STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 7176

| | |
|---|---|
| Petition of Green Mountain Power for | ) |
| Approval of an alternative regulation plan | ) |

PREFILED SURREBUTTAL TESTIMONY OF
WILLIAM STEINHURST
ON BEHALF OF
THE CONSERVATION LAW FOUNDATION

September 15, 2006

Summary: Dr. Steinhurst's testimony addresses certain issues raised in the rebuttal testimony of Mr. Kvedar and Mr. Smith.

Prefiled Testimony
of
William Steinhurst

## I. INTRODUCTION

**Q. PLEASE STATE YOUR NAME AND OCCUPATION.**

A. My name is William Steinhurst, and I am a Senior Consultant with Synapse Energy Economics (Synapse). My business address is 45 State Street, #394, Montpelier, Vermont 05602.

**Q. ON WHOSE BEHALF DID YOU PREPARE THIS PREFILED SURREBUTTAL TESTIMONY?**

A: I prepared this testimony on behalf of the Conservation Law Foundation. I have previously prepared separate direct testimony that was filed in this proceeding on behalf of AARP, but have not prepared surrebuttal testimony on behalf of AARP in this proceeding.

**Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

A. My testimony will address certain issues raised in the prefiled rebuttal testimony of Mr. Kvedar and Mr. Smith.

## II. Prior GMP Cost-cutting Efforts

**Q. WHAT DID THE COMPANY'S REBUTTAL TESTIMONY SAY ABOUT ITS PRIOR COST-CUTTING EFFORTS?**

A. Mr. Kvedar's prefiled rebuttal testimony argues that the Company's prior successes should be a basis for recognition, rather than criticism, and in any event such prior successes do not undermine the cost control incentive inherent in the Earnings Sharing Band. He also states that the potential for prudence investigations provides ample incentive to seek lower costs, and certainly as much incentive as under traditional regulation. Kvedar reb. at 3-4.

**Q. DO YOU HAVE ANY RESPONSE TO THOSE POINTS?**

A. Yes, I do.

First of all, I do not claim that the proposed Plan "reduces or eliminates the incentive to control costs" *because* of the Company's prior cost cutting. Rather, I note that non-power costs are important to any incentive the Plan may create because they are not covered by the Power Adjustment Mechanism. As a practical matter, prior successes in non-power cost-cutting will likely limit the benefits that customers will actually realize from any such incentives. I level no criticism of the Company's past cost-cutting efforts, but only note their existence, and their practical effect. The Company holds out certain incentives for cost cutting as a reason why the proposed Plan meets the statutory criteria and should be approved. However, prior cost cutting in areas relevant to those incentives reduces the value of any such incentives and the savings that can be passed on to customers. There are simply fewer opportunities for incentives to reduce non-power costs.

Second, potential recourse to prudence investigations is not relevant. The proposed plan is aimed at replacing traditional regulation with a different structure meant to create meaningful financial incentives for Green Mountain Power to make good decisions. If the only “incentive” is avoiding a prudence investigation, it fails to present an effective alternative to traditional regulation.

## III. Decoupling

**Q. WHAT IS MR. SMITH’S POINT REGARDING DECOUPLING?**

A. He argues that the proposed Plan “will decrease the extent to which the Company’s financial success between rate cases is linked to increased sales to end use customers and may be threatened by reductions in those sales.” Smith reb. at 1. He points out that the relevant statute requires a decrease in the linkage between sales and financial success of the Company, not complete elimination of that linkage, and claims that I use the phrase “effectively decouple” to mean a complete elimination of the linkage. He criticizes my testimony as “theoretical.”

**Q. DO YOU AGREE WITH HIS CRITICISM?**

A. No, I do not. My criticism is anything but theoretical. While complete elimination of this linkage would be a natural goal under the statute, I am concerned here with the practical effect of the proposed Plan (if any) on the Company’s day-to-day actions as they may affect sales and earnings. As I pointed out in my prefiled direct testimony, the Company's own model demonstrates that GMP's financial success, as measured by return on equity, would be greatly affected by changes in sales, up or down. This is not in dispute. Every day, each decision and each action of every Company employee that affects sales will directly affect earnings right up to the limit on earnings imposed by the Earnings Sharing Mechanism. As noted in my direct prefiled testimony, it is actions at the margin that matter the most in determining corporate and individual behavior. Some theoretical limit to how much extra earnings can be generated by changes in behavior will not drive actual behavior of management or employees.

