I were in place in late June and early July, the work of the Department and its consultant, Larkin Associates (Larkin) of Livonia, Michigan[5] in reviewing GMP's 2016 filing had been underway for several months[6]. It was expected the Department's work would wind up within a month (on August 1) after which the Department and GMP would announce an agreement on the Company's rates.

At that point, it was not possible to "monitor and detail" the Department's performance in this "rate proceeding" in the way a news reporter, or legal or regulatory expert, might have reviewed the Department's performance under "traditional ratemaking." This was true, not only because the process was nearly over; but also, because of the nature of the proceeding, itself.

GMP's 2016 Rate Adjustment "proceeding" was unlike a "rate case" under traditional regulation. The Alt. Reg. process did not involve pre-filed testimony, cross examination of experts or the filing of legal memos which explained each party's position. Instead, the Alt. Reg. process was a two-month period of intense review of scores of issues which necessitated informal give-and-take between the Department's technical experts and lawyers and their counterparts at GMP. This negotiating process was expected to culminate in a "global agreement" on August 1.

I decided it would be very difficult to "monitor" and "detail" this process in the one month left to me before the projected August 1 agreement without seriously disrupting the work of Department's lawyers and experts who were involved in intense negotiations.

There was another problem. Since the Board first approved GMP's Alt. Reg. Plan in 2006, each of GMP's annual "rate adjustment" filings has been resolved through a negotiated "global agreement" between GMP and the Department. As far as I could tell from the Board's records[7], the Department had not asked the Board to make a formal decision on the merits of any disputed issue in these annual rate

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the Burlington Electric Commission (1999-2001). I have served as a part-time hearing officer for seven different Vermont administrative agencies since 2007.

[5] The Larkin firm is an expert in utility regulation and accounting. Larkin has served as an expert to ratepayer advocates in numerous states in all parts of the country. Larkin accounting expert, Helmuth W. (Bill) Schultz, has served as an expert for the Department and the Vermont Public Service Board for approximately 25 years.

[6] A chronological summary of events affecting GMP's Rate Adjustment Filing is attached as exhibit 1.

[7] The Board's website has the formal decisions it has made since it approved GMP's first Alt. Reg. Plan in 2006. In each decision, the Board approved an agreement between GMP and the Department. I found no record of a Board ruling on the merits deciding any disputed issue raised by the Department involving Alt. Reg. https://www.google.com/webhp?sourceid=chrome-instant&ion=1&espv=2&ie=UTF-8#q=Vermont+public+service+Board+alternative+regulation

adjustment filings or, for that matter, on any one of the three Alt. Reg. Plans GMP has had since 2006. This meant that there was no "Alt. Reg. precedent" for me to use to assess the Department's performance in GMP's 2016 filing.

American Association of Retired Persons (AARP)

The American Association of Retired Persons (AARP) has been the Department's harshest and most persistent critic since the Board approved GMP's current Alt. Reg. Plan in August, 2014.

In January, 2015, AARP provided financial support for An Analysis of Vermont Alternative Regulation, by Dr. David Dismukes, Ph. D. of the Center for Energy Studies, Louisiana State University (2015 AARP Report)[8]. The study begins by explaining how alternative regulation plans are meant to benefit both regulated utilities and their ratepayers through "modifications" to traditional regulation which enable shareholders and ratepayers to share "efficiency savings." The study goes on to allege that the 2010 predecessor to GMP's current Alt. Reg. Plan provided significant benefits to GMP and its shareholders and meager benefits to the Company's ratepayers.

In February, 2016, roughly thirteen months after the first study, AARP commissioned a second study by Dr. Dismukes (2016 AARP Report).[9] This second study was published while the Department was reviewing components of GMP's 2016 Rate Adjustment Filing - the filing which is the subject of this report. The AARP study was sharply critical of the role played by the Department's Public Advocacy Division in approving GMP's current Alt Reg. Plan (2014-2017) and its predecessor (2010-2013). It was also critical of the Department's performance in negotiating the "global agreement" on GMP's 2015 Rate Adjustment Filing - an agreement that set rates that GMP ratepayers would pay from October 1, 2015 through September 30, 2016.

Since there were no hearings to monitor, no expert testimony to consider and no legal briefs and memos to review in order to make the assessment, I decided that under the circumstances, the best way to assess the Department's performance in the 2016 GMP filing was to determine: (1) whether AARP's criticism of the Department's past performance was valid, and, if so, (2) whether the specific elements of this criticism continued to have validity when "tested" against the Department's performance in reviewing and negotiating the settlement of GMP's 2016 Rate Adjustment Filing.

For example, the AARP's February, 2016 report said that the process the Department had agreed to in GMP's current Alt. Reg. Plan for reviewing and approving proposed additions to GMPs "rate base" failed to set any standard to ensure these projects were: (1) "needed" to provide service to GMP's ratepayer's; (2) "cost-effective" in that they had been compared to less expensive alternatives and (3) "in service" to ratepayers on the date GMP said they would be.[10]

[8] 2015 AARP Report, Exhibit 2

[9] David E. Dismukes, Ph D, A Critique of the Vermont Department of Public Service's Ratepayer Advocacy Activities, Organization and Act 56, Section 21 (b) Report, Acadian Consulting Group, February 24, 2016, -(2016 AARP Report - Exhibit 3

[10] 2016 AARP report, p.7 -Exhibit 3

I was confident the detailed 2016 "Larkin Reports" (discussed below) would serve as an effective means of determining whether the process for reviewing capital additions continued to fail ratepayers in 2016.

Larkin Reports

The GMP Alt. Reg. Plan calls for Larkin[11] to complete a review of the agreement which GMP and the Department have negotiated to ensure that, among other things, the agreement complies with "traditional rate-making and Board orders regarding cost-of-service filings."

On August 15, 2016, Larkin filed two reports to meet this requirement. One was a detailed, issue-by-issue analysis of the August 1 agreement which not only identified the issues which were addressed during the negotiations; but also, noted how these issues were resolved in the Department agreement with GMP on August 1, 2016. The other report dealt specifically with the Earnings Sharing Adjustment (ESAM) in GMP's Alt. Reg Plan and GMP's effort to have ratepayers pay for 50% of GMP's alleged "under earnings" in the 2015 rate year.

The clarity and detail of the analysis in these reports made it possible to test the validity of the criticism of the Department's advocacy on behalf of GMP's ratepayers in AARP's February 2016 Report[12].

II. FINDINGS

The Department's statutory obligation to protect the interest of GMP's ratepayers is set out in 30 VSA§ 2(a) (6):

> "(6) Review of proposed changes in rate schedules and petition to the public service board, and representation of the interests of the consuming public in proceedings to change rate schedules of public service companies . . ."

As a "licensed monopoly" GMP does not have to fight for "market share." Scott Hempling, an expert in regulatory law, who has testified as an expert witness for the Department in the past, describes the distinction between competitive markets and regulatory monopoly markets:

> "Competitive Markets - Since the market sets the price, you make money by beating competitors. Regulatory Monopoly Markets - *Since the regulators set the price, you make money by persuading the regulators."*[13] (emphasis added)

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[11] Board Order, Dockets 8190, 8191, August 25, 2014 ¶ 72, p. 19 calls for an independent party with expertise in ratemaking and accounting to file a review of each base rates filing within two weeks of the August 1 agreement between GMP and the Department. The review is to assess the agreement's "(1) accuracy, (2) completeness, (3) compliance with traditional ratemaking and Board orders regarding cost-of-service filings, including calculation of regulated earnings, and (4) consistency with GMP's actual cost and with" the Alt. Reg. Plan in effect at the time. Larkin has been retained to do the report for the past several years.

[12] Dr. David Dismukes, A Critique of Vermont Department of Public Service's Ratepayer Advocacy, Organization and Act 56, Section 21 (b) Report, February 24, 2016 (AARP 2016 Report) - Exhibit 3

[13] Scott Hempling, Are Regulators Allowing Returns on Equity Above the Real Cost of Equity? Presentation to the NARUC Consumer Affairs Committee July 13, 2014, Section I, D p.3 – Exhibit 4

The Department was obligated to "carry the fight" for ratepayers to ensure rates generated through GMP's2016 Rate Adjustment Filing were "just and reasonable."

Traditional Regulation in Vermont

The Board set GMP's rates for decades through what is now called "traditional regulation" or "traditional rate-making." Put very simply, this process involved taking GMP's costs in one twelve-month period and then "adjusting" them upward or downward to set rates that would cover the costs GMP would incur to serve its ratepayers in a future twelve- month period.

Traditional rate-making in Vermont often involved "fully-litigated rate cases." These cases were time-consuming and expensive; but, they did subject GMP's rate requests to intense scrutiny.

For instance, on April 20, 1990, GMP filed for a 15.69% rate increase. (Docket 5428). Department experts and lawyers, joined by outside experts, including Larkin, conducted intensive discovery involving many rounds of interrogatories, requests to produce and depositions and then cross-examined GMP witnesses over the course of five days of hearings in late August and early September. Department witnesses submitted pre-filed testimony on September 21, 1990. The Department's testimony challenged more than forty components of GMP's case. Department witnesses were cross-examined over the course of six days of hearings in mid-October and early November. Witnesses from the Department and GMP were cross-examined over the course of three days of rebuttal testimony from November 26-28, 1990.[14]

GMP filed a second petition for a rate increase of 9.9% on July 20, 1991 – just 15 months after it had filed for a 15.69% rate increase in Docket 5428. Department lawyers engaged in the same process in this case (Docket 5532) as they had a little over a year earlier. They eventually submitted pre-filed testimony that challenged approximately twenty-five components of GMP's case. Hearings in the case were conducted over the course of six months from November,1991 into April, 1992.
The Board issued a decision which granted GMP a 5.6% rate increase on May 21, 1992 1992 – approximately ten months after GMP had filed for the rate increase.[15] The decision specifically addressed, and ruled on, each of the issues raised by the Department.

