

STATE OF VERMONT  
PUBLIC SERVICE BOARD

Docket No. 7120

Investigation into Vermont Electric Cooperative, Inc.'s )  
tariff filing requesting an overall rate increase in the )  
amount of 14.35%, and proposed rate design changes, to )  
take effect December 1, 2005 )  
Hearing at )  
Montpelier, Vermont )  
September 13, 2006 )

Order entered: 10/6/2006

PRESENT: James Volz, Board Chair  
David Coen, Board Member  
John Burke, Board Member

APPEARANCES: Victoria J. Brown, Esq.  
Primmer Piper Eggleston & Cramer, PC  
for Vermont Electric Cooperative, Inc.

Geoffrey Commons, Esq.  
for Vermont Department of Public Service

Michael Marks, Esq.  
Tarrant, Marks & Gillies  
for Smugglers' Notch Management Company, Ltd.

**I. INTRODUCTION**

In this Order, the Vermont Public Service Board ("Board") approves a Memorandum of Understanding ("MOU") jointly submitted on July 13, 2006, by Vermont Electric Cooperative, Inc. ("VEC" or "Company") and the Department of Public Service (the "Department"). In accordance with the terms of the MOU, the Board authorizes VEC to increase its base rates by 14.35%.<sup>1</sup>

---

1. In accordance with 30 V.S.A. § 226(b), VEC is currently collecting this increase through a temporary surcharge.

## II. BACKGROUND

On October 14, 2005, VEC filed a petition and revised tariff sheets reflecting a 14.35 percent increase in its rates, effective with service rendered on or after December 1, 2005; the proposed rate increase would increase VEC's annual revenues by \$7,732,528. The filing also included a cost-of-service study, as required by a Memorandum of Understanding entered into between VEC and the Department in Docket Nos. 6850 and 6853.

VEC's existing tariffs reflect two rate zones: Zone 1, which encompasses the prior VEC standalone service territory, and Zone 2, which covers the former Citizens service territory that VEC acquired in 2004. In its October 14 filing, VEC proposed to move all Zone 1 customers to the rate schedules that were approved for Zone 2 and then to increase rates for all rate classes. The result of that approach would have been that, on a weighted average basis, customers in Zone 1 would have experienced a rate increase of 11.40%, and customers in Zone 2 would have experienced a 17.74% rate increase. VEC had also proposed to eliminate the existing winter-summer rate differential in Zone 2 and adopt a single blended rate.<sup>2</sup> VEC also proposed several modifications to the rate schedules to mitigate adverse effects that would be experienced by several of VEC's larger customers.

At the Board's request, on November 4, 2005, VEC submitted tariff sheets which would implement the two alternate rate design changes that VEC had proposed, but without the rate increase. On November 14, 2005, VEC submitted tariff sheets for one of its street lighting rates which had been inadvertently omitted from the earlier filings.

On November 16, 2005, the Department, pursuant to 30 V.S.A. Section 225, informed the Board that it had reviewed the filing and recommended that the Board investigate the proposed rate increase. The Department stated that it had no objection to implementation of the rate design changes concurrently with the rate surcharge, and it believed that there was insufficient cost basis to retain the seasonal rate differences. The Department further stated that regardless of whether the proposed rate design was allowed into effect, it believed that the rate design changes should remain subject to further review in a follow-up proceeding or a later phase of this investigation.

---

2. The existing Zone 1 rates do not have a winter-summer differential.

On November 18, 2005, the Board issued an order which suspended the proposed rate design changes. The Board noted that, under 30 V.S.A. § 226(b), it could not suspend a proposed increase in a cooperative utility's rates. Accordingly, it required VEC to implement the rate increase effective December 1, 2005, by means of an identical 14.35% surcharge to each class of ratepayer under the rate design tariffs previously approved by the Board.

On November 12, 2005, the Town of Brunswick ("Brunswick") Selectboard, on behalf of Brunswick, submitted a letter expressing its desire to intervene in this docket. Brunswick expressed its concerns about the reliability of VEC's service and asked the Board to examine the possibility of having Public Service Company of New Hampshire ("PSNH") serve the Brunswick area. On December 1, 2005, Smugglers' Notch Management Company, Ltd. submitted a motion to intervene.

On December 8, 2005, a prehearing conference in this docket was held. At that time, the Board granted Smugglers' Notch's Motion to Intervene on a permissive basis under Rule 2.209(B). The Board set a deadline of December 20, 2005, for parties to respond to Brunswick's request to intervene. The Board also set a schedule for this proceeding.

On December 27, 2005, the Department submitted a letter in support of Brunswick's intervention request. VEC also submitted a letter stating that it did not object to intervention by Brunswick to address reliability concerns, but that it was working with Brunswick to resolve those concerns. VEC opposed having the Board consider Brunswick's request to consider service from PSNH in this docket. The Board granted Brunswick permissive intervention as to service-quality issues by Order issued January 5, 2006, but it declined to consider in this docket the Town's request to be served by a company other than VEC.

