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January 12, 2015

Mrs. Susan M. Hudson, Clerk
Vermont Public Service Board
112 State Street
Montpelier, Vermont 05620

Re: Docket 7970-VGS System Expansion

Dear Mrs. Hudson:

Attached for filing with the Board are an original and seven copies of the Department's Comments on Second Revised Cost Estimate of Phase I Project. Please let me know if you have any questions.

Sincerely,

Louise C. Porter

Louise C. Porter
Special Counsel

cc: Service List

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 7970

Petition of Vermont Gas Systems, Inc. for a certificate of public good, pursuant to 30 V.S.A. § 248, authorizing the construction of the "Addison Natural Gas Project" consisting of approximately 43 miles of new natural gas transmission pipeline in Chittenden and Addison Counties, approximately 5 miles of new distribution mainlines in Addison County, together with three new gate stations in Williston, New Haven and Middlebury, Vermont

THE VERMONT DEPARTMENT OF PUBLIC SERVICE COMMENTS ON SECOND REVISED COST ESTIMATE OF PHASE I PROJECT

The Vermont Department of Public Service (Department) hereby provides the following comments to the Vermont Public Service Board (Board) on the December 19, 2014, announcement by Vermont Gas Systems, Inc. (Vermont Gas) that the cost estimates for the Addison Natural Gas Project (Phase I Project) have increased to $154 million.

Background

On December 23, 2013, the Board issued its final order in the above-referenced proceeding and granted Vermont Gas a certificate of public good (CPG) for the Phase I Project. The cost of the Phase I Project contemplated in the December 23 Order was $86.6 million. That order is presently on appeal before the Vermont Supreme Court in Docket No. 2014-135. The primary issue on appeal is whether the December 23 Order is a final judgment.

On July 2, 2014, Vermont Gas disclosed a net increase of $35 million in the project's cost, for a revised cost estimate of approximately $121 million. In response to this revised cost estimate, the Board sought and was granted a remand from the Vermont Supreme Court to allow the Board to determine whether to reopen the proceedings in light of the new cost information, and to address that information if the Board determined that the proceedings should be reopened.

During the remand proceedings, the Board took testimony and held a technical hearing on the new cost information. The Board evaluated the new cost information pursuant to Rule

60(b)(2). The Board's analysis focused on whether the effect of the new cost information is of a nature that is so material and controlling as to probably change the outcome reached in the December 23 Order. *Order Re: Rule 60(b) Reconsideration*, Order of 10/10/14 at 14 (October 10 Order). After evaluating the evidence adduced during the remand proceeding, the Board concluded that it could discern no grounds for reopening the December 23 Order pursuant to Rule 60(b)(2) due to the new cost information announced by Vermont Gas on July 2.

The case was thereafter returned to the Vermont Supreme Court, which held oral argument on the pending appeal on November 18, 2014. The Vermont Supreme Court has not yet issued a decision in this proceeding.

On December 19, 2014, Vermont Gas made a filing with the Board, in which it provided a further revision to the estimated costs associated with the Phase I Project. Vermont Gas now reports that the Phase I Project is estimated to cost $154 million, comprised of a $138 million capital cost estimate plus a $16 million contingency. This total project budget is approximately 78 percent more than the project budget when the CPG was granted. Vermont Gas stated that it is currently in the process of developing supporting analysis and testimony to explain the budget process that led to the current budget number, along with analysis supporting the continued substantial economic and environmental benefits of the Phase I Project. Vermont Gas plans to file this supporting information in early 2015.

On the same day, the Board issued a memorandum in which it sought comments on Vermont Gas's announcement from the parties by the close of business on January 8, 2015.

On December 22, the Department of Public Service filed a motion for relief pursuant to Rule 60(b) of the Vermont Rules of Civil Procedure (VRCP). The Department's motion was made in advance of the one-year time limit for motions made pursuant to Rule 60(b)(1), (2), and (3) in order to preserve the Board's and the parties' ability to carry out a review similar to the one carried out by the Board in its October 10 Order, should the Board decide that it is appropriate to do so. The Department indicated that it would provide further recommendations to the Board by January 8 on recommended next steps—*e.g.*, such as processes conducted pursuant to Rule 60(b) and/or pursuant to Board Rule 5.408.

Mr. Nathan Palmer filed a response to Vermont Gas's December 19 filing as well as an Emergency Motion to Enlarge Time, Halt Construction, and Appoint Independent Counsel.

