STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6460

Tariff filing of Central Vermont Public Service Corporation requesting a 7.6% rate increase, to take effect December 24, 2000	))))	Schedule of Hearings *See Appendix A* Appearances *See Appendix B*

AND

Docket No. 6120

Tariff filing of Central Vermont Public Service Corporation requesting a 12.9% rate increase, to take effect July 27, 1998	)))	

Order entered: 6/26/2001

Michael H. Dworkin, Chairman
David C. Coen, Board Member
John D. Burke, Board Member

OPINION AND ORDER

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I. INTRODUCTION

In this Order, the Public Service Board ("Board") considers a request by the state's largest electric utility, Central Vermont Public Service Corporation ("CVPS" or the "Company") to increase its retail rates by $19 million (or 7.6 percent), effective with service rendered July 24, 2001.[1] After the filing, CVPS reached a settlement (embodied in the Memorandum of Understanding or "MOU") with the Vermont Department of Public Service ("Department" or "DPS"), in which those parties agreed that the Board should approve a smaller, $9.852 million (or 3.95 percent), rate increase, effective with bills rendered on or after July 1, 2001.[2] As part of the settlement between themselves, CVPS and the Department also agreed to the following (as well as other items discussed later in this Order):

- A rate freeze through the end of 2002, absent extraordinary circumstances;
- A cap on CVPS's Return on Equity ("ROE") at 11 percent until the earlier of the end of 2003 or the effective date of a new rate order;
- Finalization of the temporary rates granted in Docket 6120, for the period January 1, 1999, to the effective date of the 3.95 percent rate increase approved in this Order;
- Final resolution of issues arising from CVPS's 1991 decision to lock-in early to the power purchase contract between Hydro-Québec and the Vermont Joint Owners[3] (the "HQ-VJO Contract"), including possible rate disallowances due to CVPS's imprudence and application of the used-and-useful doctrine;
- CVPS's write down of $9 million in regulatory assets;
- Adoption of a Service Quality Plan designed to assure high quality electric service for consumers; and
- CVPS's discontinuation of the booking and deferring of Account Correcting for Efficiency ("ACE") amounts on and after July 1, 2002, and commitment not to seek thereafter either the continuation of the ACE mechanism or the adoption of a replacement mechanism.

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1. In Docket 6120, we also consider an earlier rate request by CVPS seeking an increase of $29.833 million, or 12.9%, in annual revenues. The Board granted CVPS temporary rates in Docket 6120, which authorized CVPS to increase its rates by $10.902 million or 4.7%, effective January 1, 1999.

2. The MOU, which the Board admitted into evidence as Exhibit Joint-1, is attached to this Order as Appendix E. Throughout this Order, we refer to the document as the "MOU" rather than as Exhibit Joint-1.

3. The Vermont Joint Owners ("VJO") of the Highgate interconnection facility are eight parties, including Vermont's two largest electric utilities: CVPS and Green Mountain Power Corporation ("GMP").

CVPS and the Department contend that, in the context of the overall settlement, the resulting rates will be just and reasonable. The American Association of Retired Persons ("AARP") opposes approval of the MOU, arguing that the resulting rates would not be just and reasonable, because the settlement commits CVPS's ratepayers to paying significant costs for Hydro-Québec power that CVPS acquired imprudently and that is not economically useful.[4]

The central issue is this case is the ratemaking treatment of the Company's purchases of power from Hydro-Québec pursuant to the HQ-VJO Contract. Uncertainty concerning CVPS's ability to recover all of its costs associated with this Contract has clouded the Company's financial stability since 1994, when the Board first imposed an ROE penalty on CVPS due to failures and errors in the Company's overall power supply management (including the HQ-VJO Contract).[5] This uncertainty has continued until today.

At the present time, we are presented with a choice between two basic options. The first is to adhere to traditional cost-of-service ratemaking methodologies. This would entail employing the same standards that we did in Docket 5983 to disallow costs of the HQ-VJO Contract due to CVPS's imprudent early lock-in and, potentially, based upon a finding that the HQ-VJO Contract was not economically useful.[6] In the adjusted test year alone, such an approach could result in cost disallowances of between $3.5 million and $28 million. Over the remaining life of the HQ-VJO Contract, the excess costs resulting from CVPS's imprudent decision would greatly exceed this amount. Our adoption of this approach, however, would come with a price: the large cost disallowances would be highly likely to lead to a downgrade in CVPS's credit rating, diminish the Company's access to capital, and place CVPS in an unstable financial situation. Those consequences would be likely to increase costs for CVPS and its ratepayers.

The second option available to the Board is that set forth in the MOU. CVPS and the Department request that the Board impose no further rate disallowances due to past actions

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4. Vermont Yankee Nuclear Power Corporation ("Vermont Yankee Corporation"), the only other party in Docket 6460, took no position on the MOU. The Vermont Public Interest Research Group, which is a party in Docket 6120, also took no position on the MOU.

5. Dockets 5701/5724, Order of 10/31/94 at 111–112.

6. In addition, the Board could reactivate the ROE penalty originally adopted in 1994, either at the 75 basis point level set in Dockets 5701/5724 or at a higher amount.

associated with the HQ-VJO Contract. Instead, we would assure the future rate recovery of these power costs (assuming CVPS prudently manages the HQ-VJO Contract in the future). This approach would contribute to CVPS's financial stability. At the same time, it would require CVPS's customers to pay rates (now and in the future) that provide for full recovery of the costs of the HQ-VJO Contract, despite CVPS's imprudent decision to commit to that Contract.

In this Order, we conclude that the option set out in the MOU is necessary for the good of ratepayers. An electric utility such as CVPS requires continual access to capital markets to meet new demand for service and to upgrade or replace existing facilities so that customers will receive reliable service. Vermont Electric Power Company, Inc. ("VELCO"), the state's transmission-owning entity (of which CVPS owns 55 percent), also predicts a need for capital to fund plant upgrades to ensure reliable power supply. CVPS presently maintains an investment-grade credit rating and access to capital, so that the Company and VELCO are able to meet the demands of a highly capital-intensive business. If the Board were to establish rates in this case based upon traditional cost-of-service methodologies, however, CVPS could face the loss of access to capital markets, which could produce significant financial difficulties.[7] Therefore, in order to ensure the continued financial viability of CVPS, we find it appropriate to deviate from our typical ratemaking approach and instead to set rates "necessary to ensure efficiency and progress in the art and the continued attraction of capital to the enterprise."[8] Accordingly, we approve a rate increase for CVPS of $9.852 million (or 3.95 percent), effective with bills rendered on or after July 1, 2001. The resolution of the HQ-VJO Contract issues will enable CVPS to retain its investment-grade credit rating and allow the Company to remain financially

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7. In addition to the impact upon VELCO, CVPS's financial difficulties also could adversely affect other Vermont electric utilities. Under the "step-up" provisions of the HQ-VJO Contract and the Amended Participation Agreement (under which the VJO make power purchased under the Contract available to most other electric utilities in the state), if a Participant fails to pay for power, all other Participants must assume the defaulting Participant's obligations on a pro rata basis. CVPS purchases the largest share of power under the HQ-VJO Contract. If CVPS's financial situation caused the Company to default on its contractual obligations, the remaining Vermont utilities would have to make substantial additional purchases under the Contract — purchases which they cannot afford and which provide power they do not need. This sequence of events could cause serious financial difficulties for most other Vermont electric utilities.

8. *See Tariff Filing of Central Vermont Public Service Corporation*, Docket 5132, Order of 5/15/87 at 132, fn. 43; *Tariff Filing of Green Mountain Power Corporation*, Docket 6107, Order of 1/23/01 at 3.

viable. It also will help to preserve the financial stability of the Vermont electric utility industry, thus allowing the delivery of reliable and efficient electric service to Vermonters.[9]

Our approval, however, is subject to one condition: the rate increase we approve today commits CVPS's ratepayers to pay large costs now and in the future for power purchased under the HQ-VJO Contract. These are costs that would not be recoverable under traditional ratemaking methodologies. It is necessary and appropriate to balance these higher rates imposed on ratepayers with a mechanism designed to protect ratepayers against a risk of unfairness if our decision leads to unjust enrichment or windfall profits. This mechanism, which will be triggered only in the event of an acquisition or disposal of some or all of CVPS's assets, or merger, at a price in excess of book value, will protect ratepayers from the unjust enrichment of CVPS's shareholders and ensure a fair allocation of the benefits of today's Order. Today's Order provides that stockholders and ratepayers will share equally in any such premium, up to a maximum amount (for ratepayers) of $16 million.

II. POSITIONS OF THE PARTIES AND THE PUBLIC

Central Vermont Public Service Corporation

In listing the many benefits which will accrue to ratepayers from the MOU, CVPS cites the maintenance of its financial viability and continued access to the capital markets, the establishment of a Service Quality and Reliability Plan, the provision of additional customer protections, imposition of a rate freeze and earnings cap, and the final resolution of issues surrounding the continued recovery of the costs of power purchased pursuant to the HQ-VJO Contract which will allow all parties to move on to address other issues, including those related to the regional electric wholesale markets.[10] The Company's position is that the MOU provides rate relief that is necessary to enable it to provide reasonable and adequate service to ratepayers.[11] For these reasons, CVPS asks the Board to accept the MOU in all respects without condition or modification.

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9. Boyle supp. pf. at 10.
10. CVPS Brief at 3–4.
11. *Id.* at 36.

CVPS maintains that imposition of a protection against unjust enrichment is not warranted because rates established under the MOU will not be in excess of those that would be established by traditional ratemaking methodologies, and such a mechanism was "purposefully excluded from the terms of the MOU by the Stipulating Parties."[12] While CVPS's current financial condition is partially the result of its decision to lock-in the HQ-VJO Contract (as was GMP's in Docket 6107), CVPS states that the other two contributing factors to GMP's poor financial condition that the Board cited in Docket 6107 are not relevant in CVPS's case, i.e. unprofitable investments in unregulated businesses, and continuation of an unjustifiably high common dividend payout to shareholders. Accordingly, CVPS's position is that there is no need for an unjust enrichment provision, or any extraordinary measures to protect against CVPS shareholders receiving a financial windfall.

CVPS asks that if the Board finds it cannot accept the MOU without a protection against unjust enrichment, such a mechanism should not frustrate CVPS's proposed reorganization into a holding company, should not be triggered by the sale of one of its non-regulated businesses, and should have a maximum cap of no more than $16 million on the sums that would be returned to ratepayers.[13]

Department of Public Service

The DPS recommends the Board unconditionally approve the MOU, reminding the Board that the MOU is the composite result of concessions by both parties on many issues. The DPS believes the compromises promote the general good of the state and provide significant benefit to ratepayers. Among the benefits cited are: rate stability, the reduction of future costs through the agreed-upon writeoffs, the imposition of customer service standards, and the resolution of uncertainties relating to the HQ-VJO Contract which will enable CVPS to be a financially viable company with continued access to the capital markets.[14] In support of the MOU, the DPS warns that if the full disallowance permitted under traditional rate-making principles were imposed, the

12. *Id.* at 6 and 97.
13. *Id.* at 102, 105; tr. 5/15/01 at 185–186 (Boyle).
14. DPS Brief at 2–3.

financial impact on CVPS could cause irreparable harm.[15] In addition, the DPS cites the considerable Company and regulatory time which has been, and will continue to be, consumed by HQ-VJO Contract-related issues if these issues are not resolved in the current order.

With regard to AARP's specific proposed unjust enrichment suggestions (which we describe below), the Department believes they go beyond what is supportable by the evidence in this case,[16] and the DPS recommends that the Board accept the MOU as is. However, should the Board condition acceptance of the MOU with the establishment of a protection against unjust enrichment, the DPS advises that such a mechanism should be triggered by the Company's merger or sale of some or all of its assets, with 50% of the premium above net book value paid to ratepayers, up to a maximum of $16 million.[17]

American Association of Retired Persons

AARP alleges a history of misconduct and mismanagement by CVPS, resulting in its recommendation that this Board should reject the MOU, because the resultant rates will not be just and reasonable.[18] In support of its position, AARP refers to the prior finding by the Board in Dockets 5701/5724 that the decision to lock-in early to the HQ-VJO Contract was imprudent, and estimates that, for the 1999-2016 period, $130 million (net present value) in above-market costs could have been avoided, had the lock-in not occurred.

However, if the Board accepts the MOU in order to maintain CVPS's financial viability, AARP suggests it impose a protection against unjust enrichment. The mechanism AARP suggests to provide this protection is a four-part unjust enrichment/merger or acquisition condition similar to that adopted for GMP in Docket 6107, but more stringent.[19] AARP's specific unjust enrichment proposal calls for the sharing of 50% of the above-book value premium paid, up to a cumulative maximum of $65 million, in the event of the merger or acquisition of the Company, or sale of any part of the Company including its unregulated assets.

15. *Id.* at 8.
16. DPS Reply Brief at 2.
17. DPS Brief at 22–23.
18. AARP Memorandum of Law at 2, 5.
19. *Id*. at 3.

AARP recommends that the protection against unjust enrichment also be triggered if and when CVPS's shares reach 150 percent of the value they held on the date the MOU was executed by the DPS (May 7, 2001), and such price is sustained for 12 months.[20]

Members of the General Public

In addition to hearing from formal parties in Dockets 6120 and 6460, early in Docket 6460's proceedings, public hearings were held to gather information from, and the opinions of, the public at large. In Docket 6120, we convened public hearings on September 23, 1998, in Middlebury and November 17, 1998, in White River Junction. On February 19, 2001, in Docket 6460, we held a public hearing at eight locations in or close to CVPS's service territory via the Vermont Interactive Television Network. One member of the public spoke in support of the rate increase; no members of the public spoke against the increase. This Board also received a handful of letters from the general public, prior to the May 7, 2001, signing of the MOU, largely in opposition to CVPS's original 7.6 percent rate increase request. The Board received no letters subsequent to the signing of the MOU.[21]

III. CRITERIA FOR DECISION

Vermont law requires this Board to set rates that are "just and reasonable."[22] This Board has typically achieved this result using cost-of-service rate-making methodologies; however, the statutory standard of "just and reasonable" affords us broad discretion in the manner in which we determine rates.[23] The Vermont Supreme Court has observed:

> 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. 30 V.S.A. § 218 authorizes the Board to set rates, tolls, charges or schedules or to change regulations, measurements, practices or acts of the utility relating to its service in order to insure those reasonable rates

20. *Id.* at 3–4.

21. The Board also received a letter from GMP supporting the MOU and asserting that rejection of the MOU would undo much of the benefits resulting from the resolution of Docket 6107.

22. *See*, *e.g.*, 30 V.S.A. § 218(a).

23. *See, e.g.*, Docket 5983, Order of 6/8/98 at 2, 22–23, 25; Docket 6107, Order of 1/23/01 at 16–18.

> and adequate service. The choices the Board makes in this area are subject to great deference in this Court so long as it can be shown they are directed at proper regulatory objectives.[24]

In exercising this broad discretion, it is well-settled that we must balance the interests of the ratepayers and the interests of the utility.[25]

Vermont legal standards are consistent with principles enunciated by the United States Supreme Court, which has long held that regulatory agencies have broad discretion in the method used to set rates, so long as the end result represents a balancing of ratepayer and shareholder interests and falls within a range of reasonableness.[26] The Court first articulated this "end result" test in *FPC v. Hope Natural Gas Co.*, in interpreting the "just and reasonable" requirement of the Federal Power Act:

> [I]t is the end result reached not the method employed which is controlling. It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.[27]

This determination of whether the end result is reasonable requires "a balancing of the investor and consumer interests."[28]

Since *Hope*, the United States Supreme Court has consistently followed the "end result" test and its requirement that both ratepayer and investor interests be considered. For example, in *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), the Court reaffirmed that "investors'

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24. *In re Green Mountain Power Corp.*, 142 Vt. 373, 380 (1983) (citations omitted); *accord*, *In re Citizens Utilities Co.*, 769 A.2d 19, 23 (Vt. 2000).

25. *In re Citizens Utilities Co.*, 769 A.2d at 31-32; *In re Village of Hardwick Electric Dept.*, 143 Vt. 437, 443 (1983); *In re New England Telephone and Telegraph Co.*, 115 Vt. 494, 512 (1949).

26. It is appropriate for us to look to U.S. Supreme Court precedent for additional guidance in interpreting the "just and reasonable" rate requirement of Vermont statute. The Vermont Supreme Court has not only itself relied on that precedent, but also has expressly noted that its own decisions interpreting the "just and reasonable" standard have "consistently followed" U.S. Supreme Court precedent. *Petition of Village of Hardwick Electric Dept.*, 143 Vt. at 442–443; *see In re Citizens Utilities Co.*, 769 A.2d at 30-32; *In re New England Telephone and Telegraph Co.*, 115 Vt. at 512–513.

27. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) (citations omitted).

28. *Id*. at 603.

interests provide only one of the variables in the constitutional calculus of reasonableness."[29] In that case the Court further explained that:

> The Commission cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress. Accordingly, the "end result" of the Commission's orders must be measured as much by the success with which they protect those interests as by the effectiveness with which they "maintain credit and attract capital."[30]

More recently, in *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989), the United States Supreme Court strongly reaffirmed *Hope* and its progeny:

> [A]n otherwise reasonable rate is not subject to constitutional attack by questioning the theoretical consistency of the method that produced it. "It is not theory, but the impact of the rate order which counts." *Hope*, 320 U.S., at 602. The economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result. The Constitution is not designed to arbitrate these economic niceties.[31]

In *Duquesne*, the Court emphasized that the Constitution does not bind the States to follow a single rate-making methodology:

> The adoption of a single theory of valuation as a constitutional requirement would be inconsistent with the view of the Constitution this Court has taken since *Hope Natural Gas, supra*. As demonstrated in *Wisconsin v. FPC*, circumstances may favor the use of one ratemaking procedure over another. The designation of a single theory of rate-making as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors. The Constitution within broad limits leaves the States free to decide what ratesetting methodology best meets their needs in balancing the interests of the utility and the public.[32]

In sum, our statutory mandate is to set rates at a "just and reasonable" level. In so doing, we must take into account the financial viability of the utility, so long as the end result remains

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29. 390 U.S. at 769.
30. *Id*. at 791.
31. 488 U.S. at 314.
32. *Id*. at 316 (footnote omitted).

fair to ratepayers. Within the confines of these fundamental requirements, we have considerable latitude in the manner in which we determine rates in any specific proceeding.

AARP argues, however, that the Board cannot simply accept a settlement agreement or conclude that the rates are just and reasonable. According to AARP, the Board has a duty to make clear the basis for its decisions and make affirmative findings as to the essential elements of what is being allowed and what is not. The Board, AARP asserts, retains this duty even in the context of a stipulation.[33]

The Vermont Supreme Court has made clear that this Board has an affirmative duty to disclose the facts underlying its decisions.[34] As part of this duty, the Board's "conclusion must be supported by specific findings on the essential elements on which the ultimate finding must be based."[35] The Board's findings do not, however, need to be as comprehensive as AARP implies; they do not need to address each element of the record. Rather, the findings and the order only must demonstrate what the Board decided and how the Board reached its decision.[36] Moreover, as AARP suggests, the Board must fulfill this duty even in the context of a settlement agreement. We have a duty to independently review stipulations and settlements to ensure that the settlement embodied therein is consistent with the applicable legal standards.[37]

One additional Court decision significantly affects our consideration of the rate requests that are the subject of the current dockets — the Vermont Supreme Court's recent Order in *In re Tariff Filing of Central Vermont Public Service Corporation*, 769 A.2d 668 (2001). In that case, CVPS challenged the Board's ability to examine issues related to the prudence of the HQ-VJO contract and whether that Contract was used-and-useful, asserting that the doctrines of collateral estoppel, res judicata, and equitable estoppel barred the Board from considering these issues. The Vermont Supreme Court issued its decision on February 9, 2001, affirming in part and reversing and remanding for further consideration portions of the Board's April 17, 1998, Order

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33. AARP Memorandum of Law at 4.

34. *Petition of New England Telephone and Telegraph Co.*, 135 Vt. 527, 543 (1977).

35. *Petition of New England Telephone and Telegraph Co.*, 115 Vt. 494, 501–502 (1949).

36. *Petition of Hardwick Electric Department*, 143 Vt. 437, 444–445 (1984).

37. Docket 5132, Order of 7/31/87 at 35-36 (1987) (citing *Petition of New England Telephone and Telegraph Company*, 120 Vt. 181 (1957); *In re Citizens Utilities Company*, Docket 6332, Order of 9/21/00 at 4 (citing *Petition of New England Telephone and Telegraph Company*, 135 Vt. 527, 540 (1977)).

(which ruled that these doctrines did not prevent the Board from considering the prudence and used-and-useful issues). Specifically, the Court stated that:

> We hold that the Board is collaterally estopped, based on its prior determinations in a 1994 rate case, from considering further whether CVPS acted imprudently by locking into the HQ contract in August 1991. We conclude that it is premature to determine whether the Board may take any further action in this rate case based on the imprudence it found in the 1994 rate case. Finally, we remand for further proceedings on whether the Board may determine if the power purchased from HQ is useful. In all other respects, the order of the Board is affirmed.[38]

The Court reiterated this holding in its concluding paragraph:

> In summary, we hold that, based on issue preclusion arising from the 1994 rate case, the Board is precluded from considering whether CVPS was prudent in connection with its decision to lock into the HQ contract. This decision does not preclude the Department from litigating whether CVPS was prudent in negotiating and entering into the HQ contract and does not determine what sanctions the Board may impose in this rate case based on its 1994 imprudency decision. We remand for further consideration on whether the Board is precluded from considering in this rate case whether the HQ power is nonuseful because it is uneconomical. We reject CVPS's arguments that the Board is further precluded from considering claims or issues based on claim preclusion (res judicata) or equitable estoppel.[39]

The Supreme Court's Order effectively precludes the Board from allowing additional litigation on two issues:

- Whether CVPS acted imprudently by locking-in early to the HQ-VJO Contract in 1991. The Supreme Court concluded that the Board has already found CVPS to have acted imprudently.
- Whether the HQ-VJO Contract is used-and-useful under the test the Board employed in Dockets 5701/5724.[40]

The Court's Order does not preclude litigation on other matters, including the following:

- Whether CVPS was imprudent in negotiating and entering into the HQ-VJO Contract.

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38. *CVPS*, 769 A.2d at 671.
39. *Id*., 769 A.2d at 689–690.
40. *Id*., 769 A.2d at 685-686.

- Whether the Board should reinstate, modify, or increase the 75-basis-point penalty imposed in Dockets 5701/5724 for CVPS's management errors.
- Whether the Board can and should disallow costs associated with CVPS's imprudent decision to lock-in early to the HQ-VJO Contract.
- Whether the Board should find the HQ-VJO Contract to be not used-and-useful under a different test than employed in Dockets 5701/5724 (this includes litigation of the appropriateness of establishing a different test and the nature of that test).