On January 23, 2006, after due notice, a Public Hearing was held via Vermont Interactive Television ("VIT"), with participation available at the Brattleboro, Johnson, Newport, St. Albans and Williston VIT sites. Four members of the public spoke at the Public Hearing. The Board also received many written public comments. The primary issues raised by the public comments are complaints about the quality and reliability of service that VEC has been providing, and objections to the magnitude of the proposed rate increase.

VEC and the Department engaged in extensive discovery and eventually settlement negotiations over a period of several months. VEC and the Department filed with the Board periodic reports on the status of their negotiations.

On July 13, 2006, VEC and the Department submitted the MOU, in which they agreed that, subject to the terms of the MOU, the 14.35% revenue increase requested by VEC is in the general good of the state. By Memorandum issued on July 20, 2006, the Board set a date by which other parties could file comments and/or request a hearing. On July 17, 2006, Smugglers' Notch submitted a letter stating that, based on the understanding that VEC's rate design remain suspended pending completion of a fully allocated cost of service study yet to be filed, it did not object to adoption of the MOU by the Board. The Board received no other comments on the MOU.

On August 31, 2006, the Board issued a notice of a technical hearing to be held on the MOU on September 13, 2006. The Board also issued a Memorandum asking VEC and the Department to be prepared to respond at the hearing to a series of questions posed by the Board. VEC and the Department submitted responses to some of the Board's questions on September 11, 2006, and on September 13, 2006, the Board convened the technical hearing. The MOU was entered into the evidentiary record as Exhibit Joint 1; VEC and the Department's response to the Board's questions was admitted as Exhibit Board 1.

On September 26, 2006, VEC and the Department filed a joint proposed order for the Board's consideration.

### **III. FINDINGS**

Based on the evidence in the record in this docket, we hereby make the following findings.

1. In the MOU, VEC and the Department agreed that the Board should approve VEC's request for a 14.35% rate increase, subject to the terms of the MOU. The increase is almost entirely related to increases in the cost of power. The increase is necessary to improve the Company's reliability and to maintain its financial integrity. Exh. Joint 1 at 2; tr. 9/13/06 at 14–15 (Schultz), 16 (Bursell).

2. The MOU provides for a Business Process Review and Audit ("BPRA") to review VEC's processes in a number of areas, including Board of Directors' processes and procedures, power planning, budgeting, organizational structure and staffing levels, company decision-making processes, and strategic planning. Exh. Joint 1 at 2; exh. Board 1.

3. The BPRA will be conducted by a consultant hired in response to a Request for Proposal to be issued by VEC and approved by the Department. Exh. Joint 1 at 2; exh. Board 1.

4. In the MOU, VEC agrees that it will implement recommendations made by the auditor performing the BPRA, except that if either VEC or the Department believes a recommendation to be unreasonable, that party will provide the other party with a written counter-proposal or detailed explanation why implementation of the recommendation is unreasonable. If VEC and the Department cannot reach agreement, the party opposing implementation of the auditor's recommendation may petition the Board for resolution of the disagreement. Exh. Joint 1 at 3.

5. The Department agrees to support rate recovery of cost of the BPRA (which may require an Accounting Order to authorize deferral of costs of the BPRA), so long as VEC implements the recommendation of the auditor (or gets consent not to), cooperates with the auditor, and avoids any imprudent or unreasonable conduct in connection with the BPRA. Exh. Joint 1 at 3.

6. VEC acknowledges that its recording of the transition and transaction costs associated with the acquisition of the Citizens Communications Company assets was not in all respects in accordance with FAS 141, which governed the recording of the transaction; however, when considering the entire transaction, including the provisions of the MOU, VEC and the Department agree that the transition and transaction costs could now be considered to be recorded in accordance with Generally Accepted Accounting Principles as provided for under FAS 71. Exh. Joint 1 at 3–4.

7. VEC also acknowledged that its accounting for the Citizens acquisition was (a) different from that reported to the Board and the Department after the acquisition, (b) inconsistent in certain respects with VEC's representations to the Board and the Department prior to the acquisition, and (c) inconsistent in certain respects with regulatory accounting. *Id.*

8. Inconsistencies in VEC's accounting resulted in some costs being understated and some being overstated. Importantly, however, there was no harm to VEC members because over time

the overstatements and understatements would balance out. VEC's accounting entries were reviewed by and found to be acceptable by VEC's outside auditors. Tr. 9/13/06 at 25–28 (Schultz), 29 (Bursell), 42 (Schultz).

9. In the MOU, VEC acknowledges that in most circumstances, the recording of a deferral by an entry to Miscellaneous Deferred Debits or Other Deferred Credits must be authorized by the granting of an Accounting Order issued by the Board. Exh. Joint 1 at 4–5.

10. In the MOU, VEC agrees that its accounting staff must become familiar with Board rate-making practices and precedents, and it agreed to use its best efforts to follow Board accounting precedents. VEC also agrees to cause its Chief Financial Officer to attend training in regulatory accounting and ratemaking and to inform the Department and Board of the date(s) and general content of such training. Exh. Joint 1 at 4, 5.

