

**STATE OF VERMONT
PUBLIC UTILITY COMMISSION**

Case No. 17-3142-PET

Vermont Department of Public Service
request for workshop on utility rate regulation

DEPARTMENT OF PUBLIC SERVICE COMMENTS
ON PROCESS AND DISCUSSION ITEMS

On June 26, 2017, the Public Utility Commission (Commission) opened an investigation into the regulation of electric and natural gas utilities in Vermont. The Commission scheduled an initial workshop for August 8 and established July 18, 2017, as the date by which interested persons should file comments on potential topics for discussion. By this filing, the Department respectfully recommends topics for discussion at the initial workshop, and provides recommendations on process going forward.

The Department appreciates the Commission's recognition of the importance and timeliness of this investigation. As state policies chart a course to a cleaner energy future, and technological advances continue to present challenges and opportunities that did not exist even a decade ago, Vermont's electric and natural gas utilities are experiencing a time of significant change. However, as the Commission explained, Vermont's regulatory structure was developed prior to the advent of these changes. Over time, Vermont policy makers have revisited the forms of utility regulation to ensure that they are adequate to meet the challenges of the day. For example, in light of the rigidity of traditional regulation and the need to induce utilities to advance state energy policy through innovation and improved performance, the Legislature authorized utilities to operate under alternative forms of regulation by enacting 30 V.S.A. § 218d in 2003. Now, with a decade of experience of Vermont's largest utilities operating under alternative regulation plans, and in light of the technological and policy advancements noted above, it is once again imperative for regulators to convene stakeholders to critically evaluate what has worked and what improvements could be made to the manner in which utilities are

regulated in Vermont. The Department appreciates the Commission's leadership in convening this discussion and looks forward to working with stakeholders on this important issue.

Background

The Department believes that while traditional regulation served the state well for the better part of a century, it also had notable shortcomings. Traditional cost of service regulation relies primarily on contested rate cases to achieve just and reasonable rates that are fair to both ratepayers and utility shareholders. While these heavily litigated cases may have been well suited to setting cost-of-service-based utility rates, they were notoriously ill-suited to achieving desired public policy outcomes, such as the deployment of energy efficiency and renewable resources. This form of regulation also tended to perform poorly in times of rapid changes in the fuel prices and related purchased power costs. In times of increasing fuel prices and purchased power costs, rate cases would be stacked one atop the next as utilities sought to capture the increased fuel costs in their rates. In times of decreasing fuel prices and purchased power costs, utilities often would seek to retain approved rates for as long as possible, thereby enjoying increased earnings by charging rates that were set on higher, out-of-date fuel prices and purchased power costs. The following list sets forth additional concerns with traditional regulation:

Decoupling – Under traditional regulation, there is a strong link between customer sales growth and the financial performance of the utility. In essence, earnings and electricity sales are coupled. The effort to break that link is referred to as decoupling. There are various approaches to achieving partial or total decoupling. The Department believes that decoupling is essential for a utility system that relies on a diverse mix of clean energy and distributed solutions on the customer side of the meter. Under traditional regulation, efforts to decouple utility earnings from sales were largely unsuccessful.¹

¹ See *Investigation into the existing rates of Central Vermont Public Service Corporation*, Docket Nos. 6946 & 6988, Order of 3/29/05, at 150 (“Purchase power adjustment clauses provide utilities with the ability to flow through increases or decreases in the cost of power directly to retail customers in between rate investigations. Vermont Supreme Court precedent prohibits the use of PPA clauses as such flow-through mechanisms are inconsistent with the customer notice requirements of 30 V.S.A. § 225) (referencing *Allied Power and Light Company, et al.*, 132 Vt. 354 (1974) (striking down a purchased power and fuel adjustment clause as inconsistent with statutory notice requirements applicable to traditional regulation)).

Transparency – Traditional regulation can often suffer from a lack of transparency, given the complexities of a rate case and black box settlement agreements, which establish a bottom-line rate change without demonstrating the merits of the individual component parts. The concern over transparency is also present with the manner in which alternative regulation plans have been implemented in recent years.

