

July 8, 2005

Mrs. Susan Hudson, Clerk
Vermont Public Service Board
112 State Street, Drawer 20
Montpelier, VT 05620-2701

Re: Docket No. 6860

Dear Mrs. Hudson:

I.

With the issuance of the certificate of public good in this case, the scope of the Northwest Reliability Project has changed in significant respects. Upon receipt of the CPG, VELCO began a diligent effort to review the project's expected cost in light of the changes in design. Preliminary analyses indicated that costs had escalated significantly, irrespective of design changes, and as a consequence, using both our own staff and outside consultants, we undertook a rigorous process to update the cost estimates for all components of the project. That process is now sufficiently far along that we believe it is appropriate to present our findings to the Board.

Our original estimate was \$120 million.¹ The reviews that we and our consultants have just completed posit a figure of \$198 million plus a contingency of fifteen percent.²

The drivers of the increase in the estimated cost are several. The principal ones are (1) a high rate of inflation in the cost of materials, equipment and construction and engineering services since the time-frame of the original estimate, 2002 - 2003 (\$34 to \$40 million); (2) the changes in scope made in the course of the regulatory process, and refinement of the engineering design since the filing (\$23 to \$28 million); and (3) the fact that the original estimate did not reflect certain elements of cost (\$10 to \$15

¹ The actual figure Mr. Dunn presented was \$128 million. A part of the project, however, the Sand Bar PAR, was removed, and treated as a separate project. It has since been completed – under budget – and hence its cost was not updated with the other components of the NRP. For consistency of analysis, its budgeted amount (\$8 million) has been subtracted from the original NRP budget, thus yielding the figure of \$120 million.

² The NRP is not unique in experiencing a substantial increase in estimated capital costs. Northeast Utilities' Southwest Connecticut Phase 1 project has increased by 238% since RTEP02, and by 179% since RTEP03. For NU's Phase 2 project, the comparable figures are 200% and 130%. NU's Glenbrook project has increased by 257% since RTEP02. National Grid's Central Massachusetts project has increased by 48% just since RTEP04. NSTAR's Boston project has increased by 28% since RTEP04, according to the company's latest figures, but is widely expected to cost much more.

million).

As is more fully explained below, the updated cost estimate does not alter the essential fact that Vermont requires this project to maintain electric system reliability. There simply is no feasible alternative.

II.

We engaged La Capra Associates to re-evaluate two of the Alternative Resource Configurations as soon as it was apparent that the costs of the project had changed significantly. La Capra did not re-evaluate all of the ARCs, but only those two, Numbers 4 and 5, that were shown by La Capra's original study to be the most competitive with the NRP on an economic basis. Not surprisingly, the ARCs have also seen substantial cost inflation. Their costs, though, have not risen quite as much as has the NRP, and so their estimates have improved relative to the latter. ARC 4, which on a net societal cost basis was virtually the same as the NRP, now appears to be about seven percent less costly, if PTF treatment is ignored, but only about one percent less expensive if PTF is accounted for. ARC 5, which was five percent less than the NRP, is now twelve percent less, without PTF, and six percent less with PTF accounted for. Thus, the costs of the NRP and ARC 4 are virtually identical if PTF treatment is taken into consideration. The differential between the NRP and ARC 5 is more significant, although with PTF treatment, the difference is not much beyond the range of error of the study. It should also be borne in mind that ARC 5's cost advantage depends, in part, on a factor that is particularly difficult to value, purchased power costs that are assumed to be avoidable as a result of conservation and DSM measures, and on a non-market-validated value, avoided air emissions. Moreover, these comparisons do not account for the greater congestion costs that would be incurred if the NRP were deferred or abandoned, and one of the ARCs pursued instead.

Whatever the apparent cost advantages of any of the ARCs, they assume significant investment by other parties. No sign exists that any such investment is forthcoming. Moreover, both of the ARCs rely heavily on significant new generation being sited in northwestern Vermont, and the obstacles to any such development remain unchanged. Further, despite their theoretical promise of savings over the long term, both ARC 4 and ARC 5 are much more expensive than the NRP in terms of their up-front capital requirements.

