

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6790

Investigation into Village of Ludlow Electric Light)	Hearing at
Department's tariff filings re: proposed revenue and rate)	Montpelier, Vermont
design changes)	July 21, 2003

Order entered: 8/19/2003

PRESENT: Ennis John Gidney, Hearing Officer

APPEARANCES: William B. Piper, Esq.
Primmer & Piper, P.C.
for Village of Ludlow Electric Light Department

June E. Tierney, Esq.
for Vermont Department of Public Service

I. INTRODUCTION

In this Proposal for Decision, I recommend that the Board approve the Memorandum of Understanding ("MOU") between the Village of Ludlow Electric Light Department ("Ludlow") and the Vermont Department of Public Service ("DPS") that was filed on June 13, 2003, with one modification. The MOU provides for an 11.8 percent increase in Ludlow's revenue requirement to take effect with bills rendered on October 1, 2003, and additional increases to take effect with bills rendered on October 1, 2004, and October 1, 2005.¹ In addition, the MOU provides for three phases of rate design changes to take effect with bills rendered on those same dates. These changes would eliminate seasonal rates, and result in all major classes of customers paying stable or lower rates (when considered on a year-round basis),² although Ludlow's total

1. While the MOU refers to the changes taking effect with "bills rendered" on October 1, 2003, 2004 and 2005, this is essentially the same as service rendered on or after September 1 for each of these years.

2. Off-Peak Water Heating and Area Lighting are the only classes whose rates would increase as a result of this MOU.

revenues would increase primarily because of significant projected load growth as the Jackson Gore project is completed.³

I recommend that the Board modify the MOU by approving only the changes proposed to take effect with bills rendered October 1, 2003. While the proposed additional increases in revenue requirement and the second and third steps in the proposed rate design may be reasonable, I am concerned that there are too many uncertainties related to Ludlow's projected load growth and power costs over the three-year period covered by the MOU. Therefore, I recommend that the Board require Ludlow to file a comparison of actual versus projected load growth, power costs, revenue, and net income levels at the time it files proposed tariffs for the changes scheduled to take place with bills rendered on or after October 1, 2004, and October 1, 2005. This information will enable the Board to determine at that time whether the proposed additional increases in revenue requirement and second and third steps in the rate design should be approved.

II. PROCEDURAL HISTORY

On September 13, 2002, Ludlow filed revised tariffs to reflect proposed changes to the cost assignments and rate designs for each of its rate classes, including the elimination of the winter-summer rate differential, to take effect on a service-rendered basis commencing January 1, 2003.

On November 15, 2002, Ludlow filed revised tariffs and a class cost of service study in support of the proposed rate design changes. Ludlow also requested a stepped implementation of the proposed rate design changes, with the first step taking effect on September 1, 2003, the second step taking effect on September 1, 2004, and the third step taking effect on September 1, 2005.

On November 20, 2002, Ludlow amended its November 15, 2002, filing to reflect revisions to the proposed Large Commercial and Industrial rate designs.

3. The Jackson Gore project is a major new construction project that is located in Ludlow's service territory.

On December 19, 2002, the DPS, pursuant to 30 V.S.A. § 225, informed the Board that it had reviewed the filings and recommended that the proposed rate design changes be suspended and investigated.

On December 23, 2002, the Board opened this docket and appointed me Hearing Officer.

On February 7, 2003, and February 25, 2003, the Clerk of the Board sent the parties Board staff's questions regarding Ludlow's class cost of service study and accompanying rate design proposal.

On March 27, 2003, an informal workshop was held to discuss the proposed rate changes that are the subject of this Docket. At the workshop, Ludlow provided answers to Board staff's questions regarding its filing.

On May 22, 2003, I conducted a public hearing at the Ludlow Town Hall in Ludlow, Vermont.

On June 13, 2003, the DPS filed the MOU and its attachments. The MOU and its attachments were admitted into evidence at the technical hearing as exhibit Joint-1.

On July 7, 2003, the Clerk of the Board sent the parties Board staff's questions regarding the MOU.

On July 16, 2003, Ludlow filed a response to Board staff's question regarding the results of Ludlow's power redispach. On July 18, 2003, Ludlow filed a revised response to that same question. This revised response was admitted into evidence at the technical hearing as exhibit Ludlow-1.

