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August 8, 2008

Ms. Susan M. Hudson, Clerk
Public Service Board
Chittenden Bank Building, 4th Floor
112 State Street
Post Office Drawer 20
Montpelier, VT 05620-2701

Via Hand Delivery

Re: Docket No. 7336: Petition of Central Vermont Public Service Corporation for Approval of an Alternative Regulation Plan Pursuant to 30 V.S.A. § 218d ("Plan");
Brief and Proposal for Decision of Central Vermont Public Service Corporation

Dear Ms. Hudson:

In accordance with the schedule in the above-referenced docket, enclosed for filing are one original and six copies of the Brief and Proposal for Decision of Central Vermont Public Service Corporation. Copies have been provided electronically to the parties today, with hardcopies being mailed.

Please note that as a result of a new Word program recently installed, a few footnotes actually print on the following page. I apologize for any inconvenience.

Thank you, and should you have questions concerning this filing, please do not hesitate to contact me.

Sincerely,

Kenneth C. Picton
KCP/k
enc.
c: Parties

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 7336

Petition of Central Vermont Public Service)
Corporation for approval of an Alternative)
Regulation Plan pursuant to 30 V.S.A. §218d)

CENTRAL VERMONT PUBLIC SERVICE CORPORATION
BRIEF AND
PROPOSAL FOR DECISION

August 8, 2008

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I. INTRODUCTION

In this Brief and Proposal for Decision, Central Vermont Public Service Corporation ("CVPS" or the "Company") requests that the Vermont Public Service Board ("Board") approve the Company's Alternative Regulation Plan (the "Plan" or "CVPS Plan") with certain modifications pursuant to 30 V.S.A. §218d.[1]

In this filing, the Company responds to concerns raised by the Board or the Vermont Department of Public Service (the "DPS" or "Department") during the proceedings in this docket. The Company also reaffirms its support for the Memorandum of Understanding between the Company and Department in the Company's last rate proceeding, Docket No. 7321, to the extent it governs implementation of the Plan. Under the Memorandum of Understanding, the Company and Department agreed, for purposes of the Alternative Regulation Plan, that the authorized return on equity upon the Plan effective date shall drop from the current authorized ROE of 10.71% to 10.21%, resulting in a rate decrease of 0.5% ($1,379,000 below existing rates). Furthermore, the Company supports the Stipulation it had reached with the Conservation Law Foundation ("CLF") as a measure to advance state energy policy goals under alternative regulation.

The CVPS Plan will govern the Company's rates for the next two to four years. The Plan will, in many ways, strengthen the connection between CVPS's costs and its rates. Through a more efficient regulatory oversight process, it will permit annual rate adjustments to reflect changes in operating costs and efficiency gains. The Plan contains meaningful incentives for the

[1] The original CVPS Plan was filed August 31, 2007. The Plan was updated on March 28, 2008 and it is the updated version that constitutes the "Plan" or the "CVPS Plan". The proposed modification relates to providing more notice to ratepayers of rate changes.

Company to find efficiency gains in power management and operations, while allowing investments to improve network delivery services. In addition, the Plan provides for regular (quarterly) rate adjustments to flow through to ratepayers increases or decreases in power and transmission costs (which make up the majority of CVPS's total costs). Importantly, the Plan provides a lower return on equity which has the effect of immediately lowering customer rates. Through this framework, and other provisions, the Plan will enable CVPS to continue to have a reasonable opportunity to recover its operating costs and earn a fair return on equity.

The Department opposes only the Plan's incentive formation, specifically the formulation of cost caps (the "Unicap" and "Subcap") and aspects of the formulation of the Earnings Sharing Adjustment Mechanism. Based on the CLF Stipulation, the Conservation Law Foundation supports the Plan as consistent with the statutory requirements for such plans in 30 V.S.A. § 218d.

We have considered the Department's objections and believe that the Board should approve the Plan with certain modifications as discussed below. The evidence indicates that the rate decrease of 0.5 percent on November 1, 2008, will result in rates that are just and reasonable. No party has presented evidence that would support a different rate decrease.

If the Board determines that a non-power cost cap should be established in lieu of the proposed Unicap and Subcap, the Company recommends, at page __ of this Brief, an alternative for consideration as a reasonable non-power cost cap formulation that is consistent with the model approved for the VGS alternative regulation plan.

The Company submits that, on balance, approval of the alternative regulation plan is in

the best interest of both CVPS and its customers.[2] In addition to the customer benefits described below, the Plan provides clear benefits to CVPS. It will improve the Company's financial position by allowing more rapid pass-through of justifiable cost changes, particularly power costs that can vary significantly due to changes in the wholesale market. Power adjustment mechanisms are viewed favorably by Standard & Poor's credit rating analysts. These improvements will help CVPS return to investment grade and thus will likely help CVPS obtain capital at more favorable rates than it could otherwise. Earnings will be largely decoupled from the volume of sales and that will align the Company's interests with Vermont's policy initiatives promoting energy conservation and distributed generation. The enhanced financial posture and lower capital costs will, in turn, help CVPS as it negotiates replacements for the two major long-term contracts for power from the Vermont Yankee Nuclear Power Station ("Vermont Yankee") and Hydro-Quebec that expire in 2012 and 2016, respectively.

The Plan will also benefit customers over its term. The direct benefits include a lower return on equity (which reduces rate increases) and the possibility that rates can be further reduced by the earnings-sharing provisions of the Plan if CVPS can reduce costs and operate more efficiently, thereby improving its earnings. Moreover, customers are likely to derive indirect benefits as a result of these incentives for CVPS to provide least-cost energy service to its customers. Specifically, any cost savings that result from CVPS's efforts to improve its earnings will be passed on to customers through the mandatory adjustments in the Plan. Finally, to the extent that CVPS's improved financial position helps it obtain favorably priced, long-term

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[2] Compare *Petition of Green Mountain Power Corporation for approval if an Alternative Regulation Plan*, Docket No. 7176, Order of 12/22/06 at 3 ("GMP Plan") and *Petition of Vermont Gas Systems, Inc. for approval of an Alternative Regulation Plan*, Docket No. 7109, Order of 9/21/06 at 9 ("VGS Plan").

power arrangements, customers will, over time, benefit from any power cost savings that result.

Significantly, the Board, the Department, consumer groups, customers, and other interested persons will continue to have an opportunity to evaluate the reasonableness of the various rate adjustments and the Board can open investigations if these changes may not be warranted. We also expect the Board to carefully review the allocation of risks and benefits over the next two to four years to provide a sound basis for evaluating changes in the future. It is essential that the Plan result in a fair distribution of these risk and benefits. Since this is the third alternative regulation plan in Vermont, and the second for an electric utility, the Board already has the benefit of direct experience. Due to this experience, it is reasonable for the Board to find that the rate adjustment mechanisms and related incentives in the Plan, together with reduction of CVPS's ROE by 50 basis points, result in just and reasonable rates. In addition, we expect that the incentives inherent in the Plan will encourage efficient operation of CVPS and promote the state's energy goals. Because of these expectations, we submit that the overall balance of risks and rewards is fair.

II. PROCEDURAL HISTORY

On August 31, 2007, CVPS filed a petition requesting approval of an alternative regulation plan pursuant to 30 V.S.A. § 218d. On October 11, 2007, the Board convened a prehearing conference in this proceeding. The following persons entered appearances: Dale A. Rocheleau, Esq., Morris L. Silver, Esq., and Kenneth Picton, Esq., for Central Vermont Public Service Corporation; Geoffrey Commons, Esq., for the Department of Public Service; Sandra Levine, Esq., for the Conservation Law Foundation; and James Dumont, Esq., for AARP. The Board approved a Protective Agreement between the Company and the Department on January

30, 2008. On March 26, 2008, the Board granted permissive party status to AARP and CLF. On April 10, 2008, the Board adopted a schedule for this proceeding targeting a Board decision date by October 2, 2008 and a plan effective date on November 1, 2008.

The Board held a public hearing using Vermont Interactive Television on May 1, 2008. No member of the public participated in the May 1 hearing. The Board held technical hearings regarding the Company's proposed Plan on July 9 and 10, 2008. The Board ruled during the hearing and later issued a Protective Order on July 16, 2008, concerning the confidentiality of two exhibits and certain portions of testimony filed by CVPS witnesses Pamela Keefe and Roslyn Cook.

This matter is now ready to be decided.

