STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 5983

Tariff filing of Green Mountain Power	)
Corporation requesting a 16.715% rate	)
increase, to take effect July 31, 1997	)

Order entered: 6/8/98

ORDER RE: MOTION TO RECONSIDER

I. INTRODUCTION

On March 20, 1998, Green Mountain Power Corporation ("GMP" or "Company") filed a motion asking the Board to revisit and reconsider several issues addressed in the final rate Order in this docket (hereinafter referred to as the "Rate Order").[1] Responsive filings were made by the Department of Public Service (the "Department" or "DPS"), International Business Machines Corporation ("IBM"), the Vermont Public Interest Research Group ("VPIRG"), the Vermont Grocers' Association, the Vermont Electricity Consumers Coalition, and American Skiing Company.

In today's Order, the Company's motion is granted in part and denied in part. The elements of this Order are summarized below.

In its filings, the Company asserts that the Rate Order creates immediate financial hardship due to the manner in which certain financial and accounting principles are addressed, and requests that we revise or restate our rulings on these points to avoid invoking those accounting rules. We grant these requests, and make clear what we stated at our most recent hearing on this issue: our Rate Order was based on evidence that the allowed rates would permit a positive cash flow, profits on utility operations, and the continued provision of adequate and reliable service. We have not intended in this docket to precipitate the financial insolvency, much less the bankruptcy, of the Company. And, as the Company stated at oral argument, except for the need to reiterate

1. The Board signed the Order on February 27, 1998. It was returned from the printer and released to the parties and the public on March 2, 1998.

that our ratemaking treatment for the Hydro-Quebec Contract was provisional, the Rate Order did not create an immediate financial crisis for GMP.[2]

As a means to assist the Company, its customers, and its financial partners, in today's Order we take the following steps: (a) we revise the treatment given to $9.1 million in power cost credits received by GMP in 1997, and adopt the accounting treatment sought by the Company and the Department; (b) we clarify our intent to reserve to the future the ratemaking treatment for costs associated with the clean-up of the Pine Street Barge Canal Superfund site; (c) we set out in broad terms the bases for determining the power cost allocation adopted in this proceeding, emphasizing that it is not the mechanical result of a particular formula, but rather reflects our consideration of several methods of analysis, including that recommended by the Department; and (d) we reiterate, as stated in the Rate Order, that the power cost exclusion set here is provisional, and will be revisited in further proceedings.

We do not, however, amend the dollar amount of the power cost disallowance established in the Rate Order for the current rate period. Our goal in this proceeding has been to fashion a remedy for excessive power costs that fairly balances the interests of both the Company's shareholders and its ratepayers. In view of all of the relevant evidence demonstrating the imprudence of the Company's actions leading up to the Contract "lock-in" in 1991, and the non-used-and-usefulness of the Contract over its entire life, we conclude that an exclusion of $5.48 million in power costs associated with the Hydro-Quebec Contract is just and reasonable. We have tested this figure using five different methods of calculating reasonable power cost adjustments, including the methods recommended by the Department, IBM, and the independent investigator, and the method used by the Board in the 1987 *Seabrook* decision. The adjustment in this docket is squarely within the range of results suggested by all five of these methods.

We recognize that $5.48 million is a significant sum, but it is still a small fraction of the total cost of Hydro-Quebec power which, even after recent mitigation efforts, is over $39 million in the rate year. On an after-tax basis, this exclusion will result in a reduction to the Company of approximately $3.2 million in net lost income during the rate year, while the ratepayers will pay approximately $33.5 million. Thus, the effect of our Order has been to assign to GMP's shareholders approximately 10% of the current cost of the Hydro-Quebec Contract, while the

2. As GMP stated, "if the methodology and measures are intended by the Board to be provisional and applicable in the current proceeding, we don't have a problem." Tr. 4/13/98 at 126.

ratepayers will continue to pay the remaining 90%. In the context of an overall cost of service of over $160 million, and annual profits from utility operations of approximately $9 million, we conclude that the power cost adjustment ordered here reflects a fair balance of the interests of GMP's equity investors and its customers for the current year.

In view of the broad public interest in the Hydro-Quebec Contract and its substantial cost, and the continuing nature of the challenges it poses to Vermont utilities, customers, and to the Vermont economy, we judge that it is appropriate to speak plainly on certain aspects of the situation we all now face.

As a starting point, it is our duty to make it clear to all parties and to the public that our decisions regarding utility rates will not be directed by political pressure or public relations campaigns. This proceeding has involved the parties and the Board in the examination of a complex factual record. We heard the testimony of 49 expert witnesses over the course of 30 days of technical hearings, and reviewed a written record of more than 13,500 pages. Our decisions in this proceeding have been, and will be, decided upon the basis of the evidence in that record, regulatory precedent, and the law of Vermont. We will not decide this matter, or any rate case, on debates outside of the hearing room, or on assertions of the parties not grounded in the law or the evidence in the record.

In this context, we remind the parties that it will not be productive to present to the Board and the public claims about costs, rate and environmental impacts, or financial effects that are not based on a solid factual foundation. Some of the public statements made in connection with this Docket seem at variance with representations made in formal financial filings, or in the hearing room. Vigorous advocacy is, of course, a Vermont tradition — however, it will exact a price in public misunderstanding if not factually grounded and tempered by a genuine desire to reach solutions to challenging problems.

Finally, the record of this docket and other similar proceedings convinces us that the public good will be best advanced, not through the simple allocation of excessive power costs between utility shareholders and ratepayers, but through the creative process of mitigating and reforming Vermont's historic power supply arrangements. Electricity industry restructuring may offer some new opportunities to restructure and mitigate expensive power supply costs, but it is by no means the only way to do so. Vermont utilities and their suppliers have previously explored several potential mechanisms to mitigate excessive power costs. A number of parties, including the Department, have been working to this end; accomplishing it will require continuing creativity, hard work, and good will. We urge the parties to these dockets, and others — utilities and power suppliers both inside and outside Vermont, customers, and public officials — to explore aggressively the means of mitigating Vermont's rising power costs, including those resulting from decisions made by the Vermont Joint Owners in 1991. To this end, the Board intends to convene, within the next sixty days, a forum on electricity futures, in which we will solicit suggestions from a broad range of participants as to how cost reduction initiatives can best be advanced. The Board will provide all appropriate assistance to call forth mitigation proposals, to evaluate them rigorously, and to support reasonable solutions for the economic benefit of Vermont and the general good of the state.

II. Rulings on the Motion

A. Cost of Capital

GMP asks that the Board reconsider our ruling that 11.25 percent represents a fair and equitable cost of capital for the Company, and instead set the Company's return on equity at 12.0 percent.[3] GMP cites to three "new" risks that the Company asserts were not included in the evidence previously considered. Those "new" risks according to GMP are (1) the finding of imprudence of the lock-in of the Hydro-Quebec Contract and the imposition of a twenty percent disallowance of Contract-related power costs associated with that imprudence, (2) the finding that a portion of the Hydro-Quebec Contract is not used and useful and the imposition of a $3.68 million disallowance associated with that finding, and (3) the finding that GMP transferred assets to GMER without adequate compensation to ratepayers and the imputation of 5 percent of the value of GMP's equity interest in GMER as an obligation of the Company to compensate ratepayers for this transaction.

GMP's argument, that these are "new" risks that must be considered as *evidence*, is not persuasive. First, as explained in some detail below, these assertions overstate the reasoning and effect of the power cost disallowance ordered in this proceeding.[4] More importantly, these are not new risks facing the Company; they are the consequence of utility regulatory principles of

3. This is a change in the Company's original position in which they requested a return on equity of 13.0 percent. GMP motion at 21.

4. The Motion refers to a 20 percent or $9.4 million prudence disallowance and a $3.68 million used-and-useful disallowance. However, the Order imposed a total disallowance of $5.48 million on both principles.

which shareholders are well-aware, and for which shareholders have been compensated in the return on equity. All utilities in this state operate under the obligations of prudent management, the requirement that power supplies must be used and useful to be included in rates, the requirement to demonstrate known and measurable changes, restrictions on affiliate transactions, and so on. When, as in this case, the evidence supports the exclusion of costs from rates based upon these principles, the exclusion does not create a new risk to the Company, and the remedy does not then become "new" evidence in the record of the case. If that were so, then the historic rate of return has been overstated . Moreover, if the rate of return has to be adjusted after a rate case to take into account the results of the case itself, then each successive adjustment in the rate of return would affect the perceived risk profile of the utility and rate cases could conceivably go on *ad infinitum*.

Since the lock-in of the Hydro-Quebec Contract in 1991, GMP and other utilities in the state have been well aware that they have borne the risk that Contract costs might not be fully recovered in rates, and have been reminded of this risk in several Board orders.[5] The financial markets and GMP's investors have had considerable time to factor in this risk; GMP cannot now argue that somehow this is a "new" risk from the perspective of its financiers. And we do not accept the argument that the Company's return on equity should be raised to compensate shareholders for the effects of the Company's imprudence; this would stand prudence as a ratemaking principle on its head.

Thirdly, the transfer of assets from the regulated to the unregulated side of the business was a decision made strictly by Company management. It is, of course, part and parcel of the new business venture which also brought the Company, at low cost, a major equity share in a new business, financed largely by outside capital. These developments may affect the Company's risk profile both positively and negatively;[6] in either event, they are the result of management decisions concerning unregulated activities. An adjustment to regulated rates to reflect the value of the assets transferred is not a "new" risk, nor is it an appropriate basis for a cost of equity adjustment in this docket.

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5. See Rate Order, findings 107, 545, and 549.

6. On the one hand, entry into promising lines of business may position the Company well for the future. On the other hand, the Company's recent experiences with unregulated lines of business have been mixed; over the past five years the Company has earned much lower returns from its unregulated subsidiaries than from its regulated electric services.

Finally, GMP has had adequate opportunity to present evidence on these matters and to rebut the positions of the Department and IBM that the Company's return on equity should be at or below that which we allowed in our Order. IBM's witness recommended a cost of equity of 10.6 percent and the Department's witness estimated that the Company's cost of capital was in the range of 10.25 to 11.25 percent. The disallowances that GMP cites as "new evidence" were based on positions of parties in the case itself. GMP had an adequate opportunity to present rebuttal evidence on the potential adverse effects of these disallowances during the hearings, and to show the effects that could, as the Company argues now, flow from the imposition of returns in that range. After reviewing the record evidence, we set the cost of equity at the high end of the recommended range.

The Department, in its reply to GMP's motion for reconsideration, endorses the allowed return of 11.25 percent for the Company as fair and appropriate, and fully supported by the evidence. The DPS asks that, if the Board reconsiders its decision, we reopen the record on this matter before changing our ruling.[7] IBM and the American Skiing Company ask us to reject GMP's motion for reconsideration on this issue. While in its response to IBM and the DPS, GMP asserts that it would welcome the opportunity to provide proof on this matter, in fact, GMP declined our suggestion that the record be reopened should the Company wish to submit new evidence on this or other matters.[8] The 11.25 percent return on equity included in the Order is reasonable, was based on substantial evidence, and need not be amended.