On December 24, the Board set a date of January 5, 2015, for comments on the Department's and the Palmers' motions.

Subsequently, on December 31, Vermont Gas filed a proposed schedule for consideration of the cost increase in this filing.

On January 2, 2015, the Board issued a scheduling order modifying the January 5 and January 8 response dates. The Board directed that all responses on the filings referenced in the Board's December 19 and December 24 memoranda be filed by January 12.

Comments

As an initial matter, the Department has serious concerns regarding the significant revision to the Phase I Project's budget. This revision is significant in its own right. However, when viewed in light of Vermont Gas's July 2 cost estimate revision, the December 19 announcement from Vermont Gas results in a project that is estimated to cost approximately 78 percent more than it was estimated to cost when the CPG was granted. With a cost estimate increase of this magnitude, the facts and assumptions underlying the CPG have potentially changed to such a degree that it is imperative that the Phase I Project be reconsidered in a manner that would allow the Board to evaluate whether it continues to meet the criteria set forth in 30 V.S.A. § 248. Accordingly, the Department strongly urges the Board to investigate whether the Phase 1 Project remains in the public good in light of the revised cost estimate announced December 19.

In asking the Board to open an investigation into Vermont Gas's second revised cost estimate, the Department has considered two threshold issues: (1) what is the appropriate scope of review of the Phase I Project in light of the second revised cost estimate, and (2) what procedure is best suited to accomplish the rigorous review of the Phase I Project necessitated by the second revised cost estimate.

Scope

In the Department's view, the answer to the first question is relatively clear. The review must be sufficient to ensure that the Project continues to meet the relevant criteria set forth in 30 V.S.A. § 248(b) as well as remaining in the general good of the State (as specified in 30 V.S.A. § 248(a)). Importantly, the Department believes that the review should be conducted in such a manner as to evaluate all relevant changes to the Project to date (focusing, of course, on the significant upward cost estimates), as well as the economic environment in which the Project exists today.

This is different from the manner in which the Department viewed the first cost increase. In that instance, the Department evaluated the new cost information provided by Vermont Gas on July 2, 2014, and determined that the likelihood that those revised cost estimates would overwhelm the benefits of the Project was small, such that it did not make sense to open a proceeding to formally revisit the merits of the Project. The Department explained its rationale in response to a petition from the Conservation Law Foundation (CLF) asking the Board to issue a declaratory order that an amendment to the CPG issued in this proceeding is necessary. *See Response of the Vermont DPS to CLF's Petition for Declaratory Ruling and for Injunctive Relief*, Docket No. 7970, 7/31/14 at 3. Both in its initial response to the CLF Petition and in the remand proceeding conducted by the Board in September of last year, the Department's analysis attempted to isolate the impact of the revised cost estimates, leaving other variables constant with the underlying analysis. *See* Walter (TJ) Poor pf. rem. at 5 (explaining his understanding of the scope of the remand proceeding and his efforts to comply with that scope).

The Board very reasonably initiated a proceeding to independently evaluate the first revised cost estimate and to determine whether it justified reopening the underlying proceedings. The Board's analysis went beyond simply evaluating the Project in light of the first revised cost estimate; it also evaluated the availability of heat pumps and their effect on the "need" for this Project. October 10 Order at 17-18. Ultimately, the Board concluded that the first revised cost estimate provided no basis for reopening the December 23 order pursuant to Rule 60(b)(2). October 10 Order at 30.

In the Department's view, the second revised cost estimate is different from the first. As a general matter, two significant upward cost revisions announced in a relatively short timeframe

(approximately 6 months) provide a sufficient (if not compelling) basis for subjecting Vermont Gas's cost estimations to greater scrutiny. In its October 10 Order, the Board determined that there was a reasonable basis to find that Vermont Gas's first revised cost estimate was reliable. October 10 Order at 20. The Department agrees with this finding and believes that the Board's determination that the first cost revision was reliable was well-supported and reasonably explained. *Id.* at 20-21. It is therefore discomfiting that less than three months after the October 10 Order, a second upward cost revision of significant magnitude was announced. While the Department will not prejudge the accuracy or reliability of the second cost revision at this time, the Department urges the Board to initiate a proceeding with a scope broad enough to subject Vermont Gas's revised cost estimate (and the procedures and personnel utilized in crafting it) to heightened scrutiny. The Department bases this request not on any lofty legal principle, but instead on the common sense principle that where two cost increases follow in such rapid succession, it is important to take a step back and thoroughly evaluate the company's numbers and processes.

