

STATE OF VERMONT  
PUBLIC SERVICE BOARD

Docket Nos. 5841/5859

Investigation into Citizens Utilities Company )  
re: alleged investment in facilities without )  
proper regulatory approval, and omission of )  
least-cost analysis of such investments )

AND

Investigation into the existing rates of )  
Citizens Utilities Company )

Order entered: 08/28/97

ORDER ON MOTIONS TO CLARIFY, RECONSIDER, AND AMEND

I. Introduction

On June 16, 1997, we issued an Order resolving these two Dockets. On June 30, 1997, Citizens Utilities Company ("Citizens" or "the Company") filed a Motion for Clarification, Reconsideration and Request to Accept Compliance Filing. On the same date, the Department of Public Service ("DPS" or "the Department") filed a Motion to Clarify or Amend. On July 10, 1997, both the DPS and, collectively, the Barton Village, Inc., Electric Department, Enosburg Falls Electric Department, and Orleans Electric Department ("the Villages") filed responses to Citizens' Motion. Also on July 10, Citizens submitted both a response to the Department's Motion and a letter requesting an expedited determination that a proposed installation of grounding rods would violate neither 30 V.S.A. § 248 nor our June 16, 1997, Order in this Docket. On July 11, the DPS filed a supplemental response addressing the Company's proposed refund methodology. We heard oral argument on these filings on July 16, 1997.

By Order issued on July 21, 1997, we resolved those issues for which the parties had requested a prompt decision. Today's Order resolves the remaining issues raised by the parties' Motions and argument.<sup>1</sup> Other than as stated in this Order and in our Order of July 21, 1997, Citizens' Motion for Clarification, Reconsideration and Request to Accept Compliance Filing and the Department's Motion to Clarify or Amend are denied.

## II. Corrections to Cost of Service

In its June 30 filing, the Company proposes certain specific corrections to the cost of service attached to our June 16 Order, which result in a corrected reduction in rates of 14.65 percent. In approving the Company's compliance tariffs, our July 21 Order noted that we have determined these corrections to be appropriate. We have revised Attachment 1 to our June 16 Order to reflect these corrections; the revised Attachment 1 is included with today's Order.

## III. Return on Equity Penalty

### A. Future Modification

In the proposed terms of probation set forth in our June 16 Order, we include a provision by which we reserve the right to modify the return on equity penalty. In its June 30 filing, Citizens requests that we clarify and modify this provision, such that "satisfaction of the enumerated requirements of the Order should be the basis of modification."<sup>2</sup>

We decline to modify this provision of our Order. While the Company's compliance or noncompliance with the specific requirements of the Order will certainly be significant factors in future modifications of the penalty, we will not preclude the possibility of modifications, in either direction, based on future circumstances that we cannot now foresee.

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1. At the July 16 oral argument, the DPS withdrew its request to modify the June 16 Order with respect to expenditures on energy efficiency programs. Tr. 7/16/97 at 30-32. Accordingly, today's Order does not address that issue.

2. Citizens Motion at 2.

## B. Magnitude of Penalty

Citizens contends that we have exceeded our authority in imposing a 525 basis point reduction on the Company's cost of equity.<sup>3</sup> Specifically, the Company argues that the reduction is not based on evidence of record, produces a return that is outside the range of reasonableness, fails to account for a reduction in return on equity that results from use of a hypothetical capital structure, results in the Company being penalized twice for the same conduct, and is an unconstitutional taking.<sup>4</sup> In their Responses, the Department and the Villages dispute the Company's arguments.<sup>5</sup>

### 1. Board Authority

Our June 16 Order included substantial discussion of our authority to impose a significant return on equity penalty. The Company has not directed us to any errors in that analysis, and we decline to modify that discussion.

### 2. Evidence in the Record

Citizens contends that there is insufficient evidence in the record to support the reduction in return on equity of 525 basis points.<sup>6</sup> Our June 16 Order set out the three independent bases for the 525 basis point reduction in return on equity. While there is no specific testimony or exhibit in the record that recommends a reduction of precisely 525 basis points, this remedy lies well within the range of outcomes supported by competent testimony. Department witness Steinhurst recommended a range of remedies, including a substantial reduction in return on equity, up to revocation of the Company's Certificate of Public Good.<sup>7</sup> Company witness Love also recommended that the Board impose painful and

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3. Citizens Motion at 3.