IV. REASONABLENESS OF RATES

Findings

Temporary Rates

1. CVPS's original rate filing in Docket 6120 requested a rate increase of $29.833 million, or 12.9%, in annual revenues. MOU at ¶ 2.

2. On December 11, 1998, the Board approved a temporary rate increase of $10.902 million, or 4.7%, in Docket 6120, effective with service-rendered January 1, 1999. MOU at ¶ 2; *Tariff Filing of Central Vermont Public Service Corporation*, Docket 6120, Order of 12/11/98.

3. CVPS subsequently reduced its rates by $2.979 million (approximately 1.2 percent)(effective with bills rendered February 1, 2000) and $1.048 million (or .42 percent) (effective with bills rendered February 1, 2001) to reflect reduced costs, as a result of agreements in Docket 5980, *Investigation into the Department of Public Service's Proposed Energy Efficiency Plan*. MOU at ¶ 3; Docket 6120, Orders of 12/22/99 and 12/21/00.

The Docket 6460 Rate Increase

4. The test year in Docket 6460 began July 1, 1999, and ended June 30, 2000. The adjusted test year begins July 1, 2001, and ends on June 30, 2002. Frankiewicz supp. pf. at 2.

5. CVPS's original rate filing in Docket 6460 (dated November 9, 2000) requested a rate increase of $19.0 million, or 7.6%, in annual revenues.[41] MOU at ¶ 4.

41. The increase of $19.0 million was relative to the rates in effect at the time of the filing, which included the temporary rates granted in Docket 6120.

6. Much of CVPS's cost increase is due to scheduled increases in the cost of the Company's purchased power — most materially power purchased under the HQ-VJO Contract. Boyle supp. pf. at 5.

7. Since the Board approved the Docket 6120 temporary rates in December of 1998, CVPS's undercollection of costs related to the HQ-VJO Contract has increased to approximately $11.7 million per year. Boyle supp. pf. at 4–5.

Specific MOU Provisions

8. Pursuant to the MOU, CVPS's adjusted test-year cost of service for ratemaking purposes was recalculated to be $259,197,000. Similarly, anticipated revenues from current rates were projected to provide $249,345,000. These changes produce a revenue deficiency of $9,852,000 in the adjusted test year. Attachment 1 of the MOU at Schedule 1.

9. In the MOU, CVPS and the Department agreed that a rate increase in CVPS's annual revenues of $9.852 million, or 3.95 percent, effective with bills rendered July 1, 2001, will result in just and reasonable rates when considered in the context of the MOU and will allow the Company's revenues to equal its anticipated, adjusted cost of service for the adjusted test year. MOU at ¶ 12.

10. The cost of service that is the basis of the 3.95 percent increase is, in effect, a "bottom line" settlement. With certain exceptions specified in the MOU, the settlement does not reflect agreement on any particular elements of the Company's cost of service. Boyle supp. pf. at 2; tr. 5/15/01 at 60–61 (Frankiewicz); MOU at ¶ 14.

11. Under the MOU, the Company's allowed rate of return on common equity is 11.0 percent. MOU at ¶ 29; exh. DPS-L&A-3 at Schedule 4.

12. The MOU also provides a cap on CVPS's earnings during 2001, 2002, and 2003:

> 30. To the extent that CVPS's calendar year earned return on equity on its Vermont jurisdictional electricity utility operations in 2001 exceeds 11.0%, the dollar amount of such excess shall be applied (a) to reduce regulatory asset accounts as specified by the DPS and approved by the Board at the time of any such excess or (b) as otherwise agreed by CVPS and the DPS. Any such dollar amount of excess in 2002 and 2003 over CVPS's allowed return on equity in effect in such calendar year also shall be credited as provided herein, unless a

> superseding approved agreement or order on rates shall have earlier become effective.

13. Under the MOU, CVPS agrees not to file a petition with the Board requesting any further increase in retail electric rates that would be effective prior to January 1, 2003. In the event of a major storm, power supply interruption or outage in excess of forecasted outage rates relating to Vermont Yankee or Hydro-Québec deliveries, CVPS may seek emergency rate relief pursuant to 30 V.S.A. § 226(a) or seek an accounting order from the Board permitting the deferral of costs associated therewith. The Department agrees to support any such request for an accounting order. The Department reserves its right to contest the ultimate recovery of such booked and deferred costs. Boyle supp. pf. at 6–7; MOU at ¶¶ 17–18.

14. The MOU provides that:

> 19. CVPS shall not, in this or any future proceeding to determine CVPS's rates, be subject to any further penalty or disallowance of costs incurred in the purchase of power pursuant to the HQ/VJO Contract based on CVPS's prudence relating to any act or omission occurring prior to the effective date of the order approving this MOU.
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> 20. CVPS shall not, in this or any future proceeding to determine CVPS's rates, be subject to any further penalty or disallowance of costs incurred in the purchase of power pursuant to the HQ/VJO Contract based on the application of any "used or useful" theory.
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> 21. CVPS shall not, in this or any future proceeding to determine CVPS's rates, be subject to any further ROE penalty on account of the Order in Docket Nos. 5701/5724. Said ROE penalty shall be permanently lifted and removed.

MOU at ¶¶ 19–21.

15. The MOU provides that the existing temporary rates (which have been in effect since January 1, 1999) will be made permanent:

> 13. The Parties further agree that the Temporary Rates allowed by the Board in Docket No. 6120 since January 1, 1999 have resulted in just and reasonable rates for the period such Temporary Rates have been in effect; that such Temporary Rates should remain in effect through June 30, 2001; and that such Temporary Rates will result in just and reasonable rates through June 30, 2001. It is the intention of the Parties that the Temporary Rates currently in effect shall become permanent.

MOU at ¶ 13.

16. Under Paragraph 15 of the MOU, CVPS will write down certain regulatory assets in the amount of $9 million. The regulatory assets to be written-down are as follows:

- SFAS 112 - Post Employment – $109,982;
- 1997 Workforce Reduction – $1,836,770;
- Year 2000 - Incremental Costs – $1,870,326;
- Unamortized Loss on Reacquired Debt – $179,925;
- Small Power Producers Accounting Order – $452,373;
- Retail Choice Accounting Order – $110,989; and
- various Conservation and Load Management accounts[42] – $4,439,635.

MOU at ¶ 15 and Attachment 2.

CVPS's Current Financial Situation

17. S&P's current Corporate Credit Rating for CVPS is BBB-, on CreditWatch with negative implications. Boyle pf. at 14, 19; exh. CVPS-Boyle-11; exh. CVPS-Boyle-13.

18. Fitch Rating Service has rated CVPS's First Mortgage Bonds at BBB, Second Mortgage Bonds at BBB-, and Preferred Stock at BB+, with a Rating Watch-Down. Boyle pf. at 18–19.

19. Approval of the MOU will enable CVPS to continue to meet the financial covenants under its First Mortgage Bonds, Second Mortgage Bonds, other financing agreements, and preferred stock. Boyle supp. pf. at 18.

20. Statement of Financial Accounting Standards ("FAS") 5 is titled Accounting for Contingencies. It requires a company to record a loss and corresponding contingent liability when the loss is deemed to be both probable and reasonably estimable. Boyle pf. at 45; McKnight reb. pf. at 12.

21. FAS 71 is titled Accounting for the Effects of Certain Types of Regulation. It provides for regulated entities to establish regulatory assets and liabilities and thereby defer the income statement impact of certain costs and revenues that will be realized in future rates. Boyle pf. at 47; McKnight reb. pf. at 11.

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42. The allocation of this $4.4 million to CVPS's individual Conservation and Load Management accounts is discussed below in Section V.E.

22. Approval of the MOU should permit CVPS to continue to meet the criteria required to prepare its financial statements in accordance with FAS 71. Boyle supp. pf. at 3, 17–18.

Application of Traditional Cost of Service Methodologies

23. Had CVPS acted prudently in 1991, CVPS could have purchased a mix of resources that would have cost the Company between three and 5.7 cents per kWh during the adjusted test year. Chernick reb. pf. at 52.

24. In 2001, CVPS's power purchase costs under the HQ-VJO Contract are likely to exceed the cost of a prudent alternative by between $3.5 million and $28.5 million; these amounts would be less if an appropriate adjustment were made to reflect the Contract's environmental benefits. Chernick reb. pf. at 52; Docket 6107, Order of 1/23/01 at 36–37, 41, 43-45.

25. Over the remaining life of the HQ-VJO Contract (i.e., from 2001-2015), the uneconomic costs associated with CVPS's share of the HQ-VJO Contract are significant and could be as high as $98 million on a net present value basis (before accounting for the Contract's environmental benefits). Biewald reb. pf. at 13.

26. CVPS has not demonstrated that "it has eliminated the excessive power costs imposed on customers by ineffective and improvident management decisions, or that it is on a reasonable and equitable path towards doing so."[43] Through the remaining life of the HQ-VJO Contract, CVPS ratepayers will pay significantly more than they would have had CVPS eliminated the excessive power costs. Thus, CVPS has not met the criteria outlined in the Board's Dockets 5701/5724 Order of 10/31/94 for removal of the ROE penalty (as described in Part IV.A.3.c., below). Findings 24–25, above.

Discussion

43. *Investigation Into the Existing Rates of Central Vermont Public Service Corporation AND Tariff Filing of Central Vermont Public Service Corporation,* Dockets 5701/5724, Order of 10/31/94 at 172.

A. THE HYDRO QUÉBEC-VERMONT JOINT OWNERS CONTRACT

1. Background

The pivotal issue in determining CVPS's rates is the treatment of the HQ-VJO Contract, an issue that has been in dispute since 1994. CVPS and the other Vermont Joint Owners entered into the Contract with Hydro-Québec in 1987, committing to purchase a substantial amount of power beginning in 1990 and continuing to 2016. In the case of CVPS, the purchase amounted to approximately one-third of the Company's power needs during that period. The Board, after extensive hearings, approved the HQ-VJO Contract in 1990, subject to a number of conditions. This approval, however, did not bind CVPS to the power purchase — CVPS and the other Vermont Joint Owners had the right to decline to purchase power under the Contract if the regulatory approvals obtained by either the VJO or Hydro-Québec were not adequate.

In August 1991, CVPS abandoned this right to reject the HQ-VJO Contract and, instead, locked-in to the Contract, despite information that would have caused a reasonable utility manager to take a different action. In 1994, the Board examined the reasonableness of CVPS's early lock-in to the HQ-VJO Contract and concluded that CVPS had not demonstrated that lock-in decision to have been prudent.[44] The Board also rejected the Department's rationale for declaring the HQ-VJO Contract not economically useful. In a broader context, the Board examined CVPS's overall management of its power supply resources and found that CVPS had been "improvident." The latter conclusion caused the Board to adopt a 75-basis point penalty on CVPS's ROE. The Board did not, however, exclude any of the imprudent costs from rates. The Board has not removed the ROE penalty adopted in 1994, although in 1996, the Board suspended its rate effect based upon a settlement of a subsequent rate case between CVPS and the Department.[45]

More recently, the Board issued its Order in Docket 5983, establishing rates for GMP. In that Order, the Board explicitly found that GMP had been imprudent in locking-in early to the HQ-VJO Contract. Moreover, the Board determined that, because the HQ-VJO Contract would

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44. Dockets 5701/5724, Order of 10/31/94 at 109 (Finding 244). The Vermont Supreme Court has since ruled that this Board determination constituted a finding that the early lock-in had been imprudent. *In re Tariff Filing of Central Vermont Public Service Corporation*, 769 A.2d at 678 (2001).

45. *Tariff Filing of Central Vermont Public Service Corporation*, Docket 5863, Order of 4/30/96 at 7.

not provide economic benefits over its remaining life, the Contract was not used-and-useful. As a result, the Board excluded the imprudent and non-used-and-useful costs from rates. This proceeding did not directly affect CVPS. However, some analysts believed that because CVPS and GMP were joint signatories to the HQ-VJO Contract (and made the lock-in decision jointly), the standards the Board enunciated could be similarly applied to CVPS. The Docket 5983 Order created great uncertainty for the Company in both the regulatory and financial environment. On the regulatory side, CVPS and the Department agreed to a pro forma disallowance in Docket 6120, reducing CVPS's rate request by an amount proportionate to the disallowance that the Board adopted for GMP in Docket 5983. From the perspective of the financial markets, the potential that the Board would apply similar ratemaking treatment to CVPS created uncertainty over future rate recovery and the exclusion of certain costs associated with the HQ-VJO Contract, and has had a noticeable effect upon CVPS's overall financial health.[46]

The ratemaking treatment of the HQ-VJO Contract in this proceeding thus has two aspects. First, from a strict financial perspective, CVPS's existing rates were based upon a cost of service that did not include full recovery of the costs of the HQ-VJO Contract. After negotiations with the Department, in 1998, CVPS requested that the Board approve temporary rates in Docket 6120 that included a pro forma disallowance of a portion of the HQ-VJO Contract costs.[47] Solely to obtain full recovery of these costs on a going-forward basis, CVPS would need to increase its rates by 4.6 percent, which is less than the rate increase provided in the MOU.[48] Second, the Board must now affirmatively address whether to exclude imprudent costs and any costs that may not be used-and-useful based upon traditional ratemaking methodologies and/or whether to extend the ROE penalty originally adopted in 1994.

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46. Boyle supp. pf. at 9.

47. CVPS suggests in its testimony that the Board has denied CVPS recovery of these costs. This is incorrect. In Docket 6120, the Board approved the temporary rates that CVPS itself requested and did not adjust those rates. Similarly, in Docket 6018, the Board did not exclude any costs associated with the HQ-VJO Contract. Instead, at CVPS's request, the Board stayed and eventually dismissed the proceeding without making any substantive rulings on CVPS's rates.

48. Boyle supp. pf. at 4–5; tr. 5/15/01 at 202 (Boyle).

2. Treatment of the HQ-VJO Contract Under Traditional Cost of Service Regulation

The MOU provides one solution to the uncertainty created by the HQ-VJO Contract. In order to examine the reasonableness of the rate increase embodied in the MOU, it is necessary to determine the ratemaking treatment of the HQ-VJO Contract in the absence of that agreement.

Under traditional cost-of service regulation, we start with the presumption that utility expenditures are reasonable and prudent. This presumption provides companies a reasonable measure of certainty as they exercise their discretion and manage their affairs. This presumption does *not* "guarantee" rate recovery, however, but rather is rebuttable.[49] In particular, long-standing utility rate-making principles require that, in order to be fully recoverable in rates, expenditures must be both prudent and used and useful for the provision of service to customers.

A prudence determination is simply an inquiry into the reasonableness of utility management decision-making. Generally, imprudent expenditures by utilities are not recoverable from ratepayers.[50] The used-and-useful principle is a two-part standard.[51] A utility's expenditures for a particular resource (or other item) can be included in rates if the resource is both *used* — that is, necessary to provide service to ratepayers — and *useful* — which is to say, economic for the purposes it is serving.[52] An investment or cost is not used and useful, *i.e.,* has failed, when it is not expected to yield net present value benefits, after consideration of non-price benefits, over its remaining lifetime. Both parts of the standard must be satisfied in order for the overall principle to be met and rate recovery permitted.[53]

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49. *See* extensive discussion in Docket 5132, Order of 5/15/87 at 79–89.

50. *Investigation of Vermont Electric Cooperative, Inc's Request to Increase its Rates AND Investigation into DPS/NYPA Tariff Filing AND Petition of Vermont Electric Cooperative, Inc. and Vermont Electric Generation and Transmission Cooperative, Inc. to Restructure its Long-Term Debt,* Dockets 5630/5631/5632, Order of 12/30/93 at 52; Docket 5983, Order of 2/27/98 at 217.

51. Docket 5983, Order of 2/27/98 at 246. We found in Docket 5132 that a "long-standing principle of regulatory law has been that an investment must be 'used and useful' for the provision of public service before the public should be asked to bear its cost." Docket 5132, Order of 5/15/87 at 129–130, citing Mass. DPU 85-270, Order of June 30, 1986, at 27.

52. Docket 5983, Order of 2/27/98 at 246.

53. *Id*. at 246. As we have stated:

> One exception to the literal "used and useful" rule is longstanding. It provides that the rule need not be stringently applied if a greater recovery is "necessary to ensure efficiency and progress in the art and the continued attraction of capital to the enterprise." *Washington Gas Light Co. v.*

(continued...)

The dual requirement that utility expenditures be both prudent and used-and-useful provides a safeguard so that those ratepayers do not bear the costs when a utility makes unreasonable decisions and that ratepayers do not pay the entirety of expenditures for which they receive no benefit.[54] These two rate-making tenets both look at the reasonableness of utility actions from different perspectives. As the Court of Appeals for the District of Columbia has concluded, a used-and-usefulness review works best in tandem with, but subsequent to, a prudence determination; neither should be applied mechanically, but rather with an eye to factual and equitable considerations:

> Prudence is, of course, relevant to the process of striking a reasonable balance in rate-setting for public utilities. Requiring an investment to be prudent when made is one safeguard imposed by regulatory authorities upon the regulated business for benefit of ratepayers. As I see it, the "used and useful" rule is but another such safeguard. The prudence rule looks to the time of investment, whereas the "used and useful" rule looks toward a later time. The two principles are designed to assure that the ratepayers, whose property might otherwise of course be "taken" by regulatory authorities, will not necessarily be saddled with the results of management's defalcations or mistakes, or as a matter of simple justice, be required to pay for that which provides the ratepayers with no discernible benefit.[55]

In addition (or as an alternative) to excluding imprudent and non-used-and-useful costs, the Board may adjust the Company's ROE.[56] The Board did precisely that in 1994, imposing the 75-basis-point penalty on CVPS for power supply management failures (although the Board suspended the rate effect of the penalty in 1996).

CVPS has argued that the Board is limited in its ability to use these traditional approaches. In particular, CVPS states that the Board has not found CVPS to be imprudent, that the Board is estopped from finding the Contract not used-and-useful, and that the Board is

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53. (...continued)
Baker, 188 F. 2d 11, 19 (D.C. Cir. 1950), *cert. denied*, 340 U.S.952 (1951). Even that exception is limited by the overriding rule that it must not result in unfairness to ratepayers.
Docket 5132, Order of 5/15/87 at 132, fn. 43.

54. *Jersey Central Power and Light Co. v. FERC*, 810 F.2d 1168 (D.C. Cir. 1987).

55. *Id.* at 1189-91 (footnotes omitted). "The two principles thus provide assurances that ill-guided management or management that simply proves in hindsight to have been wrong will not automatically be bailed out from conditions which government did not force upon it." *Id.* at 1190.

56. *See*, *In re Citizens Utilities Company*, 769 A.2d at 24–26.

limited to reinstating the 75 basis point ROE penalty (although CVPS acknowledges that the Board may increase that penalty under the Vermont Supreme Court's recent decision[57]).

We do not agree that the Board's authority is so limited. First, the Vermont Supreme Court decision does not limit the Board's remedies for CVPS's imprudent actions to reinstatement of the previous ROE penalty. As we stated above in Section III, the Court expressly declined to rule on the possible actions the Board could take. The factual differences between the adjusted test year in Docket 6460 and 1995 (the adjusted test year for the 1994 decision) are significant: CVPS's costs for purchasing power under the HQ-VJO Contract are three to four times larger than earlier, so that the impact on ratepayers is far greater.[58] Given the changes, the 75-basis-point ROE penalty that was reasonable in 1994 could well be significantly larger now.[59]

Second, the Board clearly retains the authority to reimpose the 75-basis-point ROE penalty "as long as CVPS's service is being impaired as a result of the high price of its power."[60] Moreover, the Board could modify or increase the ROE penalty based upon changed circumstances or CVPS's performance in eliminating the excess power costs. In fact, the Vermont Supreme Court expressly declined to limit the scope of the Board's authority to adjust the ROE penalty, stating:

> we believe it is premature to determine whether collateral estoppel precludes the Board from adopting *a modified or increased rate-of-return reduction* in this case for the imprudency it found in 1994. At this point, we can only speculate on what basis the Board may act, and the nature and extent of the reduction it might adopt.[61]

Third, CVPS's argument that the Board has not found the early lock-in to the HQ-VJO Contract imprudent is refuted by the very Supreme Court decision on which the Company relies. Although the Board did not expressly find CVPS to be imprudent in 1994, the Court has since

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57. *In re CVPS*, 769 A.2d 668.

58. Tr. 5/15/01 at 174 (Boyle).

59. The fact that CVPS's purchases under the HQ-VJO Contract would increase was known during the 1994 case. As those higher costs were not in the adjusted test year, however, it was premature for the Board to adopt an adjustment to rates at that time in anticipation of later costs.

60. *In re CVPS*, 769 A.2d at 682.

61. *In re CVPS*, 769 A.2d at 683 (emphasis added).

determined that the Board implicitly found as much when the Board concluded that CVPS had not met its burden of demonstrating the prudence of its actions.[62] Thus, application of traditional ratemaking methodologies would clearly entail a determination of the appropriate amount to be excluded from rates due to CVPS's imprudence.

Finally, CVPS asserts that the Board previously found that the HQ-VJO Contract was used-and-useful. The Vermont Supreme Court has ruled that the Board's prior determination collaterally estops the Board from imposing a disallowance based upon application of the same test. However, the Court also made clear that regulatory agencies, such as the Board, can change the applicable regulatory framework based upon certain conditions.[63] Thus, the Board could find that a change in the applicable regulatory policies was appropriate and thus impose a used-and-useful disallowance.[64]

Thus, we conclude that we have the authority to disallow imprudent and non-used-and-useful costs and/or impose a penalty on CVPS's ROE through the application of traditional cost of service methodologies. Below, we consider the specific rate impacts that would flow from employing these methodologies.

3. Rate Effects of Employing Traditional Cost of Service Methodologies

a. Prudence

Since the Board has previously found CVPS's early lock-in to the HQ-VJO Contract to be imprudent, we must next determine what amount should be disallowed from CVPS's retail rates. In the 1998 GMP decision, we described the method by which we make this determination:

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62. *In re CVPS*, 768 A.2d at 678.

63. *In re CVPS*, 768 A.2d at 685-686. Specifically, the Court noted that:

> The Restatement (Second) of Judgments recognizes that collateral estoppel generally applies to issues of law, Restatement (Second) of Judgments § 27 (1982), but provides exceptions to the general rule when:
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> > (2) The issue is one of law and (a) the two actions involve claims that are substantially unrelated, or (b) a new determination is warranted in order to take account of an intervening change in the applicable legal context or otherwise to avoid inequitable administration of the laws[.]