Furthermore, the Department believes that the second revised cost estimate potentially renders the Project a much closer call on certain section 248 criteria. At some point, the costs of a project such as this could overwhelm the benefits. The Department cannot say at this time whether the second revised cost estimate approaches that tipping point—however, it is clear that the margin is shrinking. Accordingly, the Department believes that an investigation is necessary to determine whether the Project remains in the general good of the state in light of the second revised cost estimate. In conducting this investigation, the Board should address other developments in the broader economic environment (e.g., the recent decline in oil prices) that have occurred since the December 23 Order, not unlike the manner in which the Board evaluated the availability of heat pumps in its October 10 Order. This does not mean that every 248(b) criterion must be re-evaluated from the ground up as certain criteria do not stand or fall on project costs. However, Vermont Gas should be required to demonstrate that the Project continues to satisfy those criteria that are impacted by costs (for instance, 248(b)(2), (4), (6)). The Department believes that the Palmers articulate this idea well by setting forth a number of "material developments" that should be addressed. See Comments and Motion of Nathan and

Jane Palmer in Response to Cost Increase Filing of Vermont Gas, 12/23/14 at 2-3. Without opining on the merits of any one of these "material developments," the Department generally agrees that the proceeding should allow parties the opportunity to present evidence on such material developments and their impact on the Project, so long as they generally pertain to Project costs.

In sum, the Department believes that the Board should initiate a proceeding that is of sufficient scope to rigorously test the reliability of Vermont Gas's second revised cost estimate and to evaluate the reasons for the escalating costs. Additionally, the proceeding should allow for an evaluation of the Project and its second revised cost estimate in the context of the current economic environment.

Procedures

Having determined that a thorough investigation is necessary to evaluate the Project in light of the second revised cost estimate, the next question is what process is best suited to conducting that analysis. The Board has two options pursuant to which it can conduct a project-specific review in light of the second revised cost estimate. The Board could investigate whether to re-open the proceeding pursuant to Rule 60(b) to determine whether relief from the December 23 final order is necessary. In the alternative, the Board could investigate whether an amendment to the CPG issued with the December 23 Order is required pursuant to Board Rule 5.408. The Department believes that there are pros and cons to both procedures, and discusses them here so as to assist the Board in evaluating the question.

To the extent there may be any doubt, the Department believes that the Board is free to investigate the Project in light of the second revised cost estimate via Rule 60(b) or Board Rule 5.408. Moreover, the Department believes that both procedural mechanisms provide a meaningful and effective opportunity for the Board to investigate the Project in light of the second revised cost estimate. In the two instances where the Board has previously addressed significant cost increases in projects undertaken by a regulated utility—the Northwest Reliability Project in Docket No. 6860 and first revised cost estimate related to this Project—the Board has proceeded pursuant to Rule 60(b)(2). However, it is important to emphasize that this is not the only tool that the Board has to ensure that a particular project remains justifiable in light of

significant cost increases. Unlike a court, for which Rule 60(b) would typically provide the only means of providing relief from a judgment, the Board retains ongoing jurisdiction over the utility and its jurisdictional projects. 30 V.S.A.§§ 203, 209. Thus, where newly discovered evidence materializes, e.g., new cost information like that presented in the first and second cost revisions, the Board is able to address that information in the context of determining whether an amendment to the underlying CPG is necessary in light of that new evidence. In this way, the Board may allow a previous final judgment to stand, while at the same time conducting a full and searching analysis as to whether newly discovered evidence rises to a level that would necessitate an amendment to an underlying CPG.

In many ways, the two proceedings are similar. For example, both a Rule 60(b)(2) proceeding and a Board Rule 5.408 proceeding are essentially conducted in two steps. A Rule 60(b)(2) proceeding begins with the threshold determination as to whether the new evidence at issue is of "such a material and controlling nature as will probably change the outcome." October 10 Order at 7 (quoting Docket No. 6860, Order of 9/23/05 at 21, et al.). Only if this threshold determination is made is the underlying decision re-opened.[1] Similarly, under Board Rule 5.408, an amendment to an underlying CPG is required only if there has been a "substantial change" in the approved proposal. The rule defines a substantial change as "a change in the approved proposal that has the potential for significant impact with respect to any of the criteria of Section 248(b) or on the general good of the state under Section 248(a)." Thus, a threshold determination is necessary in both frameworks, the difference being the standard under which that threshold determination is made.