The fact that the Base Rate filings will incorporate an estimate of sales reductions anticipated due to Efficiency Vermont programs is of no comfort. Once that estimate is incorporated in the Base Rate, there is an immediate incentive to increase sales (or avoid any further decreases) from that level.

The Board should be most concerned about incentives that play out at or around the sales assumed in the Base Rate filing, not some theoretical upper or lower bound or the change in earnings from what they might have been absent the proposed Plan. As a result, the proposed Plan fails to effectively decouple because it still delivers considerable economic benefits to the Company as a result of any increased sales at the margin.

**Q. DOES THE FORMULATION OF THE PROPOSED POWER ADJUSTOR OFFSET THIS CONCERN?**

A. Only partially. The proposed Power Adjustor uses the Company's established average cost of energy rather than the actual cost incurred. This does give the Company a potentially offsetting incentive to limit growth of sales at the times of the very highest energy prices, i.e., hours where the excess of market price of energy over the average cost of energy embedded in the existing retail rate is more than the non-power portion of the retail rate. But, conversely, it maintains the Company's incentive to grow sales in all other hours of the year, when a much larger volume of sales occur. While an incentive to avoid growth in peak loads is of value, it is not the same as an incentive for least cost service. If it were, load control programs would dominate demand-side management program design rather than energy efficiency programs.

## IV. Incentives for Efficient Operation

**Q. DOES THE COMPANY HAVE ANY CONTROL OVER OR ABILITY TO HEDGE "COMPONENT A" COSTS?**

A. Yes, it does. The Company makes market and operational decisions that influence its requirement for products under Component A and influence the cost of acquiring those products. This is especially true in the long run. For example, the Company's decisions about what supply-and demand-side resources to acquire (including distributed utility resources), where to site them, and how to operate them, affect its need for (or ability to sell) Component A products such as Transmission by Others, capacity under existing contracts, LICAP, energy for line losses, and various ancillary services. To the extent that the Company purchases forward contracts for capacity or ancillary services, it would certainly be making decisions about those products. While some of these items have *prices* set by the ISO or markets outside GMP's control, the quantities are not necessarily outside the Company's control. Thus, the overall amount paid, especially for longer term costs, is within the Company's control and those costs should not be fully passed through to ratepayers without an incentive for the Company to reduce those costs through good management decisions.

**Q. PLEASE COMMENT ON THE ISSUES OF GMP'S INFLUENCE OVER OTHER ENTITIES AND ITS ABILITY TO HEDGE FORWARD CAPACITY AND ANCILLARY SERVICES.**

A. Mr. Smith argues that "the Company's ability to influence outcomes on many of these matters is questionable." Smith reb. at 15. He also states that the forward capacity auction rules and the ancillary services markets are not in place and cannot be hedged.

While GMP's voting share in ISO-NE is small and its voting share in VELCO is less that 51%, it is not reasonable to assume the Company is without influence. I find it hard to believe that VELCO would impose actions on GMP over which the Company had no influence. My experience is that VELCO actions are brought forward in a manner that is at least acceptable to GMP. ISO-NE decisions have been swayed by interests with very small voting shares through vigorous advocacy and hard negotiation. Just as important, it is my understanding that Vermont ratemaking holds utilities responsible for the actions of entities in which they hold an interest, whether that is or is not a controlling interest.

With regard to the evolving markets for forward capacity and ancillary services, as Mr. Smith points out the latter commences very soon, and both of them will be in effect for a number of years during the life of the proposed Plan. It is not reasonable to decide the treatment of those items based on a situation that will change shortly.

**Q. DOES THAT COMPLETE YOUR TESTIMONY?**

A. Yes, at this time.