The Department appealed (p. 15 below) components of the Board's decision to the Vermont Supreme Court.

Alternative Regulation (Alt. Reg.)

In 2003, the Vermont Legislature authorized the Department and the Board to approve "alternative forms of regulation." It was evidently an effort to make the rate-setting process more efficient and effective by providing rate stability for ratepayers and limiting risk for utilities such as GMP – utilities which were being asked to make major investments in "Vermont-based renewable energy" and "demand side management."

[14] Department's Brief in Docket 5428, submitted to the Board on December 7, 1990, - Exhibit 5
[15] Department's Brief, Vermont Supreme Court, Docket NO. 92-353, filed October 1, 1992 p. 2 -Exhibit 6

The statute authorizes the Board and the Department to approve "Alt. Reg." Plans which offer utilities like GMP:

> (1) clear incentives to provide least cost energy service to their customers; (2) provide just and reasonable rates to all classes of customers; (3) deliver safe and reliable service; (4) offer incentives for improved performance that advance state energy policy such as increasing reliance on Vermont-based renewable energy and decreasing the extent to which the financial success of distribution utilities between rate cases is linked to increased sales to end use customers and may be threatened by decreases in those sales; (5) promote improved quality of service, reliability and service choices; (6) encourage innovation in the provision of service; (7) establish a reasonably balanced system of risks and rewards that encourages the company to operate as reasonably as possible using sound management practices; and (8) provide a reasonable opportunity, under sound and economical management, to earn a fair rate of return, provided such opportunity must be consistent with flexible design of alternative regulation and with the inclusion of effective financial incentives in such alternatives." 33 VSA§ 218 d (a)

Dr. Dismukes, AARP's utility expert, explained the justification for alternative regulation in his 2015 report:

1. Under traditional cost of service ratemaking, regulators typically have less information about the true cost of service and the nature of that service than the utilities they regulate.
    - This can lead to circumstances in which ratepayers pay a return on capital additions that are "inefficient" (e.g. "gold plated")[16]

2. Under traditional cost of service ratemaking, it is not uncommon for there to be significant "lag" time between the time rates go into effect and the time regulated utility comes in for a traditional rate case.
    - If the utility saves on costs during this "lag time" by operating more efficiently, ratepayers may not get the benefit of these savings.[17]

3. The goal of "alternative regulation" is to take "a little of the "old" (cost of service ratemaking) and combine it with a little of the "new" (formulaic increases in rates and fixed regulatory review periods) to increase the effectiveness of the utility regulatory process, thereby enabling both parties (utility and ratepayers) to share "efficiency savings" while at the same time reducing administrative costs for both parties. [18]

GMP's Alternative Regulation (Alt. Reg. Plan)

The Board approved GMP's first Alt. Reg. Plan[19] in 2006. It approved updated Alt. Reg. Plans for the Company in 2010 and 2014.[20]

[16] 2015 AARP Report, Slide 2-3-Exhibit 2
[17] Ibid.
[18] 2015 AARP Report, slides 4, 19 – Exhibit 2
[19] Board order in Docket Nos. 7175, 7176 (December 22, 2006)
[20] Board Order in Docket Nos. 8190 and 8191 (August 25, 2014)

The 2016 Larkin Report explains the fundamental benefit that the switch from "traditional ratemaking" to "Alt. Reg." has brought to GMP:

> "Under traditional ratemaking, the Company is afforded an opportunity to earn a reasonable rate of return. Under Alt. Reg. . . . the Company is essentially guaranteed a return with minimal risk."[21] (emphasis added)

Base Rate Adjustment

The Base Rate Adjustment was the focal point of the negotiated agreement between the Department and the Company in 2016. When GMP filed its annual proposal for a rate adjustment on June 1, 2016, its filing reflected a base rate revenue deficiency of $14.217 million which would have required a 2.57 % rate increase. The Department's lawyers and experts were able, through negotiation, to convince GMP to reduce its proposed base rate increase to a slight rate decrease for the Base Rate Adjustment.[22]

The Base Rate Adjustment is central to the GMP's Alt. Reg. Plan. It is meant to "forecast" the "adjustments" to the Company's "test year"[23] costs that will be needed to produce "just and reasonable" rates in the upcoming "rate year" which in 2016 is the period from 10/1/2016 through 9/30/2017.

The Base Rate Adjustment is, in fact, the sum of five "adjustments" to the Company's "test year" costs. The "capital spending adjustment" is the only one of the five that must be developed in compliance with traditional ratemaking principles. The other four components of the Base Rate Adjustment are either adjustment by formula or adjustment by "true up" - a practice that the Vermont Supreme Court and other high courts in the U.S., had determined was illegal under traditional ratemaking as "retroactive ratemaking."[24]

(1) "Capital Spending Adjustment" - GMP's Alt. Reg. Plan, provides for "adjustments" to historic rate year costs for GMP's proposed additions to its rate base investment through the end of the "rate year." These proposed additions can only be included in the Company's rate

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[21] Larkin Associates, PLLC, Report on Analysis of Rate Year Ending September 30, 2016 Green Mountain Power Cost of Service Request and Cost of Capital Request Under Alternative Regulation (August 14, 2015) (2015 Larkin) pp. 1-2 - Exhibit 8

[22] Larkin Associates, PLLC, Report on Analysis of Rate Year Ending September 30, 2017 Green Mountain Power Cost of Service Request and Cost of Capital Request Under Alternative Regulation (Augus15, 2016) (2016 Larkin) pp. 1-2 – Exhibit 8

[23] GMP's "historic test year" for the 2016 Base Rate Adjustment was the twelve-month period between April 1, 2015 and March 31, 2016.

[24] "Retroactive ratemaking" is defined as "the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established." *In Re Central Vermont Public Service Corporation,* 144 Vt. 46, 52 (1984)

base if GMP proves that each proposed addition meets the "known and measurable" standard/ "test" as it has developed under Vermont law.

(2) Base O&M Costs/ "Current Non-Power Costs" Adjustment - Under GMP's Alt. Reg. Plan, rate year costs that are neither projected power costs or estimated rate base additions ("current non-power costs" or "platform costs"), are calculated by multiplying the sum of these "Current Non-Power Costs" x CPI -U-Northeast. [25] (The CPI-U Northeast for GMP's 2016 Base Rate Adjustment was 0.6%[26])

(3) "Earnings Sharing Adjustor" (ESAM) The ESAM is the difference between GMP's authorized return on rate base for the last full rate year's Base Rate Adjustment and GMP's actual return on rate base for the previous rate year. The amount of the ESAM is added to the Base Rate Adjustment and included in rates for the upcoming rate year. [27]

(4) Exogenous Change Adjustment – This adjustment consists of two potential adjustments for cost or revenue changes occurring in the test year (4/1 – 3/31):

- Exogenous Non-Storm Changes - are material cost or revenue changes that in aggregate exceed in any year $1.2 million adjusted annually for inflation.
  - "Changes" that are covered include: all "judicial, regulatory, or legislative changes affecting" GMP, net loss of major customer(s) load (not related to storms), major unplanned maintenance costs or investments and major repairs to company-owned power plants. [28]
- Exogenous Storm Changes - are increased costs relating to incremental maintenance expenses incurred by GMP due to major storms that exceed $1.2 million, adjusted annually for inflation.
- GMP's proposed exogenous change adjustment must be filed with the Department by May 1for inclusion in the Base Rate Adjustment for that year.[29]

(5) Return on Equity (ROE) Adjustment – GMP's authorized return on equity is calculated in July. It is tied to the 10-year treasury bond.

". . . allowed return on equity component shall be adjusted by a percentage amount equal to 50% of the difference of the average of the ten-year Treasury note yield to maturity(a) as of the last twenty trading days ending two weeks prior to filing and (b) as of the twenty-day period used for the last return on equity component." [30]

Power Adjustor

Although Sansoucy says the "basis for the procedure (Power Adjustor) is sound," Sansoucy proposes changes to add a "robust adjudication process":

[25] Consumer Price Index for All Urban Consumers in the Northeast Region. (June 4 MOU), §III A. 5 – Exhibit 9
[26] 2016 Larkin, p. 4 -Exhibit 8
[27] June 4, 2014 MOU -GMP-AARP (June 4 MOU), pp.6-8 - Exhibit 9
[28] Board Order, Docket No. 8090, 8191, F. 20-22

[29] Board Order 8190, 81891, F-21-23
[30] June 4, 2014 MOU, p.4 - Exhibit 9

"Costs relative to power supply are not to be included in the base rates. As such, a separate power supply cost recovery procedure shall be established. The current procedure requires quarterly filings reporting the actual power costs vs. the forecast power costs. These quarterly variances are then aggregated to establish as Power Adjustor to base rates for the following year. The basis of this procedure is sound but, similar to the Alt. Reg. Plan, it lacks a robust adjudication process. As such, we recommend that the Company file a Power Supply Cost Recovery Plan and a Power Supply Cost Recovery Reconciliation annually." (This process is described in the "Sansoucy Proposal" which is attached to this report.")