B. FERC Headwater Benefits

GMP argues that it should be allowed to recover FERC headwater charges. The basis for the Company's claim is that it has received a bill for these charges; thus, the bill from FERC is known and measurable. GMP asserts that the Board's denial of continued amortization of these costs stands the known and measurable standard "on its head."[9] The Department concurs with the Board's decision.[10] IBM took no position on this matter on reconsideration.

We agree with the Department. While GMP argues that receipt of a bill from FERC for $838,000 for headwater benefits is a known and measurable change, the Company's own witness

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7. DPS reply at 14-15.

8. GMP reply at 14.

9. GMP motion at 10.

10. DPS reply at 6-8.

testified that GMP's position before FERC is that it does not owe FERC the $838,000; nor has GMP paid any of this bill. Thus, although GMP may have been billed by FERC, GMP is contesting the charge and does not plan to actually pay it during the rate year. Therefore, the record shows that the known and reasonable cost to GMP for FERC headwater charges in the rate year is zero. As the Department notes, to impose this cost on ratepayers at this time is essentially asking ratepayers to prepay an amount that may never have to be paid.[11]

GMP also argues that the Board erred by leaving open the question of future rate treatment for FERC headwater benefit payments.[12] We do not agree. Once those costs have become known and measurable, and are subject to examination, we will be able to evaluate their rate treatment. We are not able to do so on the present record. As stated in our Order, "the Company remains free to request rate relief [for FERC headwater charges] in subsequent cases if it can demonstrate that the charges are known and measurable."[13]

C. Pension Fund Issues

1. Pension Instruction

The Rate Order included a requirement that GMP notify the Board prior to making any disbursements from its pension funds outside of the normal course of business. GMP claims that this requirement is erroneous and should be modified. The Company first argues that the requirement to provide notice was not an issue at the hearings and thus should not be included in the Order. This assertion is not supported by the record. On several occasions, the Board heard testimony from GMP witnesses that addressed the pension funds.[14]

The Company also asserts that ERISA prevents the Board from ordering GMP to provide such notice, which, according to the Company, constitutes the Board assuming authority over the pension trust. However, the Company has not cited to anything in the record nor in ERISA or cases thereunder that support its position.

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11. *Id* at 7.

12. GMP cites to 3 V.S.A. § 812 requiring the Board to include a ruling on each proposed finding. The Supreme Court has ruled that the Board is not required to rule individually upon each request as long as the record shows that each proposed finding was considered. *In re Village of Hardwick Electric Company*, 466 A.2d 1180, 445, (1983). Since GMP did not specify the proposed finding it implies that the Board has not acted upon, we cannot respond on point. However, as the Order properly notes, "Proposed findings not consistent with the following are hereby rejected." Order at 35.

13. Order at 74.

14. See, tr. 11/3/97 at 70-74 (Griffin); tr. 1/7/98 at 206 (Griffin); Dutton reb. pf. I, 11/24/97 at 8.

Finally, GMP claimed that the Order was overly broad in that it would require that the Company obtain approval of disbursements from the pension fund for the normal course of business for its unregulated enterprises. The Department recommended that the Board modify the Order, so that instead of obtaining approval prior to disbursements, GMP would instead provide advance notice of disbursements outside of the normal course of business.[15]

On this point, we are persuaded by the parties' comments. Consistent with the Company's assertions during hearings that "GMP will not use overfunding in the pension fund to plan to provide capital funds for GMER or any other business venture,"[16] the Order was intended to ensure that GMP provide notice of such disbursements. However, GMP is correct that our instruction is overly broad in that it would require GMP to obtain Board approval for many disbursements from the pension fund, including disbursements made in the normal course of business for its unregulated enterprises.

We, therefore, modify this requirement in two ways. GMP will not be required to obtain prior approval for disbursements outside of the normal course of business; instead, the Company shall notify the Board within ten days of the time the Company makes such a disbursement. In addition, the notification requirement applies only to disbursements outside the normal course of business for the regulated Company or its unregulated affiliates covered by the pension fund. This modification will ensure that the Department and the Board receive adequate notice that the Company has used pension funds outside of normal uses, thus allowing either agency to initiate any further inquiry that might be called for. At the same time, the narrowed instruction will eliminate the unnecessary and unintended prior approval requirement.

2. Pension Disallowance

GMP, in its motion for reconsideration, argues that the Board has no jurisdiction to impute to the pension fund the full value of GMP's pension funds in the amount of $585,000 that were used by the Company to enhance the benefits for a group of twenty-six employees of the regulated parent corporation, who left the employ of GMP to work for an unregulated affiliate. IBM, in response, points out that, if the Board were preempted on this issue, then we could make

15. DPS Reply Comments at 12.
16. Dutton reb. pf. I, 11/24/97 at 8.

no determinations of rate recovery for *any* of GMP's pension expenses.[17] GMP cites generally to a lack of Vermont statutory authority as well as controlling federal authority for its jurisdictional argument.

We do not agree with GMP's arguments that the Board has no statutory authority to require the imputation of pension costs in the future as a means of compensating ratepayers for the transfer of pension assets to the unregulated side of the business.[18] Under 30 V.S.A. § 218(a) the Board may order or make changes in a company's rates or practices so that the resulting rates are just and reasonable. There are many possible mechanisms to achieve this result.[19] Here we seek to ensure that ratepayers will be appropriately compensated for the value of the enhanced benefits that were provided to employees who left the regulated company for GMER.

GMP also contends that there are factual infirmities in the Board's decision. First, GMP argues that, because the Company's pension fund covers all employees and thus includes funds contributed by shareholders, there is no legitimate basis for the Board's imputation of any of its pension funds. Second, GMP argues that, because it did not seek recovery of any pension costs in this case, there is no present cost to disallow.

The Department endorses the objective of protecting ratepayers from having to incur any of the costs of added pension benefits given to induce employees to transfer to the Company's unregulated affiliate, but recommends that we modify the Order. Since the Company requested no recovery of pension costs in the present case, the DPS believes that the Board's imputation of pension costs associated with the GMER pension enhancements will not adequately protect future ratepayers from incurring costs associated with the Company's actions. Instead, the Department recommends that the Board implement an accounting mechanism to ensure that the $585,000 will not be paid by GMP ratepayers in the future.[20] IBM asks the Board to reject the Department's proposal and uphold its original decision.[21]

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17. IBM reply at 31.

18. We need not determine what authority state regulatory commissions may have to direct utilities' management of pension funds. It is undisputed that this Board, like other state commissions, has the responsibility of determining which salaries and benefits, including pension costs, should be included in regulated rates. We note that GMP provides no citations in support of its assertion that the Board is preempted or lacks authority for the ratemaking treatment of GMP's pension fund.

19. *In re Green Mountain Power Corp.*, 142 Vt. 373, 455 A.2d 823 (1983).

20. DPS reply at 12-13.

21. IBM reply to DPS at 11-12.

Before addressing GMP's specific claims of error, it is important to recall the purpose of the pension fund adjustment. A number of employees working in GMP's regulated operations were encouraged to transfer to the new, unregulated GMER. As part of the solicitation to these employees, GMP offered an enhancement to their pensions, which the Company testified had a value of approximately $585,000.[22] As we stated in the Order, this use of the pension fund to enhance the benefits of employees who departed GMP for an unregulated affiliate represents part of the value that the regulated side of the business transferred to GMER, without compensation to ratepayers. If anyone will benefit in the future from GMP's venture with GMER, it will be GMP's shareholders. Therefore, it is appropriate to compensate the regulated side of GMP's business for the value of the transfer, so that ratepayers do not pay the costs of the incentives paid to encourage employees to move from the regulated to the unregulated side of the business.

The parties presented a broad range of recommendations to compensate ratepayers for the GMER transaction. The adjustment to rates in the Rate Order, $117,000,[23] was intended to provide part of this compensation.[24] This adjustment was not a disallowance of the recovery of pension costs. As GMP correctly states, the rate filing contained no costs associated with pensions, due to the fact that the pension trust is currently overfunded.[25] Therefore, the Order imputed revenue to retail rates reflecting the value of the pension enhancements to GMP employees departing for GMER.[26]

After reviewing the arguments of the parties, we see no basis to alter the basic premise of the Rate Order — that ratepayers should be compensated for the value of assets, including the pension enhancements, transferred to GMER. The Order imputed revenues into GMP's rates as compensation for the value of assets transferred. The pension fund enhancement was simply one of the means by which we valued these assets.

The Department and GMP have persuaded us, however, that it may be preferable to establish a deferral account rather than making a $117,000 adjustment in this case. This approach protects present and future ratepayers from absorbing any of the enhanced benefits that were granted to GMER employees. Thus, we will require GMP to set aside $585,000 in a separate

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22. GMP's witnesses made it clear in their testimony that the pension fund would make the payments to employees who left GMP for GMER. Tr. 11/3/97 at 68-69 (Griffin); Dutton reb. pf. V at 3.

23. This represents the $585,000 amortized over five years.

24. GMP did not ask the Board to reconsider other adjustments related to the transfer of assets to GMER.

25. Order at 164.

26. The Order also did not require GMP to take any of these monies directly from the pension fund.

deferral account. In the next rate case in which GMP asks ratepayers for recovery of contributions to the pension fund, GMP shall first draw down the full amount set aside in this deferral account, before recovery of any further pension costs is granted by the Board.[27]

GMP's comments raised one other issue. GMP correctly points out that the pension fund covers all employees, including those in GMP's unregulated affiliates. This fact, however, does not lead inexorably to the conclusion that we should not impute to the benefit of ratepayers *any* of the value of the pension enhancement. Even though the pension fund covers all employees, it is appropriate to take steps to ensure that GMP's regulated ratepayers do not pay for the pension enhancement through retail rates. While it may be appropriate to adjust the amount of the compensation to reflect the fact that part of the pension fund was derived from contributions by GMP's unregulated operations, GMP presented no evidence on what portions of the pension fund have been contributed by ratepayers and shareholders respectively. In the absence of such evidence, the record supports the inclusion of the $585,000 in the deferral account. GMP may, in future rate proceedings, submit evidence on the proportion of the pension fund provided by unregulated operations, and the deferral account ordered here will be adjusted accordingly.

D. Payroll Issues

1. Payroll

GMP asks for reconsideration of our decision with respect to payroll costs, arguing that the Board's use of the Company's expense ratio of 62.74 percent, in conjunction with a reduction in headcount, results in double counting for purposes of calculating payroll expense. In its original filing, GMP calculated payroll costs based on a headcount of 345 employees. GMP acknowledges that this headcount did not reflect a known and measurable change that occurred after the Company's filing; twenty-six employees left GMP for the Company's unregulated affiliate, GMER. In its testimony, GMP asserted that it would replace thirteen of the departing employees.