One key difference between a Rule 60(b) proceeding and a Board Rule 5.408 proceeding is the way in which they would interact with a decision under appeal, such as the December 23 Order. It is clear that for the Board to conduct a Rule 60(b) proceeding for a decision currently on appeal, the Vermont Supreme Court must remand the proceeding to the Board. However, it does not follow that such a remand is necessary for an amendment proceeding being carried out

[1] For this reason, the Board specifically articulated the purpose of the evidence being admitted in the remand proceeding, keeping it separate from the evidence upon which the underlying CPG is based. See October 10 Order at n.7.

under Board Rule 5.408. The subject of an amendment proceeding is not to question, alter, or provide relief from a final order. Rather, the subject of an amendment proceeding is to compare the project originally approved by the Board with the project as currently envisioned. If it is determined that no substantial change has been made, that is the end of the inquiry. Alternatively, if it is determined that a substantial change has been made, a new filing must be made by the petitioner seeking approval for the modified project. In no way does this procedure affect the underlying order. As the Board has explained, "[w]ith a substantial change, the Board's order approving the original project is not reopened—the original CPG remains valid for the project as approved—but instead the amended application is considered in a new proceeding." Order on Remand Re Reopening Proceedings, Docket No. 6860, Order of 9/23/05 at 20 and n.28 (noting that "[i]f a substantial change has occurred, without an amended CPG the permittee would not be authorized to proceed with the modified project, regardless of whether the original CPG were on appeal.")

While there are similarities and differences between the two rules, the Department believes that the Board could reasonably proceed under either. Recent history would suggest that the Board proceed under Rule 60(b)(2). It was in light of this recent history that the Department made its Rule 60(b) motion on December 22, to preserve the Board's ability to carry out a review under that standard. While the Department believes that that process was effective, the Department highlights two drawbacks. First, it is the Department's view that the Rule 60(b) process, occurring pursuant to a time-constrained remand from the Supreme Court, imposed a relatively significant burden on the parties (especially those appearing pro se, such as the Palmers) and presumably for the Board as well. Vermont Gas has already proposed an expedited schedule similar to the one used with respect to the first revised cost estimate. While the Department strongly agrees with the Board's explanation in the Remand Order that procedural delays should be avoided to the extent possible, the Department respectfully suggests that taking this proceeding off of an expedited 30-day timeframe may be useful and of benefit to the public. October 10 Order at 29. Second, and intertwined with the first concern, the Rule 60(b) framework necessitates a remand from the Supreme Court, further delaying the finality of the

underlying case. All else equal, finality of the underlying case is something that should be prioritized where possible.

In the past, specifically with respect to the Northwest Reliability Project, the Department has advocated for application of the "substantial change" test for utility project cost increases, which existed by virtue of Board precedent (Rule 5.408 had not at that time been promulgated). *See* Department Memorandum on Whether to Reopen and Request for Evidentiary Hearing, Docket No. 6860 (9/1/05), at 5-8 ("The 'substantial change' test also appears better suited to promoting the goals of § 248 than VRCP 60(b) because it specifically focuses on the potential for significant impact under the criteria contained in that statute, namely, the promotion of the general good of the state under § 248(a) and the economic, engineering, least-cost planning and natural resource criteria of § 248(b). In contrast, VRCP 60(b) is a generalized rule that was developed primarily to address the rights of parties and not a statute that seeks to promote the general good. VRCP 60(b)(2) also appears to set a high bar of 'material' and 'controlling' evidence that would 'probably change the outcome.'") The Board did not reject this approach on the merits, instead noting that the limited scope of its remand from the Supreme Court compelled it to proceed under Rule 60(b). Order on Remand Re Reopening Proceedings, Docket No. 6860, Order of 9/23/05 at 19.[2]

This amendment proceeding is the procedural mechanism advanced by CLF in response to the first revised cost estimate. In response to that filing, the Board opened Docket No. 8330. *Order Opening Docket and Soliciting Comment*, Docket No. 8330, Order of 9/10/14. While the Department initially opposed CLF's petition, as noted above, it did so because the Department's initial analysis demonstrated the first revised cost estimate did not rise to the level of a "substantial change" that would require an amendment. The Department cannot, based upon the existing record, make that conclusion with respect to the second revised cost estimate. Accordingly, the Department no longer opposes the Board entertaining CLF's request for a declaratory order regarding the necessity of an amendment to the underlying CPG.