AARP's Criticism of the Department's "Ratepayer Advocacy"

AARP's February, 2016 report, was sharply criticized the Department in four important areas. However, it is important to note at the outset that AARP and the Department had taken steps to address each of these problems well before the AGO began its review in late June, 2016. In fact, three of the four problems had been addressed (with varying degrees of success) in 2014 when the Board approved GMP's current Alt. Reg. Plan.

1. **"Performance Adjustment" to GMP's Return on Equity (ROE)**

Dr. Dismukes, charged that this mechanism for annual adjustment of the Company's ROE gave GMP "bonus rates of return" if GMP's overall earnings were higher than those of utilities that were comparable to GMP – i.e. GMP was entitled to an even greater return if it could show it "was already earning more than most of its peer utilities."

1. Dr. Dismukes said: "This ROE performance adjustment mechanism effectively allowed GMP to "double dip" on excess earnings since the adjustment gave the utility a "bonus" rate of return if its overall earnings were higher than a peer group of comparable utilities.

2. In other words, according to Dr. Dismukes, "the mechanism allowed the utility to earn more in excess earnings, if it could show that it was already earning more than most of its peer utilities." Again, the "deal negotiated by the Department provided significant benefits to GMP, inexplicably at ratepayers' expense." 2016 AARP Report. P.7[31]

3. Problem Addressed in 2014 - AARP negotiated the elimination of the ROE "performance adjustment."[32]

2016 – "Effectiveness" of the Department's "Ratepayer Advocacy" on the ROE Issue

The 2014 amendment eliminating the "earnings performance" adjustment to ROE had relatively little impact on ROE in GMP's 2016 "rate adjustment." But, Britain's vote to leave the European Union did. Britain's Brexit vote in June, 2016 served to move ROE in the right direction for GMP ratepayers. They will be paying a 9.02% ROE in rates for the period from October 1, 2016 – September 30, 2017.

[31] 2016 AARP Report. P.7 – Exhibit 3

[32] Board Order Docket 8190, 8191¶ 10

Under the terms of GMP's Alt. Reg. plan, ROE is adjusted annually based on the yield of the ten-year treasury bond[33]. Yield on the bond had dropped sharply[34] by the time of annual ROE adjustment in July, 2016, which happened not long after Britain's vote to leave the European Union. The result was the ROE dropped from 9.44% to 9.02.

- 10.25% - ROE when GMP's first Alt. Reg. Plan was adopted in 2006[35]
- 9.6% - ROE when GMP's current Alt. Reg. Plan was adopted in 2014[36]
- 9.02% - ROE in rates for the 2017 "rate year" (10/1/2016-9/30/2017)[37]

The trend is obviously going in the right direction for GMP ratepayers. But, the question remains whether the current ROE is still unreasonably high. The Board's Deputy General Counsel, George Young, raised the issue at the Board's annual workshop on GMP's proposed rate adjustment. He noted that Mr. Schultz, primary author of the annual Larkin reports, had said that under Alt. Reg., GMP is "essentially guaranteed a return with minimal risk." Mr. Young questioned whether it is reasonable to allow GMP such a "risk premium above the long bond" (30-year U.S. Treasury Bond) under circumstances where GMP's risk of not earning its authorized return is "drastically reduced."[38]

2. <u>"Capital Expenditure Mechanism" – Reviewing Rate Base Projects</u>

This is a particularly significant issue. The Department's agreements with GMP have authorized GMP to add $188 million to the company's rate base over the two-year period from September 30, 2015 through September 30, 2017.[39] This is an increase of 16%[40] over two years. If rate base growth continues at this pace, GMP's rate base will double in 9 years.

Ratepayers pay GMP a "return of" its rate base investment (rate component for depreciation expense) and a "return on" this investment (rate component for ROE)[41]. The Department is responsible for ensuring these investments are: (1) "needed", (2) cost-effective and (3) in service to ratepayers at the time GMP says they will be in service to ratepayers.

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[33] "The allowed return on equity component shall be adjusted by a percentage amount equal to 50% of the difference of the average of the ten-year Treasury note yield to maturity(a) as of the last twenty trading days ending two weeks prior to filing and (b) as of the twenty-day period used for the last return on equity component." June 4, 2014 MOU, p.4 - Exhibit 9

[34] Sam Goldfarb, Jon Sindrieu, Min Zeng, *Treasury Yields Hit Historic Lows Amid Brexit Fallout*, Wall Street Journal, July 4, 2016 http://www.wsj.com/articles/treasury-yields-hit-historic-lows-amid-brexit-fallout-1467414740

[35] Order Docket 7175, 7176, December 22, 2006, pp. 13-14

[36] Order Docket 8190, 8191, August 25,2014, p. 6

[37] GMP, schedule 3, August 1, 2016 – Exhibit 11

[38] Transcript of Board Workshop Re: Docket/Tariff 8618 (9/13/2016) pp. 79-80 - Exhibit 12

[39] $1,164,743,000 on 9/30/2015 (Larkin ESAM Report, p.5) and $1,352,771,000 authorized through 9/30/2017 - (GMP Schedule 4, August 1, 2016) – 1,352,771,000 -1,164,743,000 = 188,028,000. Exhibit 10, Exhibit 13

[40] 188,028,000/ 1,164,743,000 = .1614

[41] In the 2015 rate year, the Department agreed to have ratepayers pay GMP a $86.89 million "return on" its rate base investment. (GMP Schedule 4, May 31, 2014) It agreed to have ratepayers pay a $95.235 million return in the 2017 rate year (GMP Schedule 4, August 1, 2016) Exhibits 13, 14

AARP Criticism

Dr. Dismukes was critical of the Department's approval of a "capital expenditure mechanism" which, he alleged, permitted GMP to "pass through in rates" the estimated cost and in-service dates of these capital additions without requiring GMP to provide documentation such as: "the purpose" of the project and a cost-benefit analysis or the "anticipated and final costs" of a project.[42] Dr. Dismukes charged that "mechanisms of this sort are entirely inconsistent with alternative regulation principles."[43]

(1) Dr. Dismukes explained further:

- "Typically, utilities under ARP (Alt. Reg. Plan) -type mechanisms are given pricing flexibility to cover rising costs, including any capital-related costs. (footnote omitted) The Department, however, agreed to a mechanism which effectively allowed GMP to have its proverbial cake and eat it too. GMP would increase rates based on the ARP's formulaic method and would also be allowed under the Department's settlement to pass along additional capital expenses on a dollar-for-dollar basis without going through a standard rate case. The Department did not *impose or require the utility provide any documentation on these capital expenditures, including identify individual capital projects, the purpose of the capital project, and how it met the utility's longer run capital plan, the anticipated and final cost for each capital project, or any other standard information*. . ." [44] (emphasis added)

(2) Problem Addressed in 2014

In 2014, the Department negotiated an amendment which did address what Dr. Dismukes described as the Department's failure to require GMP to provide any of the "standard" documentation that is required before a capital addition can added to rate base.

(3) "Attachment 7" to GMP's current Alt. Reg. Plan requires GMP to prepare and file the following for each new capital project:

- "A capital project summary sheet with amounts tying out to the amounts requested";
- A work order describing: the proposed project; GMP's reason(s) for doing the project and "projected start and end dates of the project";
  A detailed cost benefit analysis for projects over $3 million; a cost-benefit analysis or a financial analysis for projects in over $300,000 but less than $3 million and a quantitative analysis for projects under $300,000
- "Actual Cost and Cost Estimates" [45]
- If GMP fails to provide the detailed analyses referred to above when it makes its base rate filing on June 1, a specific provision of Attachment 7 gives the Department, and ultimately the Board, the authority to "exclude from rates" any, and all, capital projects which were not properly documented. [46]

[42] 2016 AARP Report, pp. 6-7- Exhibit 3
[43] 2016 AARP Report p. 6 – Exhibit 3
[44] 2016 AARP Report, p.7 – Exhibit 3
[45] Attachment 7 to GMP's current Alt. Reg. Plan (Attachment 7) pp. 1-2 -Exhibit 9
[46] Attachment 7 p. 1 - Exhibit 9

2016 –Effectiveness of Department's Efforts to Review GMP's Proposed Additions to Rate Base

The Department's lawyers and experts were successful in getting GMP to agree to exclude $37.325 million[47] from GMP's proposed additions to rate base in the 2016 filing for failure to meet the "known and measurable" standard. That is, GMP was unable to prove why a proposed project would benefit ratepayers, or why there was not a less expensive alternative to a proposed project or why the Company's estimates "in service" dates for a proposed project were reasonable. However, the 2016 proceedings exposed a serious problem with the Alt. Reg. process for pre-approving proposed additions to rate base. The Company went back on its agreement to "exclude" millions of dollars from its rate base in 2015 and suffered little consequence for it.

"Known and Measurable" Standard

The "known and measurable test" has served as an important protection for GMP's ratepayers for decades. In 1994, the Vermont Supreme Court upheld the Department's claim that the Board had abused its discretion by failing to properly apply the "known and measurable standard" in a "fully-litigated[48]" GMP rate case in 1992. *In Re Green Mountain Power Corp*. 162 Vt. 378, 381 (1994)

The Department's Director of Public Advocacy at the time was James Volz, current Board Chair. The basis for the Department's appeal was testimony from Larkin Associates-at that time a new comer to Vermont.