On July 21, 2003, I conducted a technical hearing at which Ludlow and the DPS presented testimony in support of the MOU. No party opposed the MOU.

III. FINDINGS

Jackson Gore Project

1. Three Act 250 permits have been issued for the Jackson Gore project. These permits are:

- Jackson Gore Phase I, issued February 22, 2002 (permit number 2S0351-31-EB);

- Solitude Village 11-lot subdivision, issued February 22, 2002 (permit number 2S0351-25R-EB); and
- Solitude Village 22-lot subdivision, issued October 22, 2002 (permit number 2S0351-25U-EB).

Tr. 7/21/03 at 19 (Gibbons).

2. The estimated load impacts of the Jackson Gore project were obtained from the Act 250 permit application. The individual kw loads for the components of the Act 250 project were assigned diversity factors to arrive at winter and summer peak loads. Billing kw for classes that are demand billed and monthly energy uses for each component of the project were estimated based on load shapes from current Ludlow customers who are expected to have usage patterns similar to the new customers. Tr. 7/21/03 at 19 (Gibbons).

3. Ludlow's load is expected to increase by approximately 38 percent in three years as a result of the Jackson Gore project. Exh. Joint-1 at page 2 of Attachment 2.

4. The estimated load impacts of the Jackson Gore project were incorporated into the appropriate rate classes for cost assignment purposes and determination of incremental revenue effects, and were used to generate incremental power cost values. Tr. 7/21/03 at 19 (Gibbons).

5. Incorporating the estimated load impacts of the Jackson Gore project allows Ludlow to reflect the benefits of the economies of scale in its rates. This enables all of Ludlow's rates to be lower than they otherwise would be if the estimated load impacts from the Jackson Gore project were not included. Exh. Joint-1 at pages 2–3, 7 of Attachment 2; exh. Ludlow-5.

Revenue Requirement

6. The cost of service approved by the Board in Ludlow's most recent rate case, Docket 6575 was the basis for the class cost of service study in this Docket. Tr. 7/21/03 at 15 (Gibbons); exh. Joint-1 at page 6 of Attachment 2.

7. Ludlow reviewed all items in the cost of service approved by the Board in Docket 6575, and only anticipates changes in four items: power costs; revenue-based taxation; street light revenues; and net income. Tr. 7/21/03 at 15 (Gibbons).

8. The cost of service approved by the Board in Docket 6575 includes \$3,161,791 in power costs for Ludlow. In the current proceeding, Ludlow performed a power redispatch for the

combination of Ludlow's current load and estimated load for the Jackson Gore project using Ludlow's committed energy and capacity resources as of March 2003 and March 2003 forward prices for power. This power redispatch showed expected annual power costs of \$4,562,590 for the 12-month period beginning September 2005. However, the cost of service attached to the MOU only includes \$4,213,603 in power costs for that same time period. Exh. Ludlow-1; exh. Joint-1 at page 10 of Attachment 2; tr. 7/21/03 at 8 (Cole).

9. Ludlow's revenue-based taxes will increase as Ludlow's revenues increase. Exh. Joint-1 at page 10 of Attachment 2; tr. 7/21/03 at 15 (Gibbons).

10. Ludlow's street light revenues will increase by \$20,514 as a result of a change in street and area light rates that was previously approved by the Board outside this Docket. Exh. Joint-1 at page 10 of Attachment 2; tr. 7/21/03 at 15 (Gibbons).

11. The cost of service approved by the Board in Docket 6575 included negative \$60,000 in net income. The cost of service attached to the MOU phases in a \$150,000 increase in net income over three years, resulting in a positive annual net income of \$90,000. Exh. Joint-1 at page 10 of Attachment 2; tr. 7/21/03 at 15–16 (Gibbons).

12. The MOU provides for a revenue requirement of \$4,925,551 in the 12-month period beginning September 1, 2003. This represents an 11.8 percent increase in Ludlow's revenue requirement. The MOU provides for additional increases in Ludlow's revenue requirement to take effect with bills rendered on October 1, 2004, and October 1, 2005. Exh. Joint-1 at page 10 of Attachment 2.

Rate Design

13. The MOU provides for stepped implementation of the proposed rate design changes, with the first step taking effect with bills rendered on October 1, 2003, the second step taking effect with bills rendered on October 1, 2004, and the third step taking effect with bills rendered on October 1, 2005. Exh. Joint-1 at 2.