In the case-in-chief, the Department argued for removal of all twenty-six positions based on information it was given in discovery. The DPS asked us to reduce headcount by all twenty-

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27. Alternatively, since in this transaction GMP conferred a benefit on GMER, should GMER provide GMP with compensation for this transaction and GMP wished to do so, it could prepay the deferral account and remove it from the Company's books.

six GMER positions, and also to use the historic five-year average expense ratio up through the end of 1996. The Company also recommended use of a five-year average expense factor, but relied on an average calculated through March of 1997. The DPS argued that if the Board accepted the Company's claim in rebuttal that five of the GMER positions had been filled, then the DPS would accept that higher headcount and the resulting higher payroll costs. The Department never went so far as to recommend inclusion in payroll of all thirteen of the GMER positions that the Company claimed would be replaced.

We accepted GMP's attestation that it would fill thirteen of the vacant positions during that rate year and treated this as a known and measurable change, ordering a reduction in headcount to reflect thirteen of the twenty-six employees who would not be replaced. We also considered evidence on the appropriate payroll expense factor to use for the rate year and accepted the Company's expense ratio of 62.74 percent.

In response to GMP's motion for reconsideration, the DPS still recommends use of its expense factor for payroll but provides no further explanation or evidence in the record for the reasons to do so.[28] IBM contests the position of both the Department and GMP, arguing that the Board correctly used the ratio that the Company itself claimed was more indicative of the labor levels at which service will be provided in the rate year.[29] GMP now argues that the Board erred in using both a lower expense ratio and ordering a reduction in headcount from the Company's original request. GMP asks that the Board reconsider and use the historic five-year expense ratio instead.

The Company's argument, that ordering a reduction to headcount and then applying the Company's expense factor is double counting, relies on a presumption that the lower expense ratio, which is below the historic five-year average, was utilized by GMP as a proxy *exclusively* to reflect the departure from the Company of twenty-six employees.

However, GMP's own prefiled testimony belies this claim. GMP's witness offered the following explanation for use of the lower expense factor:

> In light of the changes affecting the utility industry, and the Company's efforts to prepare for participation in a restructured industry, we believe that the lower

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28. DPS response at 10.
29. IBM response to the DPS at 10.

> expense percentage is more indicative of the labor levels at which service will be provided to our ratepayers in the rate year.[30]

The Company's witness also stated at the hearings that the lower expense ratio is a proxy "for recognizing that some costs . . . of GMER in the test year needed to be adjusted for *and* . . . to be more cost competitive in the future." [31]

We took GMP's statements at face value. To accept, as the Company now would like, that the GMER transaction should be the *exclusive* indicator of changes facing the industry in general, and GMP in particular, is not credible. The reasons the Company presented for using the lower expense ratio go far beyond the known and measurable change associated with the departure of one group of employees to GMER. The record shows a distinct trend in declining headcount over the past four years and GMP's witness even acknowledged that " . . . the existence of GMER was a recent short-term phenomenon that lowered the cost of service in the test year."[32]

We conclude that use of the lower expense ratio is warranted and the reasons for its application differ from those that support the adjustment we made to headcount for the known and measurable departure of thirteen employees that the Company concedes will not be replaced. The latter, as the Company admits, is a one-time occurrence. The trend in GMP payroll and the challenges facing the industry in general need to be reflected in addition to this one-time event. Thus, a reduction to headcount and use of a lower expense ratio are both warranted for reasons that stand on their own; they are not duplicative. The Company's motion for reconsideration on payroll is denied.

2. PITW

GMP asks for reconsideration of our treatment of PITW, arguing that the Board used the lower DPS expense ratio of 58.75 percent for PITW, rather than the Company's expense ratio of 64.13 percent, when arguably that lower ratio was used by the DPS to account for the transfer of twenty-six GMP employees to GMER. In its filing for a rate request, GMP had included twenty-

30. Griffin pf. 7/11/97 at 3. See also the following statements by GMP (emphasis added): "*some* of these [GMER related resignations] were already removed in the calculation of the five-year average expense ratio;" and "this effect [of GMP employees charging time to unregulated activities] is *partly* reflected in the five-year expense ratio . . .." Griffin reb. pf. 11/24/97 at 3, 5-6.

31. Tr. 11/3/97 at 39-40 (Griffin) (emphasis added).

32. Tr. 1/7/98 at 205 (Griffin).

six employees who transferred to GMER after the test year. The Department used a lower payroll expense factor than did GMP, to account for the effect of these transfers in the adjusted test year.

The Board's Order allowed GMP to include thirteen of the twenty-six positions attributable to GMER transfers, in its payroll cost of service. However, in the treatment of PITW, the Board did not explicitly account for the lower headcount; rather we used the DPS expense factor of 58.75 percent, accepting the Department's logic that this ratio better reflected the impact of the GMER transfers on PITW costs.

GMP argues that we should not have used the Department's expense factor for PITW, since it fails to account for the Board's inclusion of thirteen of the twenty-six positions granted to GMP in the Board's decision on payroll.[33] In response to GMP's motion, the Department supports the Board's analysis and use of the Department's expense ratio for PITW since the Company's original PITW request was not net of employee reductions. Thus, the Department argues, use of a lower expense ratio is appropriate.[34]

In the compliance phase of this Docket, we agreed with GMP that the treatment of PITW in our Order failed to account for the inclusion of the thirteen GMER transfers that the Company will replace. The Board allowed GMP to correct this oversight in the compliance phase of the Docket, effectively increasing the PITW amount granted in our Order by \$125,048.[35] GMP is now seeking, in this motion, further reconsideration of this matter. Our decision, as amended in the compliance filings, shall stand. Since we already allowed the Company an adjustment for PITW expenses attributable to the thirteen GMER transfers in the compliance phase of the Docket, our decisions on payroll and PITW are consistent. We need not make any further adjustments here.

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33. GMP motion at 14.

34. DPS reply at 11.

35. *See*, GMP letter faxed to the Board on 3/6/98 re: compliance filing which states "The PITW calculation should reflect costs for the thirteen employees allowed by the Board in the Order. The Board used the DPS PITW calculation which did not relect (sic) costs for the thirteen employees. Board staff and the DPS tentatively agreed this was correct. This increases the cost of service by \$125,048;" *see* also, GMP workpapers in support of its compliance filing, faxed to the Board on 3/9/98 at Attachment COS 3-1.

3. Payroll Incentive Plans

The Company objects to our ruling on the incentive pay programs, Order at 94. However, the Company may have read too much into this ruling. We do not conclude that incentive pay plans must be excluded from rates. However, the Company did not effectively rebut the testimony of DPS witness Schultz, who characterized GMP's existing incentive programs as ineffective, expensive, and of benefit mostly to shareholders. Had the Company placed the actual plan into evidence, or shown how employee base pay without the plan payment would compare with industry and regional averages, Mr. Schultz's testimony might have been less persuasive. Based upon the evidence before us, we conclude that our previous ruling was correct.

E. Administrative Notice

GMP has asked us to reconsider our ruling[36] on its motion[37] requesting us to take administrative notice of certain documents. The original motion asked for notice of seven specific items from previous Board dockets: prefiled testimony of four witnesses in other dockets, a position paper by the DPS, and the positions taken by parties to those dockets.

Our Order admitted the prefiled testimony for the purpose of showing that the testimony had indeed been filed, although not for the truth of the matters contained therein. We admitted the DPS position paper, but declined to search the records of the previous dockets to establish the various positions that may have been taken by the parties.

GMP has asked that we 'clarify' our Order, meaning that we grant the original motion. Specifically, GMP requests that we accept the documents for the facts stated therein, not for the limited purpose set out in our Order. The DPS and IBM respond that our ruling on the motion was correct. At oral argument GMP rested upon its brief and made no further comments; nor did any other party.

"Evidentiary matters [in Board proceedings] are governed by [3] V.S.A. § 810." P.S.B. Rule 2.216 (A). That section permits the notice of "judicially cognizable facts." 3 V.S.A. § 810(4). The Supreme Court has interpreted § 810(4) to refer to facts which may be judicially noticed under V.R.E. 201.[38] Subsection (b) of V.R.E. 201 provides:

36. At pages 33–34 of the Rate Order.
37. Dated January 28, 1998.
38. *In re Handy*, 144 Vt. 610, 481 A.2d 1051 (1984).

> A judicially noticeable fact must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned.

The Reporter's Notes give two pages of examples of facts that have been judicially noticed in Vermont. We cannot find that the materials that GMP has asked to be noticed fall within either of the two categories of facts that may be noticed. We did take notice of the fact that four pieces of testimony had been filed with the Board in prior cases, because the fact that a statement was filed can be shown conclusively by recourse to publicly available records. GMP's motion, however, goes far beyond this non-hearsay use. GMP's brief on its motion for reconsideration[39] argues:

> The January 28 Motion asked the Board to take notice of this testimony to show "that costs of power purchased under the VJO/Hydro-Quebec contract were included in the Company's rates" in Docket Nos. 5428 and 5532 (GMP's two previous litigated rate cases), and that in Docket No. 5532 the Department reviewed the Company's power costs and saw no imprudence. January 28 Motion at 1–2. In other words, the Company requested that the Board take notice of the truth of the testimony previously filed before it.

Our Order declined to take notice partly because we could not tell, from what was before us, that the testimony had even been admitted in the previous dockets. GMP responds that "[t]his concern is unfounded" because its motion "did not turn on whether the testimony had been admitted (as opposed to filed) in the prior dockets." We find this to be a remarkable proposition: that the Board should accept a fact as having been conclusively proven (see V.R.E. 201(g)) because a witness for a party has prefiled testimony stating that fact in another case. From the record before us, we cannot tell if the testimony was amended, successfully attacked on cross examination, or later withdrawn.

More generally, it is not clear why GMP has asked the Board to so strain the limits of administrative notice. Witnesses for both the DPS and IBM were available throughout two months of hearings and could have been asked about their prior positions; both parties were also available to respond to a Request to Admit pursuant to V.R.C.P. 36. Finally, it is not clear how the facts GMP wishes to have established through administrative notice would be relevant to the

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39. GMP brief filed 3/20/98.

determination of this proceeding, without raising administrative and evidentiary burdens that would counsel for its exclusion (See V.R.E. 403).

We conclude that our previous ruling was correct.

F. Pine Street Remediation

GMP requests clarification of the Board's ruling on the sharing of costs relative to the remediation of the Pine Street Barge Canal Superfund site.[40] GMP is unclear whether the Board made a determination that costs would be shared, or whether that determination had been reserved for a later case when the costs had actually been incurred. The DPS agreed that the Order should be clarified on this point. Both believed that the Order did not rule on the question of sharing, but suggested that the language could be clearer. IBM's response was that the Order should be clarified to state that the issue had been determined, in favor of sharing.