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[2] The Department also requested that the Board rule that the substantial change test would apply on a prospective basis. The Board declined to make such a ruling because the request was beyond the scope of the proceeding. Order on Remand Re Reopening Proceedings, Docket No. 6860, Order of 9/23/05 at n.29.

In sum, the Department believes that of primary importance is that the Board investigate the Project in light of the second revised cost estimate. The Department believes that either the Rule 60(b)(2) approach or the Board Rule 5.408 approach can accommodate this review. However, all else equal, the Department believes that the amendment process is more likely to provide an effective means of review of the Project in light of the second revised cost estimate.

At the same time, the Department does not believe that a stay of the Project is in order at present. At present, there has been no determination that a substantial change has occurred to the Project. Moreover, the second revised cost estimates are just that—estimates. Without a bright line clearly established by the Board that a project is stayed if estimated costs increase by a certain percent, the Department recommends that the Board refrain from imposing a stay on the Project, so as to avoid the type of regulatory delays identified by the Board that could result in even further cost increases. That said, it should go without saying that simply identifying a cost estimate in a section 248 proceeding is not sufficient justification for actually recovering that cost from ratepayers. The company's prudence and performance of the construction of the Project will be reviewed in a rate case prior to any costs being recovered from ratepayers. Vermont Gas bears the risk that it can demonstrate its actions to be prudent with respect to the development and construction of the Phase I project and that any cost overruns can be reasonably documented and explained. [3]

As a final note, the issue of the Project's rate impact (including cross-subsidies among rate classes) has been discussed extensively in the initial proceeding and especially in the remand proceeding. The Board addressed these arguments in general terms. However, it also astutely noted the following in the October 10 Order:

> At this stage, we have no competent basis for concluding that existing ratepayers actually will pay more. The Board has not been asked to approve a change in rates due to the Project. Moreover, it is possible that the Board could adopt rate design options that would mitigate or eliminate any cross-subsidy, such as by setting different rates for new customers. However, based upon the record

[3] *See also Re Green Mountain Power Corp.*, Docket No. 5983, Order of 2/27/98 at 61-65 (articulating concerns regarding project cost estimates in a section 248 proceeding, and disallowing cost overruns where insufficient explanations for the overruns were provided in a rate case).

> before the Board in this proceeding, there appears to be a reasonable possibility of existing ratepayers incurring higher charges for a period of time. For this reason, we have undertaken the analysis reflected in today's Order and in the December 23rd Order concerning whether the anticipated rate impacts of the Project would result in an unjust cross-subsidy. We emphasize that our analysis of this issue in this Section 248 proceeding has been limited and therefore does not constitute a conclusive or binding review by this Board of the actual rate impacts of the Project.

October 10 Order at n.72.

The Department agrees with the Board's reasons for addressing potential rate impacts only in broad terms in the context of this section 248 proceeding. However, just as importantly, the Department strongly agrees with the Board's statement that Vermont Gas is not authorized to recover any costs associated with the Phase I Project until the Board can review such costs in a rate proceeding. Importantly, any discussion pertaining to ultimate rate impacts over the course of decades is fraught with speculation. What costs are or are not recoverable, and what, if any, impact a project's management should have on a company's return on equity are items that are properly reserved for a future rate case. Accordingly, while it is important to have a broad understanding of the general ratepayer impacts that a project might have when considering whether it is in the general good of the state, it is just as important to keep the overall regulatory context in mind and avoid placing too much stock in the myriad assumptions pertaining to future rate case and rate design determinations. Accordingly, the Department will seek a full rate case before the Board prior to Vermont Gas recovering any costs associated with the Phase I Project.

Miscellaneous motions

In addition to filing comments and a motion for relief pursuant to Rule 60(b), the Palmers have also submitted motions to enlarge time, halt construction and appoint independent counsel. The motion to enlarge time is unnecessary and should be denied. There is no pending schedule in this docket and, thus, no deadlines to be extended or delayed. As set forth above, the Department does not support a stay of the Project at this time and therefore recommends that the motion to halt construction be denied. Lastly, the motion to appoint independent counsel should

be denied. The Palmers have not identified a basis for such appointment, citing only their own difficulties with the process and criticism of the petitioner.

Dated at Montpelier, Vermont this 12th day of January 2015.

VERMONT PUBLIC SERVICE DEPARTMENT

By: Louise C. Porter

Louise C. Porter
Special Counsel

cc: Docket Nos. 7970 Service List

PSB Docket Nos. 7970 - SERVICE LIST

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