III. POSITIONS OF THE PARTIES

A. CVPS

CVPS argues that the Board should approve the Plan. Also, consistent with the Docket 7321 Memorandum of Understanding, the Company supports an allowed ROE of 10.21% upon the Plan effective date, with an attendant rate decrease of 0.5%.[3]

CVPS maintains that the Plan presents opportunities to improve traditional ratemaking and lower costs to consumers. CVPS asserts that traditional ratemaking produces numerous costs for consumers, including rate case expenses, lag between cost changes and rate changes,

[3] Under the Plan, the authorized return on equity (ROE) would decrease from 10.71% to 10.21% for the balance of the 2008 rate year. Assuming a Plan effective date of November 1, 2008, this 50 basis point reduction in the ROE would in effect produce a benefit to customers of $240,000 for the balance of 2008. Tr. 7/9/08 at 115 (Deehan). The Company will need guidance from the Board on whether this benefit should be implemented as a rate reduction on the November 1 effective date, or credited to ratepayers as a regulatory liability that would offset the revenue requirement in 2009. No other Plan adjustments would be applicable for this period of November and December 2008.

and increased financial uncertainty that may raise the utility's cost of capital. CVPS submits that the Plan eliminates most of these costs and the financial uncertainty, which will benefit ratepayers. In addition, CVPS argues that the Plan will reduce customer costs in other ways, including lowering the cost of capital, encouraging the Company to reduce costs, and setting a cap on earnings. Finally, CVPS contends that the Plan will improve CVPS's financial stability and improve the Company's access to capital.

B. DEPARTMENT

The Department recommends a number of revisions to the Company's Plan. First, the Department proposes that the Plan be revised to replace the Unicap and the Subcap with a "Non-power cost cap" comparable to existing non-power cost caps used in other Vermont utility alternative regulation plans. According to the DPS, "[t]he non-power costs cap would be formulaically determined by using a lagging consumer price index, prospectively adjusted for the rate year (1) targeted productivity changes and (2) any unusual rate base changes occasioned by known and measurable and used and useful net plant and other rate base additions."[4] The Department asserts that these revisions "will provide just and reasonable rates for Vermont rate payers over the duration of the plan and will be formulaically determined to avoid extensive debate and litigation."[5]

The Department proposes that the CVPS non-power cost cap be set at $6.2 million for 2009 and $8.7 million for 2010. The Department set these caps using its recommended formulaic approach, applied to components of the 2008 alternative regulation cost of service

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[4] Behrns pf. at 13.
[5] Id.

agreed upon in Docket No. 7321.[6] The Department did not provide a valuation for 2011 and 2012.[7]

The second revision proposed by the Department relates to the earnings sharing adjustment mechanism. The Department recommends that the Board adopt a single set of "dead bands" and "sharing bands" that are broader and consistent with other alternative regulation plans in Vermont. The Department argues that CVPS has not demonstrated that the broader range of bands would be detrimental to the attainment of an investment grade corporate credit rating nor had CVPS demonstrated that a more narrow set of bands will promote a credit rating upgrade.[8]

Finally, there are three other revisions proposed by the Department:[9]

1. Recovery of unanticipated distributed resource costs not included in energy efficiency charges or in base rates should be evaluated as they arise to determine if amendments to the Plan should be proposed as opposed to CVPS requiring accounting deferrals for such costs.
2. The earnings sharing adjustment should be made only once per year on a bills rendered basis on July 1.
3. The aggregate "exogenous event" provisions as shown in the proposed Plan need to be clarified.

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[6] Id.
[7] Tr. 7/10/08 at 193 (Behrns).
[8] Behrns pf. at 15-16.
[9] Behrns pf. at 16-17.

C. CLF

In the CLF Stipulation, CLF agreed to support the approval of the CVPS Plan and related initiatives described in its agreement with the Company.[10]

D. AARP

AARP did not participate in the technical hearings in this proceeding and did not take a position regarding approval of the CVPS Plan.

IV. EFFECT OF MEMORANDUM OF UNDERSTANDING IN DOCKET NO. 7321

A. Findings

1. In Docket No. 7321, the Board approved a Memorandum of Understanding ("MOU") between the Company and the Department authorizing CVPS to increase its rates by approximately $6.402 million, or 2.3%, effective with bills rendered on or after February 1, 2008. Docket No. 7321, Order of 1/31/08 at 18; Exh. CVPS-WJD-3 at 2.

2. [RESERVED]

3. [RESERVED]

4. The MOU provides that, pending adoption of an alternative regulation plan or an order in a future rate case, an earnings cap of 10.71% ROE will be in effect for CVPS. With the rate increase effective on a bills-rendered basis February 1, 2008, this earnings cap will be prorated for the period from January 1, 2008, until the effective date of an Alternative Regulation Plan or an order in a future rate case. If no alternative regulation plan is implemented or no order in a future rate case is issued, the earnings cap will remain in place. Exh. CVPS-WJD-3 at 5, ¶

13(a)(i).

5. For purposes of CVPS's alternative regulation plan filing in this Docket No. 7336, the MOU provides that upon the effective date of CVPS's filed Alternative Regulation Plan, the Company's authorized ROE should be 10.21% and the COS, rate base, and cost of capital set out in MOU Attachment 2 should be adopted, resulting in a rate decrease of 0.5% ($1,379,000). Exh. CVPS-WJD-3 at 6, ¶ 16.

6. In the MOU, the DPS and CVPS acknowledge that implementation of a reasonable Alternative Regulation Plan for CVPS is desirable. The MOU contemplates that Alternative Regulation items not resolved by February 15, 2008, would be submitted for Board resolution in this Docket No. 7336 so that implementation of the Plan is not unduly delayed.[11] The parties further acknowledged that the following items were the primary sources of disagreement between them: (i) the formulation of the cost caps (uni-cap and sub-cap) related to total overall costs including power and non-power costs; and (ii) the formulation of the dead bands and sharing bands. Exh. CVPS-WJD-3 at ¶ 17.

Business Process Review

7. Under the MOU, the DPS and CVPS agreed that CVPS will conduct an independent Business Process Review ("Review") to assure that the Company's cost controls are sufficiently challenging and that it is operating efficiently. Docket No. 7321, Order of 1/31/08 at 1; Exh. CVPS-WJD-3 at 3-4. Exh. CVPS-WJD-3 at 3-4, ¶ 12.

8. The scope of the Review includes but is not limited to the following areas:

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[10] Exh. CVPS-Rebuttal-PJK/RDC-5 at 3.

[11] The MOU sets the date for submitting unresolved issues to the Board as December 31, 2007. In the Docket No. 7321 proceeding, CVPS and the Department agreed that this date should be February 15, 2008.

- analysis and evaluation of management's execution and implementation of the Company's mission, vision and values;
- analysis and evaluation of managerial and decision-making processes to enhance cost efficiency and organizational productivity;
- the use of technology with a focus on its use to enhance productivity;
- organizational structure and staffing levels;
- organizational development plans and practices including succession planning;
- wage and salary structure including size and compensation of the Senior Officer team;
- the Company's response to regulatory input including its annual surveys, and ability and willingness to adapt based on such input;
- vehicle leasing/replacement program and associated financing;
- D&O insurance design and cost including coverage and limits; and
- Other operational and managerial areas as mutually agreed by the Parties.

Exh. CVPS-WJD-3 at ¶ 12.

9. Huron Consulting is the independent consultant retained jointly by CVPS and the DPS to perform the review. Keefe/Cook pf. reb. at 15; Tr. 7/9/08 at 5 (Rocheleau).

10. The schedule for the Business Process Review calls for completion of a final report by October 2008. Keefe/Cook pf. reb. at 15.

11. CVPS is required to file the completed Business Process Review report with the Board. Docket No. 7321, Order of 1/31/08 at 18.

12. CVPS must implement the recommendations made by the consultant performing the Review; *provided that*, if any of the recommendations are not considered reasonable by

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Docket No. 7321, Order of 1/31/08 at 5, fn 5.

CVPS, CVPS will first consult with the DPS to resolve any issues, and, if that consultation does not lead to a mutual agreement, the MOU provides that CVPS must submit the issue to the Board for resolution. Exh. CVPS-WJD-3 at ¶ 12(c).

13. Under the MOU, attachment 2 is intended by the DPS and CVPS to be the basis for CVPS's alternative regulation plan, going forward. In the event an alternative regulation plan for CVPS is not approved, the alternative regulation Cost of Service, rate base, and cost of capital provide in attachment 2 will have no effect. Tr. 7/10/08 at 139 (Behrns); accord Docket No. 7321, Order of 1/31/08 at 6.

Rate Change Upon Alternative Regulation Plan Effective Date

14. Assuming the Board approves the CVPS Plan effective on November 1, 2008, the approval would have the effect of lowering the Company's revenue requirement for the balance of rate year 2008 by $240,000 due to the lower allowed ROE. Tr. 7/9/08 at 115 (Deehan).

15. The dollar amounts and percentages of CVPS's total cost of service that are described later as "Category A" and "Category B" power costs, based on the Cost of Service that was agreed to in the MOU, are as follows:

"Category A" power items	$79 Million	28%
"Category B" power items	$85 Million	30%
Total Power Cost items	$164 Million	58%

Tr. 7/9/08 at 247-248 (Cook); Exh. CVPS-Rebuttal-PJK/RDC-3.