Our intent, and we believe the fair reading of our Order, was to reserve for a future docket all issues pertaining to the sharing of remediation-related costs between the Company and its customers. GMP has explicitly acknowledged our authority to reserve an issue for later consideration; we think that such a reservation is especially appropriate when, as here, there are presently no costs to be included in rates.

G. Searsburg EPRI Deduction

GMP asks the Board to reconsider our decision to reduce ratebase to reflect funds that GMP expects to receive from EPRI and DOE for the Searsburg Wind Project. The Company asserts that this $418,000 deduction was not appropriate because $175,000 had already been deducted from ratebase by GMP, and the $243,000 expected from EPRI and DOE will not be received during the rate year and, thus, is not known and measurable.

The DPS agrees with GMP on this issue, but it wishes to ensure that ratepayers will receive full credit for these funds when GMP receives them. To accomplish this, the DPS suggests that the Board should, when the funds are received, order the Company to book the amount to reduce Searsburg plant balances and accrue an AFUDC credit on the amount until the next rate case. Further, the DPS suggests that this AFUDC amount should be then credited against a DSM deferral account.

40. Rate Order at 68-69.

In its brief, IBM states that it is not able to determine whether the $175,000 was deducted twice as GMP claims, so it takes no position on that portion of the proposed adjustment. IBM states, however, that there is no basis for restoring the $243,000 to ratebase. IBM argues that the Board did not reduce ratebase related to the Searsburg project on the grounds that the EPRI/DOE funds would be received by GMP during the rate year. To the contrary, IBM suggests that the Board was aware that these funds would not be received during the rate year. Rather, the Board reduced ratebase because the receipt of the EPRI/DOE funds represents a "legitimate capital cost reduction that will reduce the projected per kWh cost of the plants' output." (Board Order at 62.) Finally, IBM asserts that GMP is wrong in asserting that the EPRI/DOE funds are not known and measurable because the Company already knows the amount of this funding and when it will be received.

We agree with both GMP and the DPS that ratebase should not have been reduced by $418,000 at this time. It is now clear from review of GMP Exhibit 11 that the ratebase for the wind project had already been reduced by $175,000 to account for EPRI/DOE funds to be received during the rate year. We also concur with GMP and the DPS that, while it is known that GMP will receive the remaining $243,000, this transfer is unlikely to occur during the adjusted test year. Consequently, ratebase should not be reduced during the rate year to account for these anticipated funds. We do, however, agree with the DPS that when the funds are received, the Company should book the amount to reduce Searsburg plant balances, and an AFUDC credit should be accrued on this amount until the next rate case. We also adopt the DPS's recommendation (to which GMP did not object) to credit this amount to a DSM deferral account.

H. $9.1 Million Regulatory Credit

In its motion for reconsideration, the Company asks that we amend our Order with respect to the accounting treatment given to $9.1 million of credits to the cost of service that were received by GMP in 1997.[41] The Company argues that our action "ignored agreements regarding the appropriate uses of such moneys and the Board's own prior treatment of the Company's request to recognize them in a specific manner. In addition, the Board's ruling imperils the Company financially due to accounting requirements that GMP will have to follow unless this

41. Rate Order at 262-265.

portion of the Order is reconsidered."[42] The Company points out that its proposed amendment to the Order will have no revenue impact (*i.e.*, will not affect the level of rates) because the increase in amortization expense that it requires will be offset by the elimination of a corresponding credit (of $719,000) to Contract power costs.[43]

The DPS supports GMP's request, for the reasons put forward by the Company.[44] IBM, however, opposes the motion, arguing, among other things, that earlier agreements and accounting orders did not bind the Board to specific ratemaking treatment of the $9.1 million and that, furthermore, the Board's decision on February 27th was entirely consistent with the evidence in this docket.[45]

The question before us is whether the requested accounting treatment of certain cash receipts in a particular period should have later ratemaking effect. In this instance, GMP received $9.1 million in payments from Hydro-Quebec in 1997 (under the terms of two sell-back arrangements) and asked to book those monies as credits to income in 1997 and 1998. The Company asserts that doing so deferred the filing of a request for, and ultimate implementation of, an increase in rates in 1997. First, the Company contends that it was the intent of the settlement in Docket 5857 that a payment of $1.1 million was to be booked to income for the period June 1, 1997, to May 31, 1998. Second, GMP maintains that, under the terms of its request for an accounting order, issued by the Board on December 31, 1996, the entirety of an $8.0 million payment was properly booked to income in 1997.[46]

In our Order, we concluded that "[i]t is by no means certain that, in the absence of those payments, GMP would have filed for a rate increase or, more importantly, have been awarded the increase sought."[47] We also concluded that, because GMP had obligated itself to higher future costs of HQ power in return for the $9.1 million in up-front payments, it was appropriate that future ratepayers (who will be paying those additional costs) also receive a share of the benefits associated with them; consequently, for ratemaking purposes, we directed the Company to

42. GMP Motion at 5.
43. *Id*.
44. DPS Response at 4-5.
45. IBM response at 20-26.
46. GMP Motion at 5-7.
47. Order at 265.

amortize the credits (*i.e.*, the benefits) over the periods during which their corresponding costs would be incurred.[48]

We must begin by reaffirming the bases for the Rate Order. The evidence amply supports the ratemaking treatment given these credits, which was consistent with our long-standing policy of matching benefits and costs over the appropriate time period. Moreover, we must emphatically state that nothing in either the Docket 5857 stipulation or the December 31, 1996, accounting order required that the two payments be treated, *for ratemaking purposes*, as credits to income in 1997. Indeed, the stipulation does not even address the issue;[49] and the accounting order explicitly states that it (the order):

> is limited to the accounting treatment for the subject costs and revenues and does not bar any party from contesting, or the Board from determining, or disallowing, the reasonableness or prudence of such costs, or the ratemaking treatment for such revenues, in whole or part, in any rate proceeding.[50]

GMP asked for and received an accounting Order with this language included; it accepted the language and the Order and did not at any time inform the Board that it would rely upon the Order in future rate proceedings (*i.e.*, that it interpreted the quoted language as meaningless). There can be no argument that, in reaching its decision in this docket, the Board acted entirely within the reservation contained in the accounting Order, and reached a conclusion that was fully supported by the evidence.

We do not accept GMP's implied contention that accounting orders and other similar rulings have precedential effect for later ratemaking. This would plainly be at odds with Vermont statutes and case law, as well as the condition quoted above.[51] Under 30 V.S.A. § 221, the Board is authorized to issue accounting orders; notice and opportunity for hearing are not

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48. *Id*.

49. With respect to the $1.1 million payment, the Company states that "it asked the Department of Public Service to provide a letter for consideration by the auditors reflecting that it was the intent of the parties in settling Docket No. 5857 that . . . $1.1 million would be booked to income 'to reduce rate requirements'" in 1997. GMP Motion at 6. On April 2, 1996, the Department sent a letter to GMP stating that it was the DPS's intent that the $1.1 million payment be wholly credited to the Company's income in 1997. *Id*.

It goes without saying that no agreement among parties or unilateral statement by one can bind the Board in later proceedings. IBM argues, rightly, that the Department's letter is irrelevant in this context. IBM Response at 22. The DPS's letter cannot have been presumed by GMP or its auditors to have constituted a commitment of any kind to treat the $1.1 million payment as a credit to income in 1997, for the purposes of setting rates.

50. Letter Requesting Accounting Treatment of Certain Costs and Revenues, 12/31/96, at 3.

51. GMP dismisses the quoted condition as "boilerplate." However, from the Board's perspective, the language was an essential component of our willingness to grant the accounting Order, and others that contain similar language. We use streamlined procedures precisely because we do not intend accounting Orders to be dispositive of the ultimate ratemaking treatment, as reflected in the "boilerplate" condition.

necessarily required. We must stress that, in the absence of full notice and opportunity for hearing on a request for an accounting order, such an order will not have final effect in a later rate proceeding under 30 V.S.A. §§ 225-227, and it would be wrong for any party to think otherwise. On this basis, we would decline to amend the Rate Order.

We are, however, concerned about the potential for unintended financial consequences to flow from our earlier decision in this docket. Regulatory treatment of the credits for ratemaking purposes may have accounting impacts that will affect the Company's cash flows and creditworthiness. We conclude that the uncertainty surrounding this possibility is sufficiently high so as to counsel an alternative approach to the credits, one that satisfies the Company's concerns without adversely affecting ratepayers. Therefore, we amend the Rate Order in the manner GMP recommends — by recognizing an increased amortization expense and an offsetting elimination of the credit to Contract costs.[52]

I. Hydro-Quebec/VJO Contract

GMP requests that we reconsider several aspects of the portions of our Order ruling that the Company's lock-in of the HQ/VJO Contract was imprudent and that the Contract was not used-and-useful under well-established principles of utility ratemaking. GMP does not request reconsideration of our basic findings and conclusions on these issues. Instead, the Company argues that our decision threatens GMP's financial situation, creates a bankruptcy risk, requiring us to recognize an increase in the cost of capital otherwise found just and reasonable, and that we incorrectly calculated the appropriate disallowance. We address each of these issues here.

<u>1. GMP's Financial Health</u>

The Company's Motion for Reconsideration states that our Order "seriously jeopardizes GMP's financial health."[53] GMP informs us that our Order caused it to disclose to shareholders "the prospect of write-downs that would be far in excess of the Company's shareholder equity."[54] GMP goes so far as to suggest that we must adjust the return on equity to signal investors that

52. GMP Motion at 8.
53. Motion for Reconsideration at 1.
54. *Id*. at 2.

"the Board does not intend to deliberately force GMP and Vermont's other utilities into bankruptcy."[55]

However, in its Reply Comments and at Oral Argument, GMP significantly ameliorated these statements. Although the Company expressed concern over its cash flow, it also acknowledged that it "does not have one foot in Bankruptcy Court."[56] The Company continues to be able to borrow money to finance utility operations.[57] GMP's concerns over bankruptcy, in fact, relate solely to the question of whether the Board's Order will trigger an immediate writeoff under Financial Accounting Standard ("FAS") 5 of an estimate of the entire imprudent and non-used-and-useful costs of the Contract over its remaining life. As GMP made clear, the need for a FAS 5 write-off depends upon a number of factors, including our willingness to reexamine the methodology for calculating the disallowance in the subsequent proceeding outlined in our Order.[58] To the extent that the disallowance in this proceeding is provisional, with parties reconsidering both the amount and methodology in future proceedings, FAS 5 is unlikely to be triggered.[59] As GMP stated, "if the methodology and measures are intended by the Board to be provisional and applicable in the current proceeding, we don't have a problem."[60]

The Department and other parties disagreed with the Company on the potential bankruptcy risk associated with the exclusion of some Contract-related costs from rates. The Department echoed GMP's later comments, arguing that FAS 5 would not be triggered by a provisional disallowance. The Department concluded that the Order did not have the effect of causing write-downs under the financial accounting rules.[61] In addition, the Department made clear its view that the level of disallowance we ordered in this proceeding, although larger than its final recommendation,[62] does not materially affect the Company's financial viability.[63] IBM also counters that there is no evidence that the Board's Order "imperils the utility's financial

55. *Id*. at 21. We address the adjustment to the ROE below.

