

H.227 An act relating to the repeal of Vermont's statute permitting alternative forms of regulation for electric and natural gas companies.

D R A F T Memo for House Committee on Energy & Technology Rep. Cynthia Browning 3/1/17

I believe that the alternative regulation for rates has led to results adverse to the interests of Vermont ratepayers and advantageous to the interests of the shareholders of for profit utilities through a process that is not public in terms of either procedure or record. I believe that we should return to traditional rate cases, even though they are costly and time consuming, because there will be advantages in terms of public participation and public record, and because there may be substantive benefits to ratepayers resulting from a process in which greater inspection and evaluation of utility requests is undertaken. This is especially important in that the for-profit utilities that have taken advantage of the alternative regulation are both either monopolies or near monopolies in their service areas. If we need to provide greater flexibility to adjust rates to cost changes between traditional rate cases, there could be very limited provisions for adjustments based on the cost of fuels only.

At the time of the merger of GMP and CVPS I was already concerned about the ability of the Department of Public Service to properly regulate the new entity in the interests of ratepayers, given the complexity of the issues and the lack of public oversight, and given the tendency for regulated monopolies to push for favorable rules in every way they can in the interests of their shareholders. At that time I offered a bill that would have repealed alternative regulation so that going forward all rate cases would be on the public record and DPS would have the time and the experts to fully vet GMP proposals, and to get rulings from the Public Service Board. This bill was not pursued by the legislature. The GMP/CVPS merger was supposed to save ratepayers millions through various efficiencies. Such savings may or may not have been realized. But we now have experts concluding that the alternative rate regulation process has likely COST ratepayers millions through GMP's exploitation of the process, and DPS's inability to protect us. (See Simpson report.)

Please don't miss another opportunity to do right by Vermonters. If you care about affordability, transparency, and accountability, repeal alternative regulation now.

Background.

With regulated utilities the rates that customers will pay are set by a regulatory process since there are no market forces to determine the price. Such ratepayer rates will be designed to cover allowable costs of providing the service and achieving a rate of return on the utility's capital investment in physical plant and equipment to provide the service. Therefore a utility can increase its income from rates by either expanding the rate base of capital investment or increasing the allowed rate of return on that capital base.

Traditional Rate Case.

A traditional utility rate case would be a semi judicial process in which reports and briefs are filed by a utility and by the department of public service as a case before the Public Service Board. The utility's cost structure, capital base, and rate of return are set and that determines rates for providing service. Some advantages of this are that 1) there is a substantial public record and perhaps an opportunity for members of the public to participate in the process; and 2) the PSB can rule on matters of interpretation or application of statute to particular rate-making issues, which establishes precedent for future cases.

Some disadvantages are that this legal process is time consuming and costly. Because of this the rates tend to be set for an extended period of time, and if there are significant changes to a utility's cost structure or investments during that period, there is no easy and straightforward way to adjust the rates to reflect such changes.

Alternative Rate Regulation.

In this regime rates to be charged to utility customers are set through a private negotiated settlement process between the utility and the Department of Public Service. The utility requests certain customer rates based on operating costs, suggests including certain costs in the rate base, and advocates for a certain rate of return on investment. The Department of Public Service may request more information, hire experts to analyze the material, and make counter offers. A negotiated settlement emerges from this back and forth process, and parts of the process may be available to the public afterwards.

The advantages of this are that it is faster and easier to adjust rates to reflect fluctuations in utility costs, and new investments in the capital base, and the process is less costly to both the utility and the DPS. It was also seen as appropriate given that GMP was being asked to make substantial investments in efficiency and renewable energy that they should have a way to be sure that they would get a return on those investments. The disadvantages are that the DPS may not have the time or the expertise to properly evaluate the complex information provided by the utility, that there is no public record of the process nor opportunity to participate in it, and that matters of interpretation in terms of allowable costs and so forth may be resolved differently at different times, rather than through the setting of formal precedent by the PSB.

Simpson Report (see quotes below)

The Simpson Report on Alternative Regulation documents a number of problems with the recent history of this regime with Green Mountain Power. (I believe that Vermont Gas has also used this regime, but only a recent GMP case was evaluated by Simpson.) Among his conclusions are that this process may have allowed the costs of certain projects to be included in the rate base that did not meet the proper standards for such inclusion, and that the rate of return that is guaranteed to the utility may not be justified given that the return is basically guaranteed for this regulated utility. This has most likely meant that substantial costs have been imposed on ratepayers over time. Such considerations lead Mr. Simpson to conclude that alternative rate regulation should be suspended for a period of time, and that GMP should undertake a traditional rate case. It is my understanding that such a case has been initiated.

Browning Recommendation.

But mere temporary suspension of the alternative rate regulation regime is not enough to protect the interests of ratepayers. I believe that this process must be repealed, and we should return to the use of the traditional formal rate case. It may be that this process could be reformed in a way that would provide some flexibility to deal with exogenous shocks in terms of costs for power between formal rate cases. But if we decide to return to an alternative rate regulation regime, I think that we should start from scratch, because the existing process has unfolded in a way that is against the interests of ratepayers.

Quotes from the Simpson Report: Vermont Department of Public Service's "Ratepayer Advocacy" in Green Mountain Power's 2016 Rate Adjustment Filing Under Alternative Regulation Bob Simpson [This was a report for the Vermont Attorney General done at the direction of the Legislature.]

"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." 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) p.1-2 Exhibit 8 as quoted on p.10 of Simpson.

"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.” p. 25 Simpson

Concerning the failure of DPS to get PSB guidance through litigation on recurring issues:

“... 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 adjustment proposed by GMP. there have been no final Board decisions on several recurring issues raised by Larkin – decisions which are likely to have benefitted ratepayers. ... It is reasonable to believe that the Board will agree to many of the positions Larkin has taken on these issues. This could save ratepayers millions of dollars.” p.28-29. [Larkin was a consultant hired by DPS]

“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 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. This 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.” Pre-filed testimony of Helmuth W. Schultz in Docket 8698, August 22, 2016, p.7 – Exhibit 16.