

STATE OF VERMONT
PUBLIC UTILITY COMMISSION

Case No. 17-3142-PET

Vermont Department of Public Service request for workshop on utility rate regulation	
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Order entered: 07/23/2018

VERMONT UTILITY REGULATORY STRUCTURE: CHALLENGES AND OPPORTUNITIES

I. INTRODUCTION

In 2017, the Public Utility Commission (“Commission”) commenced this workshop process¹ to “broadly review emerging trends in the utility sector” and to “evaluate existing forms of regulation in light of these trends.”² In today’s Order we provide guiding principles that are intended to serve as considerations for any future electric or natural gas utility rate regulation plans filed pursuant to 30 V.S.A. § 218d. In particular, we note the importance of any such proposed plan in advancing State energy policy, as required by Section 218d(4). This document emphasizes alternative regulation as a tool that may be utilized to enable and encourage energy service innovation in the achievement of those policies. Therefore, we encourage utilities to think “outside the box” when developing alternative regulation plans and not to be bound by conventional approaches. The time has come to find creative solutions to achieve policy goals, and it is imperative that we, as regulators, confront and consider these solutions with open minds.

Utilities in Vermont and across the nation face a variety of new challenges, including flat or declining sales, the decentralization of power generation, and, in certain jurisdictions, including Vermont, enactment of ambitious policy and environmental goals. At the same time, customers and regulators continue to demand that these utilities provide cost-effective, safe, and reliable services. To address these challenges, utilities, customers, and other market actors are developing and adopting new and innovative technologies, services, and business models.

These challenges and opportunities, and others identified by stakeholders over the course of this proceeding, must be addressed within the framework of existing statutes. The

¹ The procedural history of this workshop process is detailed in Appendix A.

² See Case No. 17-3142-PET, Order of 6/26/17. In its petition requesting that the Commission begin this review process, the Vermont Department of Public Service acknowledged that the electric and natural gas sectors are experiencing significant changes and that it would be appropriate to review Vermont’s current regulatory structure in light of these changes.

Commission acknowledges that these challenges and opportunities may be addressed regardless of whether a utility's rates are regulated under a traditional model or under an alternative regulation plan. Section 218d of Title 30 authorizes the Commission to "approve alternative forms of regulation" provided that the Commission finds that any such regulatory plan meets certain enumerated statutory criteria. Since the Legislature enacted this statute, the Commission has approved regulatory plans that were intended to be comprehensive replacements for traditional regulation. More recently, the Commission has approved plans that focused on power and gas cost changes, leaving other aspects of regulation to traditional rate cases.

This document takes no position on the merits of alternative regulation as compared to traditional regulation, or on a regulation plan for any particular utility. Instead, we attempt to synthesize the concepts that are important to address in any future alternative regulation plans.

II. TRADITIONAL AND ALTERNATIVE REGULATION

Traditional regulation

Vermont law requires that rates be "just and reasonable" and not "unjustly discriminatory" or preferential (or otherwise in violation of Chapter 5 of that Title).³ Traditional regulation achieves these goals through a cost-based approach, providing regulated utilities a fair return on investments used to serve the public as well as recovery of prudently incurred operating costs. The Commission traditionally has employed a methodology for determining rates that bases them upon representative costs of a company during a recent year (the "test year"), adjusted to reflect anticipated changes during the period the rates are expected to be in effect (the "rate year") to the extent the company can demonstrate that such changes are known and measurable.⁴ The resulting rates include a reasonable level of profit for utilities, so it has been described as a "cost-plus" form of ratemaking. This approach has been used for decades in Vermont, although the Commission has occasionally deviated from strict application of the cost-based ratemaking approach.⁵

³ Section 218(a) of Title 30; *see also* § 209(a)(4) (providing that the Commission has jurisdiction over rates when they are unreasonable or in violation of law).

⁴ The "known and measurable" standard has been explained in numerous Commission Orders. *See, e.g., Tariff filing of Green Mountain Power Corporation*, Docket 5983, Order of 2/27/98; *Tariff filing of Central Vermont Public Service Corporation*, Docket 6946, Order of 3/29/05.

⁵ *See, e.g., Tariff Filing of Green Mountain Power*, Docket 6107, Order of 1/23/01.