64. CVPS itself has stated that the Docket 5983 Order fundamentally altered the applicable legal standards. Exh. AARP-2 at 9. Because of our determination below that it is appropriate to establish rates on a basis other than the use of traditional cost of service methodologies, we need not affirmatively decide whether the conditions outlined in the Vermont Supreme Court's Order and the Restatement (Second) of Judgments apply here.

> Our task, in measuring the harm that has been created by the Company's imprudence, is to compare the cost of the Contract to the cost of the reasonable and prudent portfolio that would have been acquired instead in 1991 and the following years.[65]

Employing this approach, the Department estimates that if CVPS had not imprudently locked-in early to the HQ-VJO Contract, the Company would instead have committed to a mix of resources that would have prices in 2001-2002 of between 3 cents per kWh and 5.7 cents per kWh.[66] By comparison, CVPS expects to pay 6.389 cents per kWh in 2001 and 6.454 cents per kWh in 2002 for power purchased from Hydro-Québec.[67] Thus, using the middle of the Department's range of options for an alternative portfolio, CVPS will pay $18 million more for HQ-VJO Contract power in 2001 than it would have had the Company purchased power under the alternative portfolio instead of locking-in to the HQ-VJO Contract. By comparison, CVPS asserts that the alternative to the HQ-VJO Contract power is $57 million higher in expected costs (on a net present value basis) than the HQ-VJO Contract.[68]

Attempting to analyze the specific portfolio that a prudent utility would have purchased to replace the HQ-VJO Contract is inexact.[69] Had CVPS not locked-in early to the HQ-VJO Contract, the Company would have needed to purchase power equal to approximately one-third of its total needs over an extended period of time. CVPS had many possible options for meeting its resource needs. In all likelihood, CVPS would have met these resource needs through a mix

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65. Docket 5983, Order of 2/27/98 at 249.

66. Chernick reb. pf. at 52.

67. Chernick reb. pf. at 53.

68. Deehan/Cater/Amelang sur. pf. at 69. CVPS includes large adjustments for the HQ-VJO Contract's environmental and risk benefits in this calculation. CVPS has not demonstrated that the risk adjustment is appropriate. We have previously recognized that the price of the HQ-VJO Contract is more stable than some alternatives. Docket 6107, Order of 1/23/01 at 45. However, CVPS has not demonstrated why this price stability should increase the value of the asset. A stable, but above market contract may not have price fluctuations, but that fact does not diminish the fact that it is above market prices. Moreover, CVPS's approach has various methodological flaws. *See* Chernick reb. pf. at 12-24.

In addition, CVPS has not shown that its estimate of the environmental benefits is reasonable. First, the environmental benefits CVPS now asserts it would have used to assess resource needs had the Company cancelled the HQ-VJO Contract are values developed in Massachusetts. However, at the time, CVPS was using other, much lower values for environmental externalities during this time period. Chernick reb. pf. at 8. Second, use of the Massachusetts adders also fails to take into consideration the environmental impacts of hydro facilities, such as Hydro-Quebec's, which is necessary for a balanced analysis. Biewald reb. pf. at 25. Thus, we cannot rely upon CVPS's present valuation of environmental externalities.

69. Chernick reb. pf. at 6.

of short and long-term power acquisitions.[70] Exact replication now of the resources that would have made up a prudent portfolio, however, is virtually impossible. Nonetheless, to determine the financial impact of CVPS's imprudent decisions, it is necessary to make some judgment as to the likely scenarios and resulting power costs.

On the whole, we find the Department's analysis to be a reasonable starting point for the determination of the rate year costs of the imprudence.[71] Had CVPS acted prudently in 1991, CVPS could have purchased a mix of resources that would have cost the Company between three and 5.7 cents per kWh during the adjusted test year.[72] This means that the amount of the extra costs for ratepayers arising from CVPS's imprudence ranges from $6.7 million to $32.1 million in the adjusted test year.[73]

We cannot accept this figure without some adjustment, however. As we found in Docket 6107, it is appropriate to reflect the likely cost of Installed Capacity (or a replacement product) in the analysis.[74] Factoring in this component, the range of an imprudence disallowance would be

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70. Docket 5983, Order of 2/27/98 at 249.

71. We find CVPS's assertion that the HQ-VJO Contract is less expensive than alternative resources unpersuasive. Two specific issues require mention. First, CVPS maintains that the Contract is cost-effective. Yet at the same time, the Company has actively pursued efforts to terminate the Contract through the arbitration with Hydro-Québec of issues arising from Hydro-Quebec's failure to deliver power for an extended period in 1998 following a severe ice storm. Boyle pf. at 88-90. If the former assertion is correct, it is hard not to conclude that efforts to abrogate the HQ-VJO Contract were imprudent. We do not reach that conclusion; both CVPS and GMP have made it clear that termination of the HQ-VJO Contract through arbitration would likely produce significant cost saving. In this light, CVPS's present assertions as to the cost-effectiveness of the HQ-VJO Contract must be rejected.

Second, CVPS's analysis assumes that in the absence of the HQ-VJO Contract, CVPS would have implemented significantly more demand-side management measures. If this is correct, it appears to be inconsistent with statements made at the time the utilities sought approval of the HQ-VJO Contract (where the utilities asserted that the Contract would not displace any otherwise cost-effective DSM measures). Moreover, failure to obtain these DSM resources may constitute a violation of Condition 8 of the Board's Order approving the HQ-VJO Contract, which incorporated the utilities' commitment to attain the same level of demand-side management savings after purchases under the Contract. *Application of Twenty-Four Electric Utilities*, Docket 5330, Order of 10/12/90 at 40.

72. Chernick reb. pf. at 52.

73. CVPS will purchase 938 GWh under the HQ-VJO Contract during the adjusted test year. The cost of this power is approximately $64.21/MWh ($63.89/MWh in 2001 and $64.54/MWh in 2002), yielding a total cost of $60.2 million in the adjusted test year. A prudent portfolio at $0.03/kWh ($30/MWh) would have cost $28.1 million, which is $32.1 million less than CVPS will pay. A portfolio at the higher end of the range – $0.057/kWh ($57/MWh) would have cost $53.5 million, which is $6.7 million less than CVPS will pay for HQ-VJO Contract power during the same time period. Chernick reb. pf. at 52-53.

74. Docket 6107, Order of 1/23/01 at 43.

from $3.5 million to $28.9 million.[75] In addition, this Board has recognized that the HQ-VJO Contract has some environmental benefits that should be incorporated into any effort to value the impact of the imprudence.[76] CVPS has not been able to demonstrate the reasonableness of its estimate of the environmental benefits.[77] However, we conclude that consideration of these benefits is unlikely to alter our fundamental conclusion that a reasonable imprudence disallowance would be significant.

We also do not have an evidentiary record that would permit accurate calculation of the prudence damages beyond the adjusted test year. Estimates of the excess costs due to imprudence over the remaining life of the HQ-VJO Contract range as high as $100 million (on a net present value basis).[78] Although, based upon recent changes in market prices, we would expect the actual financial effects of the imprudence to be less than this figure, it is clear that a large disallowance in each of the Contract's remaining years would be appropriate to reflect CVPS's imprudent early lock-in.

b. Used-and-Useful (Economic Usefulness)

Applying the used-and-useful standard that the Board employed in Docket 5983 (and again in Docket 6107), the Department estimates that the costs of CVPS's purchases under the HQ-VJO Contract will exceed their economic value by $98 million over the remaining life of the

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75. None of the parties proposed an Installed Capacity adjustment to the measures of the imprudent costs. For that reason, the parties in this proceeding also did not quantify the likely costs of Installed Capacity. However, based upon our review of the record and the calculation of the effects of CVPS's imprudence, we believe this adjustment is appropriate. We note that both the methodology and result are consistent with our recent findings in Docket 6107. *See* Order of 1/23/01 at 36–47. In that case, we concluded that the cost of Installed Capacity was the price ($1.85/kW-mo.) times 12 months times the capacity (143,000 kW for CVPS). Order of 1/23/01 at 43, fn. 134. We expect that the value would be similar today. For CVPS, this produces an adjustment of $3.2 million, which is subtracted from the $6.7 million to $32.1 million range found earlier.

Even if we did not include an adjustment for Installed Capacity, our overall decision in this Order would remain unchanged. Without the adjustment, the measure of CVPS's imprudence in the adjusted test year would be larger and would imperil the Company's financial viability.

76. Docket 6107, Order of 1/23/01 at 43–45.

77. We do not find CVPS's arguments regarding the magnitude of the HQ-VJO Contract's environmental benefits persuasive. Although the Contract clearly has environmental benefits, CVPS has vastly overstated those benefits. *See* fn. 68.

78. Tr. 5/16/01 at 22 (Steinhurst).

Contract (on a net present value basis).[79] In fact, if the Department employed CVPS's forecasts of market prices of power instead of the Department's own forecasts, this figure balloons to $160 million.[80] CVPS counters by arguing that on a net-present-value basis, the HQ-VJO Contract power is $153 million less expensive than the market forecast for power for the period 2001 through 2016 (when environmental and risk benefits are factored in), so that even if one employed the used-and-useful standard, the HQ-VJO Contract is both used and useful.[81]

Overall, although we recognize the difficulty in predicting future market prices for power, we find the Department's estimate of the future market prices reasonable.[82] Based on evidence of record, we conclude the HQ-VJO Contract might exceed those market prices by as much as $98 million over its remaining life, of which one-half could have been assigned to shareholders (as described below). Our best estimates of future power costs persuade us that the figure could be materially lower; however, under any likely scenario it would remain quite large.

Under traditional ratemaking, the Board has generally not required utility shareholders to absorb the entire uneconomic costs arising from investments found not to be used-and-useful, but instead has required a sharing of those costs.[83] In most cases, this has been accomplished by having ratepayers and shareholders share those costs equally.[84] In addition, it is appropriate to value the environmental benefits of the HQ-VJO Contract in determining the full above market costs.[85] Regardless of the uncertainties surrounding the upper bound of the above-market

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79. Biewald reb. pf. at 13.

80. Exh. DPS-BEB-4 at 2.

81. However, CVPS's Chief Financial Officer also acknowledged that a used and useful disallowance could be as great as $86 million. Tr. 5/15/01 at 93 (Boyle).

82. As with CVPS's prudence calculations, the Company includes large adjustments for the HQ-VJO Contract's environmental and risk benefits. We do not accept either of the specific adjustments put forward by the Company in our calculation of likely uneconomic costs of the Contract. *See* fn. 68.

83. In cases where the Board has found utility investments to be uneconomic, the Board typically fashions a remedy that shares the resulting burden of uneconomic costs between shareholders and ratepayers. Docket 5132, Order of 5/15/87, 83 PUR 4th 590–594. The Board has done this to allocate the costs of failed investments in major power plants between ratepayers and shareholders. *See, e.g., In re Central Vermont Public Service Corp.*, Docket No. 5132, 83 P.U.R. 4th 532, 594 (Vt. PSB 5/15/87); *In re Central Vermont Public Service Corp.*, Docket Nos. 4496/4504, Order of 12/4/81, at 11–14; *In re Central Vermont Public Service Corp.*, Docket No. 4634, 49 P.U.R. 4th 372, 376 (Vt. PSB 9/16/82); *In re Central Vermont Public Service Corp.*, Docket No. 5030, 72 P.U.R. 4th 733, 747–49 (Vt. PSB 2/18/86).

84. Docket 5132, Order of 5/15/87 at 5.

85. *See* Docket 5983, Order of 2/27/98 at 208–209 (Finding 642), 254.

portion (i.e., the portion that is not economically used and useful) of the HQ-VJO Contract, there is no doubt that, even after consideration of these environmental benefits and the application of a 50/50 sharing of the uneconomic costs, the amount of a rate disallowance would be measured in the tens of millions of dollars.[86]

c. The ROE Penalty

In Dockets 5701/5724, the Board imposed a 75 basis point penalty upon CVPS's ROE due to the Company's "mismanagement of its power supply."[87] At that time, we stated that:

> [t]his reduction should remain in place until the Company demonstrates, through tangible results, that it has eliminated the excessive power costs imposed on customers by ineffective and improvident management decisions, or that it is on a reasonable and equitable path towards doing so.[88]

In 1996, the Board suspended the rate effect of this ROE penalty, stating that:

> We are not, however, permanently removing [the penalty] at this time, because we are not persuaded that the Company has met the standards set out in our 10/31/94 Order for removal of the penalty. With respect to the standard, we conclude that the Company has shown no basis upon which to conclude that it has "*eliminated* the excessive power costs" imposed on customers by ineffective and improvident management decisions. Neither, in our view, has the Company demonstrated that "it is on a reasonable and equitable path towards . . ." eliminating these excessive power costs.[89]

CVPS has presented evidence showing changes to the Company's management of its supply resources. These changes, the Company argues, are sufficient to justify elimination of the ROE penalty.[90]

We find these assertions unpersuasive and find instead that CVPS has not achieved tangible results in reducing its above-market power costs.[91] The fundamental concern raised by

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86. This figure represents only a used-and-useful disallowance.
87. Dockets 5701/5724, Order of 10/31/94 at 171–172.
88. Dockets 5701/5724, Order of 10/31/94 at 172.
89. Docket 5863, Order of 4/30/96 at 28.
90. *See*, for example, Boyle pf. at 60–104.
91. Tr. 5/16/01 at 29 (Steinhurst); Chernick sur. pf., generally; Biewald sur. pf., generally.

the Board in both the 1994 and 1996 Orders — the excessive power costs resulting from the Company's mismanagement of its power supply resources — remains. As we discussed above, ratepayers are still paying well above market prices for HQ-VJO Contract power. Similarly, CVPS's ratepayers continue to pay for the excessive costs arising from CVPS's earlier imprudent decision to waive its opportunity to terminate the HQ-VJO Contract without liability. The absence of progress on these fronts could, at a minimum, justify reimposition of the 75-basis-point ROE penalty. However, we also note that CVPS's purchases under the HQ-VJO Contract have increased greatly since 1994 so that CVPS now purchases more power from Hydro-Quebec and pays more more than three times as much for power under the HQ-VJO Contract as it did in 1994.[92] With the larger purchases, the adverse impacts upon ratepayers have also grown. This change suggests that it may be appropriate to increase the ROE penalty, rather than maintain it, so that larger effects of the Company's earlier management failures and current inability to reduce excessive power costs do not fall exclusively on ratepayers.

4. Financial Impacts of Rate Disallowance

In the previous Section, we concluded that application of traditional cost of service ratemaking principles could produce significant rate disallowances. The Department and CVPS assert that such disallowances could harm CVPS and that approval of the MOU is needed in part to assure CVPS's continued access to capital. In this section, we examine the likely effect of the rate disallowance discussed in the previous section upon CVPS's financial stability and access to capital.

To date, major credit rating agencies have rated CVPS's securities as investment-grade, although the ratings are only marginally above non-investment-grade. S&P's current Corporate Credit Rating for CVPS is BBB- on CreditWatch with negative implications.[93] Similarly, Fitch Rating Service rated CVPS's First Mortgage Bonds at BBB, Second Mortgage Bonds at BBB-,

92. Tr. 5/15/01 at 174 (Boyle).

93. Boyle pf. at 14–16; exhs. CVPS-Boyle-11, 12, and 13.

and Preferred Stock at BB+, with a Rating Watch-Down.[94] Investment-grade credit ratings have historically enabled CVPS to obtain capital to fund its needs.

Significant rate reductions (such as those justified by the application of traditional cost of service regulation) are likely to cause a downgrade of the Company's credit ratings. The S&P and Fitch ratings are accompanied by concerns, which arise primarily from the uncertainty about the future collection of costs to cover HQ-VJO power costs. This uncertainty is the principal impediment to having a clean investment grade rating and could limit CVPS's future ability to raise capital.[95] Rate disallowances that convert this uncertainty into a reality are likely to cause rating agencies to act on the concerns they have already expressed.

More importantly, the record shows that the exclusion of HQ-VJO Contract power costs at the lower end of the ranges we have identified could force a downgrade of CVPS's credit ratings. The Department and CVPS have agreed that CVPS will write-off $9 million from regulatory asset accounts. In the adjusted test year, this write-off will have a rate effect of approximately $4.2 million (with additional benefits to ratepayers in future years), which would allow the Company to retain its investment-grade credit ratings.[96] They also testified that a larger, $13 million write-off, previously recommended by the Department, is likely to lead to a downgrade in the Company's credit rating.[97]

This testimony does not, however, support the conclusion that a disallowance at even the lower end of the range of a possible prudence disallowance ($3.6 million in 2001 and additional amounts for each remaining year of the Contract) would allow CVPS to retain its present credit ratings even though the rate effect in the adjusted test year is similar to that of the $9 million write-off. First, the $9 million write-off (and $4.2 million effect on rates) will finally resolve the HQ-VJO Contract issue and will only affect revenues for a short period of time. The prudence disallowance leaves the rate issues in the remaining years unresolved, so that the certainty that the MOU provides would not occur. Financial markets are unlikely to respond favorably to this

94. Boyle pf. at 18–19; exh. CVPS-Boyle-16.

95. Tr. 5/15/01 at 149–150 (Boyle).

96. Exh. CVPS-Boyle-54.

97. Tr. 5/16/01 at 89-90 (Ross). Similarly, the $25 million write-off the Department originally proposed would likely trigger a downgrade. Ross supp. pf. at 2; exh. DPS-WLR-12.

continued uncertainty. Second, this comparison only considers prudence and only at the extreme lower end of the range of possible rate disallowances. Including rate disallowances based upon application of the used-and-useful principle or a continuation of an ROE penalty, the lower end of a reasonable rate disallowance would exceed the $4.2 million rate effect (from the write-off) even in the adjusted test year. As the Company will barely retain its investment grade status under the MOU, we conclude that use of these rate methodologies or adoption of the Department's original recommended write-off, could cause serious and irreparable harm for CVPS, particularly given the poor prospects for mitigation of the HQ-VJO Contract.[98]

The disallowance of HQ-VJO Contract power costs also raises issues concerning two financial accounting standards — FAS 5 (which requires a company to record a loss and corresponding contingent liability if the loss is deemed probable and can be reasonably estimated) and FAS 71 (which permits utilities to record current period costs that will be recovered in future rates as regulatory assets, thus deferring the related expenses to future periods). Under FAS 5, CVPS clearly would need to write off any amounts that the Board specifically disallows for the adjusted test year. It is possible that CVPS could also be required to write off anticipated rate disallowances in subsequent years. In this case, the mandated write-off would be significantly larger than the $25 million write-off that the evidence demonstrates would lead to a downgrade in the Company's credit ratings and could have the same effect.[99]

Under FAS 71, companies that are unable to earn their allowed rate of return over a period of time may be required to abandon use of the accounting treatment enabled by that accounting statement.[100] CVPS has not earned its allowed rate of return over the past several years.[101] Thus, rate disallowances that prevent CVPS from earning its allowed rate of return in

98. Steinhurst supp. pf. at 6.

99. Boyle reb. pf. at 3.

100. McKnight reb. pf. at 11.

101. Exh. Board-1 at 12. To a large degree, the under-earning has occurred because of the tactical choices the Company made in not pursuing rate relief or in requesting that the Board grant smaller rate increases than the Company believed it needed. Thus, CVPS sought a stay of the proceedings rather than asking the Board to grant rate relief in Docket 6018. And in Docket 6120, CVPS asked the Board to grant the temporary rates now in existence (which did not allow full recovery of HQ-VJO Contract power costs). Nonetheless, we recognize that, although CVPS bears the responsibility for its recent failure to earn its allowed rate of return, the failure to earn its return in the next several years could require additional write-offs and imperil CVPS's financial health.

the future could require CVPS to discontinue the use of FAS 71. This could require additional immediate write-offs, thereby creating additional financial pressures upon CVPS.[102]

Collectively, the write-downs required by FAS 5 and FAS 71 could create serious financial problems for CVPS.[103]

The financial consequences of the application of traditional ratemaking methodologies suggest that CVPS's current ratings would be downgraded, with potentially severe consequences. Lower credit ratings increase the costs for CVPS and its ratepayers.[104] More significantly, CVPS's size means that a degradation of its credit ratings could lead to the Company's being unable to obtain capital at all.[105] Although CVPS is the state's largest electric utility, it is still quite small from the perspective of the investment community. The Company does not have sufficient size to create an active trading market for its securities.

We have also noted that the proposed MOU is explicitly aimed at maintaining CVPS's credit rating as investment-grade, rather than at the "continuing financial viability" standard applied in the case of GMP (Docket 6107). We have asked the parties whether there is a meaningful distinction between these two standards, and the testimony has persuaded us that there is not. It is entirely possible that unless CVPS retains an investment grade rating, the Company would not have access to capital[106] and would not continue to be financially viable over the long term.[107] As explained by one witness:

> There is in principle a possibility that the outcome in this case that cause[s] the company to lose its investment grade bond rating might still leave the company financially viable. But in my opinion, that's a very risky strategy to try to follow, because there are many ways in which to follow from an attempt to thread that needle, could create negative consequences for the company's finances that would snowball and quickly eliminate any narrow band of possibility that's in there. In other

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102. Tr. 5/9/01 at 27 (McKnight).

103. Tr. 5/16/01 at 57–58 (Steinhurst).

104. According to CVPS, the difference between a BB and a BBB- rating could be as much as two percentage points of interest. Tr. 5/15/01 at 33 (Rice).

105. Tr. 5/15/01 at 36, 39–40 (Rice).

106. Tr. 5/15/01 at 36 (Rice).

107. Tr. 5/16/01 at 62 (Steinhurst).

> words, it would result in what I believe would be a brittle outcome that would not survive — not be likely to survive significant stresses.[108]

The loss of access to capital markets is clearly unacceptable. The operation of a regulated utility is a highly capital-intensive endeavor. CVPS and other electric utilities have constant needs for capital both to meet new demand for service and to upgrade or replace existing facilities to ensure reliable service. In addition, VELCO is planning significant capital additions necessary to continue to provide reliable power supply within the state. CVPS owns approximately 55 percent of VELCO's common stock and supports approximately 45 percent of VELCO's cost of service. Thus, VELCO's financings are affected by CVPS's credit ratings and access to capital.[109] If CVPS is to continue to operate as an electric utility, the Company will require access to capital markets.

Finally, we note that CVPS's ability to meet its obligations also could affect other Vermont utilities. As we explained in our recent Docket 6107 Order, purchases from Hydro-Quebec are governed by the HQ-VJO Contract and the Amended Participation Agreement.[110] Through those arrangements, if CVPS fails to pay for its share of purchases under the Contract and Participation Agreement, other Vermont utilities must assume a pro-rata increase of the HQ-VJO Contract purchases. CVPS now purchases the largest share of power under the Contract — over 40 percent.[111] A default by CVPS would thus cause other Vermont utilities to nearly double their purchases of expensive power — power that they may not need and which would be very difficult to resell without loss. The obligation to purchase this additional power could place other Vermont utilities in an unstable financial situation similar to CVPS's.