11. In the MOU, VEC agrees to file quarterly financial statements with the Department for each of the next ten quarters following the execution of the MOU and will make such summaries available on its website and at its office. It will notify members annually in writing of the availability of the information. Exh. Joint 1 at 4.

12. In the MOU, VEC agrees to continue to conduct performance evaluations for all personnel, including members of management pursuant to Performance Evaluation Procedures and Performance Evaluation Guidelines that VEC had developed. Exh. Joint 1 at 5–6; exh. VEC-1.

13. In the MOU, VEC acknowledges that its failure to fund the Management Incentive Plan ("MIP") in 2006 breached the agreement it reached with the Department when the two parties negotiated the MIP. VEC further agrees that it was appropriate to have some managerial compensation contingent upon meeting or exceeding explicit performance standards and expectations. Finally, VEC agrees to implement the MIP as previously agreed to or provide a proposed revised MIP by November 1, 2006. Exh. Joint 1 at 6.

14. Under the MOU, VEC will file a Fully-Allocated Rate Class Cost of Service Study ("FARCCSS") within 60 days of the date of issuance of a final order approving a revenue requirement in this docket. The FARCCSS will include a bill frequency analysis. Exh. Joint 1 at 6.

15. In the MOU, VEC agrees to increase the funding of its vegetation-management program, on a calendar-year basis, for the next four years, resulting in the following minimum funding levels: 2006 - \$1.3 million; 2007 - \$1.6 million; 2008 - \$1.9 million; and 2009 - \$2.2 million. These numbers are based on VEC's current service territory and will be subject to modification if VEC's service territory changes. The MOU establishes specific requirements for the funding and accounting of this vegetation-management commitment. Exh. Joint 1 at 6–7.

16. In the MOU, VEC agrees to hire a right-of-way technician/mapping technician that reports to the Right-of-Way Coordinator within six months of approval of the MOU. Exh. Joint 1 at 7–8.

17. To address the reliability problems experienced in the Town of Brunswick and adjacent areas, VEC agrees to a number of operational improvements. In particular:

(a) VEC is in the process of installing SCADA controlled motor-operated air break switches at its Bloomfield step-down transformer site to enable VEC to remotely switch between the Island Pond Substation source and the PSNH Bloomfield source.

(b) VEC has implemented a vegetative-management program to complete trimming on the Island Pond distribution circuit that supplies the Brunswick area by the end of the calendar year.

(c) VEC re-energized the Guildhall connection to PSNH as the primary source for the Guildhall area, to minimize the exposure due to outages in the Guildhall area on the line from the Island Pond Substation, which serves the Brunswick area.

(d) VEC has installed fuses on all side tap lines on the Island Pond distribution circuit that serves the Brunswick area.

(e) VEC has entered into a contract with New Hampshire Electric Cooperative ("NHEC"), under which NHEC will provide outage response assistance in the Canaan/Brunswick area in an effort to improve restoration responses, thus cutting response time.

Exh. Joint 1 at 7-9; exh. Board 1.

#### **IV. DISCUSSION**

It is clear that the MOU is the result of a thorough and probing investigation by the Department that turned up certain deficiencies in VEC's accounting for the Citizens acquisition and in meeting its commitments under the MIP. It is also clear that the MOU represents a significant effort by VEC and the Department to address those deficiencies and to set the Company on a course to improve its operations, increase its reliability, and enhance its financial integrity. In VEC's next rate case we will have a further occasion to evaluate the effectiveness of the corrective actions agreed to in the MOU.

VEC will also submit a class cost of service study to address rate design issues that were deferred from this case. This will provide the parties and the Board an opportunity to review VEC's current rate designs and to make any required changes, including placing all VEC customers on a single set of rates.

The evidence demonstrates that approval of the MOU, including all of its terms and conditions, will result in just and reasonable rates and will promote the public good. Therefore, the Board approves the MOU as a reasonable resolution of this proceeding.

#### **V. ORDER**

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

1. The Memorandum of Understanding between Vermont Electric Cooperative, Inc. ("VEC") and the Vermont Department of Public Service, filed on July 13, 2006, is hereby approved. VEC shall comply with all of its obligations under the Memorandum of Understanding.

2. VEC is entitled to rates that will increase retail revenues by 14.35 percent above existing base rates, on service rendered on or after December 1, 2005.

3. VEC shall file appropriate tariffs to reflect the above rate increase within 10 days of the issuance of this Order.

4. VEC shall file the Fully Allocated Rate Class Cost of Service Study required under the Memorandum of Understanding no later than 60 days from the date of this Order. The Board will open a separate docket to address that filing.

Dated at Montpelier, Vermont, this 6<sup>th</sup> day of October, 2006.

<u>s/James Volz</u>	)	
	)	PUBLIC SERVICE
	)	
<u>s/David C. Coen</u>	)	BOARD
	)	
	)	OF VERMONT
<u>s/John D. Burke</u>	)	

OFFICE OF THE CLERK

FILED: October 6, 2006

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: psb.clerk@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.*