16. The dollar amounts and percentages of CVPS's total cost of service that are described later as "Subcap" items, based on the Cost of Service that was agreed to in the MOU, are as follows:

"Subcap" items $42.1 Million 15%

Tr. 7/9/08 at 247-248 (Cook); Exh. CVPS-Rebuttal-PJK/RDC-3

17. The dollar amounts and percentages of CVPS's total cost of service that are described later as "Non-power" items, based on the Cost of Service that was agreed to in the MOU, are as follows:

"Non-power" items $121.6 Million 42%

DPS-RWB-1.

B. Discussion

Base Rate Determination

For the purposes of CVPS's Alternative Regulation Plan filing in this Docket No. 7336, the Company and the DPS agree that, upon the effective date of CVPS's filed Alternative Regulation Plan, the MOU provides that the Company's authorized ROE should be 10.21% and the COS, rate base, and cost of capital set out in the MOU attachment 2 should be adopted, resulting in a rate decrease of 0.5% ($1,379,000). Exh. CVPS-WJD-3 at 6, ¶ 16.

Under the MOU, upon the adoption of CVPS's Alternative Regulation Plan, the following changes would occur:

Increase in revenue requirement (relative to rates prior to Docket No. 7321)	$5,023	1.8%
Return on Equity	10.21%	

Exh. CVPS-WJD-3 at 6, ¶ 16.

During the hearing, some ambiguity existed as to whether the parties intended to be bound by the specific figures set out in each line of the COS or whether the MOU should be

treated as a bottom-line settlement, in which the Board was not asked to affirmatively find that each line item was reasonable but rather to evaluate only the overall rate level.

In Docket No. 7321, the Board's approval of the MOU and the schedules attached thereto did not constitute approval of any of the specific line items in MOU attachment 2. The Docket No. 7321 Order makes clear that the Board's approval of the bottom-line settlement and the MOU "does not in any way determine issues in Docket No. 7336, including the COS set out in attachment 2, a 10.21% ROE for CVPS's Alternative Regulation Plan as implemented, or any other issue."[12] Docket No. 7336 has different parties, and nothing in the Docket No. 7321 Order was intended to affect, modify or prejudice the position of any parties in Docket No. 7336 with respect to the terms of CVPS's alternative regulation plan, or to restrict the Board in any way in its consideration of such terms and the positions of any parties thereto. To the extent that CVPS and the Department believe that the MOU has a broader affect upon their positions in this Docket No. 7336, the Board said it would resolve the issue in this proceeding.[13]

Such an adjustment was intended to be effective on approval for the then-remaining balance of the 2008 rate year.[14] The Company submits that all other issues regarding the establishment of an alternative regulation plan are not governed by the MOU. Indeed, the MOU expressly states:

> Further, in consideration of this settlement, CVPS and DPS agree that, upon the effective date of CVPS's filed Alternative Regulation Plan, as may be approved in Docket No. 7336, the authorized ROE shall be

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[12] Docket No. 7321, Order of 1/31/08 at 14.

[13] Id. Company has only stipulated its support for an adjustment in the Company's weighted average cost of capital to reflect a lower return on equity by 50 basis points, resulting in a 50 basis point drop in the

> 10.21% and the attached Cost of Service (attachment 2) shall be adopted resulting in a rate decrease of 0.5% ($1,379,000). Other than this express provision, nothing in this settlement of Docket No. 7321 is intended to affect, modify or prejudice the position of either party with respect to the terms of CVPS's Alternative Regulation Plan, as filed.[15]

Thus, the Board is free to adopt MOU attachment 2 as the Base Rate for alternative regulation as argued by the DPS or some other Base Rate. The Company acknowledges that the MOU words, "the attached Cost of Service (attachment 2) shall be adopted," can be interpreted to mean that the Company should be bound to the line items in the first year of the alternative regulation plan (*i.e.*, 2008). Furthermore, the Company acknowledges that, in its Plan, a rate year cost of service ("COS") filing shall determine "Base Rates."[16] The only Cost of Service in evidence in this proceeding is attached to the MOU. However, nothing in the MOU intends or requires the Company to maintain the same revenue requirement for subsequent years when a new base rate filing is required under the CVPS Plan and rates are reset on January 1. There is no dispute between the parties that resetting the Cost of Service in the 2009 and forward rate years is allowed and does not violate the MOU. The Department does not oppose the plan of CVPS to make a base rate filing in late 2008 for new rates to take effect on January 1, 2009. As it testified, the DPS wants the 2008 rate year COS to serve as the "jumping off" point for rates under the Plan, but that would last only until a new base rate COS is approved for 2009. If the Public Service Board were to adopt the 2008 MOU cost of service as the baseline, the cost cap

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Company's rates under alternative regulation. Tr. 7/10/08 at 55-56 (Rocheleau)

[14] Exh. CVPS-WJD-3 at 6, ¶ 16. Attachment 2 assumes a cost of capital "at February 1, 2008."

[15] Id.

formula for 2009 base rates should be more compensatory of existing costs plus an appropriate escalation factor as discussed below.

V. THE ALTERNATIVE REGULATION PLAN

A. Findings

1. The Proposed Plan

a. Term

18. The CVPS Plan would take effect 30 days after the Board's order instituting the Plan and terminate, unless extended, on December 31, 2010, except that certain adjustments to CVPS's rates would occur at specified dates subsequent to the termination of the Plan. Exh. CVPS-WJD-2 at 1.

19. The Company would have the right to exercise two successive end-of-term extension options of 1 year in length each. To be effective, these options must be exercised by CVPS by April 15, 2010 for year 2011, and by April 15, 2011 for year 2012. Exh. CVPS-WJD-2 at 1.

b. Rate Adjustments

20. Under the proposed Plan, CVPS would be unable to seek adjustments in rates that, under traditional ratemaking procedures, would be effective before the Plan terminates. However, the Plan allows the Company to apply for and receive temporary rates pursuant to 30 V.S.A. § 226(a). Exh. CVPS-WJD-2 at 1.

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[16] Exh. CVPS-WJD-2 at 3.

21. The proposed Plan establishes a framework for regular rate adjustments for the 2009 and 2010 rate years, unless extended, based on prescribed methodologies. These adjustments would be: (1) annual base rate filings; (2) quarterly power adjustments; and (3) annual earnings reconciliation adjustments. Exh. CVPS-WJD-2 at 1-10; Behrns pf. at 6-7.

22. The regular rate adjustments under the proposed Plan could mean that customer rates are adjusted four times per year. Deehan pf. at 26, 27. By contrast, under traditional ratemaking, customer rates change much less frequently. Deehan pf. at 6, 7; *see, e.g.,* the Company's six previous rate cases: Docket No. 7321 (rates effective February 2008); Docket No. 7191 (rates effective January 2007); Docket Nos. 6946/6988 (refund effective April 2004; rates effective April 2005); Docket Nos. 6460/6120 (rates effective January 2001 and July 2001); Docket No. 5863 (rates effective June 1996 and January 1997); Docket Nos. 5701/5724 (rates effective November 1994).

23. The annual January 1 base rate adjustment would be subject to suspension, with an April 30 deadline for Board decision. The other adjustments would not be subject to suspension, although the Board could initiate a rate investigation under 30 V.S.A. § 227(b) at any time, on its own motion or upon request, and the retroactive effect of the Board's order would be consistent with that section. Exh. CVPS-WJD-2 at 2, 12.

24. Under the Plan, on November 1, 2009 and 2010 CVPS would file a cost of service supporting a base rate change to be effective on January 1 of the subsequent years. The November 1 filing date and January 1 effective date would apply to rate years 2011 and 2012 if the Plan is extended. The annual filing would generally be identical to a traditional rate filing, except for the following differences. First, loads and revenues would be based on a forecast for

the year the rates would be in effect. Second, increases in the Company's overall rates, and in certain controllable non-power costs, would be capped in accordance with Company-specific formulas. Third, the allowed ROE under the Plan would adjust in subsequent years by 50% of the prior year's basis-point change in 10-yr Treasury Bill yields to maturity (*i.e.*, average yield as of the last twenty trading days prior to October 15 before the filing differenced with the average yield of the last twenty trading days prior to October 15 of the previous year). Deehan pf. at 10; Exh. CVPS-WJD-2 at 4-6.

c. Aggregate Rate Change Cap ("Unicap")

25. An aggregate cap (the "Unicap") would limit the aggregate increase in Base Rates and the Power Cost Adjustment Mechanism rates described in the Plan. Such a Unicap would not apply to any change in the authorized ROE or to the Earnings Sharing Adjustment Mechanism-related rate changes as described in the Plan. Exh. CVPS-WJD-2 at 4.

26. The Unicap in total would be an amount of revenue equal to the rate year's forecasted sales times 0.8¢/ kWh above the prior year's overall average revenue per kWh. Deehan pf. at 21.