14. The first step of the MOU's proposed rate design changes includes the elimination of seasonal rates. Exh. Joint-1 at 2.

15. The first step of the MOU's proposed rate design changes will result in just and reasonable rates. Exh. Joint-1 at 2.

IV. DISCUSSION

In Docket 6575, the Board required Ludlow to perform a class cost of service study based on the cost of service approved in that Docket, and to file any proposed rate design changes with the Board.⁴ The tariff filing that is the subject of this proceeding is the result of this requirement. However, there is one significant difference — before performing the class cost of service study, Ludlow adjusted the cost of service approved in Docket 6575 to reflect anticipated changes in revenues and expenses as a result of an unusually large new load that is currently being constructed (the Jackson Gore project).⁵

These adjustments raise many difficult issues, including the extent to which they are known and measurable. However, these issues have not been fully litigated. The parties have agreed to a comprehensive settlement of all the issues in this proceeding (the MOU), and therefore it is not necessary for the Board to rule on each of these issues. Rather, it is necessary only for the Board to determine whether or not the resolution included in the MOU would result in just and reasonable rates. As explained further below, I am persuaded that, at least for the 12-month period beginning September 1, 2003, the MOU does just that.

First, the MOU provides a reasonable path for adjusting Ludlow's revenue requirement so that it earns an appropriate amount of net income. Ludlow's current \$60,000 in negative net income is not sustainable over the long term, and the MOU's proposed phasing-in of the increase balances Ludlow's needs with the policy goal of rate stability.

Second, the rates agreed to in the MOU enable all customer classes to benefit from the economies of scale resulting from the Jackson Gore project. That is, these rates are lower for all classes of customers than they would have been if the Jackson Gore project had not been

4. Docket 6575, Order of 4/2/02 at 8 (order paragraph 6).

5. Ludlow also adjusted the Docket 6575 cost of service to reflect a change in street and area light rates that was previously approved by the Board outside this Docket. However, this adjustment is quite small when compared to the adjustments made as a result of the Jackson Gore project.

included in the analysis, due to economies of scale.⁶ By extension, if Ludlow's current rates were to remain in effect, as more components of the Jackson Gore project are completed, eventually Ludlow would overcollect from ratepayers. This would not be in the public interest.

Third, it is reasonable to eliminate Ludlow's seasonal rates. Changes in the New England wholesale power market's rules have greatly reduced the costs resulting from an individual utility's peak month, and have increased power costs associated with the region's peak. Thus, even though Ludlow is still strongly winter peaking,⁷ costs associated with this no longer outweigh the costs associated with the region's summer peak.

Fourth, the rates agreed to in the MOU alter the portions of Ludlow's costs that are collected from each customer class in a manner consistent with the class cost of service study. Utilities' costs change over time, and each customer class' contribution to those costs changes as well, as demonstrated by class cost of service studies. It is necessary to periodically redesign rates in order to comply with the fundamental ratemaking principle that customers should pay for the costs they cause the utility to incur. I am persuaded that at least the first step of the rate design proposed in the MOU does just that.

However, I am concerned that the underlying cost of service analysis and class cost of service study rely on many assumptions which could turn out to be incorrect, particularly in the last two years of the period covered by the MOU. For example, the assumptions regarding the Jackson Gore load could turn out to be incorrect due to differences between actual consumption and the consumption projected in the Act 250 permit application, or changes in the construction schedule. As another example, Ludlow's power costs could be significantly different from those projected in the studies. The power redispatch performed by Ludlow estimated its power costs for the 12-month period beginning September 1, 2005, to be approximately 8 percent higher than those included in its initial filing and the MOU. Since Ludlow's power costs are approximately 75 percent of its total costs,⁸ a change of this magnitude would be material. In addition,

6. *See*, finding 5, above.