The court explained that "known and measurable" changes to plant investment/ rate base were changes that are "measurable with a reasonable degree of accuracy and have a high probability of being in effect" in the year when the new rates were to go into effect.[49]

The Supreme Court found that the Board had exceeded its authority when it declined to give GMP ratepayers credit for $3.076 in "accumulated depreciation" which ratepayers had already paid for in rates. The effect of the rate approved by the Board was to require ratepayers to pay a return on an investment they had already paid off[50].

The Court also made it clear that GMP "had the burden" of proof when the Company sought recovery for projected costs in rates[51]. The Court found that GMP had "failed to meet its burden" of proof on its

[47] 2016 Larkin, p. 11 - Exhibit 8

[48] The Board considered testimony from GMP and Department witnesses on multiple issues raised by the Department in its challenge of GMP's proposed rate increase. The Board then issued an opinion which decided each issue and set out the factors supporting its decision on each issue.

[49] 162 Vt. 338

[50] 162 Vt. 382-84

[51] 162 Vt. 385

claim that ratepayers should pay in rates for a $785,000 project that was "known" to have been "cancelled."[52].

GMP's Repeated Failure to Meet Its Burden of Proof

In the years after GMP's Alt. Reg. Plan was approved in 2006, GMP consistently failed to provide "documentation" for proposed capital projects that was sufficient to meets it burden under the known and measurable standard.[53] As noted earlier, in 2014, GMP agreed to provide the Department with specific documentation with each proposed addition to rate base.[54] However, in 2015 and again in 2016, Larkin found that GMP continued to fail to provide the documentation it had committed to provide in 2014.

2016- Proposed Additions to Rate Base

1. In its 2016 Base Rate filing, GMP proposal a total for 228 projects, estimated to cost $132.85 million for additions to rate base during the 2017 rate year. This compared to 206 projects for a total of $86.499 million for 2016 rate year.[55]
2. Larkin found that the "financial analysis" that GMP had agreed to provide in 2014 was generally "insufficient" and that under "strict application" of the 2014 agreement, "a large number" of projects could have been excluded from the request.[56]
3. Larkin noted that GMP had failed to provide the agreed upon documentation for specific projects in 2015 as well.
4. For example, Larkin said "there was *no financial analysis*" provided for any of the 52 computer software projects estimated to cost $13.82 million (increase of 68% from 2015 request) that GMP proposed to add to rate base by the end of the 2017 rate year.[57]
5. There were numerous, documented instances where projects estimated to be "in service" on a particular date could not reasonably be completed on the estimated date or even within the 2017 rate year.[58] Larkin refers to this as "slippage;" but, it means if the estimate is not changed, ratepayers will be paying a "return of" and a "return on" plant investment before it is serving them.

Board Concern

On September 13, 2016, during the workshop mentioned earlier, Deputy General Counsel Young noted that "a number of" GMP's proposed additions to rate base "that are put in cost of service" either "aren't being built or aren't being built within the estimated time period." He said that this is a problem that had come up "at multiple" such workshops over the years since GMP's first Alt. Reg. Plan was approved in 2006.[59]

[52] 162 Vt. 385
[53] 2016 Larkin, p. 4 – Exhibit 8
[54] June 4, 2014 MOU, Attachment 7 – Exhibit 9
[55] 2016 Larkin, p. 9 -Exhibit 8
[56] 2016 Larkin, p.10 – Exhibit 8
[57] 2016 Larkin, pp. 18-19 – Exhibit 8
[58] 2016 Larkin, pp. 13, 16-23 – Exhibit 8
[59] Transcript, Board Workshop re: Docket/ Tariff 8618 - GMP's 2016 rate filing (Board Workshop) p.72

Mr. Young questioned whether "there is something that we need to start to build into future alternative regulation plans, assuming there are future alternative regulation plans, because we talk about it every year at this time."[60]

Alt. Reg. Process Does Not Give the Department Enough Time for Adequate Review

The size of the rate base investments the Department must review has risen dramatically since the days of traditional ratemaking.

- There has been a $188 million authorized increase in GMP's rate base over the past two years.
- In 2016, GMP proposed adding $132.853 million worth of projects to an authorized rate base of $1.260 billion. [61]
- In 1991, GMP asked the Board to authorize an increase that would make its entire rate $164.55 million. [62]

Any future Alt. Reg. Plan must "build in" enough time for the Department to complete a thorough review of each project that GMP proposes to ensure that GMP has met its burden to prove each project meets the "known and measurable standard.

1. GMP's Alt. Reg. Plan gives the Department's lawyers and experts, including Larkin, a little less than three months (May 3 -July31) to review and approve capital additions.[63]
2. As noted earlier, in Docket 5532, a "traditional rate" case involving GMP in 1992, the Department's lawyers and Larkin had approximately six months (July 19, 1991- February 15, 1992) to review and conduct discovery on proposed additions to rate base, write pre-filed testimony that challenged proposed additions to rate base and then cross-examine GMP experts in hearings before the Board.[64]
3. The "allowance for plant additions" under GMP's Alt. Reg. plan "goes beyond what would be allowed under traditional ratemaking which would limit additions to non-growth and reliability/safety projects."[65]
4. In 2015, Larkin selected 134 of proposed capital projects for review.[66] Larkin reported in 2015 that "due to time constraints" some costs were not reviewed "in the same level of detail." In other words, "Larkin not taking issue with certain rate base items should not be construed as there is no issue."[67]
5. In 2015, Larkin found an error in GMP's calculations which would have justified a rate base reduction of "approximately $2 million" but the reduction was not made because by the time Larkin noticed the error, "the Department and GMP had already reached agreement . . ."[68]
6. In 2016, GMP proposed that 228 capital projects be added to its rate base. Larkin selected 155 of them for review.[69] Larkin reported, as it had in 2015, that "due to time constraints not all costs

[60] Board Workshop, Transcript., p.73 -Exhibit 12
[61] 2016 Larkin, p. 9, GMP Schedule 4, August 1, 2015 -Exhibit 8, Exhibit 17
[62] Department Brief in Docket 5532, p. 1 – Exhibit1 5
[63] 2016 Larkin, p. 8 – Exhibit 8
[64] Department's Brief in *In Re: Green Mountain Power Corporation*, Vermont Supreme Court Docket No. 92-353, p. 2 and Department' Brief filed with the Board (2/24/1992) -Table of Contents – Exhibit 6, Exhibit 15
[65] 2016 Larkin- ESAM Report pp.7-8 – Exhibit 10
[66] 2015 Larkin, p.8 – Exhibit 7
[67] 2015 Larkin, pp. 32-33 – Exhibit 7
[68] 2015 Larkin, p.29 - Exhibit 7
[69] 2016 Larkin, p. 9 – Exhibit 8

are looked at in the same level of detail." Again, "Larkin not taking issue with certain rate base items should not be construed as there is no issue".[70]

In short, under Alt. Reg. in 2016, those who are charged with protecting ratepayers' interests have more projects to review, a wider variety of projects to review and less time to review them in than they had under traditional regulation. The Department and Larkin simply cannot submit GMP's proposals to the level of scrutiny ratepayers are entitled to.

Mr. Schultz, primary author of the 2016 Larkin reports, submitted pre-filed testimony on behalf of the Department in Vermont Gas proceedings on August 22, 2016. Mr. Schultz said he was speaking specifically of "his experience with alternative regulation in Vermont" with "electric companies."[71]

> One of the "cons," of alternative regulation is that "abuse and complacency can occur, resulting in higher rates. The abuse that can occur is that the company can develop what I think of as a 'blank check' approach to planning. The attitude that 'if money is spent, it can be recovered in rates' can develop because the level of scrutiny is limited under Alternative Regulation."[72]
>
> * *
>
> "My experience in Vermont is <u>schedule has been a factor</u> on the review process, limiting what can be analyzed as opposed to a traditional rate filing. A limited review means that some costs that would not typically be allowed in rates can fall through the cracks and get passed on and into rates. <u>With an ARP (Alternative Regulation Plan) review, the review of costs is even more important because of the ability to pass on costs so readily.</u> [73] (emphasis added)

Larkin does not have enough time under the current process to do a thorough review. The lack of time is exacerbated by the fact that under the current process, GMP lacks any incentive to meet its burden of proof under the "known and measurable standard."

This is demonstrated by the company's repeated failure to provide the documentation it has agreed to provide. Since Larkin and the Department only has three months, at most, to complete its "known and measurable" review, it is crucial that GMP provide the documentation it has agreed to provide on June 1. Since in many cases that is not done, Larkin is forced to request the documentation. And, since the process is a "negotiation" and in many cases, the Company has already invested its money, the burden of proof effectively shifts to Larkin to justify why the project should be excluded from rate base.

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[70] 2016 Larkin, pp. 29-30- Exhibit 8

[71] Pre-filed testimony of Helmuth W. Schultz in Docket 8698, August 22, 2016, p. 3- Exhibit 16

[72] Pre-filed testimony of Helmuth W. Schultz in Docket 8698, August 22, 2016, p.5 – Exhibit 16

[73] Pre-filed testimony of Helmuth W. Schultz in Docket 8698, August 22, 2016, pp. 5-6 -Exhibit 16

The result is the "known and measurable standard" is lost in the shuffle despite the best efforts of Larkin and the Department. This, in turn, has created an unreasonable risk that ratepayers are paying for millions of dollars in rate base investments that the Company has failed to prove: (1) "needed" to serve ratepayers -e.g. consistent with Company's long term plan or budget; (2) cost-effective – e.g. compared against less expensive alternative or (3) reasonably likely to be in service at the time GMP says it will be in service.