27. COS amounts greater than the Unicap are not deferred to subsequent rate adjustment periods unless such costs are eligible for recovery under the Power Cost Adjustment Mechanism or the Earnings Sharing Adjustment Mechanism. Deehan pf. at 21.

28. The aggregate cap on the proposed base-rate adjustor will help ensure that the change in base rates does not rise above 7 percent in any one year. Tr. 7/9/08 at 63, 66. (Deehan).

d. Cap on Certain Controllable Non-Power Costs ("Subcap")

29. As an added incentive for efficient management of controllable costs, a cost sub-cap (the "Subcap") would apply within the overall COS to the sum total of the following FERC accounts numbers: Administration and General (920-935); Customer Service and Information (906-910); Customer Accounting (901-905); and Sales (911-917). The total of these accounts may increase at a rate no greater than the percentage compound cumulative escalation in the Consumer Price Index for All Services ("CPI-services") (as published by the US Department of Labor in the 4 most recently available quarters prior to the annual forecasted COS filings) as determined for each year of the Plan. For initial application of the Subcap in the COS filed for rates effective in 2009, the sum total of these accounts for test year 2007 would serve as the basis of the cumulative index calculation. Exh. CVPS-WJD-2 at 5.

30. Under the Plan, it is CVPS's intention to participate with the DPS in the development of a standardized COS methodology that will apply to CVPS in preparation of its annual cost of service filings under the Plan. Exh. CVPS-WJD-2 at 3.

31. The DPS may retain at CVPS's expense an independent firm with accounting and ratemaking expertise for the purpose of determining prior to filing that CVPS's annual COS filings under the Plan conform to the standardized COS methodology. Exh. CVPS-WJD-2 at 3.

e. Power Cost Adjustment Mechanism ("PCAM")

32. The Company's rates will be subject to a Power Cost Adjustment Mechanism ("PCAM") effective on a bills-rendered basis commencing in the first month of each calendar

quarter (*i.e.*, January 1, April 1, July 1 and October 1). The PCAM is detailed in section II(C) of the proposed Plan. Deehan pf. at 18; Exh. CVPS-WJD-2 at 8-18.

33. Under the PCAM, CVPS would adjust its rates based upon the difference between actual power costs and the projected power costs included in CVPS's rates. Exh. CVPS-WJD-2 at 8.

34. The proposed PCAM would be filed within 45 days after the end of each calendar quarter ("Measurement Quarter") and would be effective for the calendar quarter beginning after the filing (*i.e.*, beginning three months after the Measurement Quarter ends) ("Collection Quarter"). Exh. CVPS-WJD-2 at 8. At the hearings, CVPS agreed to make such filings 60 days prior to the effective date so as to better provide customer notice for rates to be implemented on a bills rendered basis, Tr. 7/9/08 at 114 (Deehan).

35. [RESERVED]

36. [RESERVED]

37. [RESERVED]

38. [RESERVED]

39. [RESERVED]

40. [RESERVED]

41. The PCAM governs two categories of "power" costs – Category A and Category B. Category A is generally comprised of fixed production and transmission costs (such as capacity payments, fixed production costs, production depreciation, and Transmission-by-Others expense). Category B is comprised of the variable fuel and purchased energy costs that are not included in Category A. A spreadsheet showing the detailed breakdown of costs into Category A

and Category B is shown in Exhibit CVPS-WJD-4. Deehan pf. at 18; Exh. CVPS-WJD-2 at 8-18.

42. All Category A costs (100%) would be passed through in rates. The PCAM for Category B power costs would only reflect changes in costs that are greater than the "Power Efficiency Adjustment Band" of $315,000 and only 90% of the remaining differences would be reflected in the quarterly rate adjustment. Deehan pf. at 19.

43. The PCAM for Category B power costs provides the Company with a direct incentive to mitigate power cost risks and minimize the net cost of power. Deehan pf. at 19.

44. The PCAM will be a positive or negative adjustment per kWh applied to all kWh-denominated base rate elements. Since Category A and B costs are accounted for separately, the quarterly PCAM adjustment that occurs contemporaneously with the annual base rate change will be stated separately on customer bills rather than rolled-in with base rate changes. Any unrecovered credit and debit balance will be rolled forward into the calculation of PCAM rates for the subsequent period and balances at the end of the term of the PCAM are to be rolled into the Earnings Sharing Adjustment Mechanism. If a power costs balance exists at the end of that mechanism's term, it will be addressed in the Plan's Residual Adjustments. Deehan pf. at 19-20.

f. Earnings Sharing Adjustment Mechanism ("ESAM")

45. The proposed Earnings Sharing Adjustment Mechanism ("ESAM") would be filed by May 15, 2009 and 2010, subject to extensions and would be effective the following July 1. At the hearings, CVPS agreed to make such filings 60 days in advance of the proposed change, in order to provide sufficient notice to ratepayers so the modified filing date would be May 1. The ESAM would reflect the difference between the achieved ROE for the preceding

calendar year, calculated on a regulatory basis, and the ROE approved in this case (including the adjustment, if any, associated with Treasury note yields and the effects of the dead and earnings sharing bands as applicable). The ESAM is detailed in section II(B) of the proposed Plan. Deehan pf. at 12-18; CVPS-WJD-2 at 5-8; Tr. 7/9/08 at 114.

46. Under the ESAM, the revenue impact of the variance between target and actual earnings (subject to the earnings dead band and sharing band) would be divided by projected base rate revenue for the ensuing 12-month collection period, yielding a percentage adjustment refund or surcharge to be paid to or assessed from customers over that period. Deehan CVPS-WJD-2 at 7.

47. The ESAM is detailed in section II(B) of the proposed Plan. The ESAM is a rate adjustment mechanism designed to directly promote economically efficient management behavior – ultimately resulting in savings for consumers and bounding earnings within a reasonable range. The earnings "dead band" determines that range and it creates an "at-risk" zone of earnings around the allowed rate of return on equity. Because there is no true-up within the dead band, the Company will have the direct incentive to improve efficiency and, therefore, near-term financial results. Deehan pf. at 12; Exh. CVPS-WJD-2 at 5-7.

48. The upper limit of the dead band acts as a protection for consumers from paying rates for service that contain unreasonable levels of profit. The floor protects the Company's owners from providing equity capital at an uncompetitive return. Deehan pf. at 13.

49. The Company expects that the ESAM will stabilize earnings, and enhance Central Vermont's access to and cost of capital by helping to maintain cash flow. Deehan pf. at 13; Keefe/Cook pf. generally.

50. Stabilized cash flow is expected to contribute to improved credit metrics for the Company, which in turn are fundamental to an improved credit rating and resultant lower cost of capital. Deehan pf. at 13; Keefe/Cook pf. generally.

51. When CVPS's corporate credit rating reaches BBB or higher, if actual earnings reflect an ROE that is below the lower boundary of the earnings dead band by up to 50 basis points, an equal sharing of that variance (the "earnings sharing band"), will be reflected in the ESAM rate change. Deehan pf. at 13.

52. Once the Company's credit rating reaches BBB, its earnings bands will be identical to those the Board approved for Green Mountain Power in its alternative regulation plan. Deehan pf. at 14.

53. CVPS is currently rated BB+. Deehan pf. at 14.

54. A key objective of CVPS's Five Year Plan is to elevate the Company's corporate credit rating into the investment grades, thereby supporting the Vermont utilities' efforts to procure and develop replacement power supplies at a reasonable cost as their legacy contracts expire and to reinforce delivery networks. Deehan pf. at 14.

55. If actual earnings reflect a rate of return on equity that is either above or below the dead band (or sharing band when in effect), the ESAM rate change reflects the variance. The rate adjustment will be a uniform percentage change applied to the Company's base rate.

56. Since the ESAM recovery period runs from July 1 through June 30, and base rates are likely to change on January 1, the Company expects that it may be necessary to marginally adjust the ESAM percentage otherwise in effect at the time of the annual base rate change in order to better target the collection of the remainder of the 12 months ESAM variance amount

then being credited or collected. Any remaining ESAM credit or debit balance at the end of the 12-month cycle will be rolled forward into the subsequent ESAM calculation or treated as a Residual Adjustment at the end of the Plan's term. Deehan pf. at 14.

57. The Plan has an allowed rate of return that reflects the agreement between the DPS and the Company in Docket No. 7321 (the Company's most recent rate investigation). The proposed ROE as of the effective date of the Plan in 2008 will be 10.21%. Deehan pf. at 15; Exh. CVPS-WJD-3.

58. The allowed ROE under the Plan will adjust in subsequent years by 50% of the prior year's basis-point change in 10-year Treasury Bill yields to maturity (*i.e.,* the difference between average yield as of the last twenty trading days prior to October 15 before the filing and the average yield of the last twenty trading days prior to October 15 of the previous year). In general, the return on 10-year Treasury Bills is considered to be a risk-free rate of return on long-term investment and by reflecting one-half of the annual change in a component of the cost of equity, the allowed ROE will track the cost of equity capital during the term of the Plan better than if it were simply fixed for the term of the Plan. Deehan pf. at 15.