56. Tr. at 45.

57. Tr. at 52. As the Company stated "the cash flow situation that the Board's Order has created for us is being rectified at the moment by our ability to continue borrowing from these banks."

58. Tr. at 16.

59. Tr. at 125-6.

60. Tr. at 126.

61. Tr. at 65, 127; however, the Department's Reply Comments suggested if the Board changed its methodology, so that the disallowance increased, it could have "severe financial consequences." Department Reply Comments at 2-3.

62. The Department originally recommended a disallowance of $4.8 million in Contract-related costs, but later reduced this amount to $2.7 million. See also note 32.

63. Tr. at 59-60.

integrity."[64] IBM pointed to evidence from the record that it states show that neither FAS 5 nor FAS 71 will be triggered by the Board's Order.

As the parties to this proceeding know, we take the concerns expressed about potential bankruptcy or financial insolvency very seriously.[65] Our goal in the Order was, and is, to fashion a remedy that fairly balances the interests of the Company's shareholders and its ratepayers. To that end, the Order established rates that would permit a positive cash flow, continued profits on regulated utility operations, and the continued provision of reliable service.[66] The evidence presented by the parties demonstrated that the Rate Order would achieve that result and would not create the severe consequences suggested in GMP's initial Motion for Reconsideration.

The Company's clarifications at Oral Argument demonstrate that the Order's possible impact on GMP's financial integrity stems from the Company's potentially being required under FAS 5 and FAS 71 to recognize in one year the disallowance of Contract-related costs over the remaining term of the Contract. As GMP stated, so long as we make clear that our disallowance of certain Contract costs and the methodology by which we arrive at that result are provisional and will be revisited in the follow-on proceeding, we will not trigger the FAS 5 and FAS 71 accounting treatment. This result, in turn, means that the Order, while certainly significant, will not imperil the financial stability of the Company.

GMP's clarifications are consistent with our understanding of the evidence and with the intent of the Order. That Order [67] states that the disallowance for both imprudence and used-and-useful were intended to apply to the rates for the adjusted test year only, thus ensuring that it would "not imperil the Company's ability to provide reliable service to its Vermont customers pending resolution of power cost questions in future proceedings."[68] Both the amount of any

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64. IBM Reply Comments at 11; AARP and VPIRG did not specifically address the financial health issue.

65. Our concern over GMP's financial situation prompted us to request, at Oral Argument, whether the Company sought additional evidentiary hearings to present evidence on these issues. The Company stated quite clearly that it did not seek to submit additional evidence. Tr. at 51, 121.

66. During the hearing on the motion to reconsider, GMP noted the testimony and evidence of witnesses Kvedar and Williamson, presented during the case-in-chief, describing multi-year projections of cash flows associated with rate increases of different percentages. Tr. 4/13/98 at 47-48, referring to Kvedar reb. pf. 12/8/97 and Williamson reb. pf. 12/8/97. That evidence had been considered by the Board in reaching our original decision.

67. Rate Order at 252.

68. *Id*. at 4. The result reached in these Orders is fair and adequate, on the current record. However, our references to the potential effects of FAS 5 and FAS 71 should not be interpreted as endorsing the Company's interpretation of those rules for ratemaking purposes. Under some of the arguments presented, FAS 5 would supposedly require the Company to declare insolvency immediately, even if we were to issue an order guaranteeing profits on regulated activities for the next twenty years, simply because those profits would not be as high as previously expected. We do not believe that prudent

(continued...)

subsequent disallowance and its methodology will be revisited in subsequent proceedings. Therefore, to the extent that the initial Order created any ambiguity, we today make explicit: the amount of and the methodology by which we calculated the disallowance arising from our conclusion that GMP's lock-in of the Contract was imprudent and that the Contract is not fully used-and-useful is provisional. It applies solely to the rates we establish for the adjusted test year in this case.

2. Method for Calculating Disallowance

GMP argues that we miscalculated the disallowance for Contract-related costs. Specifically, the Company asserts that our calculation of the used-and-useful disallowance was incorrect and failed to follow the methodology set forth in our *Seabrook* decision.[69] GMP also suggests that the Department's approach to calculating the disallowance may "better preserve the status quo" while we move towards final resolution of the issues surrounding the Contract.[70]

The Department, although not agreeing with GMP's specific assertions, nonetheless states that the "Board may have erred in its application of the methodology to this case." The Department argues that the errors arise from the calculation of the imprudence and used-and-useful disallowance over two different time horizons.[71] These errors, according to the Department, cannot be corrected by using the same time frame for both calculations as there are significant problems with using either time period on its own. As a result, the Department requests that we adopt the methodology (although not necessarily the disallowance amount) recommended in its original filing.[72]

IBM argues that we properly calculated both the prudence and used-and-useful disallowances and recommends that we not adjust the Order. IBM also states that the Department's claims of possible error are wrong. VPIRG and AARP support IBM's position.

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68. (...continued)
accounting practices require such illogical results, and do not believe that ratepayers should be held hostage by such assertions. These matters must be fully explored in future proceedings.

69. Docket 5132, Order of 5/15/87.

70. GMP Reply Comments at 5.

71. DPS Reply Comments at 2. Our Order used the adjusted test year Contract costs for calculation of the imprudence disallowance. For the used-and-useful adjustment calculation, we used one year of a calculated average of the above-market costs over the remaining term of the Contract.

72. DPS Reply Comments at 3; tr. at 62.

The American Ski Company ("ASC") supports the Order, responding that GMP's claims of error fail to consider that the imprudence and used-and-useful disallowances measure two different types of harm, so the use of different time periods is appropriate. In addition, ASC points out that calculating the disallowance as GMP recommends would actually double-count the sell-back in determining the disallowance.

Finally, The Vermont Grocers' Association and Vermont Electricity Consumers Coalition both support the final Order.

As explained previously, our task under Vermont law is to establish just and reasonable rates for GMP. Under long-standing ratemaking principles, retail rates should not include the cost of imprudent investments or expenditures, as requiring ratepayers to pay for such expenditures would not result in just and reasonable rates.[73] Similarly, fair ratemaking means that ratepayers should not pay all costs associated with investments and purchases that are not "used-and-useful," but that these costs should be shared between ratepayers and shareholders.[74]

Applying these principles, we have generally excluded the imprudent portion of costs from rates, while requiring a sharing of the non-used-and-useful components of rates.[75] We explained this methodology in our *Seabrook* decision and have applied it in a number of subsequent dockets.[76] However, as we stated in *Seabrook*:

> [t]here is in fact no set formula for determining when losses from uneconomic utility investments should be shared between ratepayers and shareholders, or what the precise proportions of that sharing should be in any particular case.[77]

Moreover, the Supreme Court's rulings have made clear that the establishment of just and reasonable rates is not a rote operation, but rather requires the exercise of discretion, so that we may tailor the remedy to the facts and circumstances of this docket.[78] Exercise of this discretion is important to ensure that we balance our statutory obligation to establish just and reasonable rates with the utility's need to provide adequate service and its interest in earning a fair return.[79]

73. Rate Order at 217-220 and cases cited therein.

74. *Id*. at 242-245 and cases cited therein.

75. See Rate Order at 217-255.

76. Docket 5132, 83 PUR 4th 532 (1987); see cases cited in the Rate Order at 217-220 and 242-245.

77. Docket 5132, 83 PUR 4th 532, 601 (1987).

78. See *In re Green Mountain Power Corp.*, 142 Vt. 373, 380 (1983) ("The statutory basis of the Board's regulatory authority is extremely broad and unconfining with respect to means and methods available to that body to achieve the stated goal of adequate service at just and reasonable rates.").

79. *In re Village of Hardwick Electric Department,* 143 Vt. 437 (1983).

Upon consideration of all of these factors, we conclude that $33.5 million of the Contract-related costs in GMP's filing should be included in rates, while $5.48 million should be excluded, in this proceeding.[80] The evidentiary basis and reasoning for reaching this conclusion are set out below.

a. Range of Recommendations

The parties and expert witnesses here have presented a range of cost disallowances based upon the extensive evidence in the record. The cost of Contract power in the rate year is approximately $46.6 million.[81] The Company has presented estimates that this obligation exceeds current market prices by approximately $24.3 million in the adjusted test year (using the mid-range of the market price projections).[82] While this fact alone does not call for exclusion of power costs from rates, the independent investigator, and all parties except the Company, urged the disallowance of a portion of those costs, upon evidence of imprudence and non-used-and-usefulness of the power. At the lower end, the Department recommends that we exclude approximately $2.8 million from rates in the adjusted test year. At the higher end of the range, the independent investigator presented evidence that would support an exclusion of $11.6 million. IBM argued that the appropriate disallowance was $8.6 million during the adjusted test year. As the Order observes, this range of estimates represents "reasonable measures of the additional power costs incurred by Vermont ratepayers on an annual basis due to the Company's actions; the evidence clearly supports a disallowance within this range."[83]

We recognize that the range of reasonable estimates is broad[84] and that the establishment of a specific disallowance requires the use of judgment to arrive at a fair result. This exercise of discretion is similar to judgments we are often called upon to make on financial factors such as capital structure or the return on equity, or on other appropriate adjustments in rate proceedings based upon a range of reasonable estimates. As the Board observed in *Seabrook*:

80. Under this ruling, on a pre-tax basis, ratepayers would be paying 86 percent of Contract-related costs in the adjusted test year, and approximately 14 percent would be excluded from rates. After consideration of the tax effects of the disallowance, ratepayers will, in fact, pay approximately 90 percent of the adjusted test year costs, while shareholders will pay approximately 10 percent. See page 41.

81. Due to the $7.6 million sell-back, the cost of service contains approximately $39 million for Contract power.

82. Exhibit DPS-60 (BEB-8). After the $7.6 million in sell-back power cost reductions, the above-market adjusted test year power costs using the mid-range of market estimates are still $16.7 million. Thus, before the sell-back the above-market portion of the Contract costs is $24.3 million.

83. Rate Order at 251.

84. All parties, including the Company, agree that all of these proposed exclusions would be smaller than the current and expected above-market cost of the Contract, which is more than $24 million in the adjusted test year.