7. Tr. 7/21/03 at 18 (Gibbons).

8. Tr. 7/21/03 at 15 (Gibbons).

subsequent to the March 2003 power redispatch, two of Ludlow's power suppliers filed for bankruptcy. The effect of these bankruptcies on Ludlow's power costs is unknown at this time.⁹

Therefore, I recommend that the Board require Ludlow to file a comparison of actual versus projected load growth, power costs, revenue, and net income levels at the time it files proposed tariffs for the revenue requirement and rate design changes scheduled to take place for bills rendered on or after October 1, 2004, and October 1, 2005.¹⁰ At the technical hearing, both Ludlow and the DPS stated that they would not object to such a modification of the MOU.¹¹

I also note that the proposed rate design changes the way costs are recovered so that more costs are recovered through energy charges and less through capacity charges. I am concerned about the effect this might have on customers served under the Residential Demand rate, particularly if the proposed second and third steps of the rate design are implemented. Ludlow is still strongly winter peaking, and many of the homes served under the Residential Demand rate are occupied primarily in the winter. I am concerned that the proposed second and third steps would provide a disproportionate benefit to low-load-factor customers served under that rate, and would discourage residential demand customers from controlling their peak loads.

In the MOU, Ludlow and the DPS have taken steps to address this concern. First, the proposed rate design freezes the cost allocation to residential demand customers at 12.45 cents per kwh. In addition, the proposed rate design increases the demand ratchet, from 50 percent of over 20 kw to 85 percent of over 15 kw. Both these changes will mitigate somewhat the potential for disproportionate benefit to lower-load-factor customers.¹²

However, I remain concerned, in large part because in Ludlow's class cost of service study, the loads for the customers served under this rate in the Jackson Gore project were estimated. It is possible that these customers' actual consumption could differ significantly from

9. Tr. 7/21/03 at 25–27 (Collins).

10. This relates closely to the issue of rate stability. If there are significant changes in Ludlow's power costs, it is possible that Ludlow would file an overall revenue case within the three-year period covered by the MOU. Tr. 7/21/03 at 27 (Collins). However, too many changes in rates in a short period of time is counter to the principle of rate stability. Therefore, I recommend that the Board examine the difference between Ludlow's current load growth and power cost projections and actual results before approving further rate design changes.

11. Tr. 7/21/03 at 16, 29 (Collins); tr. 7/21/03 at 32–33 (Behrns).

12. Tr. 7/21/03 at 10 (Gibbons).

the estimates. If that were to occur, customers served under the Residential Demand rate, particularly low-load-factor customers, might not pay the full amount of the costs they cause Ludlow to incur. As a result, I recommend that the Board pay particular attention to the rate design for this rate when it considers allowing implementation of the second and third steps of the proposed rate design.

V. CONCLUSION

In conclusion, I recommend that the Board approve an 11.8 percent increase in Ludlow's revenue requirement, effective with bills rendered on October 1, 2003. I further recommend that the Board approve only the first step of the proposed rate design changes in the MOU between Ludlow and the DPS that was filed on June 13, 2003. In addition, I recommend that the Board require Ludlow to file a comparison of actual versus projected load growth, power costs, revenue, and income levels at the time it files proposed tariffs for the revenue requirement and rate design changes proposed to take place for bills rendered on or after October 1, 2004, and October 1, 2005. This information will enable the Board to determine how close Ludlow's load and power cost estimates were to actual load and power costs, and whether the second and third steps of the proposed revenue requirement and rate design changes in the MOU should be implemented.

Dated at Montpelier, Vermont, this 18th day of August, 2003.

s/Ennis John Gidney

Ennis John Gidney
Hearing Officer

VI. ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. The findings and conclusions of the Hearing Officer are adopted.
2. The Village of Ludlow Electric Light Department ("Ludlow") is entitled to rates that will produce \$4,925,551 in annual revenues for bills rendered on and after October 1, 2003.
3. The first step of the proposed rate design in the Memorandum of Understanding ("MOU") between Ludlow and the Vermont Department of Public Service that was filed on June 13, 2003, is approved. These changes shall take effect with bills rendered on and after October 1, 2003.
4. The tariffs that are included as Attachment 1 to the MOU are approved.
5. Ludlow shall file a comparison of actual versus projected load growth, power costs, revenue, and income levels at the time it files proposed tariffs for the revenue requirement and rate design changes proposed to take effect for bills rendered on or after October 1, 2004, and October 1, 2005.
6. This Docket shall be closed.

Dated at Montpelier, Vermont, this 18th day of August, 2003.

<u>s/Michael H. Dworkin</u>)	
)	PUBLIC SERVICE
)	
<u>s/David C. Coen</u>)	BOARD
)	
)	OF VERMONT
<u>s/John D. Burke</u>)	

OFFICE OF THE CLERK

FILED: August 19, 2003

ATTEST: s/Susan M. Hudson

Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: Clerk@psb.state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.