Traditional regulation also involves the application of numerous procedural requirements associated with changes in rates and terms and conditions of service, including those specified in Sections 225, 226, 227, and 229 of Title 30. Thus, the Commission does not have flexibility to alter the notice requirements associated with those provisions. In the past, this has meant that purchase power adjustment clauses are not permitted because they run afoul of the procedural requirements set out in statute.⁶ Further limitations on the Commission's discretion under traditional regulation have been delineated by the Vermont Supreme Court. For example, retroactive ratemaking (setting rates to recover costs from prior periods) has been ruled impermissible.

Traditional regulation has the benefit of being a well-defined process that has been used to set rates and regulate utility actions for many years. There is no indication that this history has been unfair to either consumers or utilities, although various stakeholders have taken issue with the application of such regulation in certain circumstances. In addition, as utilities can keep any increased profits they can obtain by cutting costs between rate cases, such regulation may encourage cost reductions.

Nonetheless, as various commenters observe, traditional regulation creates incentives to increase sales, as higher sales typically produce greater profits. This also can serve to discourage investments that may be part of the least-cost provision of service yet would result in decreased sales. Changes to the energy industry may place further pressures on traditional regulation. Net-metering and energy efficiency have decreased sales by electric utilities, which can reduce revenues between rate adjustments; in the past, sales tended to increase between cases, providing more revenue to the utility and, at times, delaying the need for a rate increase request.

Alternative regulation

Alternative regulation can best be described as ratemaking approaches that vary from traditional regulation. Section 218d simply prescribes that the Commission can “approve

⁶ See, e.g., *In re Allied Power & Light Co.*, 132 Vt. 354, 358-59, 360-361 (1974). Almost all other states have had mechanisms for the collection of changing energy-related costs, even under traditional regulation. Vermont Supreme Court precedent on traditional regulation has not permitted these types of adjustments.

alternative forms of regulation” if it finds that a plan meets the statutory criteria. Subsection 218d(d) goes on to state:

Alternative regulation may include such changes or additions to, waivers of, or alternatives to, traditional rate-making procedures, standards, and mechanisms, including substantive changes to rate base-rate of return rate setting, as the Commission finds will promote the public good and will support the required findings . . .

This provision has been used in several alternative regulation plans in Vermont to allow changes in certain power and gas costs to flow through to ratepayers without following the usual procedures under Sections 225, 226, 227. Plans for Green Mountain Power Corporation (“GMP”), Central Vermont Public Service Corporation (“CVPS”), and Vermont Gas Systems, Inc. (“VGS”) included mechanisms that allowed for a degree of “true-up” of costs (via earnings sharing provisions), even though such practices might otherwise be considered impermissible retroactive ratemaking. The Commission has approved alternative regulation plans that were intended to be comprehensive replacements for traditional regulation, but has also authorized more limited plans that focused largely on power and gas cost changes, leaving other aspects of regulation to traditional rate cases.

III. PRINCIPLES

This section provides principles that should be considered for any future electric or natural gas (as applicable) utility alternative regulation plans filed pursuant to 30 V.S.A. § 218d. These principles are intended to be complementary to the requirements of Section 218d.

General

The Commission recognizes that Vermont’s utilities vary in size and ownership structure (e.g., investor, cooperative, or municipal). Accordingly, these principles are not intended to foreclose the ability of any Vermont utility to develop and propose an alternative regulation plan. Instead, alternative regulation, from its most basic form to the more elaborate, complex, and comprehensive, should be a tool that enables innovation by all utilities and other market actors in the provision of safe, reliable, and least-cost energy services.

Alternative regulation should balance flexibility for utilities to achieve State policy goals for the energy sector with ratepayer interests in affordability. This may be accomplished through

a variety of mechanisms – for example, by aligning utility incentives with customer interests and specified policy goals. Alternative regulation allows the Commission to approve plans that provide incentives for Vermont utilities to make cost and investment decisions that are favorable to both the utility and ratepayers. For example, in past alternative regulation plans, GMP has been allowed to implement limited pilot programs that explore innovative products and services. Absent this mechanism for implementation, GMP may not have pursued these pilots. All revenues from these pilot programs have flowed to GMP customers to the benefit of both pilot participants and non-participants.