Overcapitalization – One concern of the regulatory community and the public is the risk of utility overcapitalization. This is of particular concern when earnings awards are considered generous and regulatory review of capital investments is limited in time and scope. In traditional rate cases, there was often a corollary concern that utilities would over-invest in the years being evaluated in the rate case, in order to increase the earnings allowance, even though the level of investment may not have been necessary in future years that were not subject to a rate case. This issue can also arise under alternative forms of regulation, including the regulatory plans in Vermont in recent years.

Innovation – Traditional regulation is intended to replace the discipline of competitive markets. However, the industry, as regulated under traditional forms of regulation, was generally slow to innovate. Where the pace of innovation is accelerating to meet new technological and policy challenges, lagging utilities and regulatory regimes increase the risk that important regulatory and public policy objectives will not be met.

Incentives for cost management and customer service – Incentives to manage costs under traditional regulation are limited. Management incentives to contain costs are likely modest and reduced by management's ability to seek rate increases to cover costs when they fail to achieve efficiencies.

Incentives for public interest outcomes – Utility managers have a fiduciary responsibility to serve investor interests and the public obligation to provide essential services to their customers, consistent with traditional standards of service. They are not, however, driven to foster policy objectives short of statutory or regulatory requirements or incentives. Newer forms of regulation can serve to augment statutory requirements to meet and exceed certain public interest outcomes in ways that are not well supported by traditional regulation.

Financial risk, cost of capital, purchase power costs – Vermont utilities are exposed to the financial risks of a major weather event, or a sudden shift in fuel costs. These events can be sufficiently large and outside the ability of management to control, that they affect the ratings of company debt and drive up the cost of capital. (Utilities generally are capital intensive and the costs of capital is an important determinant of the rate. Traditional regulation as applied in Vermont contributed to a higher cost of capital.) Swings in fuel costs or weather events can also sometimes precipitate intensive regulatory review and delays in the pass through of costs owing to the length of time required of formal rate cases under traditional regulation. Also, utility financial ratings have a bearing on the contract terms and requirements to post collateral or establish letters of credit that can, in the end, serve to increase the costs of purchased power. The presence or absence of a power cost adjuster can also have an impact on the cost of purchased power.

It was in light of concerns such as those described above that the Legislature enacted section 218d and authorized the Commission to approve alternative regulation plans that were geared toward overcoming the challenges associated with traditional regulation. Over the past 10 years, regulators, utilities, and interested stakeholders have attempted to address these issues in the alternative regulation plans of GMP, CVPS, and VGS.² While these efforts have met with varying degrees of success, they provide a wealth of experience on which to reflect to determine what has worked and what could be improved upon. The Department looks forward to reflecting on these issues and the state's collective experience with traditional and alternative regulation throughout the course of this proceeding.

Recommendations on Process

The Department has reached out to a number of interested parties about this proceeding to gauge the interests of different stakeholders in this investigation. Broadly speaking, the Department believes that there is general consensus about both the importance and timeliness of this proceeding. Informed by these discussions, the Department recommends that the August 8

² Alternative regulation in the electric and natural gas sectors was preceded by experience with performance-based or incentive regulation in the telecommunications sector, which the Legislature authorized by enacting 30 V.S.A. § 226b. Because the regulation of electric and natural gas utilities is fundamentally distinct from the regulation of telecommunications utilities, the Department recommends that this proceeding focus on the former.

workshop serve as the first of at least three workshops, with the second workshop to take place in September and the third to follow in either October or November. Sufficient time should pass between workshops to permit opportunities for collaboration as well as written filings following each workshop and in preparation for the next.

The Department recommends that the workshops begin with a broad discussion and then narrow as the proceeding evolves.

- **Workshop 1** – This workshop should be broad and foundational. The parties should identify regulatory options and opportunities available for Vermont utilities based on experience both in and beyond Vermont relative to the alternative forms of regulation. The parties should also seek to agree, to the extent practicable, on the goals for the proceeding. Efforts should be made to end the first workshop with a preliminary list of the topics that the participants would like to address further in the second. This list can be refined through filings following the workshop.
- **Workshop 2** – This workshop should serve to feature topics that are most controversial or in dispute, and serve to help resolve these disputes or feature them for the Commission to later deliberate.
- **Workshop 3** – This workshop to service to provide comprehensive recommendations or frameworks for performance-based regulation looking forward for the investor-owned utilities.