3. "Earnings Sharing Adjustor" (ESAM)

AARP Criticism

In his February 2016 critique, Dr. Dismukes charged that the Department had agreed to a lopsided "mechanism" (ESAM) for sharing any "over earnings" - revenue that exceeded GMP's authorized rate of return in the previous rate year[74]. Dr. Dismukes claimed the ESAM negotiated by the Department gave GMP and its shareholders an overly "generous percentage of any excess earnings" leaving little for ratepayers. [75]

1. Dr. Dismukes presented a chart which showed that over the period from 2007-2013, this "earnings sharing mechanism" (ESAM) enabled GMP and its shareholders to retain nearly $8 for every $1 it "shared" with ratepayers under the ESAM agreed to by the Department. That is, GMP took $6,647,631 for GMP over that period under the ESM while $852,447 went to ratepayers over the same period.[76]

2. Problem Addressed

   In 2014, AARP negotiated an amendment to GMP's Alt. Reg. Plan which required GMP to share more of its "over earnings" with its ratepayers.
3. Under the ESAM that expired in 2013, GMP was entitled to retain "over earnings" that were up to 75 basis points above its authorized return on equity. GMP was also required to absorb some "under earnings" – earnings that fell short of its authorized return.[77] However, if the earnings shortfall was between -75 to -125 basis points below GMP's authorized return, ratepayers would be required to "share the pain" on a 50/50 basis. [78] For instance, if "under earnings" that exceeded 75 basis points were $1 million, ratepayers would pay an additional $500,000 in rates to make up the "loss."
4. The amendments to the Earnings Sharing Adjustment Mechanism (ESAM) negotiated by AARP in 2014[79] meant that GMP was required to share more "over earnings" – earnings above the authorized ROE- with ratepayers. But, the amendment also called for ratepayers to share more of

[74] Dr. Dismukes refers to earnings that exceeded GMP's authorized return as "excess earnings." GMP's Alt. Reg. plan refers to these earnings as "efficiency savings."
[75] 2016 AARP Report, p. 6 – Exhibit 3
[76] 2016 AARP Report, p. 10 – Exhibit 3
[77] This "band" of 75 basis points either way is known as the "dead band."
[78] Board Order in Docket No. 7176 (December 22, 2006) --p.21 -paragraph 40
[79] Board Order, Docket Nos. 8190, 8191, (8/25/2014) pp. 11-12, ¶¶ 30-34

the "pain" if there were "under earnings."[80] (i.e. GMP's earnings fell short of the authorized ROE)

5. The 2014 amendment reduced the size of the so-called "dead band" for "over earnings"– the range in earnings above GMP's authorized return on equity (ROE) in which the Company is permitted to retain all its "over earnings."

- The "dead band" under GMP's predecessor Alt. Reg. Plan was set at within 75 basis points above, and below, GMP's authorized ROE.[81]
- The 2014 amendment to the ESAM reduced the dead band to within 35 basis points above the authorized ROE- once above 35 basis points GMP would have to begin sharing "over earnings."

6. But the 2014 Amendment also reduced the size of the dead band for "under earnings" from 75 basis points below GMP's authorized ROE to 50 basis points below the Company's authorized ROE. That meant greater exposure for ratepayers if GMP "under earned."

- Under the former Alt. Reg. Plan, ratepayers were not required to pay for 50% of GMP's "under earnings" until the Company's earnings fell more than 75 basis points below the Company's authorized ROE.
- Under the 2014 Amendment, ratepayers were responsible for 50% of the Company's "under earnings" as soon as GMP's earnings fell to more than 50 basis points below its authorized ROE.[82]

2016- GMP Says ESAM Requires Ratepayers to Pay 50% of the Company's Under Earnings

GMP said it had "under – earned" by $1.524 million[83]in the 2015 rate year (10/1/2014-9/30/2015). The Company claimed that under the terms of the Alt. Re. Earnings Sharing Adjustment (ESAM), the GMP was entitled to have the ratepayers pay 50% of the $1,524,000 million under-earnings as part of the 2016 Rate Adjustment.

Larkin found that this "earnings shortfall" was "driven in large part" by the fact that GMP's rate base on September 30, 2015 – the end of the 2015 rate year- was more than $41.071 million larger[84] than the amount in the projection approved by the Department and the Board in 2014 Rate Adjustment filing. The increase in rate base was, in turn, due in large part to the fact that by the end of the 2015 "rate year" (9/30/2015) GMP had $24.186 million more in additions to rate base than had been authorized.[85].

[80] Id. ¶ 34
[81] Id. ¶ 33
[82] Id. ¶ 31
[83] Larkin ESAM Report p. 1- Exhibit 10
[84] Larkin ESAM Report, p. 8- Exhibit 10
[85] Ibid. The $41.071 million over projected rate base figure had two components – (1) $24.186 million above projected plant additions and (2) accumulated depreciation was $16.885 million below projected accumulated depreciation. -Exhibit 10

GMP's authorized return on the projected rate base approved by the Department and the Board was $86.890 million. That amount was built into the rates that GMP ratepayers paid in the 2015 rate year[86]. However, the "authorized return" on the "actual" rate base – the one with the additional $24.186 million in unauthorized additions to rate base- was $88.809 million[87]. That resulted[88] in the $1.524 million in "under earnings" claim from GMP in its proposed ESAM adjustment and the claim that under the terms of the ESAM ratepayers were required to pay half of that amount ($762,000) as part of the 2016 Rate Adjustment.

The Department objected:

"… it would be inappropriate for the Company to recover under earnings from ratepayers (or avoid paying over earnings) by including costs in the ESAM for plant that had not previously been reviewed and approved. To allow recovery of costs for such unapproved plant as part of ESAM would be to expand beyond established ratemaking standards and result in a process that loses the validation principle for setting reasonable rates."[89]

Larkin did a detailed review of the projects which were included in GMP's rate base on September 30, 2015 – the end of the 2015 rate year. It found, as it had in prior filings, that there had been "slippage." That is, projects that had been approved for inclusion in rate base on a certain date were not actually "in service to ratepayers" until much later. This meant that ratepayers had been paying for months, sometimes years for projects that were not "in service."

Larkin also found, as it had in prior filings, that projects that had not been subject to "known and measurable" review were "substituted" for projects that had been found to have met the "known and measurable standard."

Computer software projects provide a good example.

1. Thirty-five projects were approved for inclusion in rate base for 2015 rate year at an approved cost of $12.295 million.
2. Of the 35 projects approved, only 8 were completed on time, 10 projects were completed late and 17 projects (total cost $1.053 million) were not done it all.
3. The total spent on the 18 approved projects which were completed was $11.654 million.
4. GMP substituted 46 projects (total cost $10.649 million) for the 17 approved projects that had not been done.
5. GMP admitted that 29 of the substituted projects had not been reviewed by the Department at all and acknowledged that most of the remaining 17 projects had been approved and included in rates for the 2013 and 2014 rate years. [90]

[86] GMP Schedule 4, 2014 Rate Adjustment Filing of the 2015 rate year (10/1/2014-9/30/2015). – Exhibit 14
[87] Larkin ESAM Report p. 5. Exhibit 10
[88] Under the ESAM ratepayers were not required to pay under earnings within the 50-basis point "dead band." June 4 MOU p. 5 - Exhibit 9
[89] Larkin ESAM Report p.8 -Exhibit 10
[90] Larkin ESAM Report, pp. 16-17 -Exhibit 10

GMP's decision to add $24.186 million in unauthorized projects to rate base worked a "triple whammy" on its customers.

First, ratepayers will be paying rates for millions of dollars in projects that have not been subject to "known and measurable review" by the Department. Second, the Department had negotiated exclusion of $21 million[91] in projects from rate base in the 2015 rate year because they did not meet the "known and measurable standard.[92] By including $24 million in additional unauthorized projects in the 2015 rate year rate base, GMP effectively nullified the $21.1 million in exclusions, the Company had already agreed to. Third, under the terms of the ESAM, GMP's ratepayers owed the Company $762,000 for under earnings caused in part by the fact that the Company had added projects to rate base without regard for its obligation to prove they would benefit ratepayers.

The ESAM is a "true up" designed, in part, to make GMP "whole" for "under earnings." As noted earlier, the Vermont Supreme Court outlawed this form of protection under traditional ratemaking as "retroactive ratemaking" – i.e. "the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established." *In Re Central Vermont Public Service Corporation,* 144 Vt. 46, 52 (1984)

The Maine Supreme Court explained the basis for its rejection of retroactive ratemaking in a 1998 decision:

> The rule against retroactive ratemaking serves two basic functions: (1) "it protects the public by ensuring that present consumers will not be required to pay for past deficits of the company in their future payments," and (2) "it prevents the company from employing future rates as a means of ensuring the investments of its stockholders," thereby removing the utility's incentive to operate in an efficient, cost-effective manner." *Public Advocate v. Public Utilities Commission*, 718 A2d 201, 207 (Me., 1998) (emphasis added)

The rule against "retroactive ratemaking" clearly did not survive Alt. Reg. But the principle behind the ban on "true ups" still makes sense. Requiring ratepayers to pay for "past deficits" relieves the Company of the incentive to operate in an "efficient cost -effective manner."

The Department did negotiate removal of the demand that ratepayers pay for 50% of GMP's under earnings from the 2016 Rate Adjustment Filing.[93]But, given GMP's demonstrated unwillingness to meet its legal obligation to prove that the capital projects it proposes to add to rate base are cost-effective and will benefit to ratepayers, there is no reasonable basis for a provision in the ESAM which requires ratepayers to make up 50% of the Company's under earnings.