Advancement of State energy policy

Pursuant to Section 218d(4), before the Commission may approve an alternative regulation plan, it must find that the proposed form of alternative regulation will “offer incentives for innovations and improved performance that advance state energy policy.” Accordingly, any future alternative regulation plan proposal should demonstrate how it will advance State energy policies, such as those articulated in Section 202a:

It is the general policy of the State of Vermont:

(1) To assure, to the greatest extent practicable, that Vermont can meet its energy service needs in a manner that is adequate, reliable, secure, and sustainable; that assures affordability and encourages the State’s economic vitality, the efficient use of energy resources, and cost-effective demand-side management; and that is environmentally sound.

(2) To identify and evaluate, on an ongoing basis, resources that will meet Vermont’s energy service needs in accordance with the principles of least-cost integrated planning; including efficiency, conservation, and load management alternatives, wise use of renewable resources, and environmentally sound energy supply.

Open participation and transparency

If utilities, regulators, and alternative regulation plans are to be trusted and accepted by ratepayers, then the transparency of and opportunity for meaningful participation in crafting and implementing such plans must be at least comparable to the degree of accessibility and transparency in traditional regulation. The Commission expects that the availability of case-

related documents in ePUC⁷ will provide a significant improvement in the ability of the public and outside parties to follow an alternative regulation proceeding, the positions of the parties, and the Commission's determinations. However, the availability of information through ePUC may not be sufficient, and the use of additional media may provide further transparency. For example, it may be appropriate for a utility to post all materials⁸ related to rate-setting and other aspects of an alternative regulation plan on its website, as well as to provide notice to customers on how to participate in related Commission proceedings. In addition, or as an alternative, to providing customer notice of proposed rate changes through their bills, it may be appropriate for utilities to provide customers with such notice through press releases, email, text messages, and social media outlets.

Coupled with such improved notice and transparency, alternative regulation plans and related Commission proceedings must afford meaningful opportunity for participation. This may take the form of increased use of public information sessions, public hearings, video conferencing, workshops, and evidentiary hearings, as appropriate.

Form of alternative regulation

As discussed above, Section 218d does not prescribe the form of alternative regulation plans. Rather, all that is necessary is that the alternative regulation that is adopted meet the statutory criteria. This means that a comprehensive alternative regulation plan, such as the plans that the Commission previously authorized for GMP, CVPS, and VGS, is not necessary. In fact, the Commission has approved plans that have a more limited focus.⁹ At the same time, comprehensive plans could provide greater benefits to stakeholders than more limited plans by balancing a range of incentives and conditions. The important consideration is not whether the plan is comprehensive, but rather how the plan advances other principles – fair balance of risks and rewards, advancing State energy policy, just and reasonable rates, and service quality.

⁷ ePUC is the Commission's electronic filing and case management system. <https://epuc.vermont.gov/>

⁸ Such materials may include discovery responses.

⁹ At the present time, both VGS and GMP operate under alternative regulation plans that focus on recovery of changing energy prices.

Alternative rate regulation

Alternative regulation may enable utilities to break the connection between sales and profits, which can remove some of the disincentive to make investments or other decisions that would advance State policy. In the evolving energy environment that the Department described in its petition at the outset of this proceeding, removing these disincentives will enable utilities to make the most efficient decisions. Accordingly, revenue decoupling mechanisms should be a consideration in the formulation of alternative regulation plans.

Several commenters stated that fuel adjustment clauses, such as those that have been incorporated into past GMP, CVPS, and VGS alternative regulation plans, have the effect of lowering the utility's cost to borrow. Therefore, it may be appropriate for alternative regulation plans to include fuel adjustment clauses and similar mechanisms that flow through to ratepayers costs that are outside the ability of the utility to control. The Department suggests that such costs should be limited to those that are material and volatile, and that these mechanisms should not be a substitute for the utility's inherent ability to manage costs and operations.

Alternative rate regulation should enable a framework in which innovative rate designs result in rates that promote least-cost, societally beneficial outcomes. Utilities are encouraged to use appropriate rate-design principles in tandem with alternative rate regulation in order to achieve desirable outcomes.