4. Citizens Brief 6/30/97 at 4-8.

5. DPS Response at 4-8; Villages Response at 1-7.

6. Citizens Brief 6/30/97 at 6.

7. Steinhurst pf. 5/15/96 at 42-47; Steinhurst pf. 8/23/96 at 22-26.

substantial remedies, and acknowledged that return on equity penalties are "standard policies . . . for a company that's gone astray."<sup>8</sup> In view of the extensive evidence of pervasive management and operational problems at the Company, we continue to believe that the remedies imposed in our June 16 Order, including the 525 basis point reduction in return on equity, are amply supported by the record. We believe it well within our discretion to tailor specific remedies and conditions—including the reduction in return on equity—directed toward correcting the substantial problems in the Company's management that this investigation has revealed.

Citizens raises one additional argument regarding the evidentiary foundation for the return on equity penalty: the Company claims that it is inappropriate to consider the financial impact of the penalty on the entire Company, rather than on just its Vermont Electric Division ("VED").<sup>9</sup> We first note that the Company does not explain why it believes it inappropriate to consider the financial capacity of the corporation as a whole, nor does Citizens provide any legal citation to support its belief. Turning to the substantive issue, the concern that we must address is whether the reduction in allowed return on equity will jeopardize the financial security of the Company. On the corporate level, no such jeopardy will result, for the reasons stated in our June 16 Order.

On the local level, we likewise conclude that the reduction in allowed return will not imperil the ability of VED to attract necessary resources. In fact, as is evident in our June 16 Order, we have concluded the opposite: this substantial reduction in allowed return is necessary to ensure that corporate management pays attention to, and makes the necessary investments in, VED management, systems, and operations.<sup>10</sup> Consequently, this substantial penalty should in fact enhance the ability of VED to attract the resources of the corporation needed to correct the many operational and managerial deficiencies identified in the June 16 Order.

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8. Tr. 2/6/97 at 119-134.

9. Citizens Brief 6/30/97 at 5-6.

10. Order of 6/16/97 at 306.

### 3. Reasonableness of Return

Citizens contends that its final allowed return on equity, after reduction by the penalty, is not within the range of reasonable returns.<sup>11</sup> We disagree. In our June 16 Order, we quoted the following holding from the Vermont Supreme Court's decision in *Petition of New England Tel. & Tel. Co.*, 115 Vt. 494, 513 (1949):

if it should appear that consumers are not being adequately served because of fault on the part of the company, due to inefficiency or improvidence or other like reasons, the commission should take such inadequacy, and its extent, into consideration in determining the rates to be fixed to the end that *a reasonable return, under the circumstances*, will result.<sup>12</sup>

Thus, our responsibility is to determine a reasonable return under the circumstances presented. That is precisely what we have sought to do in our June 16 Order,<sup>13</sup> and we continue to believe that the 525 basis point reduction in return on equity results in a reasonable return under the circumstances presented in this case.

### 4. Pro-formed Capital Structure

In our June 16 Order, we concluded the pro-formed capital structure to be reasonable.<sup>14</sup> The Company has not sought modification of that conclusion, and had itself agreed to the use of the pro-formed capital structure. Nonetheless, Citizens argues that the use of a pro-formed capital structure in effect imposes a 131 basis point penalty on the return on equity that the Company can earn.<sup>15</sup> We disagree. Consistent with our past practice, our use of a pro-formed capital structure is necessary to ensure that ratepayers not pay the higher capital costs that would otherwise be associated with a capital structure that is more equity-rich

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11. Citizens Brief 6/30/97 at 6.

12. 115 Vt. 513 (citations omitted, emphasis added); see Order of 6/16/97 at 302.

13. See Order of 6/16/97 at 300-306.

14. Order of 6/16/97 at 78.

15. Citizens' Brief 6/30/97 at 5.

than necessary.<sup>16</sup> Thus, rather than a penalty to the Company, the pro-formed capital structure is necessary to prevent ratepayers from bearing an excessive cost of capital.

### 5. Double Penalty

The Company also argues that, with the 525 basis point penalty, the Company "is being penalized twice for the same conduct," in that the Company has also been fined \$60,000 for its violations of 30 V.S.A. §§ 30, 229 and 248, and violations of our Orders in Docket Nos. 5331 and 5426.<sup>17</sup> This claim is incorrect. Our June 16 Order plainly states that the 525 basis point reduction in return on equity represents a penalty for pervasive management and operational deficiencies of the Company. In contrast, the \$60,000 fine has been imposed for the specific violations recited in Part Two, Subpart B(3) of our June 16 Order.