> [t]he value of good business reputation, an appropriate rate-of-return, the remedy for a breach of contract, the appropriate costs of environmental clean-ups, and compensation for human life itself are all areas where a tribunal must ultimately specify a precise value selected from an inherently broad range of reasonable results.[85]

In this case, although the parties have presented extensive evidence showing that GMP was imprudent and the Contract not-used-and-useful, the evidence does not fix by a mathematical formula the excessive costs to ratepayers or the portion of those costs which should be excluded from rates.[86] GMP, which bore the burden of proving the amount of Contract power costs that should be recovered in rates, requested recovery of 100 percent of these costs, relying on its assertion that it had acted prudently. GMP presented no evidence that would allow us to determine a reasonable level of costs to be included once we reached conclusions on the imprudence and used-and useful issues.[87] The Company thus failed to meet its burden of proof. As Vermont law imposes a requirement that we establish just and reasonable rates, we must exercise judgment to set fair rate levels based upon the evidence in the record. That evidence makes clear that the imprudent decision to lock in, as well as the fact that the Contract is not used-and-useful, has led to significantly higher power costs than ratepayers would otherwise be required to pay.[88] These factors might suggest that *all* of the above-market costs should be excluded from rates. However, in view of the magnitude of Contract costs, and the uncontested fact that, during the adjusted test year, it is worth a significant portion of its present cost, we do not believe it would be fair to the Company simply to exclude the Contract from rates pending further proceedings. For these reasons, we have considered the evidence of all the parties and have weighed several power cost evaluation methods in reaching our conclusions here.

b. Methods of Calculating the Power Cost Exclusion

85. Docket 5132, 83 PUR 4th 532, 587 (1987).

86. We expect that the follow-on proceeding outlined in our Rate Order will gather specific evidence on what would have constituted a reasonable portfolio for GMP to have pursued had the Company not imprudently locked into the Contract in August of 1991.

87. Vermont law makes clear the GMP benefits from a presumption that the items in its cost of service are reasonable. Once sufficient evidence is presented to burst that presumption, which occurred in this proceeding, the burden of persuasion reverts to GMP, which had the obligation to demonstrate the portion of its Contract costs that should be recovered in rates. See Rate Order at 220.

88. These facts are described in the Rate Order at 254 and fn. 460.

There are several reasonable approaches for establishing an appropriate power cost adjustment within the range presented.[89] Each of these approaches produces results that are consistent with our original determination to exclude $5.48 million from the Company's retail rates.[90]

(1) Sharing

The Department and GMP both urge us not to adopt a specific methodology for establishing the disallowance associated with our conclusions on the Contract. One approach is simply to recognize, as the Rate Order does, that the Contract is imprudent and not-used-and-useful, and to require some overall sharing of the costs between ratepayers and shareholders. We have considered and used this alternative, which both the Department and the independent investigator indirectly suggest, in arriving at our decision. Under this approach, we consider the overall allocation of Contract power costs between ratepayers and the Company, as supported by the evidence and the proposals of the participants in this Docket. The record includes a range of reasonable estimates. Of the $39 million in Contract costs in the adjusted test year, the Company seeks 100 percent rate recovery.[91] The Department recommends that ratepayers pay 92.8 percent (or $36.2 million), with the Company absorbing 7.2 percent (or $2.8 million). By contrast, the independent investigator recommended that ratepayers' share of the Contract power costs be reduced to 75 percent due to the imprudence, with the shareholders paying 25 percent. IBM's proposal would yield a similar allocation: 78 percent ratepayers and 22 percent shareholders.

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89. See, *e.g.*., Docket 5132, 83 PUR 4th 532, 587 (1987).

90. Our Order calculated the total prudence and used-and-useful disallowance at $5.48, but gave the Company an offset to this amount for certain credits received by GMP in 1997, which we amortized over a period of time. Because of our decision, discussed below, to not amortize these credits, there is no reason to reduce the disallowance here. The result – an exclusion of $5.48 million – is the same.

91. We have based the sharing percentages upon the power costs in the adjusted test year of $39 million, which incorporates the savings GMP has obtained through sell-back of some power to HQ. Absent the sell-back, GMP's adjusted test year Contract power costs would be $46.6 million instead. We find use of the $39 million figure appropriate as it entails sharing the costs that ratepayers will actually pay for the power that is significantly above-market price. GMP's own analyses indicate that the market-price for this power during the adjusted test year will, in fact, be approximately $22.3 million using the mid-range of power cost estimates developed by GMP. The sell-back may have mitigated the current above-market cost of the Contract, but has not eliminated it.

Thus, the record in this docket supports an allocation of 7.2 percent to 25 percent of Contract costs to GMP's shareholders.[92]

Sharing Percentages (millions)					
GMP Share (%)	7.2 (DPS)	10	15	22 (IBM)	25 (MSB)
Disallowance ($)	$2.8	$3.9	$5.8	$8.6	$9.75

The sharing percentage approach thus produces a range of power cost disallowances between $2.8 million and $9.75 million. The disallowance adopted in this Docket is squarely within this range. Our determination of a reasonable rate adjustment based upon the sharing of costs is not tied specifically to either prudence or used-and-useful or a particular combination of the two; the findings and conclusions on imprudence and non-used-and-useful would *each, independently*, support sharing responsibility for the Contract-related costs within this range.[93] This method of calculating a just and reasonable adjustment to retail rates is consistent with the recommendations of the Department and GMP that we adopt a method for calculating the imprudence in this proceeding that is provisional and that does not employ a specific formula over the life of the Contract.[94] Like the Department's proposal discussed above, it provides a measure of "rough justice" that produces rates consistent with Vermont ratemaking principles without adopting a certain methodology for the future that could potentially trigger an immediate FAS 5 accounting treatment.

<u>(2) Separate Prudence and Used-and-Useful Adjustments</u>

A second method for determining an appropriate adjustment to GMP's power costs is to determine the prudence and used-and-useful disallowances separately. This method flows from the Rate Order's finding that there are two independent bases for disallowing portions of the

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92. In view of our conclusions – that the Contract was imprudently committed to, and is materially not used-and-useful, and that there is substantial financial harm due to these effects – a power cost disallowance of zero is not supported by the evidence.

93. For example, the sharing percentage produced by IBM's testimony, 22 percent for the Company, relied exclusively on the Company's imprudence. Similarly, MSB's 25 percent adjustment to the Contract power costs was based exclusively on imprudence. MSB pf. at 72. The Department's recommendations were based upon concurrent prudence and used-and-useful penalties.

94. GMP Reply Comments at 5. Consistent with our statement above that both the disallowance and the methodology employed herein are provisional, we note that our use of sharing as a means to establish the disallowance and our assessment of reasonable sharing outcomes that divide financial responsibility for the purpose of setting retail rates will be revisited in the future proceedings.

Contract power costs: the Company's imprudence and the fact that the Contract is not used-and-useful under Vermont ratemaking principles. The independent bases for adjusting rates could justify concurrent rate disallowances, as recommended by the Department, or a combination of the prudence and used-and-useful adjustments.[95]

Prudence

The Rate Order concluded that GMP's imprudence had resulted in higher costs than ratepayers would have incurred had the Company pursued a prudent strategy in 1991, terminated the Contract due to unsatisfactory regulatory approvals, and made alternative purchases. As we observed, a prudent resource portfolio would, in all likelihood, have consisted of a mix of resources, including some long-term resources.[96] The evidence in the record, while sufficient to demonstrate that this strategy would have led to significantly lower costs, did not identify the magnitude of those costs savings.

The Rate Order, in calculating the Contract power cost disallowance based upon the *Seabrook* methodology, used one measure of imprudence based upon an approximation of the power cost savings that would have occurred under a prudent resource portfolio.[97] The evidence and the parties' arguments have demonstrated, that basing an imprudence adjustment on estimated power cost savings is not the sole reasonable method. As we observed in the Rate Order, the parties presented several estimates for calculating the imprudence amount, ranging from the Department's \$2.1 million[98] to IBM's recommendation that \$8.6 million be found imprudent and the independent investigator's proposal to disallow between \$9.75 and \$11.6 million.[99] Although the Order did not rely upon any one of these methods, it specifically noted that each presented a reasonable measure of imprudence; in reaching the disallowance in that Order, we considered

95. One means to combine the two adjustments is the *Seabrook* methodology, discussed in the Order and below.

96. Order at 249-250.

97. We reexamine that methodology below, concluding that employing the same method over a broader range of potential power cost savings would support an imprudence adjustment between \$6.99 and \$11.64 million.

98. See fn. 108.

99. The independent investigator recommended that 25% of GMP's power costs be disallowed as a reflection of the likely savings from a prudent resource portfolio. This adjustment can be calculated from the adjusted test year power costs (\$39 million) or the power costs that would have occurred in the adjusted test year had GMP not negotiated the sell-back (\$46.6 million), producing the two figures cited. The Department and IBM each offered its recommendation as an adjustment to the power costs in the adjusted test year (*i.e.*, after the sell-back).

each of these measurements.[100] The record would thus support a disallowance for prudence alone in the range of $2.1 million to $11.6 million.

Used-and-Useful

The Rate Order described the bases for potential used-and-useful disallowance in some detail. The evidence demonstrated, based upon GMP's own estimates of current and future power markets, that in the adjusted test year, Contract power will exceed the market price by between $7.3 million and $22.2 million, *after considering the effects of the sell-back*.[101] Over the remaining seventeen and one-half years of its term, Contract power will exceed the market price by between $87 and $269 million (in 1997 present value dollars). These undisputed estimates lead to the conclusion that the Contract will exceed the market by between $4.97 million and $15.37 million on average annually over its remaining term. After application of the principle that the above-market component of non-used-and-useful investments or purchases should be shared between ratepayers and shareholders, we conclude that an adjusted test year rate adjustment based solely on the used-and-useful calculation in the range of $2.49 million and $11.1 million would be reasonable.[102]

It is important to reiterate that our reliance upon the difference between the Contract price and the power market is for purposes of determining the size of an appropriate power cost adjustment, and not simply for determining whether an adjustment should be made. The Rate Order did not conclude that an investment or purchase was not used-and useful solely because it produced costs in excess of the market price of power for a particular period of time. As the Order states, "[a]n investment or purchase decision has failed when it is not expected to yield net present value benefits, *after consideration of non-price benefits, over its lifetime.*"[103]

Moreover, in the case of the Hydro-Quebec Contract, other factors – which the Board relied upon during Contract approval in 1990 and embodied in subsequent Orders – contribute to

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100. Rate Order at 251.

101. As the Rate Order stated, the different estimates of the above-market percentage depend upon the projections of the power market. See Exh. DPS-60 (BEB-8).