[91] Larkin ESAM Report, p. 18 – Exhibit 10
[92] Id.
[93] Larkin ESAM Report p.28 -Exhibit 10

4. Department's Alleged Failure to Accept the Recommendations of Its Consultant

AARP Criticism

In his February, 2016 Report, Dr. Dismukes, AARP's consultant, was also sharply critical of the Department's performance in negotiating the "global agreement" in GMP's annual rate adjustment filing in 2015. He specifically faulted the Department's failure to follow Larkin's advice[94] on two important issues lodged in GMP's proposed "exogenous change adjustment" for extraordinary costs incurred in a December 9, 2014 snowstorm. GMP claimed the right to recover $15.283 million[95] for these "major storm" costs.

"Storm Bonuses"

1. GMP asked ratepayers to pay $770,410 for "storm bonuses" for salaried/exempt employees who worked more than 5 hours of overtime during the December 9, 2014 storm.[96]
2. Larkin argued that the $770,410 plus $69,337 in associated payroll taxes should be excluded from rates because: (1) salaried employees are expected to work extra hours without additional compensation; (2) bonuses are discretionary, if management believes exempt employees should be paid bonuses, shareholders should at least pay some of the cost and (3) some of the extra storm costs came as a result of management's failure to do "preventive maintenance" – in light of this, Larkin argued, there is no justification for ratepayers to pay bonuses to salaried employees for working extra hours in the storm.[97]
3. Despite Larkin's advice the $770, 410 was not excluded, "as it was ultimately resolved pursuant to a global agreement" negotiated by the Department. [98]

"Vegetation Management" to Limit Storm Costs –

1. An estimated 95 % of the storm damage was caused by trees falling on wires and poles after being brought down by heavy snow.[99]
2. Larkin had argued in past annual rate adjustment filings that GMPs "vegetation management"/ "tree trimming" cycle was not aggressive enough and that company's continuing failure to address this issue "will only increase storm damage and costs in the future."[100]
3. Larkin advised that the $15.283 million "exogenous costs" should have been "adjusted" to account for the fact that GMP had failed to act "proactively" to limit damage from falling trees, but in the end, no such adjustment was made.[101]

[94] 2016 AARP Report, pp. 10-11-Exhibit 3
[95] 2015 Larkin, p. 48 – Exhibit -Exhibit 7
[96] 2015 Larkin p.52 – Exhibit 7
[97] 2015 Larkin pp. 52-53-Exhibit 7
[98] 2015 Larkin p.53
[99] 2015 Larkin, p.54- Exhibit 7
[100] 2015 Larkin p.56 - Exhibit 7
[101] 2015 Larkin p. 56-57- Exhibit 7

2016 – "Recurring Issues" Left Unresolved After "Global Agreement"

The "vegetation management" issue came up again in 2016. But, the issue was not resolved in the 2016 "global agreement" and the Department did not choose to litigate the issue before the Board. Larkin mentioned three other important recurring issues that ought to be resolved by the Board. The issues identified by Larkin are set out below.

Underspending on "Vegetation Management" – Dispute Over Proper Accounting

1. Larkin noted that GMP failed, in 2015, to spend $1,190,248 it had agreed to spend on "vegetation management/ "tree-trimming."
2. Larkin "reflected a deferred regulatory credit" for the 2017 rate year and recommended that the it be continued until the money for vegetation management is "expended as intended."[102]
3. GMP disagreed arguing that accounting on this issue had changed after the merger with CVPS (2012).[103]
4. Larkin recommended "the Board review the issue and provide guidance to whether the accounting on this issue should continue as was previously ordered.[104]

Working Capital

1. In 2016, GMP requested a working capital allowance of $46.769 million.[105]
2. Larkin has been involved in an ongoing dispute "for years" with GMP over how to calculate the working capital allowance.[106]
3. Larkin and GMP made progress in resolving some of the issues involved but "agreed to disagree" on at least one more issue.[107]
4. Larkin recommended that if these issues "are not resolved in the next filing, Larkin will recommend that the issue be litigated."[108]

Capital Structure

1. The "global agreement" calls for a capital structure of 49.70% debt-50.30% equity[109]
2. Larkin had called for a 50%-50% capital structure in this filing and recommends the same 50%-50% split "in future filings[110] because:
    - GMP is a wholly owned subsidiary of Gaz Metro of Montreal, Canada.
    - It is "not uncommon for the capital structure to reflect a 50/50 split between debt and equity when a subsidiary is the utility requesting a change in rates." [111]
3. Larkin explained:

[102] 2016 Larkin, p. 33 -Exhibit 8
[103] Id.
[104] 2016 Larkin, p. 34 – Exhibit 8
[105] 2016 Larkin, p. 30 – Exhibit 8
[106] Id.
[107] 2016 Larkin, p. 32 – Exhibit 8
[108] Id.
[109] GMP, Schedule 3, 8/1/2016 – Exhibit 11
[110] 2016 Larkin pp. 36-37 – Exhibit 8
[111] Id.

- The level of equity of a wholly owned subsidiary "is based on its earnings and parent company investment;"
- "If the funds invested are from borrowed funds, this creates a profit mechanism for the parent because the return on equity is significantly higher than any debt rate the parent incurs to make the investment."[112]

Interpretation of Provisions in the "Exogenous Cost Adjustment"

1. This issue arose in the context of the dispute between Larkin and GMP over the additional $15.283 million GMP asked ratepayers to pay in 2016 rates as an "Exogenous Change Adjustment" for extraordinary damage caused by the December 9, 2014 snow storm.
2. The Board has said that if GMP meets its burden of proof, these extraordinary storm costs can be "fully recovered in rates in the next year's rates." [113]
3. The Department and GMP disagreed on the interpretation of two provisions of the "Exogenous Cost Adjustor" in the Alt. Reg. Plan
   - Threshold - GMP interpreted the language in the plan to mean that ratepayers should begin paying costs of extraordinary storm once GMP's costs reach $600,000. Larkin read the same provision to mean that ratepayers do not have to begin paying until GMP's extraordinary storm costs reach $1,200,000.
     *Larkin asked the parties to "consider drafting clarifying language to the exogenous provision to avoid further issues."[114]
   - Subparts 2 & 4 of the "Exogenous Change Adjustment - The Department and GMP had differing interpretations of these provisions and how they interrelate. The difference in interpretations in the case of the December 9, 2014 snowstorm amounted to $2.259 million.
     *Larkin recommended "the Board make a determination of how the provision should be applied or instruct the Department and GMP to clarify the language in the Alt. Reg. Plan…"[115]

III. Conclusions

1. Additions to Rate Base – "Capital Spending Adjustment"

The 2016 Rate Adjustment Filing exposed the reality that the current process for pre-approving the projects GMP proposes to add to rate base in the upcoming rate year creates an unreasonable risk that ratepayers spend millions of dollars on projects that are not cost-effective, not needed to serve them or are not "in service" when ratepayers start paying for them.

Scott Hempling is an expert on regulatory law who, as noted earlier, has testified for the Department in past rate cases. Mr. Hempling has written, or co-authored, several articles on alternative regulation in the 10 years since the Board approved GMP's first Alt. Reg. Plan.

[112] 2016 Larkin p. 36- Exhibit 8
[113] 2015 Larkin, p.50 – Exhibit 7
[114] 2016 Larkin, pp.40-42 – Exhibit 8
[115] 2016 Larkin p. 44 – Exhibit 8

In 2008, Mr. Hempling co-authored an article on "pre-approvals" for the National Institute of Regulatory Research. He listed six conditions regulators should ensure are met when considering "pre-approvals."

1. "Any pre-approvals are granted only on a supported showing that regulatory action will benefit customers."
2. "Regulatory actions are based on a full review of relevant facts, and supported by evidentiary showings."
3. Whatever regulatory action is taken is appropriately limited or conditioned. Approval of an action as a "prudent" choice is not the same thing as approving for inclusion in rates whatever dollars are expended to pursue it. For example, if the utility seeks the commission's blessing that a particular project is "prudent," require the applicant to explain why other options were rejected (not simply why the applicant's option is appropriate)" Approving "preliminary" or "planning" costs should not be construed as approving the recovery of later incurred dollars. The key is to be certain that regulator flexibility and discretion are retained to the greatest extent possible.
4. "The regulator has adequate resources to conduct appropriate reviews of whatever is requested. . . "
5. "Roles remain properly defined. For example, while it may be appropriate to require that a utility provide periodic reports on the progress of a utility project, the regulator's oversight should not leave it as the party with responsibility for managing the project."
6. "Consideration is given for offsetting adjustments. If pre-approval will reduce the utility's going-forward risk profile, consider whether an adjustment to the utility's return on equity should be ordered in connection with whatever pre-approval is granted."[116] (emphasis added)

The process for pre-approving proposed additions to rate base in the 2016 Rate Adjustment Filing did not satisfy at least three of Mr. Hempling's pre-conditions.

The "Capital Spending Adjustment" process failed to satisfy Conditions 1 and 2. That is, the Department and Larkin repeatedly lacked the time and the documentation to conduct a "full review of relevant facts, supported by an evidentiary showing" that Department pre-approval of a project proposed for inclusion in rate base would "benefit customers."

The process failed to meet Condition 3 as well. The Capital Spending Adjustment process provided no incentive for GMP to prove a project met the "known and measurable standard." The 2016 proceedings have shown that the Department must retain discretionary authority to deny GMP the ability to add projects to rate base before the Company has proven that these projects are cost-effective and in service and providing a benefit to ratepayers.