The Department recommends that the workshops be managed by the Commission to strike a balance between progress with topics and open discussion among the stakeholders. Each workshop should be preceded by a published agenda that identifies speakers giving presentations and outlines topics for discussion. The Department would be pleased to assist in developing such agendas after review of the comments filed.

Ultimately, the Department recommends that the Commission consider managing this proceeding toward the ultimate goal of issuing a rule or order pursuant to section 218d(e) and/or 218d(h). These sections allow the Commission to establish, by rule or order, requirements governing the filing of a petition to approve an alternative regulation plan, as well as standards

and procedures by which the effectiveness of the alternative form of regulation can be determined. Such a regulatory document would provide useful guidance to the regulated community regarding the Commission's expectations for plan submittals as well as plan performance metrics.

Recommendations for Discussion at Workshop 1

The Department recommends that the first workshop be foundational in character. The workshop should be structured to allow an open discourse among the participants. In addition, the Department would hope to address the following topics.

Changing industry conditions – In recent years there have been significant developments in the utility sector in Vermont. These developments signal some changes that are fundamental in character, and are reflected in our ambitions for the sector, informed by some emerging realities. These changes are particularly pronounced in the electric utility sector, but are also present in the natural gas sector.

Perspectives on traditional regulation – Traditional regulation in Vermont may have different meanings to different stakeholders. The Department believes that some time should be spent during the workshop to clearly articulate what different stakeholders view “traditional regulation” as meaning. The Department believes it is also important to recognize the manner in which traditional regulation in Vermont differs from traditional regulation in most other jurisdictions. (For example, traditional regulation does not permit utilities to engage in a fuel or power cost adjustment mechanisms in Vermont, notwithstanding their common use in other jurisdictions.)

Comments on the existing alternative regulation plans – During the past 10 years, one or more Vermont utilities have operated under alternative regulation plans. The Department recommends that time be allocated to discuss the specific application of alternative regulation that has existed in Vermont for GMP, CVPS, and VGS over the last decade. Items for discussion include plan performance, process by which rate adjustments are made, communications with and information provided to customers, and the impact on low income assistance programs. Efficiency Vermont is also implicated by this as it has existed under a form of incentive

regulation as well for at least a decade. This conversation is needed to understand and learn from experience to date, and to bring into focus the concerns that critics of alternative regulation have levied over the past few years.

Scope of alternative regulation – Alternative regulation includes a universe of possibilities. The concept can include “performance-based regulation” (PBR), “incentive regulation,” multi-year rate plans,” and any form of otherwise traditional regulation used in other jurisdictions that involve provisions or mechanisms prohibited under Vermont laws. The Department would like to begin by organizing a discussion of the different forms of regulation.

Roles and responsibilities – The Vermont utility structure includes not only the distribution utilities, but also efficiency utilities. In certain instances, the efficiency utility and the distribution utility are the same. For most of the state, the role of Efficiency Vermont is distinct from the distribution utilities. Efficiency Vermont exists under a form of incentive regulation that drives its performance, sometimes in ways that can overlap or even conflict with utility obligations. The topic may be better placed in another venue, but should be acknowledged during the discussions.

Preliminary principles or touchstones for the next plan – The Department believes that it is important to identify a set of issues or principles that the collective group believes should be part of any future form of regulation. The Department offers the following list to start the conversation:

- Transparency of the proceedings.
- Periodic formal review of cost-of-service.
- Incentives for cost management in operations.
- Incentives for cost management of capital budgets.
- Incentives for cost management of power supply.
- Well-formed objectives for performance.
- Decoupling.
- Incentives for alignment of consumer and public interest with management.
- Outreach and communication with customers.

- Manage the scope of flow-through items and trackers.
- Protections against windfall profits or losses.
- Interaction of different forms of regulation with low-income assistance programs.

Conclusion

The Department appreciates the Commission's decision to open an investigation into this important issue and looks forward to a vigorous discussion at the first workshop. Department staff stands ready to assist the Commission in advance of the workshop with respect to the agenda or other logistical matters as requested.

Dated at Montpelier, Vermont this 18th day of July 2017.

VERMONT DEPARTMENT OF PUBLIC SERVICE

By:



Timothy M. Duggan, Special Counsel
112 State Street
Montpelier, VT 05620-2601
(802) 828-3167
tim.duggan@vermont.gov