59. Actual earnings and variances will be calculated on a regulatory basis using the same earnings determination methodology as the earnings cap calculation reflected in the Board's Order in Docket Nos. 6846/6988, modified to substitute a revenue credit in place of computing the so-called jurisdictional split. Deehan pf. at 16.

60. The calculation of actual earnings and variances shall include the earnings impact of any variance within the Power Adjustment Efficiency Band (described above) and any variance in the cost of service. The ESAM Variance Amount will be deferred and amortized

during the ESAM collection period in an amount equal to the then-current year ESAM amounts actually collected or refunded. Deehan pf. at 16.

61. Unanticipated large "exogenous factors" have the potential to produce large bottom-line impacts and therefore potentially override the desirable efficiency feature of the earnings dead band and sharing band. The Plan provides a limit of $600,000 per year on the potential aggregate effect of such outside forces on earnings. Exogenous factor cost or revenue effects on regulated return are limited in the ESAM Variance Amount calculation for the year to be not more than plus or minus $600,000 relative to the COS filed for the year. Effects expected to recur in subsequent years are to be included in the subsequent years' cost of service and reflected in base rates. Deehan pf. at 16; Exh. CVPS-WJD-2 at 7-8.

62. The proposed Plan requires CVPS to file with the Board a report of exogenous factor effects after the close of each quarter during the rate year. If the Board takes no action within 30 days of the filing of the last quarterly report in January subsequent to the rate-year, the exogenous factor quantification for the year, as contained in that report, will become final. If the Board investigates and issues an order on or before the third Friday of February, the Company will incorporate the effects of that order in its closing of the books and report of earnings to the SEC and the market in the following weeks. If the Board investigates and does not issue an order by that date in February, the Board will not issue an order any sooner than April 1 following the rate year. This delay will allow the Company to close its books in an orderly manner. Deehan pf. at 17.

63. The Company, in any case, will file its ESAM adjustment report on May 15 incorporating whatever the then-final status of the exogenous factor quantification is in the

ESAM Variance Amount and rate. Deehan pf. at 17. At the hearings, CVPS agreed to make such filings 60 days in advance of the proposed change, in order to provide sufficient notice to ratepayers, so that the filing data would become May 1. Tr. 7/9/08 at 114.

64. Exogenous factor costs or revenue effects consist of the effects on the Company from the following:[17]

- changes in Generally Accepted Accounting Principles;
- changes in tax laws;
- changes in Federal Energy Regulatory Commission or ISO-NE rules;
- extended or permanent loss or de-rate of major purchased power sources;
- loss of load (not due to variations in heating and/or cooling temperatures); or
- major unplanned operations and maintenance or investment cost such as those incurred due to storms or major repairs to Company-owned power plants.[18]

Deehan pf. at 18.

g. Residual Adjustments and Other Plan Components

65. Certain Residual Adjustments are described in section II(D) of the Plan. Exh. CVPS-WJD-2 at 10. The PCAM continues through the last billing cycle in June of the year following the last year of the Plan, and the ESAM continues through the last billing cycle in June of the second year following the last year of the Plan. Any unamortized ESAM or PCAM dollar

[17] The alternative regulation plan for Green Mountain Power Corporation (GMP) has a similar exclusion for major unplanned events exceeding $600,000 in any one year. Docket Nos. 7175/7176, Order of 12/22/06 at 20.

[18] With respect to major unplanned costs, such as storms, the Company means major cost variances (above or below) relative to the amount allowed in the cost of service for the rate year. Tr. 07/09/08 at 105-106. (Deehan). Variances have to be "major" meaning storm variances, combined with all of the other exogenous factor variances, have to exceed $600,000 per year. Tr. 07/09/08 at 31, 106 (Deehan).

balances that may exist and which have not been trued-up at the conclusion of the effectiveness of these mechanisms are to be transferred into the successor regulatory system's rates and amortized in such rates as debits or credits. Deehan pf. at 20.

66. Section III of the Plan contains commitments to:

- Maintain the Company's existing Service Quality & Reliability Plan.
- Contribute 10% of any ESAM dead band earnings in excess of the Board-approved rate of return on equity to a to-be-established low income bill assistance program.
- Continue the Company's current practice of matching contributions by its customers to the Company's Shareheat Program, and the amount of the match shall not be included in rates.
- Continue its existing efforts to promote Vermont-based renewable energy, including its Cow Power™ Voluntary Renewable Service Rider.
- Complete the actions approved by the Board in Docket No. 7095, including the filing of a long-term plan for its retail rate design and service offerings.
- Develop an annual fixed power price option (*i.e.,* an option not to be subject to the PCAM) for customers.
- In cooperation with the DPS, propose as needed to the PSB special ratemaking-related changes to this Plan in order to make development of a new power plant or commitments to major new purchased power contracts feasible and cost effective.
- In cooperation with the DPS, evaluate the effectiveness of the Plan's performance in achieving the goals of 30 V.S.A. § 218d.

Deehan pf. at 27-28; Exh. CVPS-WJD-2 at 10-12.

2. DPS Proposal

67. The Department supports the implementation of a reasonable alternative regulation plan as beneficial to ratepayers and the general good of the state, and acknowledges

that adoption of such a plan is desirable for CVPS. The Department has reviewed the CVPS Plan and in general supports most elements of the Plan. For the Department, two critical issues remain unresolved: cost caps related to non-power costs and the bands related to earnings sharing adjustments. Beyond these two issues and a few minor other changes, the Department supports the CVPS Plan. Behrns pf. at 3.

68. The Department's support for the Plan is conditioned upon CVPS compliance with the CVPS Rate Case MOU in Docket No. 7321. (Items 16 through 18, page 6 and 7, of the Memorandum of Understanding.) Behrns pf. at 4.

69. With respect to the Department's unresolved issues, the Department recommends the following revisions to the Plan:

(1) Adopting a "non-power cost cap" in lieu of the "Unicap" and the "Subcap".

(a) If the PSB determines the "Subcap" feature should be retained, the basis for determining the 2009 "Subcap" should be based on the 2008 rate year cost of service as agreed in the rate case MOU.

(2) Modifying the "earnings sharing bands" by eliminating the proposed below-investment-grade bands.

Behrns pf. at 4-5, 16.

70. The Department also proposed three other revisions to the Plan:

(a) Recovery of unanticipated efficiency or other distributed resource costs not included in EEC charges or in base rates should be evaluated to determine if amendments to the Plan should be proposed to the PSB, as opposed to CVPS requesting accounting deferrals for such costs.

(b) The earnings sharing adjustment should be made only once per year.

(c) The handling of exogenous event costs under the Modified Plan needs to be clarified to avoid any potential future difficulties regarding the proper accounting, reporting and recovery of such costs.

Behrns pf. at 4-5, 16.

71. The Department asserts that with these revisions, the Plan will provide just and reasonable rates for Vermont rate payers, will help maintain a reasonable degree of fairness and consistency among the existing alternative regulation plans in Vermont, will provide CVPS with a comparable level of business and financial risk that exists in other alternative regulation plans and will satisfy the statutory requirements for an acceptable alternative regulation plan. Behrns pf. at 5.

3. CVPS Response to DPS Proposal

72. The Company believes the Department's proposal will not satisfy what CVPS understands to be four of the statutory standards for establishing an alternative regulation plan in Vermont. The Company's rebuttal testimony and exhibits describe the potential adverse effects which the adoption of the Department's proposal could have on investor and rating agency perceptions. These are significant because they could affect the ability of the Company to raise additional capital on favorable terms and, as a result, the Company's average cost of capital charged to customers. Keefe/Cook pf. reb. generally.

73. The Company asserts that the non-power cost cap in the Department's proposal will preclude the attainment of certain alternative regulation plan goals because it begins from an unrealistically low base and does not provide for the kind of normal cost escalation that is

provided in the Vermont Gas Systems plan for operating expenditures. Keefe/Cook pf. reb. at 4; Lowry pf. reb. generally.

74. The Company asserts that its Plan provides adequate funding for the improved reliability strategies contained in its Asset Management Plan that have found support with the Department's engineering staff. The Company's proposed Subcap provides for only normal cost growth in operations where this does not involve a conflict with other statutory goals. Keefe/Cooke pf. reb. at 4-5.

75. The ultimate impact of the Department's proposal weakens performance incentives by pinning earnings at the lower end of the allowed range. Under the Company's Plan, there is an opportunity for earnings to be in a normal range and, as a result, the Company will respond better to the incentives provided by the Unicap and the Subcap. Keefe/Cooke pf. reb. at 4-5.

76. CVPS is nonetheless open to subjecting all its operating costs to the alternative formula recommended by Dr. Lowry, provided that the revenue base can first be brought to compensatory levels. Keefe/Cook pf. reb. at 5.