### 6. Confiscation

The Company's final argument for reducing the return-on-equity penalty is that it "is arbitrary and capricious and is unconstitutional confiscation of Citizens' property without due process of law in violation of the Vermont and U.S. Constitutions."<sup>18</sup> To support this argument, Citizens only cites page 65 of Robert O'Brien's September 23, 1996, prefiled testimony and states that, with a cost of equity less than the Company's cost of debt and of 30-year Treasury Bonds, the Board's decision is contrary to all of its precedent on the issue of rate of return.<sup>19</sup> The Company has not sufficiently briefed these constitutional claims. It cites no case law (including the Board precedent which it claims would call for a contrary result), and provides no explanation of how the 525 basis point penalty represents an

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16. *E.g.*, Docket No. 5656, *In re Citizens Utilities Company*, Order of 1/26/94 at 59; Docket Nos. 5700/5702, *In re New England Telephone*, Order of 10/5/94 at 75.

17. Citizens Brief 6/30/97 at 7.

18. Citizens Brief 6/30/97 at 8.

19. As explained in our June 16 Order, we have concluded that the reduction in return on equity is appropriate given the facts of this case, and the remedy is therefore consistent with our longstanding practice that return on equity, including any penalty, is established based on the facts of the specific case. *E.g.* Docket Nos. 5701/5724, *In re CVPS*, Order of 10/31/94 at 179-180. The magnitude of the penalty reflects the nature of the mismanagement that has come to light in this proceeding.

unconstitutional taking. As we cannot discern from the Company's Motion and Brief the basis for the claim of an alleged taking, we reject the Company's claim as inadequately briefed.<sup>20</sup>

#### IV. Least-Cost Transmission and Distribution Obligations

In our June 16 Order, we concluded that the Company had violated the Board's Order in Docket No. 5426 by failing to conduct least-cost planning for its transmission and distribution system.<sup>21</sup> In its Motion to Clarify or Amend, the Department asks that we "explicitly order Citizens to promptly and aggressively pursue implementation of T&D efficiency," and amend the Order to clearly state that the Order in Docket No. 5426 remains in effect. The Department also notes that it will propose a specific term of probation concerning T&D least-cost obligations.<sup>22</sup> In its Response, the Company contends that it has already taken prompt and aggressive action to implement T&D efficiency, and that thus no amendment to the June 16 Order is needed.<sup>23</sup>

Resolution of this issue is straightforward. First, our Order in Docket No. 5426 remains in effect with respect to least-cost planning for the Company's transmission and distribution system. Second, we agree with the Department that our Order in this Docket should itself include appropriate conditions to ensure that the Company implements its least-cost planning obligations. We believe this will be best accomplished by including such conditions in the terms of probation, and we invite the parties to propose appropriate terms of probation toward that end.

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20. Even after the 525 basis point reduction, the Company is expected to earn a return on Vermont operations of 5.25 percent, which exceeds the returns typically earned by Citizens' ratepayers on savings accounts in Vermont financial institutions. Citizens has not explained how its property is being confiscated by an Order that does not take the Company's capital and that sets rates that are projected to result in a positive return on that capital. We do not find such a rate of return to be confiscatory as a constitutional matter.

21. Order of 6/16/97 at 170-174, 292.

22. DPS Motion at 3. The DPS Motion further contends that "[a]ny continuing failure to implement the Docket 5426 Order should be sanctionable under Title 30 § 30, as amended," but does not request that we modify our June 16 Order to so state.

23. Citizens Response at 5-6.

#### V. Richford 46 kV Transmission Line Relocation

The Department asks us to modify our Order with respect to the issue of the relocation of a 46 kV transmission line in Richford. Noting our statement in footnote 150 of the Order that "we would expect any utility that seeks to establish an exemption from permitting requirements . . . to demonstrate comprehensively that the exemption applies," the Department contends that we should require Citizens either to make such a comprehensive demonstration with respect to the Richford 46 kV line or, in the alternative, file for a permit.<sup>24</sup> The Company opposes the Department's proposed modification, but asks for clarification of footnote 150.<sup>25</sup>

We deny the Department's requested modification regarding the Richford line. As Citizens correctly observes, our statement in the footnote explicitly is intended to provide *future* guidance. We also clarify that our statement in footnote 150 is intended only to set forth our expectation regarding the presentation of evidence in dockets that have been otherwise opened; in other words, the footnote does not mean that utilities must seek a declaration from the Board any time that a utility prepares to undertake a project that it believes to be exempt.

#### VI. Diesel Maintenance

The Department requests that we amend the June 16 Order "to reflect imprudence of the Company in its treatment of the diesels," or in the alternative that we clarify the Order to state that we do not condone the mistreatment of such assets.<sup>26</sup> We decline to modify our Order. The Department did not present sufficient evidence on which to base a finding of imprudence.