[116] Scott Hempling, Esq., Scott Strauss, Esq., Pre-Approval Commitments: When and Under What Conditions Should Regulators Commit Ratepayer Dollars to Utility-Capital Projects? National Regulatory Research Institute, (November, 2008) pp. 31-32 – Exhibit 18

The "pause" in alternative regulation proposed by Sansoucy makes sense. However, when alternative regulation returns, the new Alt. Reg. process should give the Department enforceable authority to ensure no project is added to rate base without first meeting the known and measurable standard. One way to do this is:

This could be accomplished as follows:

Year 1 – On May 1, GMP provides Larkin and Department experts with a list of projects proposed for the upcoming "rate year" together with the documentation that GMP promised to provide in 2014. If Larkin and Department experts are satisfied with GMP's proposal for a project, the financing costs for the project will be approved (by August 1) for inclusion in rates for the upcoming "rate year"

Year 2 - On May 1, GMP provides Larkin and Department experts with a list of completed projects and the evidence necessary to satisfy the Department that each project is "in service", cost-effective and benefiting ratepayers. Sansoucy advises that "at a minimum this filing should include a comparison of:

- the planned scope of work vs. the actual scope of work with an explanation of any changes;
- the planned placed in service date vs. the actual placed in service date with an explanation of any changes;
- the planned expense vs. the actual expense to include an explanation of any cost variance exceeding 10% (more or less than planned) for planned total cost of capital that is less than $1 million and 5% (more or less than planned) for planned total cost of capital of more than $1 million."

If Larkin and Department experts agree that GMP has met its burden of proof, each approved project will be added to rate base.

2. Earnings Sharing Adjustment (ESAM)

The 2016 Rate Adjustment filing showed how easily GMP can manipulate the ESAM to the detriment of its customers. The Department exposed the Company's effort to require ratepayers to pay the Company $752,000 for what was, in effect, the Company's abuse of the process. But, there is no good reason why the Department should have been put in a position where it had to expend the resources to expose this practice.

GMP has control over when it will add projects to its rate base. The Company has also repeatedly demonstrated its unwillingness to meet its legal obligation to prove that the capital projects it proposes to add to rate base are cost-effective and will benefit ratepayers. Under these circumstances, there is nothing "just and reasonable" in a provision in the ESAM which requires ratepayers to make up 50% of the Company's "under earnings."

3. Return on Equity (ROE)

Mr. Schultz of Larkin has said that "a key feature" of GMP's Alt. Reg. Plan "which distinguishes it from other jurisdictions is that essentially all" of GMP's "costs are covered" by the Plan's "sharing mechanisms."[117] Mr. Young, the Board's Deputy General Counsel questioned at the Board's Workshop on GMP's 2016 Rate Adjustment whether ratepayers should continue to pay such a relatively high "risk premium above the long bond" (30-year U. S. Treasury Bond) when Mr. Schultz has said the Company is "essentially guaranteed a return with minimal risk."

The Department should conduct a "return on equity study and determination of equity rate" in preparation for the 2018 rate case as recommended in the Sansoucy proposal.

4. Department Should Litigate to Get Board Guidance on "Recurring Issues"

Under normal circumstances, it is best to resolve disputes through a negotiated settlement rather than litigation.[118] Litigation should be the last resort- not the first impulse. This is particularly true in cases as complex as cost-of-service ratemaking. However, experience also shows that a willingness and ability to litigate has tended to strengthen the State's position in negotiations.

As noted earlier, fully-litigated rate cases under traditional ratemaking in Vermont were time-consuming and expensive. There may well be a good argument that GMP's ratepayers would not be well-served if the Department spent the time and money necessary to litigate contested issues in every annual rate adjustment filing. But, there is no such argument in the context here. When it approved GMP's first Alt. Reg. Plan in 2006, the Board expressed concern that ratepayers might not have been fairly compensated for the fact that the Plan shifted risk from GMP shareholders to GMP ratepayers:

> "*In particular, we are concerned that the Plan shifts risks from GMP's shareholders to Vermont ratepayers. No party presented evidence that permits us to accurately quantify the magnitude of this reallocation of risks.* . . Due to this uncertainty, it is not clear that the reduction of GMP's ROE by 50 basis points fully compensates ratepayers for the changes in risk. The Department and GMP have persuaded us that GMP's improved financial status will provide long-term financial benefits to ratepayers that are not directly quantifiable and are likely to outweigh any change to the risk allocation. [119] (emphasis added)

It appears from the record, though, that in the ten years since the Board's approval of GMP's first Alt. Reg. Plan, the Department has not sought a formal Board ruling to resolve any dispute between the Department and GMP over a rate adjustments proposed by GMP. Nor has the Department sought a Board ruling to resolve any dispute over any provision of either of the two GMP Alt. Reg. Plans that have been approved since the first plan was approved. This, in turn, has meant that there have been no final Board decisions on several recurring issues raised by Larkin -decisions which are likely to have benefitted ratepayers.

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[117] Larkin 2016 ESAM Report, p3 – Exhibit 10

[118] Vermont prosecutors tend to try fewer criminal cases today than they did 15-20years ago. But, even back in 2001, prosecutors in Chittenden County only tried 2% of the felony cases they charged (23 out of 1139). Vermont Judiciary 2001 Annual Statistics (7/1/2000 -6/30/2001). Pp. 22, 28 -Exhibit 19

[119] Board Order, Docket 7175, 7176, p. 34

There are several good reasons to "fully litigate" (i. e. obtain a Board decision) the recurring issues identified by Larkin.

First, Larkin has a good track in testifying before the Board. It is reasonable to believe the Board will agree to many of the positions Larkin has taken on these issues. This could save ratepayers millions of dollars.

Second, the goal of "just and reasonable rates" is best achieved if those involved in negotiating further Rate Adjustment Filings have Board rulings telling them what the rules are - on how provisions of the "Exogenous Change Adjustment should be interpreted for instance. Without these rulings, negotiations are more inefficient because they involve unnecessary wrangling over issues that should have been resolved years ago.

Third, litigating issues is likely to improve public confidence in the Department. It is an understatement to say that GMP's annual Rate Adjustment Filing is "not readily accessible to the public." The annual rate adjustment process begins with GMP filing a series of complex schedules with the Department. This filing is followed by two months of hard work and intense negotiations between Department experts and GMP experts which culminate in a "global agreement" on August 1- an agreement which is memorialized through the filing of another series of complex schedules [120]- this time with the Board.

Fully-litigated rate cases are much more accessible to the public. This process involves submission of pre-filed testimony which explains important issues raised in schedules, open hearings with live cross-examination of experts and questioning by the Board which clarifies positions taken by each expert witness and filing of briefs and memos which set out the positions the Department has taken and the reasoning behind these positons. The hearings are almost always open to the public and the pre-filed testimony and briefs and memos are, with a few exceptions, public records. Finally, the Board rules on each issue raised by the parties and explains the basis for the ruling.

This process is bound to improve public confidence in the Department because it provides the press and public with the opportunity to see and understand the important work the Department's Public Advocates do on behalf of ratepayers.

Finally, the Department, itself, recently sponsored testimony by Mr. Schultz of Larkin which makes a good case for litigation instead of serial negotiated agreements:

> "Complacency occurs when traditional ratemaking requirements are compromised by attempting to resolve issues in alternative regulation proceedings. Once the issues get resolved through compromise, subsequent negotiations will test the leniency of the requirements more and more and costs that would not be allowed under traditional ratemaking get allowed. Compromise can be good but when it erodes the standards of traditional ratemaking someone is harmed. That

[120] In 2016, the Department tried to make the Alt. Reg. Process more accessible to the public by attaching a detailed summary of the issues raised during the negotiation process and brief statement of how they were resolved. This summary was included in the schedules filed in the August 1, 2016 "global agreement" (Schedules 2.6.1 - 2.6.3, pp. 114-119) -Exhibit 20

someone most often will be ratepayers. Additionally, there is the problem that settlements do not provide binding and instructive Board precedent. Under traditional regulating when the Department and a utility litigate an issue, the Board resolves the issue and everyone has to follow it afterward. That does not happen with settlements under alternative regulation. And while litigation is possible under alternative regulation, the plans are not set up for litigation; they are set up for cases to be resolved through settlement. I think the erosion of a body of developing Board ratemaking precedent is one of the unanticipated results of alternative regulation that can result in complacency I refer to above."[121]

The Department should adopt Sansoucy's recommendation and require GMP to file a "traditional rate case no later January 1, 2018. The Department should litigate the issues raised by Larkin and its other experts to obtain a final judgment by the Board rather than resolving them through a negotiated settlement.

/s/
Robert V. Simpson, Jr.

[121] Pre-filed testimony of Helmuth W. Schultz in Docket 8698, August 22, 2016, p. 7. – Exhibit 16

ATTACHMENT

PROPOSED RECOMMENDATIONS OF CHANGES TO GREEN MOUNTAIN POWER'S RATE MAKING PROCEDURES

Prepared by: George E. Sansoucy, P.E., LLC.

Introduction:

Since the Vermont Public Service Board ("Board") approved its first Alternative Regulatory Plan ("Alt. Reg. Plan") in 2006, Green Mountain Power ("GMP") has not filed a fully litigated rate case. Instead, GMP has been subject to alternative regulation as defined by its 2006 Alt. Reg. Plan and subsequent plans, approved in 2010 and 2014. A primary goal of alternative regulation is to establish an efficient rate-making process that properly incentivizes the utility to deliver safe and reliable energy at fair and stable rates to all rate classes, while limiting a utility's risks. GMP's Alt. Reg. Plan is effective in reducing the time and expense that would be required in traditional ratemaking, however, is does not allow for the robust review essential in regulating a monopolistic entity such as GMP.