Multi-year rate plans

Multi-year rate plans can provide a steady and predictable rate path for utilities and consumers alike. Accordingly, there may be value in setting capital budgets over a multi-year period with the opportunity for stakeholder input. Any multi-year rate plan should have well-formed capital plans that match the full period of the multi-year rate plan, by year, and should provide mechanisms for oversight and implementation of the capital plans. Multi-year rate plans may contain an annual cap on capital spending that is developed based on a utility's capital plan.

Service quality and performance mechanisms

Alternative regulation plans should include clear metrics to measure a utility's performance on issues that matter to customers and regulators, and in a manner that is

understandable. Such metrics and performance criteria may encourage the achievement of high standards of service reliability, or the least-cost achievement of certain goals. Performance incentive mechanisms – wherein a utility is subject to financial or other incentives and penalties – can be used to provide foundations for utility service requirements. Performance incentive mechanisms, or any other performance-based mechanism in an alternative regulation plan, should reinforce and build upon the balanced system of risks and rewards that are associated with traditional regulation, and should ensure alignment between outcomes that benefit ratepayers and those that further an objective.

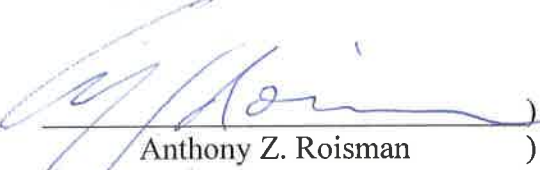
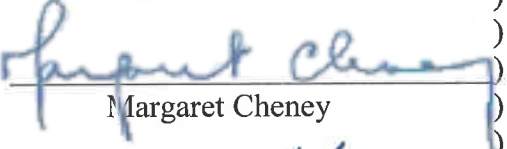

IV. CONCLUSION

This order seeks to provide principles and considerations for the regulatory community and other stakeholders interested in future alternative regulation plans. Any future alternative regulation plan will need to ensure that the basic goals of regulation continue to be met. Alternative regulation is not deregulation; rather, it is a different means of achieving the results that Vermont law requires. Whether in limited or comprehensive form, alternative regulation should enable, rather than restrict, a utility's ability to meet its public service obligations and State energy goals. If a utility feels constrained by traditional regulation and unable to innovate to achieve those ends, alternative regulation should serve as a liberating tool.

The achievement of public-service objectives and State energy goals is of paramount importance. The widespread deployment of existing, nascent, and future technologies and services will be necessary to achieve these objectives and goals. The Commission does not consider future alternative regulation plans to be limited by the framework or specific provisions of previous alternative regulation plans. Instead, we encourage proponents of alternative regulation plans to be boundless in their creativity when seeking to overcome barriers to attain these goals.

SO ORDERED.

Dated at Montpelier, Vermont, this 23rd day of July, 2018.

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Anthony Z. Roisman)	PUBLIC UTILITY
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OFFICE OF THE CLERK

Filed: July 23, 2018

Attest: 
Clerk of the Commission

Notice to Readers: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Commission (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: puc.clerk@vermont.gov)

APPENDIX A: PROCEDURAL HISTORY

On April 10, 2017, the Department of Public Service (“Department”) filed its petition requesting that the Commission begin this review process.

On June 26, 2017, the Public Utility Commission (“Commission”) issued an order opening the proceeding.

Between July 14 and July 18, 2017, comments were filed by AARP, Stephen Whitaker, Green Mountain Power Corporation (“GMP”), the Department, Vermont Public Power Supply Authority (“VPPSA”), Conservation Law Foundation (“CLF”), and Vermont Energy Investment Corporation (“VEIC”).

On August 8, 2017, the Commission convened a workshop.

AARP filed additional information on August 10, 2017.

On September 12, 2017, the Commission convened a second workshop, with presentations given by Mark Lowry of Pacific Economics Group Research LLC and Rick Weston of the Regulatory Assistance Project.

On October 6, 2017, the Commission convened a third workshop.

On December 4, 2017, the Department filed comments and recommendations on future alternative regulation plans.

On January 8, 2018, GMP filed comments on the future of rate regulation.

PUC Case No. 17-3142-PET - SERVICE LIST

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