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108. Tr. 5/16/01 at 61 (Steinhurst). The same witness emphasized the difficulty of CVPS falling below an investment-grade credit rating.

> In the GMP case 6107, the remedy necessary to avoid imminent bankruptcy was the same as the remedy necessary to ensure the financial viability in this proceeding. It's not a hundred percent clear that there is no room in between those two. But if there is, it's my belief that there isn't a lot of room.

Tr. 5/16/01 at 58 (Steinhurst).

109. Boyle supp. pf. at 13; Boyle sur. pf. at 26.

110. *See* Docket 6107, Order of 1/23/01 at 70–71.

111. CVPS purchases approximately 140 MW of power from Hydro-Quebec. Boyle reb pf. at 28. The total purchases from Hydro-Quebec that the Board approved in Docket 5330 are 340 MW. Docket 5330, Order of 10/13/90 at 20.

In sum, application of traditional ratemaking methodologies, under the unusual and very case-specific circumstances of this docket, would be likely to seriously undermine CVPS's long-term financial viability and access to capital, with resulting adverse affects upon ratepayers.

B. FINAL RATES AND RECOVERY OF HQ-VJO CONTRACT COSTS

In our recent Order in Docket 6107, we considered the appropriate mechanism for setting rates for GMP, Vermont's second largest electric utility. GMP had made the same imprudent decision to lock-in early to the HQ-VJO Contract that CVPS did. GMP also faced serious financial difficulties, stemming in part from its HQ-VJO Contract costs. Because a significant rate disallowance could have forced GMP into bankruptcy, an outcome that we found should be avoided, we concluded that it was appropriate to establish rates greater than those that we would set using traditional cost of service methodologies:

> As a result of these considerations and conclusions, we have determined that it is in the best interests of GMP, its customers, and the general public to establish rates for the period covered by the Third MOU at a level greater than would be required pursuant to traditional cost-of-service formulae, to generate the amount of revenues necessary to support the Company's continued financial viability and its ability to provide quality service to its customers.[112]

After reviewing the applicable legal standards in Vermont, we found that

> Unambiguous precedent in Vermont and elsewhere calls for us to consider carefully GMP's financial plight in setting rates. Our task is to fashion an order that permits the financial survival of the Company — and thus promoting the shareholders' interests as well as those of the ratepayers — while providing the greatest reasonable benefits for ratepayers, who will be paying rates in excess of those that would otherwise be justified on a cost basis.[113]

Considering CVPS's current financial situation, and the need for the Company to obtain access to capital at reasonable cost in the future, we conclude that it is appropriate to employ the same approach here. We thus approve the rate levels specified in the MOU, despite the fact that

112. Docket 6107, Order of 1/23/01 at 76.

113. Docket 6107, Order of 1/23/01 at 78.

they are higher than would be established if we followed traditional ratemaking methodologies. Specifically, our approval extends to the following:

- CVPS may increase its retail rates by 3.95 percent or $9,852,000, effective with bills rendered July 1, 2001.[114]
- The temporary rates that took effect January 1, 1999, are deemed just and reasonable from that date through bills rendered June 30, 2001, and are made permanent.
- To the extent that CVPS earns in excess of the 11 percent ROE granted in this proceeding, CVPS shall apply the dollar amount of such excess (a) to reduce regulatory asset accounts as specified by the DPS and approved by the Board at the time of any such excess or (b) as otherwise agreed by CVPS and the DPS.[115]
- CVPS may not file a petition requesting any further increase in retail electric rates to be effective prior to January 1, 2003, except under the circumstances enumerated in paragraph 18 of the MOU.
- The write-down of assets as specified in paragraph 15 of the MOU.

As we discussed earlier in this Section, the ratemaking treatment of the HQ-VJO Contract has created financial uncertainties for CVPS that are long-term and not fully addressed by the granting of immediate rate relief in this proceeding. Specifically, the concerns expressed in the ratings from the investment community extend to the potential for future rate disallowances. To address this concern, the MOU provides that CVPS will not be subject to HQ-VJO Contract-related rate disallowances in the future based upon application of the prudence or used-and-

114. The MOU accelerates the implementation date of the new rates by approximately 7 weeks. (In light of the provisions in 30 V.S.A. §§ 225(a) and 227(a), any new rates established by the Board in Docket 6460 would normally go into effect on a service-rendered basis on July 24, 2001.) This seven-week acceleration is estimated to result in the collection from ratepayers of approximately $1,000,000 more than would have occurred if the implementation date were not accelerated. Tr. 5/15/01 at 198–199 (Boyle). (Mr. Boyle testified that a one-month acceleration would increase revenues by $800,000. The actual acceleration is greater — seven weeks — but is phased in for the first month by being implemented on a bills-rendered basis. The $1,000,000 figure is the net effect of the longer time period and the phase-in.) Both CVPS and the DPS have testified that the acceleration of the implementation date was the result of negotiation, and is an integral part of the settlement embodied in the MOU; therefore, we decline to modify this provision of the MOU.

115. CVPS and the Department must obtain Board approval of the specific regulatory asset accounts that CVPS will write-down if CVPS generates earnings in excess of the Company's ROE. In addition, CVPS and the Department must obtain Board approval if they intend to use excess earnings for any other purpose.

usefulness principles or through reimposition of the ROE penalty from Dockets 5701/5724. In exchange, CVPS agrees to write down $9 million in regulatory assets.[116]

Because we have concluded that the interests of CVPS's ratepayers would be best served if CVPS is financially viable and retains its investment-grade credit ratings, we find that it also is appropriate, as proposed in the MOU, to declare that there will be no further HQ-VJO Contract disallowances or penalties imposed in any proceeding to establish the Company's rates based on CVPS's prudence with respect to any act or omission that occurred prior to the date of this Order. The potential for future disallowances would, in fact, undermine the certainty that we seek to achieve by granting the rate relief embodied in the MOU and establishing rates without use of traditional cost of service methodologies. For the same reasons, CVPS will not be subject to any further HQ-VJO Contract disallowances or penalties in any proceeding to establish the Company's rates based on the application of any "used or useful" theory. And, CVPS will not be subject to the reimposition of the ROE penalty in Dockets 5701/5724, even though, as we described above, the Company has not met the criteria we previously enunciated for removal of that penalty.[117]

Our decision to allow full rate recovery in the future for power purchased under the HQ-VJO Contract is not absolute. CVPS retains responsibility to prudently manage the Contract in the future. Neither the MOU itself, nor our approval of the MOU, absolves the Company from this duty.[118] If CVPS does not prudently manage the HQ-VJO Contract in the future, the Board may disallow imprudent costs. We also note that our decision not to re-institute an ROE penalty

116. Boyle supp. pf. at 8–9.

117. AARP has argued that if the ROE penalty is removed, the Company should be required to write off the net present value of the penalty over the lifetime of the HQ-VJO Contract ($13 million). We do not accept this argument. Rather, we are persuaded by Department witness Ross's testimony that $9 million is close to the maximum amount that CVPS could write off without jeopardizing its investment-grade bond rating. Tr. 5/16/01 at 88–89 (Ross). (*See also* tr. 5/15/01 at 28 (Rice)(observing that the $9 million write-off would leave CVPS very close to the edge of non-investment grade ratings.) Therefore, if we accepted AARP's recommendation regarding the write-off amount, we would be putting the Company's long-term financial viability at risk — a result we have found to be harmful to ratepayers, and contrary to the intent of the MOU.

118. Tr. 5/15/01 at 168 (Boyle).

in the future only applies to those specific management failures that occurred prior to 1994 and that were identified in the Dockets 5701/5724 Order.[119]

Financially, approval of the MOU will assure CVPS and the investment community that CVPS will be able to recover its HQ-VJO Contract power costs in the future (assuming that the Company prudently manages its resources). These assurances will provide the certainty that capital markets and the bond ratings process find important.[120] As a result, CVPS is likely to retain an investment grade rating, providing the Company with much more access to capital and reducing its costs of obtaining that capital.[121] The MOU also permits CVPS to earn 11 percent prospectively and will not trigger a discontinuance of FAS 71.[122]

Our decision will permanently resolve the difficult issues that have plagued CVPS since the Company's imprudent 1991 decision to lock-in early to the HQ-VJO Contract. At the same time, we recognize that this decision commits CVPS's ratepayers to paying costs in excess of those they would typically bear. For that reason, as we discuss in Section VI, below, the Board is adopting a mechanism designed to prevent unjust enrichment of CVPS's shareholders in the event of a sale of some or all of the Company's assets. We consider these steps, which are necessary to preserve the financial viability of CVPS, to be an appropriate balancing of ratepayer and shareholder interests, and the ultimate general good of the public.

C. CVPS'S STRATEGIC DECISIONS

In both this proceeding, and in our recent Docket 6107 decision setting rates for GMP, we applied equitable principles to the establishment of rates, balancing shareholder and ratepayer interests. In its testimony, CVPS argues that we also should consider differences between CVPS and GMP that, according to CVPS, justify more favorable treatment for CVPS in this decision. In particular, CVPS states that it has conducted cost-cutting measures equivalent to GMP's, but that it also made decisions superior to GMP in setting its dividend payment policy and in

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119. Tr. 5/15/01 at 167–168 (Boyle).

120. Tr. 5/15/01 at 47 (Rice).

121. Tr. 5/15/01 at 28 (Rice). CVPS expects that it will obtain a BBB rating with no credit watch. Tr. 5/15/01 at 150–152 (Boyle).

122. Tr. 5/15/01 at 153–154 (Boyle).

managing its investments in unregulated subsidiaries — areas in which GMP's decisions greatly contributed to its poor financial condition.

In certain ways, CVPS's managerial decisions did shield the Company from the dire financial condition that GMP faced. CVPS invested far less money in unregulated subsidiaries both in absolute terms ($28 million over 15 years as compared with GMP's investment of $43 million in 12 years), and when considered as a percentage of their investments in regulated activities during those periods (9 percent for CVPS, compared to 30 percent for GMP).[123] Since GMP has only approximately half the common shareholders' equity of CVPS, as a percentage of the Company's total capitalization, GMP's investment was much greater. In addition, CVPS's unregulated subsidiaries performed significantly better than GMP's — in the last 10 years CVPS's unregulated subsidiaries earned $8.7 million while GMP's unregulated subsidiaries lost at least $10.5 million.[124] Finally, GMP encouraged many of its most experienced employees and senior managers to transfer to its unregulated affiliates; CVPS has not experienced an equivalent diversion of intellectual capital from its core utility business.[125]

CVPS's management decisions regarding its dividend policy have also been substantially more sound than GMP's. GMP's actual dividend payout ratio exceeded 80 percent in every year from 1989 to 1997, and its dividend payment policy resulted in an unusually low level of earnings available for reinvestment.[126] In contrast, CVPS instead reduced its dividend in December 1994 — nearly three years earlier than GMP's first dividend cut. Since this dividend cut, CVPS's dividend payment ratio has been less than 70 percent in every year except one. As a result, an additional $43 million in earnings has been retained for reinvestment.[127]

CVPS's performance leads us to conclude that we need not impose constraints upon the Company's investments in unregulated subsidiaries (as we did for GMP). To date, CVPS has managed these ventures in a manner that has not placed an undue strain on the Company.

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123. Exh. CVPS-Boyle-42 at 3; 1991–2000 FERC Form 1 Reports; Docket 6107, Order of 1/23/01 at 26–27 (Findings 20 and 27).

124. Exh. Board-1 at 12; Docket 6107, Order of 1/23/01 at 28.

125. Tr. 5/15/01 at 145-146 (Boyle).

126. Docket 6107, Order of 1/23/01 at 30–31 (Findings 30–32).

127. 2000 CVPS Annual Report at 56; 1994 CVPS Annual Report at 52; Boyle reb. pf. at 37. See the chart in Appendix D, which compares CVPS's and GMP's historical dividend payout as a percent of their book value.

Moreover, although we conclude that CVPS's cost-cutting efforts have not matched GMP's, the overall managerial competence persuades us that we need not require CVPS to engage in specific measures to reduce the Company's operating costs, but can instead rely upon CVPS's Board of Directors itself to take a hard look at the need for restructuring its operations. Similarly, because of CVPS's past management of its dividend policy, we find it unnecessary to adopt an explicit dividend cap, like the one mandated in Docket 6107 for GMP.[128]

CVPS also favorably compares its corporate restructuring efforts to those of GMP. However, in this regard, the record does not support the Company's assertion. Over the last few years, GMP has undergone a significant reevaluation of its operating costs.[129] That effort led to a reduction of real estate requirements, reorganization of management, halving of senior management personnel, and elimination of management bonuses. In Docket 6107, we found that the resulting changes had produced costs savings of approximately $5 million annually.[130] Although CVPS has made some changes to reduce the Company's operating costs, it has not achieved a comparable level of savings to GMP. For example, at the same time that GMP was eliminating its management bonuses, CVPS paid large bonuses to its senior management. CVPS asserts that its cost-control efforts match those of GMP, but occurred in the mid-1990s whereas GMP's occurred more recently. In fact, CVPS's operating cost reductions occurred contemporaneously with similar GMP reductions in the mid-1990's, which produced a similar level of change at that time.[131] CVPS has not matched the more recent, and more significant efforts of GMP.

Overall, however, we find that in several ways, CVPS performed better than did GMP. This performance, we believe, shows the value of a diverse, competent, and professional Board of Directors; it also plays a significant role both in our decision to accept the MOU and in the terms and conditions we adopt. Most significantly, CVPS's management performance leads to our willingness to accept two provisions in the MOU that we might otherwise have modified or rejected. Specifically, Paragraph 12 of the MOU accelerates the rate increase by nearly two

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128. Docket 6107, Order of 1/23/01 at 123.
129. These restructuring efforts are *in addition* to cost reductions GMP made in the mid-1990's.
130. Docket 6107, Order of 1/23/01 at 10.
131. Boyle reb. pf. at 35-36.

months. This acceleration will result in the collection from ratepayers of approximately an additional $1,000,000 compared to implementation at the end of the seven-month statutory time-frame for rate proceedings.[132] In addition, under the MOU, CVPS is permitted to continue to book and defer ACE amounts for an additional half year. Based upon past ACE accruals, the extension of ACE recovery for an additional period could cost ratepayers an additional $2.3 million.[133] Thus, the acceptance of both of these provisions is another way in which ratepayers will pay more than they would under traditional cost-of-service ratemaking methodologies. In each case, our acceptance of the condition as an element of the MOU is directly linked to our determination that CVPS's strategic decisions have had material benefits for ratepayers.

V. OTHER PROVISIONS OF THE MOU

A. HQ-VJO CONTRACT ICE STORM ARBITRATION COSTS AND BENEFITS

Findings

27. Under Paragraph 16 of the MOU, CVPS will apply any amounts collected as a result of the award issued in the HQ-VJO Contract ice storm arbitration, or any settlement or agreement with Hydro-Québec or any other party relating to CVPS's HQ-VJO Contract power supply costs, first to reduce the remaining balances of deferred costs associated with the prosecution of the ice storm arbitration, and then to reduce balances in other regulatory asset accounts as approved by the Board. If the deferred costs associated with the prosecution of the ice storm arbitration are not reduced to zero, CVPS will book and defer (without carrying costs) for subsequent recovery the remaining costs. MOU at ¶ 16.

28. On April 17, 2001, the arbitration panel in the HQ-VJO ice storm arbitration issued a decision which stated that, in principle, Hydro-Québec should pay the Vermont Joint Owners approximately $20.5 million plus interest, subject to adjustment for partial deliveries. The exact amount of the award will be determined by the parties or by the arbitration panel after further litigation. Exh. Board-4 at Chapter T, Page 2.

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132. *See* 30 V.S.A. § 227(a); tr. 5/15/01 at 198–199 (Boyle).

133. MOU, Attachment 5, p.3.

29. As of March 31, 2001, CVPS's remaining balance of deferred costs associated with the prosecution of the ice storm arbitration was $2.5 million. Tr. 5/15/01 at 82–83 (Boyle); exh. CVPS-Boyle-51.

30. CVPS expensed approximately $437,000 in costs associated with the prosecution of the ice storm arbitration. It has not recovered those costs from ratepayers, and will not seek to do so in the future. Tr. 5/15/01 at 84–85 (Boyle); exh. Board-2 at 6.

Discussion

Given that (1) ratepayers are being asked to pay higher rates than they would under traditional cost-of-service ratemaking methodologies because of the magnitude of CVPS's imprudent power supply costs related to the HQ-VJO Contract, and (2) the fact that any award CVPS receives from the pending ice storm arbitration will serve to reduce its costs associated with the HQ-VJO Contract, it is appropriate for CVPS to return any financial value it receives from the ice storm arbitration to ratepayers. Rightfully, this provision of the MOU should ensure that ratepayers do not pay costs that CVPS does not incur.

At the same time, however, we do not accept AARP's argument that because the exact amount of the arbitration award that CVPS will receive is unknown, the Board can not find the costs of pursuing the arbitration to be used-and-useful.[134] The usefulness of litigation expenses cannot be judged solely by the outcome of the litigation.[135] This would have the effect of discouraging all litigation, except for that in which the Company was certain it would prevail. Rather, companies should pursue litigation if justified by a cost-benefit analysis. In this case, the

134. AARP Memorandum of Law at page 22.

135. The Board recognized in Docket 5132 that ". . . utility investments may have unquantifiable as well as quantifiable benefits. For example, . . . an investment may provide exploratory, research, or option values to ratepayers." Docket 5132, Order of 5/15/87 at 163 (footnote omitted). Litigation costs are one type of utility "investment" that, by their very nature, are not certain to succeed, but that could have an option value to ratepayers. In this case, we find that the ice storm arbitration did have such an option value.

In addition, we note that the Board has never intended for the used-and-useful test to apply to *every* utility expenditure. As the Board stated in Docket 5132, "[W]e believe it would serve no useful regulatory policy to attempt to measure the long-term economic value of *every* utility investment regardless of size; firm conclusions would be unjustified by the uncertainty in the measurements themselves." (Emphasis added.) Docket 5132, Order of 5/15/87 at 162. Therefore, when considering whether to apply the used-and-useful test to a particular utility expenditure, both the nature and the magnitude of the expense should be considered.

Company pursued the ice storm arbitration in the hope of reducing its power costs associated with the HQ-VJO Contract, an outcome which would have been highly desirable for ratepayers. Therefore, we find it was reasonable for CVPS to have pursued the ice storm arbitration.

B. VERMONT YANKEE POWER UPRATE AND OTHER SHIELDS

Findings

31. Under Paragraph 22 of the MOU, CVPS will not, in this or any future proceeding to determine CVPS's rates, be subject to any further penalty or disallowance on account of an allegation of imprudence or mismanagement at any time prior to the date of an order approving the MOU related to the following issues as raised by the DPS in this docket: that the Company failed to pursue a power uprate[136] of the Vermont Yankee nuclear power plant ("Vermont Yankee"), failed to properly manage or match its loads to its power sources and/or its power sources to its loads, or mismanaged its capital maintenance projects. MOU at ¶ 22.

Discussion

We note with interest that Vermont Yankee Corporation has not taken a position on whether CVPS's failure to pursue a power uprate of the Vermont Yankee nuclear power plant was imprudent, nor has it taken a position on the resolution of this issue proposed in Paragraph 22 of the MOU.[137]

Paragraph 22 of the MOU precludes the Board, now and in the future, from imposing any penalty on CVPS if the Board found that, prior to the date of an order approving the MOU, (1) CVPS's failure to pursue a power uprate of Vermont Yankee was imprudent, (2) CVPS failed to

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136. "Power uprate" is a term-of-art in the nuclear industry, used to refer to gaining approval from the Nuclear Regulatory Commission to operate a nuclear plant at a higher power generation level than currently or originally licensed. Power uprate can be accomplished at nuclear plants because the plants were conservatively designed to run at power levels of up to 20% higher than licensed power levels (licensed power levels were limited to levels used in the accident and safety analysis calculations for the plant). As the nuclear power industry has matured, refined calculation methods have been used to demonstrate that correct safety margins exist for operation at higher levels. Sherman pf. at 4.

137. CVPS is the largest shareholder of Vermont Yankee Corporation. CVPS and GMP combined own a majority of Vermont Yankee Corporation's shares. Robert Young, CVPS's President and Chief Executive Officer, is also Chairman of Vermont Yankee Corporation's Board of Directors.

properly match its sources to its loads with respect to forward sales of surplus energy, or (3) the Company mismanaged its capital maintenance for generation plants.[138]

While the Board is very reluctant to "shield" utilities from the consequences of their management's decisions, we are persuaded that in this particular instance it is reasonable when considered as part of the MOU's proposed overall resolution to these Dockets. In reaching this decision, we were strongly influenced by the fact that the MOU does not shield CVPS from the consequences of its *future* decisions regarding a power uprate, the matching of its sources to its loads, and the management of its capital maintenance for generation plants. CVPS remains responsible for prudently managing *all* its power supply resources, and nothing in the MOU or this Order precludes the Board from imposing appropriate penalties on CVPS if it fails to prudently manage its power supply in the future. Additionally, the Company itself pointed out that the January 1999 power uprate decision did not foreclose the possibility of a power uprate in the future.[139] We expect, therefore, that a power uprate of Vermont Yankee will be one of the options evaluated by the Company in its on-going management of its power supply resources; CVPS's management and shareholders bear the responsibility for due diligence in this continuing duty.

C. SERVICE QUALITY AND RELIABILITY PLAN

Findings

32. Under Paragraph 23 of the MOU, beginning in 2001, CVPS will measure and report its customer service, safety and reliability standards as detailed in the Service Quality and Reliability Performance, Monitoring & Reporting Plan, Attachment 3 of the MOU (the "Service Quality Plan"). The standards CVPS agrees to measure and report are substantively the same as those GMP agreed to in Docket 6107. Steinhurst supp. pf. at 3; MOU at ¶ 23 and Attachment 3; exh. Board-3 at 1-3.

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138. CVPS and the DPS have clarified that if the Board approved Paragraph 22 of the MOU, the Board would be precluded only with respect to the power supply management issues specifically raised by DPS witness Lamont on pages 3–5 of his prefiled direct testimony and pages 3–8 of his prefiled surrebuttal testimony, and DPS witness Steinhurst on page 10 of his direct prefiled testimony. Exh. Board-1 at 23; exh. Board-3 at 8.

139. Brown reb. pf. at 9–10; Boyle reb. pf. at 42.

33. The Service Quality Plan fixes minimum performance standard baselines for certain performance measures, and sets out a process for determining the remaining minimum standards. This process includes negotiation between CVPS and the Department, and submission of the remaining binding minimum standards to this Board for approval no later than three months from the date of the order approving the MOU (this submission is referred to as the "Final Plan"). Certain of the binding minimum levels already established are significantly more stringent in CVPS's service quality plan than in GMP's service quality plan, and are more in keeping with national customer service norms and CVPS's own goals. MOU at ¶ 23 and Attachment 3; exh. Board-3 at 1.