102. This range assumes that the above market costs are shared equally between shareholders and ratepayers. While the 50/50 sharing is a reasonable outcome, it is not a necessary conclusion. Along with the entire methodology, the follow-on proceeding will consider appropriate sharing of above-market costs. See *Investigation into the Restructuring of the Electric Industry in Vermont*, Docket 5854, Order of 12/30/96 at 76-77.

103. Rate Order at 245 (emphasis added).

our conclusion that a substantial portion of the Contract power is not used-and-useful. First, the Board approved the Contract on the assertion of the Vermont Joint Owners that GMP and others would be able to sell the excess power at full price during its term.[104] In contrast to those assertions in 1990 and 1991, the history of the sell-backs demonstrates that GMP cannot profitably resell the Contract power, so GMP cannot fulfill important understandings relied upon during the Contract approval process. Equally important, the Company retained the responsibility to obtain all cost-effective DSM resources, thus ensuring that the Contract would not displace the acquisition of these resources. Yet, the evidence in this proceeding demonstrates that the "potential for cost-effective investments in energy efficiency in Vermont greatly exceeds GMP's achievements to date."[105] The Contract power thus has the effect of serving demand at higher cost than would occur if GMP had committed to less Contract power, or had resold more of its Contract entitlement, and had acquired more of the available DSM resources.

For these reasons, under the terms and conditions of the Hydro-Quebec CPG, a significant portion of the Contract power is surplus to GMP's needs, and is not used-and-useful in its current power supply, nor is it expected to ever be used-and-useful over its remaining life. This is not simply a matter of price, but is independently based upon the representations made, circumstances, and Certificate of Public Good conditions attending GMP's decision to add Contract power to its power supply mix.

(3) Combining Power Cost Disallowances and Return on Equity Reductions

A third methodological approach is that proposed by the Department, essentially using the Company's return on equity ("ROE") as a benchmark for determining an acceptable adjustment to retail rates. The Department recommended an ROE penalty, combined with power cost disallowances, with the total exclusion from rates capped at one-third of the Company's ROE.[106] The Department recommended an adjustment amounting to $2.8 million under this approach, consisting of concurrent power cost disallowances for imprudence and non-used-and-useful of

104. Rate Order at 222. To enforce this requirement, the Board retained jurisdiction to order future re-allocations or resales. Docket 5330-A, Order of 2/12/92 at 46.

105. Rate Order at 262.

106. Steinhurst reb. pf. at 17.

approximately $2.0 million and a one percent ROE penalty.[107] The Department also acknowledged that it would be reasonable to blend the adjustments in different ways to arrive at an overall cost disallowance.[108]

As suggested by the Department at oral argument, the Department's approach can produce a range of results. Although the Department used one-third of the Company's ROE as a proxy for the maximum disallowance, the evidence would support recalculating the Department's recommendation by varying or eliminating this disallowance cap. For example, the testimony presented demonstrates both imprudence on the Company's part and a Contract that is not used-and-useful. For this reason, it would be appropriate to apply the $2.1 million power cost adjustments separately rather than concurrently, leading to a retail rate reduction of $4.96 million (adding in the Department's proposed ROE penalty).

More significantly, the Department based its "one-third of ROE cap" on a comparison to penalties imposed on Citizens Utilities Company ("Citizens") in Docket 5841/5859, with the suggestion that Citizens' actions merited a harsher penalty. From the perspective of imposing a "penalty," the Department's comparison is valid.[109] However, under this ratemaking approach generally, the ROE is a proxy for measuring economic harm arising from the Company's imprudent actions and decision to lock into a non-used-and-useful contract. Using the Citizens comparison, although Citizens' management and financial accounting problems merited a significant penalty, GMP's imprudent lock-in of the Contract will have much greater financial impact on its customers spanning a much longer period of time. Thus, an adjustment above one-third of the ROE might well be justified. We also note that under our ratemaking formulae, a before-tax ROE penalty will be partially offset by tax savings that the Company will experience,

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107. Applying the Department's method to the ROE and rate base found just and reasonable in the Order, rather than the ROE and rate base in the Department's testimony, the Department's one-third benchmark actually produces a disallowance of $2.9 million, consisting of a $2.1 million power cost disallowance and $760,000 ROE penalty.

108. Tr. at 62. The Department originally recommended a total disallowance of $5.26 million using this method. Steinhurst reb. pf. at 17. GMP and the Department agree that the Department's methodology helps move the Company away from certainty that might trigger FAS 5 or FAS 71. Tr. at 17-18.

109. Even accepting the Department's comparison for purposes of assessing the range of reasonable disallowances, it must be stressed that penalties (i.e., a reduction in ROE or those penalties authorized by statute) are different from disallowing imprudent costs. Cost disallowances, including the power cost disallowance recommended by the Department, do not constitute penalties, but flow from traditional ratemaking principles and our obligation to ensure that rates are just and reasonable. Here, the appropriate comparison of penalties is the Department's one percent ROE penalty with the much larger ROE penalty adopted in the Citizens case. Unlike the Order in Citizens, today's Order does not impose a penalty upon GMP.

unless those tax savings are also subtracted from the cost of service.[110] These facts warrant using a higher benchmark from which to calculate the power cost disallowance, producing, in our judgment, a reasonable range of potential disallowance from $2.8 million to $6.0 million.

(4) The *Seabrook* Methodology

In the Rate Order, we followed the *Seabrook* methodology, first excluding imprudently-incurred power costs, and then sharing the remaining, uneconomic costs between ratepayers and shareholders. Because this analysis was set out in detail in the Order, we will not repeat it here. A reasonable application of the *Seabrook* methodology would suggest a power cost adjustment of between $2.24 million and $8.95 million in the adjusted test year.

(1) Imprudence. The first step in the analysis we employed is to calculate the financial impact of imprudence. The Rate Order assumed that 20 percent of the adjusted test year power costs (before incorporating the effects of the sell-back) constituted a reasonable measure. The independent investigator, MSB, presented evidence demonstrating that this figure should instead be 25 percent. This was based, in part, upon the fact that the New York Power Authority determined in 1991-92 that a 30 percent reduction in price was necessary to make its HQ contract cost-effective, and terminated that Contract when it was unable to secure such a reduction.[111] A prudent course of action may have led GMP to enter into an alternative investment and power purchase plan that produced significant, although smaller, savings than the Rate Order assumed. Neither GMP, which bears the burden of persuasion, nor the other parties produced specific evidence as to what such lower savings may be, but giving the Company the benefit of any doubt, it is reasonable to assume that they may be as low as 15 percent of the adjusted test year power costs. Using the assumption that GMP could have saved between 15 and 25 percent of the Contract-related costs by pursuing a prudent course of action, the imprudence disallowance alone is in the range of between $6.99 million and $11.65 million, as seen on the following table.

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110. Today's Order excludes $5.48 million from rates, but permits GMP to retain associated tax savings. Alternatively, the rate adjustment could be calculated as the sum of a smaller power cost disallowance and the associated tax savings. In either event, the "bottom line" would be the same. See note 125, *infra*.

111. The NYPA and VJO Contracts had similar pricing terms. See Rate Order at 196, Finding 576, and at 200, Finding 596.

Range of Imprudence (millions)			
Imprudence disallowance percentage	15% of Contract costs	20% of Contract costs	25% of Contract costs
ATY Imprudence	$6.99	$9.4	$11.65

In the Rate Order, we credited the full amount of the reduced power costs that GMP had obtained through the sell-back of power to Hydro-Quebec to the Company, reducing the amount of the prudence disallowance and producing the $5.48 million rate adjustment that we found just and reasonable.[112] Full crediting of the results of its mitigation to reduce the imprudence disallowance is not, however, a necessary outcome. As we noted in previous Hydro-Quebec dockets, and in Docket 5854, utilities have an on-going obligation to mitigate above-market costs; such savings are the result of current actions and current conditions, and do not necessarily “relate back” to the original acts of imprudence.

Moreover, in the present case, the reduced power costs through the sell-back are part of a negotiated arrangement between GMP and HQ that has costs as well as benefits to ratepayers. In exchange for reduced power costs in the adjusted test year, GMP made certain payments to HQ and agreed to adjustments that will affect the amount of power HQ must provide later. GMP ratepayers have already paid, in rates approved previously, for the additional costs. Fairness suggests that ratepayers, rather than shareholders, should receive the benefit of these mitigation efforts.[113]

Despite these observations, for purposes of calculating the rate adjustment based upon the *Seabrook* methodology, the analysis in this section continues to credit the full amount of the sell-back to GMP prior to determining the non-used-and-useful amount, because the overall methodology produces a rate adjustment that is consistent with the evidence and results in just and reasonable rates.

112. We note, however, that the Rate Order found GMP’s imprudence to be approximately $9.4 million in the adjusted test year. We applied the credit to reduce the imprudence amount. Applying the same $7.6 million credit to the range of imprudence would alter that range to zero to $4.05 million.

113. This is consistent with the approach we employed in *Seabrook*. In that case, we determined imprudence based upon the entire cost associated with Seabrook. The proceeds of Central Vermont Public Service Corporation’s mitigation effort were not used as a credit against imprudence. Instead they served to reduce the amount of the Seabrook costs that we found not used-and-useful.

(2) Non-used-and-usefulness. During the hearings, the parties presented extensive evidence showing that the Contract significantly exceeded the market price for power. The degree to which the current and future power costs are excessive depends upon the projections of future market prices for power. Our calculation of the used-and-useful disallowance in the Order started from the mid-range market price projections. Parties also presented low- and high-market price projections. Using the same methodology that we employed in the Rate Order,[114] the used-and-useful disallowance alone produces a range of between $2.24 million and $6.92 million, if based upon an average of the long-term, above-market costs of the Contract.[115] These calculations are set forth on the following tables, along with the total disallowance for imprudence and used-and-useful under the ranges discussed above.

High Market Case Range of Used-and-Useful (millions)			
Contract to Market Price difference (adjusted by 10%)	78.3	78.3	78.3
Annual Average	$4.47	$4.47	$4.47
Imprudent costs	$0.0	$1.8	$4.05
Remaining Non-Used-and-useful costs	$4.47	$2.67	$0.42
Disallowance (50 percent)	$2.24	$1.34	$0.21
Total of prudence plus used and useful	$2.24	$3.11	$4.26

114. These assumptions are set out at pp. 254-255 of the Rate Order.

115. As explained below in Footnote 121, if we used the adjusted test year above-market costs, this higher end of this range balloons to $11.1 million.