77. The Company asserts that its Plan complies with the provisions of the Docket No. 7321 MOU. Mr. Behrns does not raise any issue of non-compliance. Keefe/Cook pf. reb. at 5.

78. The Company disagrees with the Department's concern that the Company's proposed Plan would result in unjust and unreasonable rate increases (Behrns page 8 at line 4-5). The Unicap is designed to limit annual increases to customers. Exhibit CVPS-Rebuttal-PJK/RDC-1, which is a comparison of the cost caps in Vermont ARPs, illustrates that there is *no limit* on the amount of annual base rate increases, in the cases of both the GMP Plan and VGS

Plan, or on the commodity cost rate adjustments (in the case of the VGS Plan). Based on current expected growth in kWh sales, which CVPS estimates to average approximately 0.5% annually over the period 2008 to 2011, the Company's proposed Unicap would limit annual rate increases to a range of 6% to 9% during the years 2009 to 2011. This is the *maximum* amount customer rates would increase, unless a greater increase is required due to changes in the allowed return on equity or the recovery of under earnings under the ESAM. Customer rate increases under the GMP Plan and VGS Plan are potentially *unlimited*. Furthermore, on an annual basis, the Department and Board will have the opportunity to review the Company's Cost of Service, based on an historic test year adjusted for known and measurable changes. At these times, the Department and Board may choose to investigate whether the Company is operating as efficiently as possible using sound management practices. Keefe/Cook pf. reb. at 6, 11.

79. The Department's testimony does not offer any evidence to illustrate how the adoption of CVPS's Plan would result in unfairness among the alternative regulation plans of other utilities. While the proposed Plan is different – just as the plan for GMP was different from the plan for VGS – the differences are appropriate given different circumstances. Keefe/Cook pf. reb. at 6.

80. The non-power cap Witness Behrns proposes will not generate a base of revenues sufficient to support the continued implementation of the Company's Asset Management Plan and it will eliminate the Company's ability to earn its allowed rate of return. This is especially the case for 2009 where CVPS would experience millions in disallowed costs in that year. Exh. CVPS-Rebuttal-PJK/RDC-3. Given the work the Company has done to restrain costs over the past several years, the Company does not believe that it is possible to find further efficiencies to

equal the magnitude of the forecasted disallowance inherent in the Department's proposal, which would seriously affect service quality and reliability. As a result, rather than being motivated to manage the business efficiently, the Company would be induced to either (i) dramatically delay its Asset Management Plan efforts including its reliability-driven operating efforts, or (ii) spend as needed while knowing that, no matter what it does, it will earn at or near the low end of the ESAM – with no hope of utilizing increased management efficiency to move above that floor. The effect that could have is to effectively *remove* the incentive for the Company to prudently cut marginal costs to improve its earnings, due to the magnitude of the disallowed costs. Keefe/Cook pf. reb. at 13.

81. The financial community at large, and the credit rating agency Standard & Poor's in particular, may be skeptical of the value of an alternative regulation plan that, as proposed by the Department, would produce materially large cost disallowances and effectively remove incentives for the Company to improve its financial results and effectively eliminates its ability to earn its allowed return. The Company does not know the extent to which this element of an alternative regulation plan will offset the expected benefits of the other plan elements. Keefe/Cook pf. reb. at 13.

82. Unique among Vermont utilities, the Company has prepared a multi-year Asset Management Plan, the purpose of which is to efficiently and effectively direct spending on the Company's transmission, distribution, and production assets in order to maintain system reliability and safety. Because the Company economically deferred spending on its system for the past several years in order to keep rates low and because a significant portion of the CVPS system was installed during the major utility expansion period of post World War II (1946-1955

for transmission and distribution plant and 1960s to 1970s for substations), the Company now needs to increase its capital spending. The caps proposed by the Department do not allow the Company to recover all of its costs related to planned network services in 2009, which are driven in large part by the Asset Management Plan spending. Having to delay the Asset Management Plan spending would be unfortunate for consumers because the work is needed and, if not done as planned, it will have to be done later-- perhaps at a greater cost and greater risk to reliability in the interim. Keefe/Cook pf. reb. at 13-14.

83. The Company's rates are among the lowest in the Northeastern U.S. Based on a cost of service forecast shown in Exhibit CVPS-Rebuttal-PJK/RDC-3, prepared in the spring of 2008, rate increases are expected to average a little over 5% annually during the period 2009 to 2011. Keefe/Cook pf. reb. at 14.

84. Currently, the Company is in the process of negotiating several forward sales of excess electric energy for 2009; the margin on these sales will reduce net power costs and could significantly reduce or eliminate the need for a rate increase in 2009. The Company is hoping to similarly hedge 2010 and 2011 power costs, but it may be constrained by the collateral requirements of such sales. Keefe/Cook pf. reb. at 14-15.

85. While the Company does have access to a $25 million revolving credit facility, borrowings and letters of credit (issued to meet collateral needs) under this facility are expected <u>to be near maximum allowed levels</u> by year end without a Common Stock issue. That would create a risk that, should power market prices change significantly, the forward contracts to which the Company is a party might require the posting of collateral. That collateral, on top of a fully-drawn revolving credit facility, would leave the Company with no cash buffer, all else being

equal. The Company is putting countermeasures into place in the event that it is not able to access the public equity markets on favorable terms. First, the Company has requested a $15 million increase in its short-term credit facility and is confident this can be achieved. Second, the Company has foregone the sale of the remainder of its 2009 excess energy and all of its 2010 and 2011 excess energy in order to avoid collateral calls and a liquidity crisis. The 2009 excess energy that it sold forward was done in a manner that is not likely to result in a need to post collateral. The Company's typical cash flow pattern is to generate cash in the first half of the year and to drain cash in the second half of the year. The Company is confident that the above countermeasures, combined with its cash flow pattern, will allow sufficient time and resources to access the public equity market on reasonably favorable terms and without jeopardizing its business plan. Letter of CVPS attorney Jeanne Burns, dated 8/14/08, responding to Board questions about proposed equity issuance.

86. In 2012, when the Company's current power supply contracts begin to be replaced, rates are expected to rise. Consequently, there is a limited window of opportunity in which the Company can make needed expenditures on delivery services while expecting to maintain its attractive retail rates. Delaying this work will endanger the quality of delivery services to consumers and will raise costs more over time due to continued, rapidly inflating costs of the inputs needed to perform this work. Furthermore, it would be unwise to defer more capital investment into 2012 and future years when power costs are also expected to be escalating. Keefe/Cook pf. reb. at 15.

87. The Company is currently undergoing a Business Process Review, conducted by Huron Consulting Group, which was agreed to as part of the settlement of Docket No. 7321.

Huron is reviewing the Company's staffing levels and productivity measures, among other things. The results of this Review will be available by October 2008. The Review is intended to validate the Company's cost structure or identify areas of improvement or cost reduction. The steering committee for this initiative is comprised of representatives of the Department, the Company, and Huron Consulting. Keefe/Cook pf. reb. at 15.

88. The Company will be better positioned to raise debt and equity capital on favorable terms and conditions under the terms of its Plan rather than under the ESAM dead bands and sharing bands proposed by the Department. This would benefit customers. Keefe/Cook pf. reb. at 16-18.

89. The Department's proposed changes would not achieve consistency among the Vermont alternative regulation plans. Under the Department's proposed approach, neither the cost caps nor the ESAM would be the same between the VGS Plan, the GMP Plan or the Company's Plan. Keefe/Cook pf. reb. at 18-19; Exh. CVPS-Rebuttal-PJK/RDC-2.

90. The Company expressed some flexibility with respect to the three additional revisions proposed by the DPS:

(a) With respect to recovery of unexpected efficiency or other distributed resource costs, CVPS mirrored the Board's order in the VGS alternative regulation plan in proposing special provisions that deal with the limited instance of unanticipated, intra-year distributed resource costs. However, CVPS can agree to the Department's proposal to propose Plan amendments if the need arises.

(b) With respect to the Department's proposal to eliminate the January 1 ESAM adjustment in rates each year and, instead, to have the ESAM adjustment only

occur effective July 1 of each year, the Company believes the adjustment schedule as proposed in the Plan is likely to result in greater rate accuracy (and therefore reduce the amounts of follow-on true-up amounts). Nonetheless, the Company feels this is a small issue and can accept the Department's proposal, if the Board finds that the Department's proposal provides more benefits than the Company's.

(c) Last, with respect to the process for handling exogenous factor costs, the Company is willing to work with the Department to clarify the Plan.

Keefe/Cook pf. reb. at 19-20.