#### VII. DPS Request to Increase Allocation

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24. DPS Motion at 3-4, citing Order of 6/16/97 at 136 n. 150.

25. Citizens Response at 6-7.

26. DPS Motion at 4-5.

The Department objects to our use of the phrase, "escalated exponentially," in discussing the costs of Mr. Laskow's investigation. The DPS also requests that we clarify our Order to indicate that the increase in costs for Mr. Laskow's work was entirely due to the failure of Citizens to comply with our discovery Orders.<sup>27</sup>

We will agree to change the phrase, "escalated exponentially," to "escalated substantially." Our Order already notes that the increased costs were at least in part attributable to the Company; we deny the Department's request that we go further and state that the increased costs were entirely due to the Company's failure to comply with discovery Orders, as we have an insufficient basis to draw such a conclusion.

#### VIII. Failure to Supply Information

The Department asks us to modify our conclusions with respect to the issuance of statutory penalties for two failures of the Company to provide requested documentation: the failure to give Mr. Avery access to documents; and the failure to produce Mr. Clayton's workpapers. The Department disagrees with the conclusion in our June 16 Order that these represented discovery violations, and instead contends that these were both violations of direct Board Orders.<sup>28</sup> We decline to so modify our Order. Even if subject to Board Orders, these were still discovery violations; as we stated in the June 16 Order,<sup>29</sup> we believe that such violations should, as a matter of discretion, initially be addressed through the discovery rules. Nevertheless, in appropriate circumstances, we believe that Section 30 penalties could be assessed for failure to comply with discovery orders.

The Department's Motion also requests that we schedule a hearing regarding the failure to supply certain documents to Mr. Laskow.<sup>30</sup> However, at the July 16 oral argument, the Department withdrew this request, and both the DPS and Citizens agreed that the Board need not convene a hearing prior to deciding whether the Company should be penalized under 30

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27. DPS Motion at 5-6, *quoting* Order of 6/16/97 at 275.

28. DPS Motion at 6-7.

29. Order of 6/16/97 at 299.

30. DPS Motion at 6.

V.S.A. § 30 for its failure to provide the information to Mr. Laskow.<sup>31</sup> We will address this issue in a separate Order.

#### IX. Modification of Terms of Probation

In its July 10 Response, Citizens requests that we clarify the procedures for setting the final terms of probation, and that we allow the parties to assist us in setting those terms.<sup>32</sup> We have scheduled hearings for September 9 and 10, 1997, to address these issues. As the parties should by now be aware, at the hearings they will be allowed to present evidence and argument on what should be included in the final terms of probation. Subsequent to those hearings, we will issue an Order setting out the final terms of probation.

#### X. Transmission Plant Disallowance

At the July 16 oral argument, the Villages requested that we clarify the \$1,592,444 rate base reduction that we ordered for irregularities in the Company's transmission plant accounts; specifically, the Villages ask that we clarify whether the adjustment is only for retail ratemaking purposes, or is instead also to apply to the Company's books and records.<sup>33</sup> The reduction that we ordered is only for retail ratemaking purposes. Any necessary corrections to the Company's books and records should be determined based on the transmission plant audit that is to be conducted.

#### XI. Miscellaneous Corrections

The Department requests that we correct several typographical and other minor errors in our June 16 Order.<sup>34</sup> No party has objected to these corrections. We grant the Department's request, and make the following corrections to our June 16 Order:

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31. Tr. 7/16/97 at 38-39, 42, 45.

32. Citizens Response at 11-12.

33. Tr. 7/16/97 at 49-52.

34. DPS Motion at 7.

1. On page 144, line 3 of Finding 413, the word "structure" is inserted immediately after the phrase, "wooden switching."
2. On page 174, Finding 525, the reference to "Power Technologies Inc." is changed to "Power Engineers Inc."
3. On page 228, line 2 of Paragraph 1, "furtr" is corrected to "further."
4. On page 238, Finding 813, the references to exhibits are corrected to read, "Exh. DPS-SL-5; exh. DPS-SL-6."
5. On page 244, line 2, the word "been" is deleted.

SO ORDERED.

DATED at Montpelier, Vermont, this 28th day of August, 1997.

<u>s/ Richard H. Cowart</u>	)	
	)	PUBLIC SERVICE
	)	
<u>s/ Suzanne D. Rude</u>	)	BOARD
	)	
	)	OF VERMONT
<u>s/ David C. Coen</u>	)	

OFFICE OF THE CLERK

FILED: AUGUST 28, 1997

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 of any technical errors, in order that any necessary corrections may be made.*

*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.*