It is clear, based on a review of the GMP's Alt. Reg. Plan filings, the results of oversight performed by the Vermont Public Service Department's ("Department") consultant, Larkin Associates, and the analyses provided by Dr. David Dismukes, commissioned by the American Association for Retired Persons ("AARP"), that there is significant cause for concern that ratepayers are not being treated fairly under GMP's current ratemaking procedures.

Recommendations:

1. Fully-Litigated Rate Case

The inadequate regulatory provisions, lack of sufficient time necessary to conduct a robust and complete review of GMP's annual alternative regulation filing, and the fact that there has not been a fully litigated rate case in ten years, has created a regulatory environment that fails to hold GMP accountable to its regulators and ratepayers. As years go on without a comprehensive review of GMP's ratemaking, the potential for inequities mounts and established baseline information becomes less reliable. As such, we recommend that the current Alt. Reg. Plan be allowed to expire, the baselines be established based on current factors, and a fully litigated rate case be initiated. The recommended rate case should include and/or address the following issues:

1. Term: The current Alt. Reg. Plan, filed June 4, 2014 shall be allowed to expire at the end of its term, September 30, 2017. Base rates, established as part of the last Alt. Reg. Plan filing,

effective 10/01/2016, and valid through 09/30/2017, shall remain in effect through December 31, 2018 during the adjudication of a traditional rate case.

2. Base Rate Adjustments:
    a. GMP shall file a traditional rate case no later than January 1, 2018 for rates to be effective January 1, 2019. This process shall include an extensive litigation process whereby the Department and stakeholder intervenors shall conduct intensive discovery involving interrogatories, requests for production of documents, depositions and/or technical sessions, written direct testimony, submission of relevant studies (e.g. depreciation studies), cross-examination of witnesses to take place during public hearings, and legal briefings.
    b. GMP may seek temporary rate increases pursuant to 30 V.S.A. § 226(a) and the Company may file modified or new tariffs for new services or adjustments on a revenue-neutral basis subject to Board approval pursuant to 30 V.S.A § § 225, 226, 227.
    c. Under the rate plan, GMP shall propose to revise its base rates on a service rendered basis commencing January 1, 2019 and will support its proposal with cost of service information filed with the Board on January 1, 2018.
        i. The cost of service filing shall be calculated in a manner consistent with the traditional Vermont rate making principles.
        ii. The test year shall be based on the 12-month period ending December 31, 2017 in conjunction with pro-forma adjustments to revenues, expenses, assets, liabilities and capital issuances forecast for the following 12-month period ending December 31, 2018, thereby creating a hybrid test year considering both historical and anticipated future needs of the State of Vermont and the Company.
        iii. The percentage rate base change will be determined by comparison of forecasted rate year total cost of service to the revenues that would be raised by existing base rates and projected rate year sales.
        iv. Amounts recoverable in base rates include all prudent and measurable costs other than those recoverable as a Power Supply Cost.
        v. A complete depreciation study shall be prepared by a Board approved contracted depreciation specialist. The depreciation study shall include, but not be limited to, an analysis to determine the original cost of plant, the estimated service life of assets, the accumulated depreciation reserve, gains and losses on the disposition of assets, the effects of asset retirement obligations, a determination of negative salvage, and a recommended course of action to stop negative salvage and reverse existing negative salvage in a way

that minimizes the effect on ratepayers and complies with the Federal Accounting Standards.

vi. A return on equity study and determination of equity rate.

vii. A debt to equity study and determination of the Company's debt to equity ratio.

3. Base rates established as the result of the traditional rate case shall be effective for a 3-year term ending December 31, 2021. A subsequent traditional rate case shall be filed one year prior to the expiration of the existing term (January 1, 2021) and shall include the Company's proposal for an Alt. Reg. Plan. Any authorized Alt. Reg. Plan(s) shall not exceed a term of five years, at which time a traditional litigated rate case must be filed.

2. Power Supply Cost Recovery

Costs relative to power supply are not to be included in the base rates. As such, a separate power supply cost recovery procedure shall be established. The current procedure requires quarterly filings reporting the actual power costs vs. the forecasted power costs. These quarterly variances are then aggregated to establish a Power Adjustor to base rates for the following year. The basis of this procedure is sound but, similar to the Alt. Reg. Plan, it lacks a robust adjudication process. As such, we recommend that the Company file a Power Supply Cost Recovery Plan and a Power Supply Cost Recovery Reconciliation annually.

1. Power Supply Cost Recovery Plan:
   a. The Company shall file annually a complete power supply cost recovery plan describing the expected sources of electric power supply and the anticipated changes in the cost of power supply anticipated over the future 12-month period ending December 31st.
   b. The plan shall be filed no later than 3 months prior to the effective date, January 1 of the following year, of the proposed power supply cost recovery factor, e.g. filing for the effective date of 01/01/2018 shall be filed not later than 10/01/2017.
   c. The plan shall describe all major contracts and power supply arrangements, including transmission of power, entered into by the utility for providing power supply during the specified 12-month period.
   d. The description of the major contracts and arrangements shall include the price of fuel, where applicable, the duration of the contract or arrangement, and an explanation or description of any other term or provision as required by the Department.
   e. The plan shall include the Company's evaluation of the reasonableness and prudence of its decisions to provide power supply in the manner described in the plan and an explanation of the actions taken by the Company to minimize the cost of such supply to the utility.

f. The Company shall also file, contemporaneously with the power supply cost recovery plan, a 5-year forecast of the power supply costs, based on its existing sources of electrical generation and anticipated sources of electrical generation supply. The forecast shall include a description of all relevant major contracts and power supply arrangements entered into or contemplated by the Company, and such other information as the Department may require.

g. Upon the filing of the power supply cost recovery plan, the Department shall conduct a proceeding to review the power supply and costs submitted for the purpose of evaluating the reasonableness and prudence of the plan and establishing the power supply cost recovery factor to be incorporated in the electric rates or rate schedules of the Company.

h. The power supply and cost plan proceeding shall permit reasonable discovery in order to assist the Department and intervening stakeholders to obtain information relevant in determining the reasonableness and prudence of the plan.

i. The final disposition of the proceeding shall approve, disapprove or amend the power supply cost recovery plan and provide an evaluation of the decisions underlying the 5-year forecast.

j. The power supply cost recovery proceeding shall be scheduled in such a way as to allow for comprehensive, yet expedient review, as to allow the power supply cost recovery factor to be included in rates as of January 1st of the following year.

2. Power Supply Cost Recovery:

a. Not later than three months following the end of the 12-month period covered by the utility's power supply cost recovery plan, the Department shall commence a contested cost reconciliation proceeding, to be known as a power supply cost reconciliation.

b. The Company shall file with the Department an Application, Testimony and Exhibits pertaining to plan period ending December 31st of the previous year. The filing shall include, but not be limited to, a comparison of the power supply cost recovery factors and the allowance for the cost of power supply established as part of the corresponding plan and the amounts actually expensed and included in the cost of power supply by the utility.

c. The proceeding shall permit reasonable discovery in order to assist the Department and intervening stakeholders to obtain information relevant in determining the reasonableness and prudence of the expenditures and amounts collected pursuant to the plan.

d. In its Order pertaining to a power supply cost reconciliation proceeding, the Department shall disallow costs that are deemed unreasonable or imprudent. Upon conclusion of the reconciliation proceeding the Department may authorize an adjustment to the current power supply cost recovery factor to account for the reconciliation of planned expenses vs. actual expenses of the prior plan year.

3. **Hearing to Examine the Alternative Regulation of GMP in Vermont**

Green Mountain Power has operated under alternative regulation for ten years. This ten-year history has been studied and documented through Department, as well as intervenor, oversight. While our recommendation calls for GMP to step back into traditional ratemaking, it leaves the door open for alternative regulation in the future. Institutional knowledge will likely be lost and forgotten during the time until a new alternative regulation plan is submitted for Board consideration. This offers an opportunity for the Board and Department to stop and consider the positive and negatives of GMP's Alt. Reg. Plans and document the discussions and conclusions. That way, in three or four years when/if a new plan is submitted for approval, the Board will have an institutional memory to rely on in its decision making process.

1. The Department should petition the Board for hearings to consider the terms of GMP's Alt. Reg. Plans that have been in place over the past ten years in order to evaluate the process and effectiveness of alternative regulation compared to a traditional rate making model.
2. At these hearings, evidence should be introduced through expert testimony and supporting exhibits which considers the effectiveness of GMP's Alt. Reg. Plan in adequately protecting ratepayers' statutory right to "just and reasonable rates." This testimony should:
    a. identify the strengths and weaknesses inherent in the current process for reviewing and approving proposed additions to rate base ("Capital Spending Adjustment");
    b. consider the fairness of the "Earnings Sharing Adjustment" (ESAM);
    c. consider GMP's ROE, given the fact that the Company's risk of not earning its authorized ROE is virtually non-existent;
    d. evaluate the "Exogenous Change Adjustment" language to ascertain if it provides clear and concise direction; and
    e. consider any and all other matters that the Department and/or Board deem necessary.
3. A Board decision should document the proceeding's purpose, history, arguments and conclusions, thus creating a written institutional memory of GMP's alternative regulation for future decision-makers.