91. If the Board determines that it wishes to retain the "Subcap," the basis for determining the 2009 "Subcap" may be based on the 2008 rate year cost of service as agreed in the Docket No. 7321 MOU. Exh. CVPS-PJK/RDC-6. Regarding Exhibit CVPS-PJK/RDC-6, the budget numbers in the forecast assumed a head count of 540 employees. If the Business Process Review validates the actual number of current employees (550), the non-power cost data would rise approximately $700,000 per year. In that case the cap would need to be adjusted to recognize the validated headcount. Otherwise the Company's revenue and rates would be non-compensatory for the additional employees. Keefe/Cook pf. reb. at 12, ll. 1-2 ("[t]he expected cost of 18 employees would be $1.4 million fully loaded for benefits...". 10 employees would therefore be approximately $700,000, which would be unrecoverable if not included in rates.)

92. The Company asserts that its current level of cost recovery in rates is noncompensatory. Tr. 07/09/08 at 196 (Keefe/Cook).

93. Furthermore, the Company expects, under the MOU cost of service, that it will not earn its allowed return on equity in 2008. Tr. 07/10/08 at 61 (Keefe).

94. According to the MOU cost of service, the amount currently recovered in rates for its "Subcap" categories is $42,066,000. Tr. 07/10/08 at 61 (Keefe).

95. The Company's actual spending in 2007 for the "Subcap" categories was $47,437,000. Tr. 07/10/08 at 61 (Keefe).

96. The Plan's formulation of the caps for the "Subcap" categories in 2009, 2010 and 2011 is based on 2007 actual spending, adjusted for inflation using the consumer price index for services (CPI-Services). Assuming a 2008 CPI-Services of 3.00%, the Plan's 2009 "Subcap" would be $50,766,000 ($8.7 million more than the "Subcap" categories in the MOU cost of service). Tr. 07/10/08 at 61 (Keefe).

97. Assuming a 2010 CPI-Services of 2.90% and a 2011 CPI Services of 3.10%, the 2010 "Subcap" would be $52,238,000 and the 2011 "Subcap" would be $53,857,000. Tr. 07/10/08 at 61 (Keefe).

98. The Department's formulation of a "Non-Power cost" cap covers more spending categories than the Plan's "Subcap." Tr. 07/10/08 at 61 (Keefe).

99. The Company's spending for the "Non-Power" categories was $129,894,000 in 2007 (actual). Tr. 07/10/08 at 61 (Keefe).

100. The Department's formulation of the caps for the "Non-Power" categories in 2009 and 2010, and 2011 is based on the 2008 MOU cost of service amount of $122,365,000. Exh. CVPS-PJK/RDC-3.

101. The Department's formulation proposes a cap on "Non-Power" cost increases at $6.2 million for 2009 and $8.7 million for 2010. Behrns pf. At 13. The Department did not provide a valuation for 2011 and 2012. Tr. 7/10/08 at 193 (Behrns). According to CVPS,

applying the Department's cost cap methodology to 2011 would result in a cap of $10.2 million. Exh. CVPS-PJK/RDC-3; Keefe/Cook pf. reb. at 12.

102. The Department's formulation would result in expected disallowed costs in each of these years that are significant. Exh. CVPS-PJK/RDC-3; Keefe/Cook pf. reb. at 12.

103. [RESERVED]

104. The Department's base level of non-power cost would escalate by about 2.03% annually in 2009 and 2010. Allowances for an uptick in capital spending would increase the escalation in the cap to an average of 2.56% in these two years. Lowry reb. pf. at 4.

105. Index research using industry cost data is useful for designing revenue adjustment mechanisms that satisfy the just and reasonable standard of the Vermont statute. The chief contribution of such research is to permit automatic adjustments for changes in business conditions that are beyond utility control but materially affect its cost. Index research has provided the basis for rate and revenue adjustment mechanisms that are currently operative in several nearby states and provinces. The list includes alternative regulation plans for Bay State Gas, Boston Gas, Central Maine Power, National Grid, NSTAR Electric and Gas, and the gas and electric power distributors of Ontario. Importantly, it appears as though statistical cost research provided some basis for the rate and revenue adjustment mechanism in the VGS Plan. Likewise, index research can be used to design a non-power cost cap for CVPS. Lowry reb. pf. at 5.

106. A basic result of index theory is that the growth of cost equals input price inflation less productivity growth plus output growth. The relevant measures of output growth are those that drive cost growth. When the chief cost that is the focus of regulation is, as in this case, the

cost of energy *distribution*, the number of customers served is a sensible measure of output growth. This reasoning provides the foundation for the following general formula for a revenue adjustment mechanism:

Growth Revenue = Inflation-X+growth Customers.

In this formula X, the "X factor", reflects a productivity growth target. One might also think of this as an efficiency savings target. Lowry reb. pf. at 5-6.

107. When the number of customers is the output measure, revenue growth can be capped equivalently by the following general formula,

Growth Revenue/Customer=Inflation-X,

provided that the revenue requirement is also updated to reflect the *current* number of customers. This is effectively the approach that the Public Service Board approved for the operating expenses in the VGS Plan. Lowry reb. pf. at 6.

108. One way to simplify the formula is to assume that the productivity factor (*i.e.*, the "X factor") is equal to growth in the number of customers served. The formula then becomes

Growth Revenue = Inflation.

This approach is used in the Subcap escalator that CVPS proposes and may be called the "inflation-only" method. The inflation-only method is a reasonable simplification when the approximate X factor is "in the ballpark" of the rate of customer growth. This formula has been used recently to escalate the base rate revenue requirements of three utilities in the western United States. Lowry reb. pf. at 8.

109. The MOU cost of service reflects 2006 cost conditions, as adjusted for certain known and measureable changes in 2007 and 2008 business conditions. However, it does not

reflect some of the most important changes in business conditions, such as input price and customer growth, which have placed upward pressure on utility costs since 2006. Lowry reb. pf. at 9-10.

110. Other legitimate costs have been incurred since 2006 which were excluded from the MOU cost of service due to limitations imposed by the known and measurable criteria for inclusion. These include new activities, such as increased storm restorations, efforts to improve reliability for remotely situated customers, and an uptick in replacement capital spending. While many of these initiatives were contemplated in 2007, the spending plans were not documented to the degree required to meet the known and measurable standard and thus were excluded from the *pro forma* cost of service. Lowry reb. pf. at 10.

111. The approach proposed by the DPS has the effect of creating a cost cap that, throughout the term, would continue to disallow legitimate costs that were not represented in the *pro forma* total due to regulatory lag and other reasons. The cap thus begins with a basis that does not reflect the company's current cost challenges and is too low. Lowry reb. pf. at 10.

112. A partial solution to the problem of the incorrect base is for the Board to adjust the MOU cost of service to reflect the input price inflation and customer growth that occurred in 2007 and 2008. This remedy will not, however, fix the problem that the MOU revenue requirement is insufficient to compensate CVPS for other legitimate cost increases that have occurred since 2006. This problem is only partly mitigated in the DPS proposal by the adjustments for "unusual rate base changes occasioned by known and measurable and used and useful net plant and other rate base additions". Lowry reb. pf. at 11-12.

113. Other approaches exist for solving the base problem. One is to set the base O&M

expenses at their higher 2007 level, as proposed by CVPS for Subcap costs. Alternatively, the use of a revenue adjustment mechanism could be postponed for a year pending resolution of a new cost filing by CVPS to establish 2009 rates. The rate year 2009 cost of service could then become the base cost for the adjustment mechanism to set rates beginning in 2010. Lowry reb. pf. at 12.

114. A productivity index is the ratio of an output quantity index to an input quantity index. It is used to measure the efficiency with which firms convert inputs to outputs. Measured over time, the indexes can be used to identify productivity trends. *Id.*

115. The DPS proposal sets a target at one half of the recent inflation of a CPI. The CPI for all urban areas in the US (CPI^U) was used for this purpose. Having calculated recent CPI^U growth of 4.05%, this method produced a productivity target of 2.025%. Lowry reb. pf. at 13.

116. There is no conceptual reason why the productivity growth of an electric utility should be half of the inflation in a broad consumer price index. Productivity growth is, for one thing, generally not tied to inflation growth. For example, it doesn't generally accelerate when inflation does. The CPI^U has, in any event, only recently grown at a pace as brisk as 4%. From 1996 to 2006, for example, it averaged 2.51% growth. A productivity target equal to half of this would be only 1.25%. Lowry reb. pf. at 13.

117. In original work for this proceeding, Pacific Economics Group has calculated the recent long-run growth trends in the productivity of power distributor base rate inputs for CVPS and samples of Northeast and U.S. power distributors. The operations covered comprise power distribution, customer care, and each company's administrative and general services and general

plant costs. The sample period for this research was 1996-2006. The productivity of the sampled Northeast distributors averaged 0.76% annual growth. The 0.91% average annual growth in productivity of CVPS was a little above this and virtually the same as the 1.03% average annual growth in the productivity of the full U.S. sample. Lowry reb. pf. at 14; Exh. CVPS-Rebuttal-MNL-2.

118. The productivity trend measure proposed for CVPS is the productivity trend of the Northeast sample (0.76% annual growth). Lowry reb. pf. at 14.