Mid Market Case Range of Used-and-Useful (millions)			
Contract to Market Price difference (adjusted by 10%)	$160.2	$160.2	$160.2
Annual Average	$9.15	$9.15	$9.15
Imprudent costs	$0.0	$1.8	$4.05
Remaining Non-Used-and-useful costs	$9.15	$7.35	$5.10
Disallowance (50 percent)	$4.58	$3.68	$2.55
Total of prudence plus used and useful	$4.58	$5.48	$6.65

Low Market Case Range of Used-and-Useful (millions)			
Contract to Market Price difference (adjusted by 10%)	$242.1	$242.1	$242.1
Annual Average	$13.84	$13.84	$13.84
Imprudent costs	$0.0	$1.8	$4.05
Remaining Non-Used-and-useful costs	$13.84	$12.04	$9.79
Disallowance (50 percent)	$6.92	$6.02	$4.90
Total of prudence plus used and useful	$6.92	$7.82	$8.95

Table Summary. As these tables demonstrate, the range of reasonable adjustments for non-used-and-usefulness, standing alone, extends from $2.24 million (high market case with no imprudence) to $6.92 million (low market case with no imprudence). The range, in a two-step *Seabrook* analysis, is from $2.24 million (high market/no imprudence) to $8.95 million (low market/imprudence deduction)(assuming we reduce the imprudence total by the full sell-back amount). The disallowance contained in the Rate Order, $5.48 million, based upon the mid-market price estimates, is well within both of these ranges.

Both GMP and the Department raised methodological concerns about our calculation of the disallowance. Neither of these objections requires changes in the results of the analysis set out in our Rate Order and used herein. As to GMP's argument, the Company's claims of error do not reflect the fact that our calculation of the prudence and used-and-useful disallowance was moderated in several ways to arrive at a reasonable cost disallowance that produced just and reasonable rates. For example, our calculation started from the midpoint of the estimated range of uneconomic costs, even though it is entirely possible, if not likely, that actual above-market costs incurred by ratepayers will be above this mid-point. In addition, our calculation allowed for a 10 percent reduction in the uneconomic costs (below the midpoint), before calculating the effect of the sharing. Since the sell-back savings were credited against the imprudence disallowance, we concluded that it was not appropriate to further reduce the used-and-useful amount by the amount of the sell-back, as the result did not fairly reflect the excessive costs ratepayers will incur.[116]

More significantly, acceptance of GMP's argument would result in double-counting the effect of the sell-back. All of the projections of the amount by which the Contract exceeded the market price, prepared by GMP in conjunction with assessments of its stranded costs under electric restructuring, assumed prices for the Contract that included reductions due to the sell-back agreements GMP had negotiated.[117] Specifically, the above-market costs in the adjusted test year (and other years) are less than they would otherwise be due to GMP's having negotiated the sell-back. Our used-and-useful disallowance calculation in the original Order started with the mid-point of these projections of the net economic losses of the Contract (which ranged from $87 million to $269 million).[118] Thus, the measure of above-market costs of the Contract and hence our used-and-useful calculation, starting with measurements of excessive costs that were mitigated by the sell-backs, already reflected the effect of the sell-back (as do the calculations set out above).

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116. It should also be stressed that this calculation relies upon one measure of imprudence, based upon the anticipated power cost savings GMP could have achieved through a prudent resource acquisition strategy. As we discussed above, the parties presented evidence supporting a larger disallowance than used herein. Moreover, the calculation assumes that GMP receives the entire benefit of the mitigation achieved through the sell-back.

117. Exh. DPS-60 (BEB-8).

118. Rate Order at 208, 254.

We, therefore, conclude that our original and present calculations using the *Seabrook* methodology are properly calculated. Accordingly, we do not accept the Company's claim that we erroneously calculated the used-and-useful disallowance.[119]

We also do not agree with the Department's complaint that it was incorrect to calculate the prudence and used-and-useful disallowance using two different time periods. As parties have not presented evidence that would allow us to assess specifically the resource portfolio that GMP should have pursued as a prudent, long-term resource acquisition plan, it is appropriate to determine the prudence adjustment based upon a judgment of the effects of imprudence solely in the adjusted test year. By contrast, the parties <u>have</u> presented substantial evidence showing the degree to which the Contract exceeds long-term above market prices; even the Department recommends against using the adjusted test year above-market costs to calculate the appropriate costs to be excluded from rates under the used-and-useful analysis. The evidence thus points to the need to adopt the approach used in the Order: calculate the imprudence adjustment based upon the adjusted test year costs and the used-and-useful measurement using the long-term average of the above-market costs. We add, however, that if we revised our calculation to reflect both the Department's and GMP's claims of error, the result would suggest a higher disallowance than that set out in our original Order and near the high end of the range produced by the *Seabrook* methodology.[120]

c. Conclusion

We based our decision to exclude $5.48 million from GMP's retail rates in the adjusted test year based upon an application of the *Seabrook* methodology using the mid-range estimates for both prudence and used-and-usefulness. While our conclusions were informed by other

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119. If we, as the Company suggests, rigidly applied the *Seabrook* analysis, the disallowance range would be significantly higher. As explained in note 114, infra, in *Seabrook*, we did not credit the mitigation against the imprudent amount. Moreover, prior to determining the non-used-and-useful disallowance, we incorporated the effect of the tax savings Central Vermont would receive. Following this methodology strictly, the lower end of the disallowance range would be in excess of $7 million.

120. The Order arrived at a total disallowance of $5.48 million. To maintain consistency through the calculation, as urged by the Department, we would use the adjusted test year figures for both prudence and used-and-useful. This results in a higher figure for the excessive (i.e., non-used-and-useful) HQ costs, amounting to approximately $16.7 million based upon the mid-range market forecast. Exh. DPS-60 (BEB-8). Adjusting this figure per GMP's calculation, as set out in its Motion, we would reduce the $16.7 in above-market costs by $1.8 million to reflect the imprudent amount (the $16.7 million already reflects the $7.6 savings from the sell-back), leaving $14.9 million as the non-used-and-useful component of costs to be shared between ratepayers and shareholders. Half of this figure is $7.45 million (compared to $3.68 million in our Rate Order), producing a total disallowance of $9.25 million.

considerations and methods, the Order did not formally set them out. On reconsideration, we have reevaluated our analysis based upon *Seabrook* and reexamined several reasonable alternatives for determining the appropriate allocation of power costs to fulfill our statutory responsibility.[121]

As is apparent from the analysis above, there is no single "right" figure to place on the portion of HQ power costs that should be included in retail rates, or the portion that should be disallowed. Expert witnesses testified generally to an overall range of disallowance between $2.8 million and $11.6 million in the adjusted test year, while more specific evidence presented in this proceeding supports a disallowance between $2.24 million and at least $11.1 million based upon the various methods discussed above. A "percentage sharing" method produces reasonable exclusions between $2.8 million and $9.75 million. The record on "prudence alone" would support an adjustment between $2.1 million and $11.6 million, and on "used-and-usefulness alone" between $2.49 million and $11.15 million. An adjustment focused on the Company's ROE would warrant a disallowance before tax effects of $2.8 million and $6.0 million. Finally, the two-step *Seabrook* methodology per the Rate Order yields adjustments between $2.24 million and $8.95 million.

After considering these alternative approaches, we find that it is appropriate to exclude $5.48 million, as set out in the Rate Order. We do not rely on any one method in determining the power cost exclusion to apply in this Docket, but have considered all of them. The adjustment is well within the range produced by all of the methods examined. In our judgment, the resulting allocation of costs will produce just and reasonable rates.

While our decision is based both upon prudence and used-and-usefulness, we have imposed a single disallowance based upon both principles. The evidence supports an adjustment of $5.48 million based solely upon either imprudence or the non-used-and-useful principle. Our conclusions on these two ratemaking principles were independent, producing two separate bases for excluding costs from GMP's retail rates. Our examination of the range of potential power cost exclusions based upon prudence alone (or used-and-useful alone) shows the $5.48 million adjustment to be a reasonable measure.

While we recognize that $5.48 million represents a significant cost disallowance, we must compare it to the above-market costs that ratepayers will incur. The evidence presented

121. We expect that we will evaluate other methods in subsequent proceedings.

demonstrates that in the adjusted test year, the Contract will exceed market prices by between $7.3 and $22.2 million, with $16.7 million representing the excess under a mid-range market.[122] These excessive costs occur even after giving the Company the entire credit for mitigating the above market costs by $7.6 million in the adjusted test year. Vermont ratepayers should not bear the entire burden of paying the excessive costs incurred due to the Company's imprudent actions. The $5.48 million disallowance ordered here is well within the range of reasonable outcomes under each of the methods used; it is far less than the overall above-market costs that ratepayers will pay; it is independently supported by our findings and conclusions on imprudence and non-used-and-usefulness, and less than the evidence would support on either principle standing alone; and it represents only 14 percent of overall Contract costs in the adjusted test year, and only three percent of the Company's total cost of service. On the facts of this case, we conclude that this represents a reasonable exclusion from retail rates.

Finally, it is important to recall that when fashioning an equitable remedy such as an adjustment for imprudence or non-used-and-usefulness, it is appropriate to consider the tax impacts of the proposed remedy on a company.[123] In ratemaking, a disallowance of costs does not normally create income tax impacts for which other adjustments must be made, since most disallowances are associated with costs that are neither known nor measurable – that is, are unlikely to occur in the adjusted test year. However, on occasion known and measurable costs are nevertheless excluded from rates because they are imprudent, not used-and-useful, or otherwise inappropriate for rate recovery. All else being equal, the practical effect of such a disallowance is a reduction in net income, which will itself be attended by a proportional reduction in a company's income tax liability.

The power cost disallowance that we have ordered in this docket will have just such an effect. This is because the Company is expected to pay Contract costs, including amounts that the Board has excluded from rates, thereby reducing its overall earnings. However, rates have been calculated on a fully "grossed up" basis, including revenues to pay taxes on the entire return on rate base. The taxes that the Company will pay on its reduced earnings will be less than those calculated in setting rates, and the difference between the two effectively offsets a portion of the power cost disallowance. In this case, assuming that the power cost disallowance of $5.48 million

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122. Exh. DPS-60 (BEB-8).

123. Docket 5132, 83 PUR 4th 532, 536 (1987).

leads directly to an equal reduction in net income, it will be offset by a $2.265 million tax savings, thereby reducing earnings by only $3.215 million.[124] Thus, on an after-tax basis, a power cost exclusion of $5.48 million reasonably approximates the Department's overall recommended disallowance of at least one-third of the Company's ROE, and amounts to less than 10% of the total Contract power costs in the current rate year. Considering all of the facts of this case, we conclude that a power cost exclusion of $5.48 million fairly balances the interests of GMP's ratepayers and shareholders, and is just and reasonable.

Any aspects of the Motion to Reconsider not specifically treated above are hereby denied.

SO ORDERED.

Dated at Montpelier, Vermont, this 8th day of June, 1998.

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

OFFICE OF THE CLERK

FILED: June 8, 1998

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.

124. Mathematically, this is computed as the product of $5.48 million and (1 - *t*), where *t* is the incremental tax rate. For GMP, the incremental tax rate, upon which rates were set, is 41.34 percent. Rate Order, Attachment A, Schedule 4.