Since the close of evidence in this case, Vermont has witnessed a new, all-time peak, 1086 mW on December 20, 2005, as well as a new summer peak of 1059 mW on June 27, 2005. A new peak for the month of June, 1010 mW, had earlier just been reached on June 13. Thus, the critical need for the reliability improvements delivered by the NRP continues unabated and, indeed, as shown by the peaks of last December

and this month, increases. There is no realistic alternative to the NRP.³ Meanwhile, there is little reason to think that most of the forces that have driven the cost of the this project upward will abate in the foreseeable future. It is VELCO's intention, therefore, to continue towards the realization of the NRP as rapidly as possible.

III.

The increase in the cost estimate for the project raises several issues which we wish to briefly address: (1) Was the original estimate reasonable? (2) Is the revised estimate reliable? and (3) Does the NRP remain the best alternative for meeting Vermont's reliability needs?

The original estimate was prepared by Burns & McDonnell, a large, experienced and industry-recognized consulting engineering firm. But VELCO did not rely on Burns & McDonnell's work merely because of the firm's reputation. In addition, its estimates were consistent with, indeed, somewhat above, the costs VELCO had actually experienced in its then most recent major construction program, the Rutland Region Reliability Project. Thus, the Burns & McDonnell estimate appeared to be, if anything, on the conservative side. Further, as shown in footnote 2, above, other major transmission projects in New England that were originally estimated at about the same time as the NRP and are now in or approaching the construction phase have exhibited similarly large – or larger – increases in estimated costs, further suggesting that the original NRP estimate was not out of the range of reasonableness.

Nonetheless, in the process of updating the cost estimate, we have discovered that the original estimate did not reflect certain cost elements. As part of our effort to assure proper cost management of the project, we will be implementing an estimating team that will be directly accountable to VELCO's CEO and that will oversee all future cost estimates and updates. Further, we will be producing updates on a quarterly basis, and updates will be filed with the Board and served on the parties.

The updated estimate represents the consensus of both Burns & McDonnell and a second, independent company, Power Engineers, Inc., as well as of VELCO's own staff, and with input from two other firms, CPM Technical Solutions, Inc., and PA Consulting. Every significant item of the budget was scrutinized, and the most up-to-date information available was applied. No one can guarantee that an estimate will actually be realized in practice, and the actual cost of this project will not be known until contracts are let, but VELCO believes that the revision is as accurate as it is possible to achieve.

³ Mr. Whitley, Senior Vice President of ISO-New England testified that, if the NRP were not completed in a timely fashion, the ISO could require temporary generation to be installed in Vermont pursuant to the GAP RFP provisions of the regional tariff. For a host of reasons, it would be difficult to consider this to be a viable alternative, and, as Vermont would pay all of its costs, it would certainly not be considered a desirable one by most Vermonters.

We have already indicated why we believe that it remains essential for the NRP to proceed as rapidly as possible. Vermont's vulnerability to system failure continues to grow. The needs that the NRP addresses have been advertized to the world since at least the publication of RTEP02, yet, to VELCO's knowledge, not one significant market proposal to address those needs has been forthcoming. Nor have the practical obstacles to the implementation of even theoretical alternatives diminished. In short, the NRP is the only viable strategy for meeting our reliability requirements. It should also be kept in mind that, while the increase in expected cost is significant, the actual impact of that increase on Vermont, because of regional cost sharing, will be modest, and this will be true even though a significant portion of the changes are to facilities whose costs may not be regionalized.

IV.

Accompanying this letter are the new study of Alternative Resource Configurations by La Capra Associates, and a copy of the press materials we will issue upon the filing of this letter. We stand ready to respond to any further inquiry the Board wishes to make.

We are providing a copy of this filing to the members of Vermont's legislature and, of course, to the parties to this proceeding.

Very truly yours,

Thomas N. Wies
Vice President and General Counsel