34. The Final Plan will be in effect for two years from the date of the Board's order approving it. MOU at Attachment 3.

35. The MOU provides for a successor service quality plan (the "Successor Plan") to be negotiated and submitted for Board approval upon the conclusion of the Final Plan. Financial penalties will be one of the topics discussed during the negotiation of the Successor Plan. If the parties are unable to agree on financial penalties in their negotiations, the Board could adopt such penalties. MOU at Attachment 3; tr. 5/14/01 at 89–90 (Frankel).

36. CVPS's implementation of the Service Quality Plan and the successor provision will benefit ratepayers by (1) ensuring that the full range of areas that are important to customers are measured; (2) supplying public information on the level of service that CVPS is providing; (3) supplying performance data that can be compared with other companies; and (4) focusing CVPS's management's attention in an efficient manner and thereby improving service. Tr. 5/14/01 at 75–78 (Frankel); Steinhurst supp. pf. at 3.

Discussion

Section 219 of Title 30 requires electric utilities (and other regulated companies) to "furnish reasonably adequate service, accommodation and facilities to the public." Vermont law gives this Board the authority to set standards regarding this utility obligation. Specifically, 30 V.S.A. § 209(a)(1) gives this Board jurisdiction over "[t]he . . . quality of any product furnished or sold by any company subject to supervision under this chapter," and 30 V.S.A. § 209(a)(3) provides jurisdiction over "[t]he manner of operating and conducting any business

subject to supervision under this chapter, so as to be reasonable and expedient, and to promote the safety, convenience and accommodation of the public[.]" Taken together, these statutory provisions establish the basis for service quality and reliability standards by which the adequacy of service can be measured in order to determine whether a company is, in fact, providing "reasonably adequate service" and is operating its business in a "reasonable and expedient" manner that "promotes the safety, convenience, and accommodation of the public."

Paragraph 23 and Attachment 3 of the MOU set out customer service, safety, and reliability standards by which CVPS's performance will be measured, starting in 2001. The standards cover seven broad areas of customer service (call answering, billing, metering, work completion customer satisfaction, worker safety, and reliability). Specific indices and baseline levels have been identified for some performance areas, with the remaining minimum standards to be determined through negotiation with the DPS, through a process stipulated in the Service Quality Plan. Although the indices set out in CVPS's Service Quality Plan are similar to those in GMP's service quality plan, certain of the binding minimum levels already established are significantly more stringent in CVPS's Service Quality Plan than in GMP's service quality plan, and are more in keeping with national customer service norms and CVPS's own goals.

As crafted, the Service Quality Plan provides for CVPS to waive its service fees when the Company fails to meet designated commitments for performing certain services. This is a first step to tying financial incentives to the provision of quality service. The Board recognizes that the Service Quality Plan makes explicit CVPS's agreement to adopt a successor plan which may include financial penalties and/or incentives tied to performance, thus establishing a clear expectation of financial penalties in the foreseeable future.

No party is opposing the establishment of these service quality, safety, and reliability standards, nor the process of establishing the remaining baselines.

We view the Service Quality Plan and its provision for a successor plan as beneficial to Vermont ratepayers for a number of reasons. First, in certain areas the Service Quality Plan is more comprehensive than CVPS's current service monitoring practices. In addition, implementation of the Service Quality Plan adds the twin benefits of supplying public information on the level of service CVPS is providing, and of supplying data which is

comparable to that reported by GMP, allowing for standardized comparison data for almost 70 percent of the state's electric customers. Other identifiable benefits include the establishment of a data base from which to set future, more stringent targets, the provision for the waiver of fees for missed service appointments, and expected financial penalties in the Successor Plan to be adopted after two years. In their testimony, witnesses from both CVPS and the DPS clearly indicated their commitment to the inclusion of financial penalties and/or incentives tied to performance in the Successor Plan.[140]

In this Order, we are making one minor modification to the Service Quality Plan. Consistent with the practice established by the Board in earlier dockets implementing service quality standards, we are requiring that CVPS file the monitoring reports referred to in Paragraph 2 of Section III of the Service Quality Plan with the Board in addition to the DPS.

D. OTHER CUSTOMER PROTECTIONS

Findings

37. With regard to developing customer payment arrangements, Paragraph 25 of the MOU commits CVPS to (1) add a script in its Customer Relationship Management tool prompting application of the specific reasonableness criteria in Public Service Board Rule 3.302(G) *Establishment of a Reasonable Repayment Plan*, and (2) modify the Customer Relationship Management tool to enable it to record the application of such criteria. CVPS must comply with this provision within three months from the date of this Order. MOU at ¶ 25 and Attachment 3.

38. In Paragraph 26 of the MOU, CVPS agrees to amend the household rule provision in its tariff to conform to the current Public Service Board Rule 3.302(F) *Household Rule*. CVPS will submit revised tariff sheets to the Board for its approval no later than 45 days from the date of this Order. MOU at ¶ 26.

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140. CVPS witness Boyle stated "My expectation is we will adopt financial penalties [in the Successor Plan]. Tr. 5/15/01 at 211 (Boyle). DPS witness Frankel stated "I believe that financial penalties are ultimately essential to making a service quality plan [an] effective tool." Tr. 5/14/01 at 89 (Frankel).

39. Paragraph 27 of the MOU commits CVPS and the DPS to develop documented guidelines for the application of Public Service Board Rule 3.304(C), *Winter Disconnections*, no later than three months from the date of this Order. MOU at ¶ 27 and Attachment 3.

40. Paragraph 28 of the MOU commits CVPS to develop in conjunction with the DPS standard criteria to govern the switching of customers from Residential, Rate 1, to General Service, Rate 2, when a portion of the customer's primary residence is being used for business purposes, no later than three months from the date of this Order. Such criteria will include, at a minimum, providing the customers the opportunity to use a federal income tax return to prove that less than 50% of the home is used for business purposes. MOU at ¶ 28 and Attachment 3.

Discussion

The MOU contains measures which would require CVPS to standardize, amend or tighten certain of its procedures in dealing with consumers. The Board views the MOU's customer protection provisions as beneficial to ratepayers for three reasons. First, the provisions require CVPS to change certain practices to bring its treatment of customers in line with current regulations, and will ensure DPS input into the compliance process. As a result of such input, there is a greater likelihood that conformity will be achieved, and the DPS may better understand challenges relating to implementation.[141] Second, the customer protection provisions in the MOU set a fairly tight timetable for implementation, thereby ensuring that ratepayers benefit quickly. Finally, the provisions avoid litigation risk, with its attendant delays and resource and time consumption.

E. DEMAND-SIDE MANAGEMENT ISSUES

Findings

41. Under Paragraph 34 of the MOU, CVPS's recovery of Conservation and Load Management ("C&LM") deferred amounts, Account Correcting for Efficiency ("ACE") amounts, on-going recurring amounts, and all associated accounting impacts will be as provided on Attachment 5 to the MOU. MOU at ¶ 34.

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141. Exh. Board-3 at 9.

42. Under Paragraph 35 of the MOU, CVPS will discontinue booking and deferring ACE for Energy Efficiency Utility core program savings after July 1, 2002. The Company will not seek to continue the ACE mechanism or to replace the ACE mechanism in connection with the delivery of Energy Efficiency Utility system-wide core programs. CVPS will recover all amounts booked prior to July 1, 2002, but not yet recovered, in a manner consistent with past practice. MOU at ¶ 35.

Discussion

Approximately $4.4 million of the $9 million write-off provided for in Paragraph 15 of the MOU will be used to reduce C&LM accounts. Page 2 of Attachment 5 to the MOU shows precisely how this $4.4 million will be applied to CVPS's individual C&LM accounts (oldest first, zeroing out each account before applying the remainder to the next oldest account), and what the remaining C&LM deferred amounts will be following the write-off. We find this method of applying the write-off to CVPS's individual C&LM accounts to be reasonable. We also find the C&LM deferred amounts, ACE amounts and on-going recurring amounts shown on Attachment 5 to be reasonable.[142]

Under Paragraph 43 of the Docket 5980 Memorandum of Understanding (which the Board approved in its 9/30/00 Order in that docket), CVPS will no longer accrue and recover ACE after December 31, 2001.[143] However, Paragraph 43 of the Docket 5980 Memorandum of Understanding explicitly gives CVPS the right to request Board approval of a mechanism that would replace ACE and ameliorate any effect on CVPS's opportunity to earn its allowed return caused by revenue erosion due to Energy Efficiency Utility core program savings. Therefore, while Paragraph 35 of the MOU in this Docket does allow CVPS to book and defer ACE for six months beyond that agreed to in Docket 5980, this paragraph also states that CVPS is giving up its right to request Board approval of a replacement mechanism. We find that this is a significant benefit to ratepayers.

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142. The C&LM and ACE amounts will be used as the starting point for calculating C&LM and ACE recovery in CVPS's next rate case. Tr. 5/15/01 at 62 (Frankiewicz).

143. Docket 5980, Order of 9/30/99 at A-21.

F. Costs Associated with CVPS's Ownership Share in the Millstone III Nuclear Power Plant

Findings

43. Under Connecticut law, the Connecticut Department of Utility Control ("Connecticut DPUC") determines decommissioning collections for the Millstone III Nuclear Power Plant ("Millstone"). The Connecticut DPUC's latest decision of record regarding the Millstone III Decommissioning Trust Fund ("Trust Fund") is Order 99-09-12RE-01, the order approving Millstone's sale to Dominion Nuclear Connecticut ("Dominion").[144] This decision applies to the adjusted test year for Public Service Board Docket 6460. Sherman sur. pf. at 28.

44. In Order 99-09-12RE-01, the Connecticut DPUC accepted Dominion's assertion that the Trust Fund is fully funded without further contributions. Page supp. pf. at 3–4; Sherman sur. pf. at 28; exh. CVPS-Page-2 at 4; exh. DPS-WKS-24 at 18.

45. There is some ambiguity in Connecticut DPUC Order 99-09-12RE-01 because, despite its conclusion that the Trust Fund is fully funded without further contributions, the Order did not specifically set the current decommissioning schedule to zero, nor did it specifically vacate the prior Connecticut DPUC Order 98-01-02 which has been the basis for the collection amounts billed to Millstone's owners for the last few years. Page supp. pf. at 4; exh. CVPS-Page-1; exh. CVPS-Page-2; exh. DPS-WKS-24.

46. CVPS is still receiving bills for its share of Millstone decommissioning costs in accordance with Connecticut DPUC Order 98-01-02. Page supp. pf. at 5; exh. CVPS-Page-3.

47. CVPS has committed to work with the DPS, the Connecticut DPUC and Dominion to resolve the question of whether additional contributions to the Trust Fund are needed. Page supp. pf. at 5.

48. If CVPS's recent contributions to the Trust Fund are found to have been unwarranted, CVPS expects a refund of those contributions. Page supp. pf. at 6.

49. Under Paragraph 31 of the MOU, the rates established in the MOU include recovery of $300,504 in Millstone decommissioning costs annually. If CVPS is billed less than that amount

144. Connecticut DPUC Order No. 99-09-12RE-01, dated 1/25/01, is exhibit DPS-WKS-24. Pages 13–18 of this order are also exhibit CVPS-Page-2.

in any calendar year during which the rates established in the MOU are in effect, the Company will reduce its regulatory asset accounts in order to give ratepayers credit for the difference between $300,504 and what the Company is actually billed. MOU at ¶ 31.

Discussion

Historically, the Board has allowed the collection of CVPS's share of Millstone decommissioning costs (as determined by the Connecticut DPUC) in the Company's rates.[145] It is the Board's intent to continue this practice, and enable CVPS to collect its share of Millstone decommissioning costs in the rates established by this Order.

However, the recent sale of Millstone to Dominion has created uncertainty regarding what CVPS's share of Millstone decommissioning costs will be during the period in which rates established by this Order will be in effect.[146] We expect CVPS to honor its commitment to work with Dominion, the Connecticut DPUC, and the DPS to resolve this issue, and today's Order requires the Company to report to the Board once the issue is resolved.

In the meantime, the proposed treatment described in Paragraph 31 of the MOU is a good one. This treatment will enable CVPS to recover Millstone decommissioning costs in rates (and receive the tax benefits associated with doing so[147]) if it is determined that Millstone's owners must continue to contribute to the Trust Fund. On the other hand, if CVPS does not need to make additional contributions to the Trust Fund, funds collected from ratepayers to pay those costs will be returned to ratepayers through regulatory asset write-offs (which will reduce CVPS's future costs of service). Therefore, we find that, when considered as part of the MOU's proposed overall resolution to these Dockets, MOU Paragraph 31 is in the public interest.

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145. *See*, for example, Docket 6120, Order of 12/11/98 at 5.

146. *See* findings 44–46, above.

147. Internal Revenue Code Section 468A allows current tax deductions for only those decommissioning costs specifically approved in regulatory commission orders. The Settlement Cost of Service (Schedule 1 of Attachment 1 to the MOU) passes through the tax benefit associated with $300,504 of Millstone decommissioning costs to ratepayers. Frankiewicz supp. pf. at 5.

G. COSTS ASSOCIATED WITH CVPS'S OWNERSHIP SHARE IN THE VERMONT YANKEE NUCLEAR POWER PLANT

Findings

50. Attachment 4 of the MOU sets forth the following amounts which are deemed to be recovered under the rates established by the MOU:

- Texas-Maine-Vermont Low-Level Radioactive Waste Disposal Compact payments – $0
- Vermont Yankee nuclear power plant sale costs – $0
- Vermont Yankee nuclear power plant decommissioning costs – $250,166 per month through October, 2001, and $295,840 per month thereafter.

MOU at ¶ 32 and Attachment 4.

51. Under Paragraph 32 of the MOU, if Vermont Yankee Corporation bills CVPS more than the amounts shown on Attachment 4 during the term of the rates established by this Order, CVPS is permitted to book and defer those amounts (with carrying costs) and seek subsequent recovery. The DPS may contest the ultimate recovery of such incremental Vermont Yankee costs. MOU at ¶ 32.

Discussion

Vermont Yankee Corporation has not taken a position on the MOU's proposed resolution of the costs associated with CVPS's ownership share in the Vermont Yankee nuclear power plant. However, before the MOU was filed, Vermont Yankee Corporation did submit testimony stating that (1) while it is appropriate to include payments to the State of Texas for the Texas-Maine-Vermont Low-Level Radioactive Waste Disposal Compact ("Compact") in Vermont Yankee's 2001-2002 Operating Expense Projection ("Projection"), the Vermont Yankee Corporation does not object to removal of that expense from the Projection because it appears that the payments will not be required until after the rate year; (2) $3 million in 2001 transaction costs related to the sale of the Vermont Yankee nuclear power plant should be included in the Projection because, under Vermont Yankee's current formula rate structure, these costs are recognized as an expense and billed as they are incurred; and (3) Vermont Yankee nuclear power

plant decommissioning costs should be included in the Projection at the level currently being collected.[148]

It currently appears that Compact payments will not be required until after the rate year in this proceeding.[149] In addition, there is some uncertainty as to the manner for charging future sale transaction expenses and the decommissioning rate. Both of these issues are currently under discussion in a Federal Energy Regulatory Commission settlement process.[150] Because of this uncertainty, the MOU provides that the rates set in this proceeding will contain no costs associated with the Compact or the sale of the Vermont Yankee nuclear power plant. The DPS and CVPS have also agreed on what they consider likely amounts for decommissioning and they agree that it is unlikely that the outcome of the settlement process will result in decommissioning amounts less than those provided for in Attachment 4.[151] Because of the uncertainty, these parties propose that CVPS be permitted to book and defer specified Vermont Yankee costs to the degree they exceed the estimates. The Department, other parties, and the Board may challenge recovery of such costs at the time CVPS seeks to include them in rates. We find this approach reasonable. Considering the present uncertainty, it is appropriate to include the amounts shown on Attachment 4 in CVPS's rates established by this Order, and to allow CVPS to book and defer any amounts above those shown on Attachment 4 (as described in Paragraph 32 of the MOU).

H. DOCKET 6133 ISSUES

Findings

52. Paragraph 36 of the MOU states that (1) CVPS and the DPS are to submit to the Board an agreement supporting the approval of affiliate transaction rules and codes of conduct in Docket 6133 within thirty days of the release of this Order; (2) the DPS does not object in principle to the establishment of a holding company; and (3) CVPS and the DPS agree to develop a schedule for concluding Docket 6133 in a reasonable period of time, and will file that schedule by July 1, 2001. MOU at ¶ 36.

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148. Wiggett pf. at 1–3.
149. Wiggett pf. at 3.
150. Sherman sur. pf. at 25–26.
151. Exh. Board-1 at 26; exh. Board-3 at 11.

Discussion

Paragraph 36 of the MOU binds the parties in Docket 6133 to enter into an agreement with regard to certain unspecified aspects of that case, and sets an immediate deadline for submission of a schedule leading to the conclusion of the docket. The DPS will not object in principle to the formation of a holding company, and both parties are committed to work toward resolution of any outstanding concerns.

In the present Order, we explicitly state that the Board is making no judgment as to the general merits of holding company structures. Likewise, at this time we are not making any determinations on the specifics of Docket 6133, and CVPS's proposal to create a holding company structure with the attendant transfer of assets. We conclude that Docket 6133 is the appropriate place to take up these issues, and emphasize that accepting the MOU places no constraint on the proper resolution of those issues.

VI. FORBEARANCE AND UNJUST ENRICHMENT

Positions of the Parties

AARP proposes that the Board institute a protection against the unjust enrichment of shareholders at the expense of ratepayers similar to that which the Board established in Docket 6107,[152] except that (1) the mechanism should also be triggered by the sale or merger of CVPS's unregulated assets or by a sustained high stock price, and (2) the maximum amount to be recovered for ratepayers via the mechanism should be $65 million.[153]

CVPS asserts that the Board should not condition its acceptance of the MOU on the imposition of a protection against unjust enrichment. CVPS argues that the Board should not establish a mechanism because (1) the rates established under the MOU are the product of

152. In the 1/23/01 Order in Docket 6107, the Board established a mechanism that required GMP to give to ratepayers 50 percent of any above-book proceeds from the sale or merger of GMP or its regulated assets, subject to a cumulative limit of $8 million, adjusted for inflation. The Board's order did not specify the manner in which ratepayers will receive this restitution. Rather, it allowed GMP to choose whether it wanted the manner to be decided promptly or at the time of the first triggering event. The Board also stated that the mechanism would not be implemented if doing so would cause a financial crisis for the Company. Docket 6107, Order of 1/23/01 at 112–116.

153. AARP Memorandum of Law at 20.

traditional ratemaking, therefore there is no basis to conclude that consumers will pay higher rates in order to maintain CVPS's financial position,[154] and (2) the Board can examine the need for such a mechanism at the time of an asset sale or merger transaction. CVPS witness Boyle testified that if the Board *did* establish a protection against unjust enrichment, the amount to be collected via the mechanism should be no more than $16 million, and the mechanism should not apply to the merger or sale of CVPS's unregulated assets, or to the establishment of a holding company as proposed in Docket 6133.[155] In its Reply Brief, CVPS argued that if the Board *did* establish a protection against unjust enrichment, the amount to be collected via the mechanism should be no more than $4 million (the difference between the range of net present value estimates for the full application of the return on equity penalty discussed in Section IV.A.3.c, above).[156]

The DPS originally recommended that the Board include a protection against unjust enrichment in its final order in this Docket. After signing the MOU, the DPS changed its position to recommend that the Board approve the MOU without any additional conditions. However, if the Board *does* decide that a protection against unjust enrichment is necessary, the DPS asserts that the Board should make certain that the mechanism does not jeopardize the MOU's goals (including maintaining CVPS's long-term financial viability).[157] Department witness Ross testified that a mechanism similar to that established by the Board in Docket 6107 with a "cap" of $16 million should not jeopardize CVPS's financial viability.[158]

Findings

53. The imposition of a mechanism to protect against the unjust enrichment of shareholders similar to that established by the Board for GMP in Docket 6107 is not likely to affect CVPS's credit ratings. Tr. 5/15/01 at 54 (Rice); tr. 5/15/01 at 135 (Boyle).

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154. We explicitly reject this argument. As explained in Section IV.B above, we find that the rates provided for in the MOU are significantly higher than those that ratepayers would pay if we followed traditional ratemaking methodologies.

155. Boyle reb. pf. at 32; tr. 5/15/01 at 128, 185–186 (Boyle).

156. CVPS Reply Brief at 32.

157. DPS Brief at 22.

158. Tr. 5/16/01 at 93–99 (Ross).

54. In Docket 6107, the Board established an $8 million limit (to be adjusted for inflation) on the amount to be returned to GMP's ratepayers via the mechanism that will protect against unjust enrichment. A proportionate limit for CVPS would be $16 million, given that CVPS's common shareholders' equity is currently approximately twice that of GMP ($194 million, as compared to $94 million), and that CVPS has approximately twice as many shares of stock. Tr. 5/16/01 at 98 (Ross); tr. 5/15/01 at 185–186 (Boyle).

55. A mechanism to protect against the unjust enrichment of shareholders at the expense of ratepayers, limited to approximately $16 million, would not adversely affect CVPS's financial viability. It would not affect the rating category of business outlook that a rating agency would assign to the Company, nor would it affect the Company's cost of debt or equity capital. Tr. 5/16/01 at 93, 99 (Ross).

56. The creation of a holding company such as that proposed in Docket 6133 should not trigger a protection against unjust enrichment because such a transaction does not involve a change in ownership of CVPS and therefore is not a merger or an acquisition. In addition, the creation of a holding company as proposed in Docket 6133 would not involve the infusion of new capital; rather, current shareholders would simply turn in their shares in CVPS and be issued new shares in the holding company. Tr. 5/15/01 at 127–128 (Boyle).

57. A sustained high stock price should not be a trigger for a protection against unjust enrichment because there is a potential that such a trigger could have a negative effect on CVPS's ability to raise equity capital. Tr. 5/16/01 at 95–96 (Ross).

58. If there is a cap on the amount of money to be returned to ratepayers via a protection against unjust enrichment, 50 percent of any above-book premium would be an appropriate sharing percentage to use. Tr. 5/16/01 at 97–99 (Ross).

Unregulated Subsidiaries

59. From 1986 through 2000, CVPS invested approximately $28.4 million in its unregulated subsidiaries (primarily Catamount Energy Corporation and its predecessors, Catamount Resources Corporation, and SmartEnergy Services, Inc.). CVPS's 13-month average common

equity in its unregulated subsidiaries for the year 2000 was approximately $35 million. Exh. CVPS-Boyle-42 at 3; exh. Board-1 at 12.