119. The Department uses the CPI^U as the basis for its cost cap calculations. This is generally not a good measure of the input price inflation facing CVPS. As described further in the report provided with Dr. Lowry's testimony, PEG has calculated an input price index for the base rate inputs used in power distributor services. Between 1996 and 2006 the CPI^U averaged 2.51% growth whereas the input price index for the Northeast utilities averages 3.07% growth. Thus, the inflation differential was (0.56%). Lowry reb. at 16; Exh. CVPS-Rebuttal-MNL-2.

120. Economists generally expect growth in the economy's *output* prices (*e.g.* those for consumer products) to be slower than the growth in its *input* prices by the amount of the economy's productivity growth. Likewise, CPI growth should generally be less than the input price growth for electric utilities. Lowry reb. pf. at 17.

121. The input price index for CVPS averages 3.81% growth from 2003 to 2006. From 1996 to 2003, this same index averaged only 2.78% growth. A 100 basis point swing materially affects the ability of a utility to live with the revenue requirement produced by the Vermont rate-making process, which ignores recent inflation. A 100 basis point acceleration in productivity would be difficult for any utility to achieve, and the Department's revenue requirement also fails

to reflect customer growth.

122. A productivity target will also typically include a term for customer growth. There are ample precedents for a customer growth term. A formula that does not include customer growth will also typically not have a productivity factor. Lowry reb. pf. at 18.

123. If a macroeconomic inflation measure like CPI^U is used in the formula, X should include a productivity target and an inflation differential. Research suggests that the X factor should be 0.18%, which Dr. Lowry calculated as 0.74-(3.07-2.51). Based on Dr. Lowry's calculations, an index of this kind would have averaged 3.620% growth from 2001 to 2006 and 4.010% growth in the more recent 2003-2006 period. As a final step, cost would be allowed to grow by the additional basis points proposed by the Department to finance the uptick for investments in AMI and replacement capital spending. Lowry reb. pf. at 20. *See also*, Exh. CVPS-Rebuttal-PJK/RDC-6 (spreadsheet analysis of Dr. Lowry's alternatives).

4. Stipulation with Conservation Law Foundation

124. On June 12, 2008, CVPS and CLF entered into a stipulation that resolved CLF's issues regarding the approval of the Company's Alternative Regulation Plan (the "CLF Stipulation"). In principal part, the agreements contained in the CLF Stipulation are designed to further the 30 V.S.A. § 218d objectives of: (1) providing least-cost energy service to customers; (2) implementing innovations that advance state energy policy that call for increased reliance on Vermont-based renewable energy; and (3) promoting improved quality of service, reliability, and service choices for Company customers. Exh. CVPS-Rebuttal-PJK/RDC-5; Exh. CVPS-WJD-6.

125. If approved, the CLF Stipulation commits the Company to:

(i) work with the Energy Efficiency Utility ("EEU") and the DPS to develop and

implement an EEU program to promote the installation and societally cost-effective measures including: solar water heaters, combined heat and power projects and other technology to meet niche market needs including cost-effective heat pumps (that do not incorporate electric resistance heat back-up, including electric resistance heat for defrosting coils);

(ii) recommend that a portion of its 2008 NEIL credit and its 2007 ANI amounts related to Vermont Yankee be devoted to funding a collaborative process with CLF, REV and other interested parties promptly to identify barriers to the development of CHP in targeted areas of CVPS's service territory (including review of company-wide policies and practices that may create barriers); and

(iii) fully implement Automated Metering Infrastructure ("AMI") as fast as it reasonably can under a timetable to be approved by the Board that includes agreements to introduce demand/load response programs for residential, C&I and Industrial customers, and cost-justified dynamic pricing where appropriate and consistent with the Company's rate design plan filed under Docket No. 7095.

When taken together these initiatives are designed to further least-cost planning objectives by helping customers to efficiently use and deploy resources that are shown to be cost-effective using societal cost testing principles that take into account economic and environmental considerations and risks. Exh. CVPS-WJD-6 at 1, 2.

126. The implementation of the Company's Plan helps to advance consumer adoption of net-metering installations because the Plan contains provisions to decouple utility earnings from customer loads. Similarly that testimony explains that the Plan contains terms to permit the adjustment of power costs to allow the Company to include purchases from new sources facilitating power purchases from new renewable resources including SPEED projects. The implementation of the CLF Stipulation would build on the terms of the ARP by approving a Company commitment to:

(i) offer to purchase from any new SPEED project; and

(ii) work with interested stakeholders to develop a mechanism to help customers obtain third-party financing for the installation of new on-premises renewable

generation and overcome barriers to the introduction of such resources. These commitments were designed to further the Vermont policies that call on utilities to increase reliance on new renewable resources to help meet customer electrical end uses. Exh. CVPS-WJD-6 at 2.

127. If approved, the CLF Stipulation would commit the Company to implement AMI as fast as it reasonably can under a timetable to be approved by the Board. The introduction of AMI holds the promise that the Company will be able to utilize this technology to develop innovative service offerings including automated outage reporting, demand/load response programs and cost-justified dynamic pricing. Such offerings will expand the service choices for customers and help the Company to better manage its system to improve service quality. As a result, the Company concludes that this key element of the CLF Stipulation furthers recognized public policy goals as contemplated under Section 218d. Exh. CVPS-WJD-6 at 3.

128. CVPS worked with CLF to develop settlement proposals that the Company believed could be implemented without the incurrence of substantial incremental costs. As the Company has previously explained, it plans to implement AMI and the goal of the CLF Settlement is to develop a faster-track to permit the introduction of this innovative sooner – a technology that offers efficiency gains and the opportunity to lower operating expenses. Similarly, the Stipulation terms that are focused on encouraging new renewable resources limit the Company's involvement to a scope of service that it foresees can be accomplished with reasonable and cost-efficient effort. As a result, the Company is able to recommend the approval of the CLF Stipulation without significant reservation that the settlement will unduly burden the Company or induce unwarranted rate pressures for consumers. Exh. CVPS-WJD-6 at 3.

129. The Company is prepared to move forward with the commitments contemplated under the CLF Stipulation and to take reasonable steps to advance the policy goals as contemplated thereunder. However, the CLF Stipulation does not commit the Company to assure results. In large measure, the success of the CLF Stipulation will be determined if consensus can be achieved with the many other stakeholders, including customers, that will also need to take action to bring new projects and new ways of serving customers to life. The Company believes these efforts are worth pursuing and that there is a reasonable chance that the implementation of the CLF Stipulation will be a catalyst for progress. Exh. CVPS-WJD-6 at 4.

130. Based on their Stipulation, CLF agreed to support the approval of the CVPS Plan. Exh. CVPS-Rebuttal-PJK/RDC-5 at 3.

5. Statutory Findings.

a. Incentives for Innovations and Improved Performance (§ 218d(a)(1)).

131. The CVPS Plan establishes a system of regulation in which the Company has clear incentives to provide least-cost energy service to its customers. The Plan provides for regular and timely adjustments to reflect costs that the Company would incur to hedge against costs it cannot control, the ESAM and PCAM create incentives to reduce costs by permitting the Company to retain the associated benefits and, the Plan does not displace the Company's Integrated Resource Planning obligations. Deehan pf. at 2; Kraus/White pf. at 11; Findings 17-64 and 70-125, above.

132. The Plan contains terms and conditions that are designed to provide the Company a reasonable opportunity to recover the cost of least-cost resources including distributed

resources, conservation and load management. In addition to the recovery of direct costs and expenses, the Plan sets rates on the basis of forecasted customer loads. This procedure takes into account the impacts of load changes arising from such factors as self-generation, conservation, efficiency and load management. These Plan provisions decouple the Company's earnings from its retail sales volumes between rate cases, thereby promoting the resource parity policies contemplated under Vermont's least-cost planning principles. Deehan pf. at 29.

133. The Plan also contains terms and conditions to promote efficient utility operations. The Plan includes dead bands and caps that are carefully designed to promote risk management and efficient Company operation, and encourage management to seek out achievable operating efficiencies. The rigorous targets embedded in the Plan were designed to create a challenge for managers. When these features are combined with the decoupling components of the Plan, the overall system of regulation contemplated in the Plan encourages efficient operations in a resource-neutral manner consistent with the strategies contemplated under principles of integrated least-cost planning. Deehan pf. at 30.

b. Just and Reasonable Rates (§ 218d(a)(2)

134. The Plan provides just and reasonable rates for service to all classes of customers because adjustments will be implemented for all rate classes that are subject to general rate changes, because the PCAM will be implemented on a basis that reflects most of its costs (energy), and because the remaining adjustments will be implemented on a uniform percentage basis, consistent with traditional rate changes. Deehan pf. at 2; Findings 18-64 and 67-123, above.

135. The ratemaking mechanisms contemplated under the Plan assure the transparent