

Vermont Rate Case Workshop, Part 1

Developing the Revenue Requirement



NARUC Energy Regulatory Partnership Program

*The Georgian National Energy and Water Regulatory Commission
and*

The Vermont Public Service Board

by

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Overview

- v Review of Fundamentals of Developing the Revenue Requirement
- v Case Study – Central Vermont Public Service Corporation 2005 Rate Case (Docket 6988)



I. REVIEW: FUNDAMENTALS OF DEVELOPING THE REVENUE REQUIREMENT



Legal Standards

- v Just and reasonable rates
- v Balance ratepayer and shareholder interests
- v It is the end result that matters, not the specific methodology



Definitions

- v Cost of service
 - = revenue requirement
 - = annual operating expenses + annual capital costs
- v Test year
 - = period in which expenses are compared to revenues
- v Adjusted test year
 - = test year adjusted for known and measurable changes, normalizations
 - = rate year



Cost-of-Service Analysis

- v In practice, the Board must determine three things:
 - Operating expenses
 - Rate base
 - Cost of capital



Cost-of-Service Formula

v $RR = E + d + T + (V-D)r$

E = Operation and maintenance expense

d = Annual depreciation expense

T = Taxes

V = Original book value of plant

D = Accumulated depreciation

(V-D = "net rate base")

r = Weighted average cost of capital



Rate Base

- v Rate base =
 - Original cost of plant now in service
 - Less accumulated depreciation (sum of past annual depreciation expenses on plant now in service)
 - Plus or minus other adjustments
 - u Customer deposits
 - u Working capital allowance



Rate of Return

- ✓ Principle – the authorized return must be sufficient to allow the company to compete with other investment opportunities of similar risk
- ✓ Source – Weighted cost rates for debt and equity
- ✓ Capital structure – Weighted cost of capital is obtained by multiplying the component ratio times the cost rate and summing the weighted cost rates



***II. CASE STUDY – CENTRAL
VERMONT PUBLIC SERVICE
CORPORATION 2005 RATE
CASE (DOCKET 6988)***



Procedural History (1 of 2)

- ✓ Ten years since last CVPS litigated rate case
- ✓ CVPS was operating under an earnings-sharing agreement from previous rate case
- ✓ On April 7, 2004, Board opened an investigation into CVPS's existing rates
- ✓ While that investigation was pending, on July 15, 2004, CVPS filed for a 5.01 % increase in rates (Docket 6988)



Procedural History (2 of 2)

- v Board suspended the rate increase, and consolidated it with the pending rate investigation
- v Board held prehearing conference, set schedule, determined interventions
 - Schedule provided for discovery and prefiled testimony by all parties; public and evidentiary hearings; briefs
 - Schedule constrained by statutory deadline
 - Board issued its decision on March 29, 2005



Positions of the Parties

- ✓ CVPS: requested 5.01 % rate increase, later reduced its request to 2.9 %
- ✓ Department of Public Service: requested 7.16 % rate decrease
- ✓ AARP (intervenor): did not request any specific rate level



Major Issues

- v Past overearnings
- v Deferred costs and revenues
- v Rate base
 - Plant additions
 - Interim-period and rate-year depreciation
- v Expenses
 - Power costs
 - Sale of subsidiary
- v Cost of capital
- v Treatment of regulated affiliates



Overearnings (1 of 4)

- v Most significant contested issue
- v In 2001, CVPS and DPS had reached a settlement resolving two CVPS rate requests
 - Settlement included future return to ratepayers of CVPS's earnings in excess of 11 % return on equity
 - Settlement did not specify methodology for calculating the overearnings



Overearnings (2 of 4)

- v CVPS calculated its 2001 – 2003 overearnings as \$3,156,050
- v CVPS based its calculation on its federal Securities and Exchange Commission filings, which included a return on items not allowed in traditional cost-of-service ratemaking



Overearnings (3 of 4)

- v DPS calculated the overearnings as \$17,385,000
- v DPS calculation generally followed standard cost-of-service ratemaking methodology



Overearnings (4 of 4)

- v Board concluded that settlement agreement required overearnings to be calculated according to traditional ratemaking practice
- v Board further concluded that the DPS's proposal (with a few adjustments) was consistent with traditional ratemaking practice



Deferred Costs and Revenues

- ✓ CVPS had deferred recognizing certain revenues and expenses, with over \$23 million of deferred costs on its books
- ✓ Board had previously expressed concern with CVPS's level of deferrals
- ✓ Board required most deferred accounts to be amortized over 3 years, with reverse amortizations when fully amortized



Plant Additions

- v CVPS's test-year plant investment was \$483 million; CVPS proposed \$20.9 million in additions for the rate year
- v Board concluded that many of the plant additions that CVPS included were not known and measurable, and reduced CVPS plant additions by \$2.5 million, but added \$1.4 million back for an allowable item that CVPS had omitted



Interim-period and Rate-year Depreciation

- ✓ Board concluded that both interim-period and rate-year depreciation are known and measurable, so accumulated depreciation must be adjusted to reflect them
- ✓ Adjustment for rate-year depreciation was a recent development in Board decisions, demonstrating case-by-case development of the law



Power Costs

- v Largest component of CVPS's revenue requirement
- v Calculated by projecting power costs in the rate year
- v CVPS and DPS reached agreement on most power cost issues, with the Board accepting the agreement



Sale of Subsidiary (1 of 3)

- v CVPS had sold its subsidiary in New Hampshire (a neighboring state) due to restructuring in that state
- v Sale included \$21 million payment to CVPS to compensate for expected “stranded costs” (above-market-cost power-supply obligations) from terminating contract for subsidiary’s power purchases from CVPS
 - Actual stranded costs were lower than expected, resulting in \$6.6 million gain



Sale of subsidiary (2 of 3)

- v Sale resulted in termination of service contract with subsidiary, loss of \$2.0 million in rate year that CVPS proposed to add to its Vermont revenue requirement
 - Board allowed \$1.46 million to reflect general overhead costs that CVPS could not avoid, denied remaining costs that were specific to subsidiary



Sale of subsidiary (3 of 3)

- v Sale reduced the percentage of CVPS's costs assigned to wholesale rather than retail, increasing retail costs by \$1.85 million in rate year
 - Board required these costs to be offset by amortizing over three years the \$6.6 million gain related to stranded-cost payment



Cost of Capital

- v Need to determine capital structure and cost of each component
- v Only disputed issue was return on equity
 - CVPS proposed 11 %
 - DPS proposed 8.75 %
 - AARP proposed 10 %
- v Board determined 10 % return on equity



Treatment of Regulated Affiliates

- ✓ Traditionally, investments in regulated affiliates have been treated “above the line” (assigned to ratepayers and thus included in revenue requirement)
- ✓ CVPS proposed to treat “below the line” (assigned to its investors and thus removed from revenue requirement), which would increase revenue requirement by \$2 million
- ✓ Board followed traditional practice



Final Result

- ✓ Board reduced rates by 1.88 % (almost \$5 million)
- ✓ Required CVPS to file proposed new rate design with supporting study
- ✓ CVPS and DPS each requested the Board to modify its decision; the Board largely denied the requests
- ✓ CVPS appealed to Vermont Supreme Court, which affirmed Board's decision