60. From 1991 through 2000, CVPS invested $14.9 million in its unregulated subsidiaries and $170.7 million in electric plant and related operations. Exh. CVPS-Boyle-42 at 3; 1991–2000 CVPS FERC Form 1 Reports.

61. As a whole, CVPS's unregulated subsidiaries earned a cumulative $8.7 million during the period 1991 through 2000, although they lost money in two of those years. During the same ten-year period, CVPS's Vermont regulated operations contributed positively to the Company's earnings in nine years and earned a cumulative $140.5 million.

Central Vermont Public Service's Earnings on Common Equity 1991 – 2000										
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Vermont Regulated Earnings ($000s)	16,541	17,153	16,990	12,343	15,830	16,748	14,860	-423	15,402	15,039
Unregulated Earnings ($000s)	324	1,036	1,529	300	2,202	738	3,259	1,720	-783	-1,641

Exh. Board-1 at 12.

62. As a whole, CVPS's unregulated subsidiaries' return on common equity was positive in eight of the last ten years, although it was significantly below CVPS's Vermont regulated activities' return on common equity in eight of the last ten years.

Central Vermont Public Service's Return on Common Equity 1991 – 2000										
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Vermont Regulated ROE (percent)	12.49	12.67	11.97	8.42	10.75	11.00	9.53	-0.28	10.40	9.86
Unregulated ROE (percent)	2.72	5.38	6.11	1.13	7.72	2.45	10.30	4.90	-2.08	-4.69
Allowed ROE (percent)	12.50	12.50	12.00	10.00	10.00	11.00	11.00	11.00	11.00	11.00

Exh. Board-1 at 12.

Discussion

There are significant similarities between the resolution of the prudence and used-and-usefulness of CVPS's HQ-VJO Contract costs that is proposed in the MOU, and the resolution of the prudence and used-and-usefulness of GMP's HQ-VJO Contract costs that the Board approved in Docket 6107. Specifically, both resolutions provide that the relevant utility company will not be subject to any further penalties or disallowance of costs incurred in the purchase of power pursuant to the HQ-VJO Contract based on each utility company's prudence related to any act or omission occurring prior to a particular date.[159] In addition, both resolutions provide for no penalty or disallowance of HQ-VJO Contract costs based on the application of the used-and-useful theory.[160] By accepting these provisions, the Board is allowing costs into rates that under traditional ratemaking methodologies would be excluded.[161] In both cases, the Board concluded this was reasonable in order to avoid harm to ratepayers which could occur if the particular utility were no longer financially viable.[162]

However, one possible result of this decision (as pointed out by AARP in both Docket 6107 and the current Dockets) is that the Board's approval of rates which include all of the respective utility's HQ-VJO Contract costs could lead to a financial windfall for shareholders as the result of an acquisition offer or asset sale at substantially above book value.[163] In Docket 6107, the Board concluded that:

> To avoid such unjust enrichment, and in consideration of ratepayers who will pay higher rates than are justified by routine rate-making procedures, we find it essential that the rates approved today be accompanied by a mechanism by which ratepayers will share in the above-book proceeds of any future sale or merger of the Company, or sale of its regulated assets.[164]

We reach a similar conclusion in this Order.

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159. MOU at ¶ 19; Docket 6107, Order of 1/23/01 at 76 (Finding 74).

160. MOU at ¶ 20; Docket 6107, Order of 1/23/01 at 79. We note that the language used in these two places is not identical, but the outcome is essentially the same — no disallowance of costs based on the application of the used-and-useful theory to the HQ-VJO Contract.

161. *See* Section IV.A.3 of this Order and page 54 of the Board's 1/23/01 Order in Docket 6107 for an assessment of the magnitude of those costs.

162. *See* Section IV.B, above; Docket 6107, Order of 1/23/01 at 81.

163. The Board in this Order takes no position on, and neither encourages nor discourages, any merger, acquisition, or asset sale.

164. Docket 6107, Order of 1/23/01 at 109 (footnote omitted).

As a result of CVPS's imprudent early lock-in to the HQ-VJO Contract and the resulting large potential disallowances,[165] the Company's financial viability now requires the collection of revenues higher than those calculated by routine ratesetting methodologies. This additional funding from ratepayers will likely enable CVPS to maintain its financial viability, creating the prospect that CVPS's shareholders could realize, through an asset sale or acquisition offer, a financial windfall. Such a windfall would be unattainable but for the financial stability enabled by approval of the MOU — and the unusual contribution that will be collected from CVPS's customers. Therefore, in this Order, we condition our acceptance of the MOU on the establishment of a mechanism to protect against the unjust enrichment of CVPS's shareholders at the expense of CVPS's ratepayers.

This decision to condition acceptance of the MOU on a protection against unjust enrichment is entirely consistent with the rationale that the MOU itself reflects in two of its provisions. First, the MOU includes an earnings cap, such that if CVPS exceeds its allowed return on equity, the excess will be returned to ratepayers.[166] Second, the MOU requires CVPS to pass on to ratepayers the benefits of the Hydro-Québec ice storm arbitration.[167] Both of these provisions protect ratepayers from the possibility that shareholders will profit unjustly as a result of ratepayers' payment of higher rates than would be allowed under traditional ratemaking methodologies — the first by protecting against the prospect of CVPS earning windfall profits, the second by ensuring that shareholders alone will not reap the benefits of a successful arbitration while ratepayers continue to bear the burden of higher rates that recover all HQ-VJO Contract costs.

Having determined that we cannot approve the MOU without an additional protection against unjust enrichment, we now turn to the details of that mechanism.[168] We have identified, as we did in Docket 6107, four essential elements of the mechanism and one significant

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165. *See* Section IV.A.3 for our assessment of the magnitude of the possible disallowances.

166. MOU at ¶ 30.

167. MOU at ¶ 16.

168. In designing that mechanism, our "discretion is not limited to selecting from recommendations made or supported by the parties." *In re Citizens Utilities Company*, 769 A.2d 19, 29 (Vt. 2000).

constraint upon its operation.[169] In this Order, we resolve the fundamental details for three of the four elements. We leave it to the discretion of the Company whether the fourth is to be specified in the near future or be left unresolved until the time of a triggering event (merger, acquisition, or asset sale).

The four elements are:

(1) the triggering event;

(2) the dollar amount;

(3) the beneficiaries; and

(4) the specific manner in which ratepayers receive their restitution.

The constraint is that:

(5) the windfall sharing mechanism will not be applied if it would materially impair the continued financial viability of the Company.

We discuss each of these in sections (1) through (5), below.

1. Trigger

In Docket 6107, we adopted the following trigger for the protection against the unjust enrichment of GMP's shareholders:

> The windfall sharing mechanism shall be triggered by any one of the following: (1) any merger of GMP with another company; (2) any acquisition of control of GMP that requires Board approval under 30 V.S.A. § 107; and (3) the sale or lease of any of GMP's assets so substantial as to require Board approval under 30 V.S.A. § 109.[170]

We hereby adopt the same trigger for CVPS.[171]

As in Docket 6107, AARP here proposed an additional trigger based on a sustained high stock price. We decline to adopt this trigger because, as described by Department witness Ross

169. Docket 6107, Order of 1/23/01 at 112.

170. Docket 6107, Order of 1/23/01 at 112 (footnote omitted).

171. This Order does not change existing law regarding the treatment of assets sold by CVPS except in those circumstances where existing law would result in ratepayers receiving less than the protection against unjust enrichment would provide.

in his oral testimony, such a trigger could have a negative effect on CVPS's ability to raise equity capital.[172]

In these dockets, AARP has also proposed that any sale of CVPS's unregulated assets trigger the protection against unjust enrichment, arguing that CVPS's unregulated activities have been "calamitous" and that these activities would have led to bankruptcy relief if it weren't for CVPS's regulated activities.[173] The record persuades us that AARP is incorrect to label the performance of CVPS's unregulated activities as calamitous. Most importantly, there is no compelling argument that CVPS's ratepayers have been or will be required to provide material capital (net of the value of service received) for those unregulated enterprises.

First, CVPS's investments in unregulated affiliates have been small when compared to its investments in utility plant over the same time period, and relatively close to the amount of new equity the Company has issued through its dividend reinvestment program during that period.[174] Second, in eight of the last ten years, CVPS's unregulated activities have contributed to the Company's earnings, albeit earning a lower rate of return than the Company's allowed rate of return on its regulated operations in nearly all of those years.[175] In other words, when looked at from a long-term perspective, the magnitude and performance of CVPS's unregulated activities have been such that the Company has not needed to support them with funds generated by its regulated activities. Because ratepayers have not subsidized CVPS's unregulated activities to date, there is no justification at this time for requiring a portion of any above-book premium paid for those activities to be given to ratepayers. Therefore, we decline to adopt the sale of unregulated assets as a trigger for the protection against enrichment.

However, we are concerned that this decision could create an incentive in the future for CVPS to transfer assets from its regulated to its unregulated operations in order to sell them for above book value without triggering the protection against unjust enrichment. We wish to emphasize that such an outcome would be unfair to ratepayers, and contrary to the requirements of this Order. CVPS's proposal in Docket 6133 to create a holding company and establish

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172. *See* Finding 57, above.
173. AARP Memorandum of Law at 18.
174. Finding 60, above; exh. CVPS-Boyle-42 at 2.
175. *See* Findings 61–62, above.

CVPS's unregulated activities as "sister companies" to its regulated operations only heightens our concern about this issue. Therefore, we will require the Company to address this issue in Docket 6133. Specifically, we order the Company to work with the DPS to develop a means of assuring that, if the Board were to approve the creation of a holding company, such a transfer of assets and their *subsequent* sale for above book value, could not occur without appropriate compensation to ratepayers.

CVPS's Docket 6133 proposal to create a holding company raises another issue with respect to the triggering event for a protection against unjust enrichment. The Company has presented strong evidence that the mere creation of a holding company should not trigger the protection against unjust enrichment because such a transaction does not involve a change in ownership and therefore is not a merger or an acquisition.[176] Such a transfer would not create a new source of capital — beyond the amounts already expected to be used for the fundamental operations of the Company.[177] We therefore find that, in isolation, a change in corporate structure, including the creation of a holding company, which does not change the ownership of CVPS will not trigger the protection against unjust enrichment. If, however, such a change in corporate structure also involves transferring assets from regulated to unregulated subsidiaries, we will take whatever action is necessary to ensure that ratepayers are compensated appropriately. In other words, we cannot accept a potential for a "two-step" process in which CVPS would first transfer assets to unregulated affiliates, then have the unregulated affiliates dispose of them in a way that would evade the original recapture obligation. We will require CVPS to present evidence and recommendations on this point in any docket in which it proposes a change in corporate structure, including Docket 6133.

Finally, we hereby notify the parties in Docket 6133 that in addition to the specific issues raised above, we are instructing the Hearing Officer in that docket to fully explore any other possible ramifications of the creation of a holding company on the operation of the protection against unjust enrichment created by this Order. We instruct her to consider these ramifications (as well as any possible means of dealing with them) when making her recommendation on the

176. *See* Finding 56, above.

177. *See* Finding 56, above.

Company's petition. The parties in that Docket should be prepared to present evidence and recommendations on this topic.

2. Magnitude

As in Docket 6107, the amount of the premium above net book value that is to be returned to ratepayers shall be subject to two limits (as well as the constraint described below).[178] First, ratepayers will receive only one-half of the value of the premium in order to maintain CVPS's incentive to maximize the total value of the transaction. If we allocated the full above-book value to ratepayers, we would run the risk of undermining this incentive.

Second, there shall be an absolute limit or cap on the dollar value to be returned to ratepayers. We conclude that this cap shall be $16 million, in year-2001 dollars (i.e., the cap shall be adjusted for inflation), and shall be a limit on overall, cumulative recoveries.[179] We explicitly reject AARP's proposed cap of $65 million.

In Docket 6107, we arrived at the dollar amount of GMP's cap ($8 million):

> after careful consideration of two fundamental factors: the additional amounts that ratepayers will be paying in rates in excess of those that we would establish using a traditional cost-of-service methodology, and the potential impact of the windfall sharing on the Company's financial well-being.[180]

In establishing the $16 million cap in this Order, we have carefully considered both of these factors.[181]

In Docket 6107 and in the current dockets, the memoranda of understanding under consideration by the Board included provisions that would preclude the Board from imposing

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178. *See* Docket 6107, Order of 1/23/01 at 113–115.

179. For example, if CVPS engaged in a transaction that triggered the protection against unjust enrichment and that produced a $20 million (year-2001 dollars) premium above net book value, CVPS would return one-half of the $20 million, or $10 million, in value to its ratepayers. If CVPS then engaged in a second triggering transaction that produced a $15 million (year-2001 dollars) premium, the value returned to ratepayers would be limited to $6 million (year-2001 dollars) to achieve the *overall*, cumulative return of $16 million.

180. Docket 6107, Order of 1/23/01 at 113.

181. We do not accept CVPS's argument that the appropriate limit on the amount to be collected via a protection against unjust enrichment is $4 million, or the difference between the range of net present value estimates for the full application of the return on equity penalty. As discussed in Section IV.A.2, above, we explicitly reject CVPS's contention that the Board is precluded from taking any actions other than reimposing the 75-basis-point ROE reduction in response to CVPS's imprudent early lock-in to the HQ-VJO Contract.

future disallowances related to the companies' imprudence in locking-in early to the HQ-VJO Contract. Because of these provisions, the possible level of this disallowance over the remaining life of the Contract is one indication of the amounts ratepayers will be paying in excess of the individual company's cost of service. In both Docket 6107 and Section IV.A.3.a of this Order, we concluded that we were unable to determine a range of prudence damages for the remaining life of the Contract. However, we did determine that, regardless of the uncertainties that we recognized, any reasonable measure of the net present value of the potential damages would significantly exceed $8 million in GMP's case and $16 million in CVPS's case. These partial estimates of the financial burden the settlement agreements placed on GMP's and CVPS's ratepayers provide guidance as to the reasonable range for windfall sharing.

In the current dockets, as well as in Docket 6107, other realities and uncertainties must constrain the magnitude of windfall sharing to an amount lower than the possible level of a prudence disallowance over the remaining life of the Contract. In particular, our fundamental concern for avoiding harm to CVPS's ratepayers by maintaining the Company's financial viability suggests that we limit the windfall sharing to a figure that will not disturb the capital markets. The evidence demonstrates that a $16 million cap should meet this requirement;[182] there is no evidence regarding whether AARP's proposed $65 million cap (or, in fact, any cap larger than $16 million) would meet this requirement.[183]

After considering both of these significant factors (amount of possible prudence disallowance over the remaining life of the Contract, and potential impact on the Company's financial situation), we conclude that $16 million is the appropriate limit on overall, cumulative recoveries via the protection against unjust enrichment.

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182. *See* Finding 55, above.

183. *See* Findings 53–55, above. A $65 million cap would clearly not be proportionate to that established for GMP in Docket 6107.

In addition, Department witness Ross cautioned against setting the cap so high as to "make it foolish for [CVPS] ever to do a merger transaction." Tr. 5/16/01 at 97 (Ross). We are mindful of this concern. Setting the cap so high that it effectively discourages CVPS from participating in a triggering event that would otherwise be in the public interest does not benefit either the Company's ratepayers or its shareholders. Mr. Ross testified that a $16 million cap would not create this situation. Tr. 5/16/01 at 98–99 (Ross). We have no evidence regarding whether AARP's proposed $65 million cap would create this situation.

3. Beneficiaries

In Docket 6107 we stated that:

> The beneficiaries of this windfall sharing mechanism shall be the Company's ratepayers during the period in which the funds are returned to ratepayers. Thus, if the specific sharing mechanism as finally designed provides for the return of value to ratepayers over a period of time, then the beneficiaries will be the Company's ratepayers during that same period of time. We explicitly recognize, and anticipate, that the repayment to ratepayers could either: (i) be provided to ratepayers immediately in the event of a triggering occurrence; or (ii) be extended over time, so that it does not then create an undue financial strain on the Company that might result from a one-time full-value repayment.[184]

We hereby adopt the same language regarding the beneficiaries of CVPS's protection against unjust enrichment.

4. Specific Procedure

As in Docket 6107, we recognize that clarity and predictability are desirable. We have endeavored to provide that by specifying the trigger, the amount, the beneficiaries, and a significant constraint for this provision. At the same time, we recognize that additional testimony regarding design options for a windfall sharing procedure is necessary to ensure that the resulting procedure is workable and effective, and does not have adverse implications or unintended consequences. Therefore, as in Docket 6107, we leave it to the discretion of CVPS whether the specific design of the procedure will be determined at the time of the first triggering event, or instead in a new investigation to be opened promptly, if the Company so petitions.

We emphasize, however, that "Any such procedure [for windfall sharing] must ensure that the benefit provided to ratepayers is in addition to (rather than a replacement for) other benefits appropriately assigned to ratepayers at the time of the future sale, merger or acquisition."[185] In other words,

> when an event that triggers the windfall sharing mechanism occurs, the first step is to determine what benefits ratepayers are otherwise entitled to as the result of the sale or merger. Once this determination has been

184. Docket 6107, Order of 1/23/01 at 115.

185. Docket 6107, Order of 1/23/01 at 116.

> made, the windfall sharing mechanism will apply to any remaining proceeds above book-value.[186]

5. Constraint

In Docket 6107, we established the following constraint on the protection against the unjust enrichment of GMP's shareholders:

> The continued financial viability of the Company will represent a constraint on the design and operation of the sharing mechanism. Thus, the windfall sharing mechanism will be designed not to undermine GMP's access to capital markets, and will not be implemented — even if a triggering event occurs — if the Company makes a compelling showing that to do so would precipitate, or contribute to, a financial crisis for the Company or any successor.[187]

We hereby adopt the same constraint for CVPS's protection against unjust enrichment. The intent of the MOU is to enable CVPS to retain its investment grade bond rating, and thereby its long-term financial viability. We do not intend for this protection against unjust enrichment to defeat this ultimate purpose.

VII. CONCLUSION

We conclude that the interest of CVPS and its ratepayers will be best served by approval of the MOU and the rate increase set out therein. The resulting rates, which are in excess of the rates we would establish using a traditional cost-of-service methodology, will provide CVPS with sufficient revenues to operate consistent with its public service obligations, maintain an investment-grade credit rating and access to capital markets at reasonable cost,[188] and remain financially viable.

The alternative, establishing rates in this case based upon traditional cost-of-service methodologies, could cause CVPS to lose access to capital markets, which could produce

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186. Docket 6107, Order of 2/20/01 at 3 (footnote omitted).

187. Docket 6107, Order of 1/23/01 at 116.

188. An electric utility such as CVPS requires continual access to capital markets to meet new demand for service and to upgrade or replace existing facilities so that customers will receive reliable service. CVPS presently maintains an investment-grade credit rating and access to capital, so that the Company is able to meet the demands of a highly capital-intensive business.

significant financial difficulties. In addition to adversely affecting the Company's ability to offer quality service to its customers, significant financial difficulties could cause CVPS to default on its power purchase obligations under the HQ-VJO Contract. Because of the Contract's step-up provisions, a default by CVPS would have serious financial consequences for many other Vermont electric utilities and their ratepayers — a result not in the best interest of Vermont as a whole.

Therefore, we establish rates that, while in excess of those generated by traditional cost-of-service methodologies, when combined with adequate protection against unjust enrichment, fairly balance the interests of CVPS's ratepayers and the Company and are just and reasonable.

In summary, we reach the following conclusions:

- We approve a rate increase for CVPS of $9.852 million (or 3.95 percent), effective with bills rendered on or after July 1, 2001.
- We find the temporary rates in effect since 1999 to be just and reasonable as final rates during the periods in which they were in effect.
- We approve the Third MOU, and will impose no further rate disallowances on CVPS for past actions associated with the HQ-VJO Contract, including the adoption of disallowances based on CVPS' imprudence or through application of the standard requiring that expenditures be economically useful, or reinstatement of the ROE penalty established in Dockets 5701/5724.
- The Third MOU includes several benefits for ratepayers, of which the most significant are:
  - (i) the write-off of $9 million of expenses for which CVPS may otherwise seek recovery from ratepayers;
  - (ii) a freeze on electric rates through the end of 2002;
  - (iii) a cap on the Company's earnings for 2001, 2002, and 2003;
  - (iv) the establishment of service quality standards to assure continued high quality electric service for ratepayers;
  - (v) an assurance that any proceeds gained from CVPS's (and other VJO members') arbitration of the HQ-VJO Contract arising from the 1998 ice storm will be flowed through to ratepayers.
- Because our Order requires ratepayers to pay rates in excess of those we would establish using a traditional cost-of-service methodology, we balance our approval of the Third MOU with the requirement that if CVPS sells some or all of its assets or merges with another company, then ratepayers and the Company

shall share any profit above book value derived from the transaction, up to a maximum sharing of $16 million.

Overall, we conclude that the resulting rate levels, subject to the conditions we adopt, are fair to CVPS's ratepayers and to the Company.

VIII. ORDER

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

1. The Memorandum of Understanding between Central Vermont Public Service Corporation ("CVPS") and the Vermont Department of Public Service ("DPS"), filed May 7, 2001, ("MOU") is approved, with one additional safeguard. This safeguard is set forth in Paragraphs 25–29, below.

2. CVPS is entitled to rates that will produce additional revenues in the amount of $9,852,000 or 3.95 percent above existing temporary rates for bills rendered on or after July 1, 2001.

3. The temporary rates that have been in effect for the period between January 1, 1999, and bills rendered on or before June 30, 2001, are just and reasonable, and shall be the final rates for that period.

4. The revised tariffs filed by CVPS on May 25, 2001, are approved for bills rendered on and after July 1, 2001, except that paragraph 7 of the tariff of Rate 11 (which refers to a past time period) shall be deleted. CVPS shall file a revised tariff for Rate 11 with the Board and the DPS within five (5) days of the issuance of this Order.

5. CVPS's allowed rate of return on common equity shall be 11 percent. If the Company's earnings on its Vermont jurisdictional electric utility operations exceed this level in 2001, the excess shall be returned to ratepayers through reductions to regulatory asset accounts or through other means as approved by this Board. Any excess in 2002 or 2003 shall also be returned to ratepayers in a similar manner, unless the MOU is superceded by a new Board-approved agreement or order on rates.

6. CVPS shall write down certain regulatory assets in the amount of $9 million. The regulatory assets to be written-down are as follows:

- SFAS 112 - Post Employment – $109,982;
- 1997 Workforce Reduction – $1,836,770;
- Year 2000 - Incremental Costs – $1,870,326;
- Unamortized Loss on Reacquired Debt – $179,925;
- Small Power Producers Accounting Order – $452,373;
- Retail Choice Accounting Order – $110,989; and
- various Conservation and Load Management accounts as detailed in Attachment 5 to the MOU – $4,439,635.

7. CVPS shall apply any amounts collected as a result of the award issued in the HQ-VJO Contract ice storm arbitration, or any settlement or agreement with Hydro-Québec or any other party relating to CVPS's HQ-VJO Contract power supply costs, first to reduce the remaining balances of deferred costs associated with the prosecution of the ice storm arbitration, and then to reduce balances in other regulatory asset accounts as approved by the Board. If the deferred costs associated with the prosecution of the ice storm arbitration are not reduced to zero, CVPS will book and defer (without carrying costs) for subsequent recovery the remaining costs.

8. CVPS shall not file a request for a rate increase to be effective prior to January 1, 2003.

9. If there is a major storm, power supply interruption or outage in excess of forecasted outage rates relating to Vermont Yankee or Hydro-Québec deliveries, CVPS may seek emergency rate relief pursuant to 30 V.S.A. § 226(a) or seek an accounting order from the Board permitting the deferral of costs associated with the event.

10. CVPS shall not, in this or any future proceeding to determine CVPS's rates, be subject to any further penalty or disallowance of costs incurred in the purchase of power pursuant to the HQ-VJO Contract based on CVPS's prudence relating to any act or omission occurring prior to the date of this Order.

11. CVPS shall not, in this or any future proceeding to determine CVPS's rates, be subject to any further penalty or disallowance of costs incurred in the purchase of power pursuant to the HQ-VJO Contract based on the application of any "used or useful" theory.

12. CVPS shall not, in this or any future proceeding to determine CVPS's rates, be subject to any further ROE penalty on account of the Order in Docket Nos. 5701/5724.

13. CVPS shall not, in this or any future proceeding to determine CVPS's rates, be subject to any penalty or disallowance on account of an allegation of imprudence or mismanagement at any time prior to the date of this Order related to the following issues as raised by the DPS in this proceeding: that the Company failed to pursue an uprate of the Vermont Yankee Nuclear Power Station, failed to properly manage or match its loads to its power sources and/or its power sources to its loads, or mismanaged its capital maintenance projects.

14. Beginning in 2001, CVPS shall measure and report to this Board and the Department its customer service, safety, and reliability performance as detailed in the Service Quality & Reliability Performance, Monitoring & Reporting Plan which is Attachment 3 to the MOU, except that the monitoring reports referred to in Section III, Paragraph 1 of Attachment 3 shall be filed with the Board as well as the Department. The Service Quality & Reliability Performance, Monitoring & Reporting Plan includes minimum performance standards for some of the performance measures defined in the Plan, and sets out a process for determining the remaining minimum standards. CVPS shall submit the remaining minimum standards to this Board for approval within three months of the issuance of this Order. The Plan shall be in effect for two years following Board approval of the remaining performance standards.

15. CVPS shall include a script in the "arrangement workflow" of the Company's current Customer Relationship Management tool that reminds the Customer Service Representative of the necessity to apply the specific reasonableness criteria described in Public Service Board Rule 3.302(G), *Establishment of a Reasonable Repayment Plan*, when making payment arrangements. CVPS shall also develop the necessary enhancements to its Customer Relationship Management tool to record how the reasonableness criteria were applied in each case. The wording of the script, timing of the implementation of the enhancements to CVPS's Customer Relationship Management tool, and associated training shall be completed within three months of the issuance of this Order.

16. Within 45 days of the issuance of this Order, CVPS shall file revised tariffs with this Board that amend the "household rule" provision of its tariffs to conform to the current Public Service Board Rule 3.302(F), *Household Rule*.

17. CVPS shall work with the DPS to develop, within three months of the issuance of this Order, documented guidelines for the application of Public Service Board Rule 3.304(C), *Winter Disconnections*.

18. CVPS shall work with the DPS to develop standard criteria to be used by the Company to switch customers from Residential, Rate 1 to General Service, Rate 2 when a portion of the customer's primary residence is being used for business purposes. These criteria will include, at a minimum, providing the customers the opportunity to prove, using a federal income tax return, that less than 50 percent of the home is used for business purposes. CVPS shall file revised tariffs that incorporate these standard criteria with this Board within three months of the issuance of this Order.

19. Decommissioning costs in the amount of $300,504 annually for the Millstone III nuclear power plant are deemed to be recovered in the rates established by this Order. CVPS shall credit its regulatory asset accounts, in any calendar year during the term of the rates established by this Order, for any amounts less than the decommissioning amount recognized in its rates that is actually billed for Millstone III decommissioning.

20. CVPS shall work with Dominion Nuclear Connecticut, the Connecticut Department of Utility Control and the DPS to resolve the current uncertainty regarding what CVPS's share of Millstone decommissioning costs will be during the period in which rates established by this Order will be in effect. CVPS shall report to the Board once this issue is resolved.

21. If Vermont Yankee Nuclear Power Corporation bills CVPS for Texas-Maine-Vermont Low-Level Radioactive Waste Compact payments, incremental decommissioning costs, or sale costs in excess of the amounts to be recognized in CVPS's revenue requirement as set forth in Attachment 4 during the term of the rates established by this Order, CVPS shall be permitted to book and defer (with carrying costs) for subsequent recovery such incremental Vermont Yankee Nuclear Power Corporation costs.

22. CVPS's recovery of Conservation and Load Management deferred amounts, Account Correcting for Efficiency ("ACE") amounts, on-going recurring amounts, and all associated accounting impacts shall be as provided on Attachment 5 to the MOU.

23. CVPS shall discontinue booking and deferring ACE for Energy Efficiency Utility core program savings on and after July 1, 2002. CVPS shall not seek to continue the ACE mechanism or to replace the ACE mechanism in connection with the delivery of Energy Efficiency Utility system-wide core programs. CVPS shall recover all amounts booked prior to July 1, 2002, but not yet recovered, in a manner consistent with past practice.

24. In Docket 6133, CVPS shall: (1) submit an agreement between the Company and the DPS supporting the approval of affiliate transaction rules and codes of conduct within 30 days of the issuance of this Order; (2) work with the DPS to resolve any outstanding concerns the DPS may have regarding issues raised in that docket and to develop a schedule for concluding that docket in a reasonable period of time; and (3) file this schedule with the Hearing Officer in that docket by July 1, 2001.

25. As is more fully described in Section VI of this Order, CVPS shall be subject to a protection against the unjust enrichment of its shareholders at the expense of its ratepayers. This mechanism shall be triggered by any one of the following: (1) any merger of CVPS with another company; (2) any acquisition of control of CVPS that requires Board approval under 30 V.S.A. § 107; and (3) the sale or lease of any of CVPS's assets so substantial as to require Board approval under 30 V.S.A. § 109.

26. As is more fully described in Section VI of this Order, the protection against unjust enrichment shall not be triggered by the sale of CVPS's unregulated assets, nor by the establishment of a holding company that does not involve a change in ownership and does not involve the transfer of assets from regulated to unregulated subsidiaries. If a change in corporate structure involves the transfer of assets from regulated to unregulated subsidiaries, the Board will take whatever action is necessary to ensure that ratepayers are compensated appropriately. As long as the protection against unjust enrichment is in effect, CVPS shall present evidence in any docket in which it proposes a change in corporate structure regarding whether the change also involves the transfer of assets from regulated to unregulated subsidiaries.

27. CVPS shall work with the DPS in Docket 6133 to develop a means of assuring that, if the Board were to approve the creation of a holding company, a transfer of assets from regulated to unregulated subsidiaries, and their subsequent sale for above book value could not occur

without appropriate compensation to ratepayers. CVPS and the DPS shall be prepared to present evidence in Docket 6133 on any other possible ramifications of the creation of a holding company on the operation of the protection against unjust enrichment created by this Order.

28. As is more fully described in Section VI of this Order, when a triggering event occurs, CVPS's ratepayers shall receive fifty percent of the above-book proceeds of the event, subject to a cumulative limit of $16 million, such limit to be adjusted for inflation. CVPS shall notify this Board no later than July 20, 2001, as to whether CVPS requests a prompt Board investigation into the specific design of the procedure by which the protection against unjust enrichment is to be implemented.

29. Any benefits to ratepayers provided by the protection against unjust enrichment established in this Order shall be in addition to those ratepayers are entitled to under existing law.

30. All findings and conclusions requested by the parties and not specifically adopted above are, hereby, rejected.

DATED at Montpelier, Vermont, this 26th day of June, 2001.

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

OFFICE OF THE CLERK

FILED: June 26, 2001

ATTEST: s/Susan M. Hudson
Clerk of this Board

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

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of this 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 this Board within ten days of the date of this decision and order.

Appendix A: Hearing Dates

Public Hearings

Docket No. 6120:	September 23, 1998 (Middlebury) November 17, 1998 (White River Junction)	
Docket No. 6460:	February 19, 2001	(Via VIT in Bennington, Brattleboro, Lyndonville, Middlebury, Randolph, Rutland, St. Albans, Springfield)

Technical Hearings

Montpelier, Vermont

Docket No. 6120:	November 5, 6, 1998 May 9, 2000
Docket Nos. 6120 & 6460:	May 9, 14, 15, 16, 2001

Appendix B: Appearances

Docket 6120

James Volz, Esq.
Sarah Hofmann, Esq.
Aaron Adler, Esq.
for Vermont Department of Public Service

Joseph Kraus, Esq.
Kenneth C. Picton, Esq.
Hans G. Huessy, Esq.
Mary C. Marzec, Sr. Paralegal
for Central Vermont Public Service Corporation

Morris L. Silver, Esq.
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Robert A. Mello, Esq.
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Downs Rachlin & Martin PLLC
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*Kenneth G. Jaffe, Esq.
Swidler Berlin Shereff Friedman, LLP
for Vermont Yankee Nuclear Power Corporation

David Rapaport
for Vermont Public Interest Research Group

James A. Dumont, Esq.
Dumont & Lee PC
for American Association of Retired Persons

Docket 6460

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Aaron Adler, Esq.
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Joseph Kraus, Esq.
Kenneth C. Picton, Esq.
Kimberly A. Pritchard
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Morris L. Silver, Esq.
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Dumont & Lee, PC
for American Association of Retired Persons

*Limited Appearance for Motion to Strike
**Party Withdrew

Appendix C: Procedural History

This Order resolves all remaining issues in two dockets: Docket 6120 and Docket 6460. Brief procedural histories of both dockets are provided below. In addition, a recent Vermont Supreme Court decision regarding a Board Order in Docket 6018 bears directly on some of the disputed issues in Dockets 6120 and 6460. Therefore, a brief description of the circumstances related to that appeal of the Board's Order in Docket 6018 is also provided below.

A. DOCKET 6018

Docket 6018 was an investigation of revised tariffs filed on September 22, 1997, by CVPS, in which the Company sought to increase its rates.

On April 17, 1998, the Board issued an order in which it concluded that neither res judicata, collateral estoppel, nor equitable estoppel precluded consideration in Docket 6018 of CVPS's prudence in connection with its lock-in or management of the HQ/VJO Contract ("Order on Preclusion"). The Board also concluded that those legal doctrines did not preclude a consideration of whether, and to what degree, Contract power is used-and-useful under Vermont regulatory principles and precedents.[189]

On April 30, 1998, the Board granted CVPS's Motion for Leave to File an Interlocutory Appeal of the April 17, 1998, Order on Preclusion, and stayed Docket 6018 until 15 days following the Vermont Supreme Court's decision on the interlocutory appeal.[190] On May 6, 1998, CVPS filed this interlocutory appeal.

On February 9, 2001, the Vermont Supreme Court ruled on CVPS's interlocutory appeal.[191] The only definitive ruling in the Court's decision is that the Board is precluded from further consideration of the prudence of CVPS's lock-in to the HQ-VJO Contract. The Court ruled that the Board's Order in Docket 5701, dated October 31, 1994, determined that CVPS's lock-in to the Hydro-Québec Contract was imprudent and that, because of legally complete litigation of the issue by the parties in 1994, this determination precludes further litigation of that

189. Docket 6018, Order of 4/17/98.
190. Docket 6018, Order of 4/30/98.
191. *In re Tariff Filing of Central Vermont Public Service Corporation*, 769 A.2d 668.

issue. However, the Court explicitly said that it had not resolved any of the other issues raised for interlocutory consideration. For example, the Vermont Supreme Court stated that the Board is not precluded from imposing further consequences upon CVPS for imprudence of its decision to lock in early to the HQ-VJO Contract.[192] The decision also remands for our renewed consideration the economic usefulness of the Hydro-Québec power.

On March 2, 2001, the Board accepted and acted upon a joint proposal by CVPS and the Department that recommended, in part, that Docket 6018 be closed, with resolution of any remaining issues to occur in Docket 6120.[193]

B. DOCKET 6120

Docket 6120 is an investigation of a June 12, 1998, filing of revised tariffs by CVPS. The revised tariffs set out a rate increase of 12.9 percent in base rates, representing an annual revenue increase of approximately $29.8 million, to take effect on a service-rendered basis beginning July 27, 1998.[194]

The early procedural history of this case is described in the Board's December 11, 1998, Order in Docket 6120 and need not be repeated in detail here.[195] The following is a summary of the most significant events from the beginning of this Docket through March 2, 2001[196]:

- On September 22, 1998, the Board approved a proposal by CVPS and the Department to bifurcate Docket 6120. Under this proposal, examination of the prudence and used-and-usefulness of HQ-VJO Contract power would be stayed pending the Vermont Supreme Court's decision in the appeal of Docket 6018, and the Board would issue a rate order regarding the matters not bifurcated and

192. The Court's decision also explicitly does not preclude the Department from litigating the prudence of the negotiation and entry into the HQ-VJO Contract.

193. Docket 6018 and Docket 6120, Order of 3/2/01.

194. CVPS requested a 10.7 percent increase, or $24.9 million to "cover costs primarily from the higher power costs that the company will incur to serve customers in the rate year under the Vermont Joint Owners contract with Hydro-Québec." CVPS also requested an additional 2.2 percent increase, or $5.1 million, to cover new expenses relating to the Department's proposal to create an energy efficiency utility. CVPS contended that the 2.2 percent increase would only be required if the Board approved the creation of the energy efficiency utility.

195. Docket 6120, Order of 12/11/98 at 2-3.

196. March 2, 2001, was the date on which the Board approved a consolidation of the hearings and remaining schedule in Docket 6120 with the schedule then in effect in Docket 6460. As a result, after March 2, 2001, the procedural history in Docket 6120 is the same as that in Docket 6460, and will be described in the section on Docket 6460 below.

stayed within the statutory time period. The resultant rates would be put into effect as a "temporary rate increase" according to the temporary rate mechanism set forth in 30 V.S.A. §226(a).[197]

- On December 11, 1998, the Board approved a Memorandum of Understanding submitted jointly by CVPS and the Department. Consistent with the Memorandum of Understanding, the Board approved a temporary rate increase of 4.7 percent to take effect with service rendered January 1, 1999. This Order resolved all issues in Docket 6120 except issues concerning the HQ-VJO Contract's prudence and used-and-usefulness.[198]
- On December 22, 1999, the Board approved a Stipulation filed by CVPS and the DPS to reduce CVPS's rates to lower the Company's annual revenues by $2,978,664 effective with bills rendered February 1, 2000.[199] On December 21, 2000, the Board approved a Stipulation filed by CVPS and the DPS reducing CVPS's rates by $1,048,177 effective with bills rendered February 1, 2001.[200] These rate reductions related to a reduction in responsibilities and shift of costs due to the implementation of a new statewide energy efficiency utility.[201]
- On March 2, 2001, the Board accepted a joint proposal by CVPS and the Department that provided, in part, that further proceedings should be held in Docket 6120, hearings in Docket 6120 and Docket 6460 should be consolidated, and the schedule for further proceedings in Docket 6120 should be the same as that in effect in Docket 6460.[202]

C. DOCKET 6460

Docket 6460 is an investigation of a November 9, 2000, filing of revised tariffs by CVPS. The revised tariffs reflected a rate increase of 7.6 percent in base rates, representing an annual revenue increase of approximately $19.0 million, to take effect on a service-rendered basis beginning December 24, 2000.

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197. Docket 6120, Order of 9/22/98.

198. Docket 6120, Order of 12/11/98.

199. Docket 6120, Order of 12/22/99.

200. Docket 6120, Order of 12/21/00.

201. Under the terms of a settlement approved by the Board in its 9/30/99 Order in Docket 5980, energy efficiency programs delivered by the new energy efficiency utility were to be funded via an energy efficiency charge on customers' bills, and CVPS's rates were to be reduced by the amount to be collected from CVPS's customers via the energy efficiency charge.

202. Docket 6018 and Docket 6120, Order of 3/2/01. The proposal also provided that since AARP was a party to Docket 6018 but not to Docket 6120, it should have an opportunity to file a motion to intervene in Docket 6120. AARP did so, and after giving other parties an opportunity to comment, the Board granted AARP's motion on March 14, 2001. Docket 6120 and Docket 6460, Order of 3/14/01.

At the January 3, 2001, prehearing conference, the Board approved Vermont Yankee Corporation's Motion to Intervene.[203] On January 31, 2001, the Board approved the Motion to Intervene of "Five or More Ratepayers".[204]

On February 19, 2001, the Board held a Public Hearing in person in Rutland, Vermont, and via Vermont Interactive Television at Bennington, Brattleboro, Lyndonville, Middlebury, Randolph Center, St. Albans, and Springfield. One ratepayer spoke in favor of the rate increase. No others chose to speak.

On March 30, 2001, Vermont Yankee Corporation and CVPS filed a Motion to Strike portions of the Department's prefiled direct testimony regarding CVPS's role in opposing a proposed "uprate" of the Vermont Yankee nuclear power plant. On April 30, 2001, CVPS filed a Supplemental Motion to Strike portions of the Department's prefiled surrebuttal testimony related to the same issue. The Board has not ruled on these Motions; however, today's Order makes them moot.[205]

On March 30, 2001, CVPS filed a Motion to Strike portions of the Department's prefiled direct testimony, arguing that the testimony was precluded by the Vermont Supreme Court's decision regarding the Board's preclusion order in Docket 6018. On April 30, 2001, CVPS filed a Supplemental Motion to Strike portions of the Department's prefiled surrebuttal testimony for the same reason. On May 2, 2001, after oral argument by CVPS and the DPS, the Board rejected CVPS's Motions to Strike portions of the Department's prefiled direct and surrebuttal testimony.[206]

On May 7, 2001, CVPS and the Department filed a Memorandum of Understanding ("MOU") which was a comprehensive bottom-line settlement of all their contested issues in both Docket 6120 and Docket 6460. The MOU is attached to this Order as Appendix E, and its provisions are discussed in Sections IV and V of this Order.

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203. Docket 6460, Prehearing Conference Memorandum of 1/5/01.

204. Docket 6460, Order of 1/31/01.

205. CVPS Counsel Picton stated at the May 8, 2001, status conference that if the Board approved the MOU, it would not need to rule on these Motions to Strike. Tr. 5/8/01 at 11.

206. Tr. 5/2/01 at 109–111.

On May 9, 2001, the intervenor "Five or More Ratepayers" informed the Board that it had reached a settlement with CVPS, and requested permission to withdraw their permissive intervention and terminate their participation in this proceeding. The Board approved this request on May 14, 2001.[207]

Technical hearings on the Memorandum of Understanding were held on May 9, 14, 15, and 16, 2001.

On May 24, 2001, the Board notified the parties that it would like to accept CVPS's offer (made during the technical hearings on the MOU) to enter the April 17, 2001, award of the ice storm arbitration panel in the record in Dockets 6120 and 6460, and offered other parties the opportunity to object to the admission of this document. No party objected, and the award was admitted into the record as exhibit Board-4.

On May 25, 2001, CVPS filed revised tariffs reflecting the rates that would be effective with bills rendered on and after July 1, 2001, if the MOU is approved by the Board. No party has filed comments upon the revised tariffs, and we see no inconsistency between the revised tariffs and the MOU, which we approve today. We hereby approve the revised tariffs, except that paragraph 7 of the tariff for Rate 11 (which refers to a past time period) should be deleted.[208]

CVPS, the Department, and AARP filed briefs on May 25, 2001. CVPS, the Department and AARP filed reply briefs on June 4, 2001.

On June 4, 2001, CVPS also filed a Motion to Strike portions of AARP's brief. Specifically, CVPS asked that the Board exclude: (1) the language in AARP's brief that describes its proposed protection against unjust enrichment; and (2) the Memorandum of Understanding by and among the California Department of Water Resources, Southern California Edison Company, and Edison International Corporation (the "California MOU") that is attached to AARP's brief, and the language in AARP's brief that discusses the California MOU as support for AARP's proposed protection against unjust enrichment. The basis for CVPS's Motion to Strike is that AARP did not offer these items into evidence during the hearings in this

207. Docket 6460, Order of 5/14/01.

208. If any party believes there is a material inconsistency between the revised tariffs and today's Order, they may request that the Board modify this Order approving the tariffs through an appropriate Motion for Reconsideration.

proceeding, nor did it give CVPS notice that it would be offering these items, thereby depriving CVPS of the opportunity to discover and introduce evidence in opposition to AARP's proposed protection against unjust enrichment or the California MOU.

We will discuss the two parts of CVPS's Motion to Strike separately. First, we note that, as evidenced by witness Boyle's prefiled rebuttal testimony which addresses several issues associated with a protection against unjust enrichment, CVPS was aware prior to the hearings that the imposition of a protection against unjust enrichment was an issue in these proceedings. Second, we find that CVPS had the opportunity, through its witnesses' responses to cross-examination by AARP and direct questions from the Board, to address a wide variety of issues associated with a protection against unjust enrichment. Third, we note that the Board specifically asked all parties to address the question of whether a protection against unjust enrichment should be imposed in their briefs.[209] Therefore, we deny CVPS's Motion to Strike the language in AARP's brief that describes its proposed protection against unjust enrichment.

With respect to the California MOU and the language in AARP's brief discussing the California MOU, we find that they would probably be inadmissable because of untimeliness. However, we have read the information and find it unpersuasive because of the significant factual distinctions between the situations in California and Vermont. As a result, we have not relied on this information in making our decision, and therefore need not address the question of whether it need be struck from the record.

D. THE BOARD CONSIDERING THESE DOCKETS

The composition of the Board has changed over the course of Dockets 6120 and 6460.

Throughout these proceedings, David Coen has been a member of the Board presiding over these Dockets.

Former Board Chairman Richard Cowart participated in consideration of Docket 6120 until April 1999. At that time, he was replaced by current Board Chairman Michael Dworkin in that Docket 6120's continued proceedings. Chairman Dworkin has reviewed the following

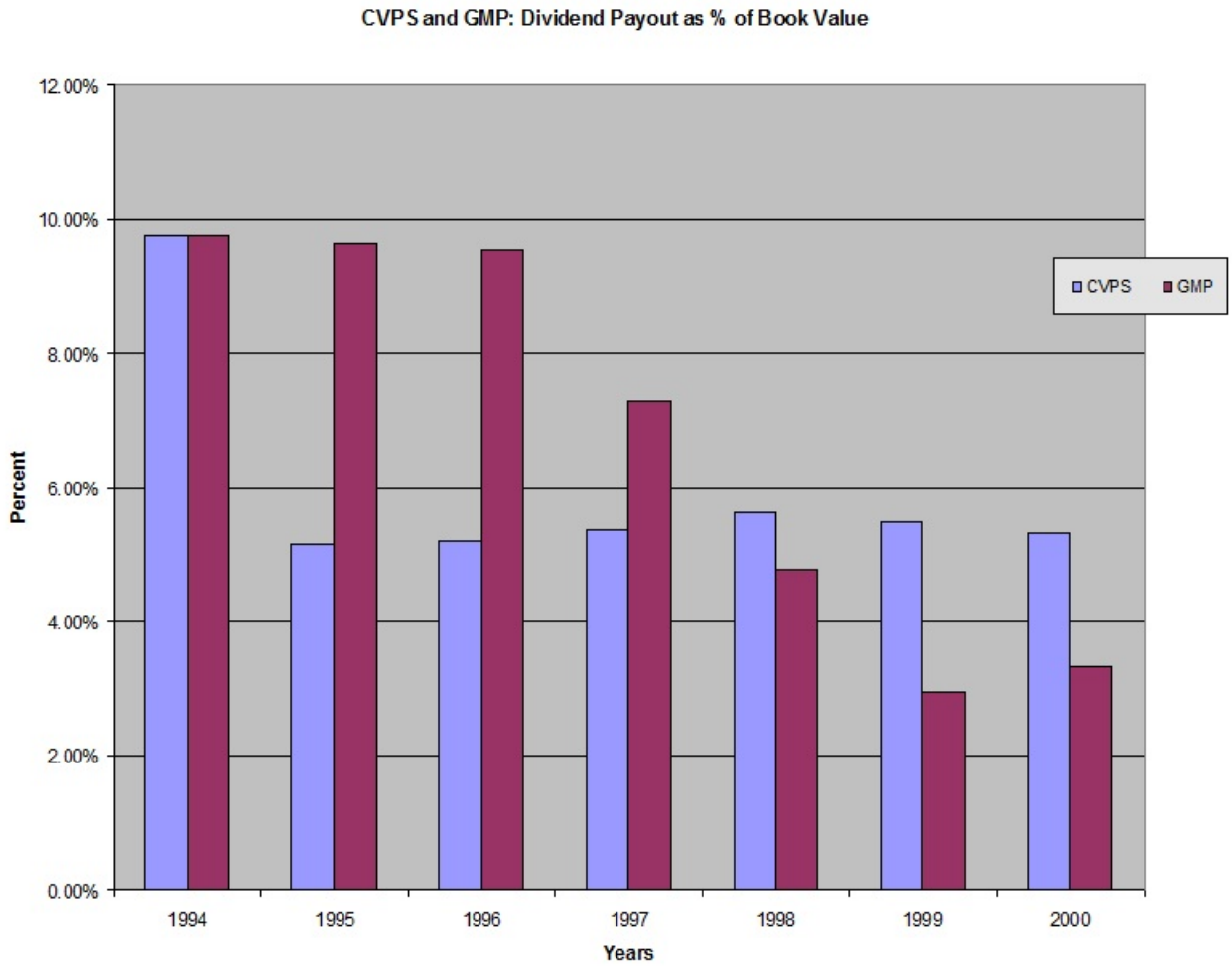
209. Tr. 5/16/01 at 121.

materials from the prior record in Docket 6120: the Board's Orders, the parties' briefs, and all items cited as relevant to the currently contested issues. He also has presided over all proceedings in Docket 6460.

Former Board Member Suzanne Rude participated in the Board's deliberations on Docket 6120 until July, 2000. On July 10, 2000, she notified the Board that she intended to take extended vacation leave until the second week of August and not participate in Board business during that period. On August 10, 2000, she resigned and recused herself from deliberations and decision-making in Docket 6120 and all other dockets pending before the Board.

Current Board Member John Burke was appointed to complete the remaining portion of Ms. Rude's term in December 2000. Board Member Burke has reviewed the following materials from the prior record in Docket 6120: the Board's Orders, the parties' briefs, and all items cited as relevant to the currently contested issues. Board Member Burke has reviewed all of the prior record in Docket 6460.

Appendix D: Chart of CVPS and GMP Dividends as Percent of Book Value



Appendix E: Memorandum of Understanding

STATE OF VERMONT

PUBLIC SERVICE BOARD

Docket No. 6120

Tariff filing of Central Vermont Public Service)
Corporation requesting a 12.9% rate increase to)
take effect July 27, 1998)

Docket No. 6460

Tariff filing of Central Vermont Public Service)
Corporation requesting a 7.6% rate increase, to)
take effect December 24, 2000)

MEMORANDUM OF UNDERSTANDING

This Memorandum of Understanding (the "MOU" or "Memorandum") sets forth the agreements reached between the Vermont Department of Public Service ("DPS" or the "Department"), and Central Vermont Public Service Corporation ("CVPS", "Central Vermont", or the "Company") (together, the "Parties"), regarding CVPS's rate increase requests as filed with the Vermont Public Service Board ("PSB" or the "Board") in the above-referenced dockets. This MOU is supported by testimony filed by the DPS and CVPS.

Introduction And Recitals

A. Docket No. 6018.

1. On September 22, 1997, Central Vermont filed a tariff requesting a 6.6 percent increase in rates, to take effect on November 6, 1997 (Docket No. 6018). The Board issued a procedural order in which it concluded that it was not precluded from investigating and litigating the "prudence" and "used-and-usefulness" of Central Vermont's purchase of power pursuant to the Hydro-Québec/Vermont Joint Owners Contract (the "HQ/VJO Contract"). CVPS took an interlocutory appeal of this PSB order and the case was stayed pending appeal. On February 9, 2001, the Supreme Court ruled on the interlocutory questions authorized by the Board's Order of April 30, 1998. See: In re Tariff Filing of Central Vermont Service Corp., ____ Vt. ____, (98-214). Pursuant to a proposal by the DPS and CVPS, the Board closed Docket No. 6018, determined further proceeding should be held in Docket No. 6120, and consolidated Docket Nos. 6120 and 6460.

B. Docket No. 6120.

2. On June 12, 1998, CVPS filed a request for a retail rate increase of $29.833 million, or 12.9%, in annual revenues (Docket No. 6120). CVPS and the DPS proposed, and the Board approved, a bifurcation of Docket No. 6120, whereby issues of the "prudence" and "used-and-usefulness" of the HQ/VJO Contract would be stayed pending the Vermont Supreme Court's decision in Docket No. 98-214. CVPS and the DPS agreed that a rate order in Docket No. 6120 could be put into effect as a temporary rate increase, including HQ/VJO Contract costs except for the portion of the costs of the HQ/VJO Contract subject to "prudence" and "used and useful" claims determined in accordance with the disallowance methodology established in Docket No. 5983. Subject to PSB review of any such "*pro forma"* HQ/VJO Contract disallowance, that

portion of the Parties' agreement was approved by Order dated September 22, 1998 in Docket No. 6120. On October 28, 1998, CVPS and the DPS entered into a Memorandum of Understanding (the "Temporary Rates MOU") that provided for a temporary increase in CVPS's annual revenues from retail customers of $10.902 million, or 4.7%, (subject to a *pro forma* HQ/VJO Contract "prudence" and "used and useful" disallowance) effective with service rendered January 1, 1999. As part of the Temporary Rates MOU, CVPS and the DPS agreed that the *pro forma* disallowance of HQ/VJO Contract related "prudence" and "used and useful" claims determined in accordance with the disallowance methodology established in Docket No. 5983 was $7,360,529 on a CVPS Vermont jurisdictional basis. On December 12, 1998, the Board approved the Temporary Rates MOU and authorized an overall temporary retail rate increase of 4.7% effective January 1, 1999.

3. On April 30, 1999, CVPS and the DPS entered into a Memorandum of Understanding (the "Core MOU") and related Bilateral Agreement in Docket No. 5980, Investigation into the Department of Public Service's Proposed Energy Efficiency Plan. To implement the CVPS/DPS Bilateral Agreement for the twelve (12) month period beginning with bills rendered on and after February 1, 2000, CVPS and the DPS entered into and filed a rate reduction Stipulation in Docket No. 6120 on October 27, 1999 (the "2000 Rate Reduction Stipulation"), in which CVPS proposed to reduce its rates to lower its annual revenues by $2,978,664 effective with bills rendered February 1, 2000. By Order dated December 22, 1999 in Docket No. 6120, the Board approved the 2000 Rate Reduction Stipulation. To further implement the CVPS/DPS Bilateral Agreement for the twelve (12) month period beginning with bills rendered on and after February 1, 2001, CVPS and DPS entered into and filed a second rate

reduction Stipulation in Docket No. 6120 on December 8, 2000 (the "2001 Rate Reduction Stipulation"), in which CVPS proposed to reduce its rates to lower its annual revenues by $1,048,177 effective with bills rendered February 1, 2001. By Order dated December 21, 2000 in Docket No. 6120, the Board approved the 2001 Rate Reduction Stipulation.

C. Docket No. 6460.

4. CVPS filed its instant request for a retail rate increase of $19.0 million, or 7.6%, in annual revenues with the Board on November 9, 2000. Direct testimony and workpapers describing the Company's request were also filed at that time. On December 14, 2000, the Board suspended the Company's request and at the recommendation of the DPS opened the instant investigation in Docket No. 6460. On February 19, 2001, the Board convened a public hearing. On March 9, 2001, the DPS prefiled rebuttal testimony on all issues raised by Central Vermont's filing. On March 30, 2001, CVPS prefiled rebuttal testimony. On April 20, 2001, the DPS prefiled surrebuttal testimony.

5. The undersigned Parties have engaged in extended discussions and review with respect to these filings.

D. Consideration

6. In this proceeding CVPS seeks a final resolution to the issues surrounding its continuing purchase of power pursuant to the HQ/VJO Contract, including issues addressed by the Company's appeal of the Docket No. 6018 Order Re: Preclusion, the decision of the Vermont Supreme Court in In re Tariff Filing of Central Vermont Service Corp., ____ Vt. ____, (98-214).

7. Subsequent to the imposition of the rate of return penalty in Docket Nos. 5701/5724, CVPS has engaged in a series of efforts to mitigate its power costs, as more fully discussed in CVPS' testimony supporting this MOU. CVPS acknowledges and agrees that its management has a continuing duty to engage in prudent management of CVPS's investments and resources, including, without limitation, CVPS's power supply resources, including the duty to pursue efforts to achieve cost-effective power supply cost reductions.

8. As an electric utility, CVPS must maintain access to capital at reasonable terms. This enures to the customers' benefit because it lowers the Company's revenue requirement from what it otherwise would be, reduces borrowing costs, and assures that the Company will be able to meet its obligations to its customers. In addition, VELCO is planning significant capital additions in order to continue to provide reliable power supply for Vermont. Any VELCO financings will be affected by CVPS's creditworthiness inasmuch as CVPS owns approximately 55% of VELCO's common stock and supports approximately 45% of its cost of service. Maintaining access to capital is also important for the Company as it pursues other initiatives designed to mitigate customers' costs including the sale of the Company's interest in Vermont Yankee.

9. The parties agree that it is important for CVPS to continue to be able to avail itself of regulatory accounting treatment under Statement of Financial Accounting Standards ("SFAS No. 71"), *Accounting for the Effects of Certain Types of Regulation*.

10. In the absence of an increase in CVPS's retail rates, the Company would not have a reasonable opportunity to earn its allowed return.

11. In consideration of the above , the Parties agree to the settlement contained within this MOU.

Cost of Service

12. The undersigned Parties agree that a rate increase in CVPS's annual revenues from retail customers of $9.852 million, or 3.95%, effective with bills rendered on or after July 1, 2001 will result in just and reasonable rates subject to the terms of this MOU.

13. The Parties further agree that the Temporary Rates allowed by the Board in Docket No. 6120 since January 1, 1999 have resulted in just and reasonable rates for the period such Temporary Rates have been in effect; that such Temporary Rates should remain in effect through June 30, 2001; and that such Temporary Rates will result in just and reasonable rates through June 30, 2001. It is the intention of the Parties that the Temporary Rates currently in effect shall become permanent.

14. CVPS's cost of service, rate base, and cost of capital are as set forth in Attachment 1. The Parties accept CVPS's proposed cost of service, rate base, and cost of capital (Attachment 1) for purposes of this Memorandum only because the overall rate levels established by this Memorandum will be just and reasonable subject to the terms and conditions hereof.

15. CVPS agrees to write-down its regulatory assets in the amount of $9.0 million. A schedule showing the specific regulatory assets that comprise the $9.0 million write-off is included as Attachment 2. The rate year effects of this write-down are reflected in Attachment 1.

16. After application of excess 2000 deseasonalization revenues and Lyndonville refund (consistent with stipulations approved, respectively, on June 8, 2000 in Docket No. 6120 and August 23, 2000 in Docket No. 6408), CVPS agrees that all amounts collected on account of the award issued by the arbitration panel in the HQ/VJO Contract arbitration, or any settlement or agreement with Hydro-Quebec or any other party relating to CVPS's HQ/VJO Contract power supply costs, shall be applied first to reduce the remaining balances of deferred costs associated with the prosecution of the ice storm arbitration, and, should the balance of such deferred costs be reduced to zero, then to reduce balances in other regulatory asset accounts as specified by the DPS and approved by the Board. Should the balance of such deferred costs not be reduced to

zero, CVPS shall be permitted to book and defer (without carrying costs) for subsequent recovery its remaining unrecovered ice storm arbitration costs. The DPS reserves its right to contest only the recovery of such remaining unrecovered costs. The Parties acknowledge that the only such amounts that could be subject to future review (*i.e.* the only amounts at risk) will be the amounts, if any, not fully recovered.

17. CVPS agrees not to file with the Public Service Board a petition requesting any further increase in retail electric rates to be effective prior to January 1, 2003.

18. CVPS and the Department further agree that in the event of a major storm, power supply interruption or outage in excess of forecasted outage rates relating to Vermont Yankee or Hydro-Quebec deliveries, CVPS may seek emergency rate relief pursuant to 30 V.S.A. § 226(a) or seek an accounting order from the Board permitting the deferral of costs associated therewith. The Department will support any such request for an accounting order. The DPS reserves its right to contest the ultimate recovery of such booked and deferred costs.

19. CVPS shall not, in this or any future proceeding to determine CVPS's rates, be subject to any further penalty or disallowance of costs incurred in the purchase of power pursuant to the HQ/VJO Contract based on CVPS's prudence relating to any act or omission occurring prior to the effective date of the order approving this MOU.

20. CVPS shall not, in this or any future proceeding to determine CVPS's rates, be subject to any further penalty or disallowance of costs incurred in the purchase of power pursuant to the HQ/VJO Contract based on the application of any "used or useful" theory.

21. CVPS shall not, in this or any future proceeding to determine CVPS's rates, be subject to any further ROE penalty on account of the Order in Docket Nos. 5701/5724. Said ROE penalty shall be permanently lifted and removed.

22. CVPS shall not, in this or any future proceeding to determine CVPS's rates, be subject to any further penalty or disallowance on account of an allegation of imprudence or mismanagement at any time prior to the effective date of the order approving the settlement MOU related to the following issues as raised by the DPS in this docket: that the Company failed to pursue an uprate of the Vermont Yankee Nuclear Power Station, failed to properly manage or match its loads to its power sources and/or its power sources to its loads, or mismanaged its capital maintenance projects .

23. CVPS agrees that its performance beginning in 2001 will be measured by the customer service, safety and reliability standards (the "Service Quality and Reliability Plan" or "SQRP") attached hereto as Attachment 3.

25. With regard to PSB Rule 3.302 (G), *Establishment of a reasonable repayment plan*, the Company agrees to enhance its current Customer Relationship Management tool "PEGA" to include a script in the arrangement workflow that reminds the Customer Service Representative ("CSR") of the necessity to apply the specific reasonableness criteria described in Section 3.302 (G) when making payment arrangements. In addition, the Company agrees to develop the necessary enhancements to PEGA to record how the reasonableness criteria were applied in each case. The wording of the script and timing of the implementation of the PEGA enhancements and associated training will be determined in accordance the time frames established in Section I, Paragraph 2 of the Service Quality and Reliability Plan.

26. In reference to PSB Rule 3.302 (F) the Company will amend the household rule provision of its tariff to conform to the current PSB rule 3.302 (F). Such amendments to the Company's Tariff Sheets will be submitted for Board approval no later than 45 days from the date of the Board's final order in Docket No. 6460.

27. In reference to PSB Rule 3.304 (C), *Winter Disconnections*, the Company agrees to fully comply with the rule. The Company and the DPS have had fruitful discussions on practical challenges faced by the Company in applying the rule. The parties agree to continue these discussions and develop documented guidelines for application of the section, consistent with the requirements of the rule. The guidelines will be completed in accordance with the time frames established in Section 1, Paragraph 2 of the Service Quality and Reliability Plan.

28. The Company agrees to work with the DPS on developing standard criteria to be used by the Company to switch customers from Residential, Rate 1 to General Service, Rate 2 when a portion of the customer's primary residence is being used for business purposes. These criteria will include, at a minimum, providing the customers the opportunity to prove, using a federal income tax return, that less than 50 percent of the home is used for business purposes. The standard criteria used to switch customers from Rate 1 to Rate 2 will be developed in accordance with the time frames established in Section 1, Paragraph 2 of the Service Quality and Reliability Plan.

29. The Company's allowed rate of return on common equity shall be 11.00%.

30. To the extent that CVPS's calendar year earned return on equity on its Vermont jurisdictional electricity utility operations in 2001 exceeds 11.0%, the dollar amount of such excess shall be applied (a) to reduce regulatory asset accounts as specified by the DPS and approved by the Board at the time of any such excess or (b) as otherwise agreed by CVPS and the DPS. Any such dollar amount of excess in 2002 and 2003 over CVPS's allowed return on equity in effect in such calendar year also shall be credited as provided herein, unless a superseding approved agreement or order on rates shall have earlier become effective.

31. Millstone III decommissioning costs in the amount of $300,504 annually are deemed to be recovered in the rates established by this MOU. CVPS shall credit its regulatory asset accounts, in any calendar year during the term of the rates established hereunder, for any amounts less than the decommissioning amount recognized in its rates that it is actually billed for Millstone III decommissioning.

32. If Vermont Yankee Nuclear Power Corporation ("VY") bills Central Vermont for Texas Low Level Waste payments, incremental decommissioning costs, or sale costs in excess of the amounts to be recognized in Central Vermont's revenue requirement as set forth in Attachment 4 during the term of the rates established hereunder, CVPS shall be permitted to book and defer (with carrying costs) for subsequent recovery of such incremental VY costs. The DPS reserves its right to contest the ultimate recovery of such incremental VY costs.

33. This MOU provides a final resolution to all issues in this case regarding CVPS's request to increase rates.

Demand Side Management

34. For the purposes of this MOU and the rates established by it, the Company's recovery of Conservation and Load Management ("C&LM") deferred amounts, Account Correcting for Efficiency ("ACE") amounts, on-going recurring amounts, and all associated accounting impacts shall be as provided on Attachment 5.

35. CVPS agrees to discontinue booking and deferring ACE on and after July 1, 2002. Thereafter, Central Vermont agrees not to seek the continuation of the ACE mechanism in connection with the delivery of EEU system-wide core programs. The Company also agrees not to seek a replacement mechanism for the ACE mechanism for such purposes. However, the Company will thereafter recover all amounts booked prior to July 1, 2002, but not yet recovered,

in a manner consistent with past practice. This agreement is not intended to alter or otherwise limit the Company's ability in any subsequent case to recover its booked and deferred ACE amounts recorded up to and until June 30, 2002, nor does this agreement limit or otherwise affect the Company's ability to continue to book, defer, and seek recovery of ACE arising on account of DSM measures installed as part of a so-called Distributed Utility Planning program.

Final Terms and Conditions

36. The Parties agree to submit an agreement supporting the approval of affiliate transaction rules and codes of conduct which have been previously agreed to by the Parties in Docket No. 6133, within 30 days of the Board's issuance of a decision in this proceeding respecting this MOU. The DPS does not object in principle to a holding company and agrees to work with the Company to resolve any outstanding concerns the DPS may have. Accordingly, the Parties agree to develop a schedule for concluding Docket No, 6133 in a reasonable period of time and file that schedule in Docket No. 6133 by July 1, 2001.

37. This MOU shall become effective upon the issuance of approval by the PSB in the manner contemplated herein.

38. The Parties agree that this MOU and any Order approving this MOU relates only to these Parties and should not be construed by any party or tribunal as having precedential or any other impact on proceedings involving other utilities. The Parties have made compromises on specific issues to reach this MOU. The MOU and any Order approving this MOU shall not be construed by any party or tribunal as having precedential impact on any future proceedings involving the Parties except as necessary to ensure CVPS's implementation of this MOU or to enforce an order of the PSB resulting from this MOU. The Parties reserve the right in future proceedings to advocate positions that differ from those set forth in this MOU, and this MOU

and any Order approving this MOU may not in any future proceeding be used against any party except as necessary to enforce CVPS's rights and obligations under this MOU or to enforce an order of the PSB resulting from this MOU.

39. Except as otherwise provided for herein, the Parties agree that this Memorandum shall be effective, and shall bind the Parties hereto, only if the Public Service Board issues an order in this docket containing terms consistent with this MOU in all respects.

40. The Parties agree that should the Board fail to approve the MOU in its entirety, the Parties' agreements set forth herein shall terminate if so requested by either Party, in which case, the Parties shall have the right to file additional prefiled testimony on all issues in the above referenced dockets and the Parties' agreements shall not be construed by any party or tribunal as having precedential impact on any future testimony or positions which may be advanced in these proceedings.

DATED at Montpelier, Vermont this 7th day of May , 2001.

VERMONT DEPARTMENT OF PUBLIC SERVICE

By: /s James Volz
James Volz, Esq.

CENTRAL VERMONT PUBLIC SERVICE CORPORATION

By: /s Kenneth C. Picton
Kenneth C. Picton, Esq.

Note to readers: The detailed attachments to the Memorandum of Understanding consist of a WordPerfect document, a Word document, an Excel spreadsheet, and three Lotus 1-2-3 spreadsheets. Because they are difficult to adapt into a consistent document form, and because of presumed limited interest by readers, they have not been included here. However, they are available from the Board's web site, compressed into a single Zip file. The download name is: *http://www.state.vt.us/psb/orders/2001/files/6460exhibits.zip*