

STATE OF VERMONT
PUBLIC SERVICE BOARD

In Re: Joint Petition of Central Vermont Public)
Service Corporation ("CVPS"), Danaus)
Vermont Corp., Northern New England Energy)
Corporation ("NNEEC") for itself and as agent)
for Gaz Metro Limited Partnership and its)
parents, Green Mountain Power Corporation)
("GMP") and Vermont Low Income Trust for)
Electricity, Inc. ("VLITE"), for approval of:)
(1) the merger of Danaus into and with CVPS;)
(2) the acquisition by NNEEC of CVPS and)
certain other Vermont companies; (3) the)
amendment to CVPS's Articles of Association;)
(4) the merger of CVPS into and with GMP;)
and (5) the acquisition by VLITE of a controlling)
interest in Vermont Electric Power Company, Inc.)

PSB Docket No. 7770

PREFILED TESTIMONY AND EXHIBITS OF NORA MEAD BROWNELL
ON BEHALF OF VERMONT ELECTRIC POWER COMPANY, INC.
AND VERMONT TRANSCO LLC
JANUARY 20, 2012

Ms. Brownell's testimony describes the federal regulatory framework in which VELCO operates; the requirements imposed on electric transmissions companies by FERC to assure the provision of reliable transmission service at reasonable rates, including requirements for open and nondiscriminatory access to transmission services; and the mechanisms available to enforce those requirements. It also describes some general principles of good governance applicable to private for-profit corporations, including public service corporations. Finally, it comments on the governance proposal offered by Professor Dworkin for the Department of Public Service and offers for consideration standard mechanisms used to address the single governance issue raised by the proposed merger in a manner that would better serve the interests of the citizens of Vermont, as well as those of VELCO and its shareholders, than would Professor Dworkin's proposal.

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In Re: Joint Petition of Central Vermont Public Service Corporation ("CVPS"), Danaus Vermont Corp., Northern New England Energy Corporation ("NNEEC") for itself and as agent for Gaz Metro Limited Partnership and its parents, Green Mountain Power Corporation ("GMP") and Vermont Low Income Trust for Electricity, Inc. ("VLITE"), for approval of: PSB Docket No. 7770
(1) the merger of Danaus into and with CVPS;
(2) the acquisition by NNEEC of CVPS and certain other Vermont companies; (3) the amendment to CVPS's Articles of Association;
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PREFILED TESTIMONY OF NORA MEAD BROWNELL
JANUARY 20, 2012

1 Q. Please state your name, business address and business responsibilities.

2 A. My name is Nora Mead Brownell and my business address is 500 Montgomery St., Suite
3 400, Alexandria, VA 22314. I am co-founder of ESPY Energy Solutions, LLC, a
4 business providing strategic planning, marketing, business, regulatory, and technical
5 expertise to energy utilities, energy equipment manufacturing and supplying companies,
6 Smart Grid manufacturers and service providers, and financial institutions evaluating
7 investments in the energy sector.

8
9 Q. Please describe your professional background.

10 A. Prior to my current professional responsibilities, I founded BC Strategies – an energy-
11 consulting firm based Alexandria, Virginia. From its inception in 2007 until I closed the

1 firm on January 1, 2010, BC Strategies worked with executive managements of energy
2 companies, Fortune 500 companies, trade associations, investment funds, and energy
3 trading firms to develop strategies for the future regarding electricity, natural gas,
4 renewables, financing, new technologies and markets.

5 Prior to opening BC Strategies, I served as a commissioner of the Federal Energy
6 Regulatory Commission (“FERC”) from May 25, 2001, until July 21, 2006.

7 As a FERC Commissioner, I was personally involved in all power matters including
8 those related to transmission. During my tenure, FERC issued a number of orders
9 refining the transmission access, reliability standards, and service requirements of public
10 utility open access transmission tariffs (“OATT”). FERC also addressed the requirements
11 of regional transmission operators (“RTO”) and independent system operators (“ISO”) to
12 assure a more structured and uniform process of designing, implementing and overseeing
13 regional wholesale markets and to assure transmission planning and access are provided
14 on a just and reasonable basis, free of discrimination and preferential treatment. During
15 this time, I voted on thousands of orders related to electricity concerns, including cases
16 involving the interpretation, implementation or enforcement of OATT rates, terms, and
17 conditions. I also authored, co-authored, led, and co-led a vast number of FERC policy
18 positions related to transmission tariffs and OATT reform. During my five year term, I
19 deliberated on requests for interpretation, complaints against transmission owners who
20 allegedly prevented access or gave preferential treatment to affiliates, and requests to
21 change OATT terms and conditions. These requests and complaints came from
22 transmission owners, transmission users, neighboring transmission providers, state
23 commissions, and generation developers.

1 Finally, as a FERC Commissioner, I oversaw and voted on enforcement matters
2 concerning allegations of non-compliance with FERC rules, policies, and orders. These
3 enforcement matters included potential and actual violations of the OATT, sometimes by
4 transmission owners, and sometimes by transmission users. Sometimes these
5 enforcement matters were public, as in the case of an audit, but most matters were
6 typically non-public investigations and only upon a FERC determination were there any
7 details made public. I was then and remain an advocate for responsive and effective
8 independent board governance of RTOs and ISOs, and am a strong proponent of FERC
9 policies that promote investment in national energy infrastructure development.

10 Prior to serving as a Commissioner at FERC, I served as a commissioner on the
11 Pennsylvania Public Utility Commission (“PA PUC”) from 1997 to 2001. As a PA PUC
12 commissioner, I, along with my fellow commissioners, evaluated Pennsylvania public
13 utilities’ proposals to implement FERC’s rules, which at the time required functional
14 separation of generation and transmission functions, employees, and accounts. These
15 changes directly impacted retail service within the state of Pennsylvania and as a PA
16 PUC commissioner, our decisions to approve these changes and allow recovery of
17 prudent expenditures had to be in the public interest, and just and reasonable. One of the
18 key policies affecting public utilities was the requirement to give third parties comparable
19 access to the transmission grid, to which historically native load had monopoly rights.
20 State commissions were responsible for assuring native load had rights preserved with
21 transmission access for generation and power supplies, along with reliable and economic
22 transmission service.

1 As a PA PUC commissioner, I gained extensive knowledge on how public
2 utilities use and access the bulk power grid under FERC rules that existed at that time.
3 During my time at the PA PUC, I also took an active role in the roll out of electric choice
4 in Pennsylvania. I was a leader in developing public policy to develop a robust
5 competitive telecommunications market in the Commonwealth and actively supported
6 Pennsylvania's pursuit of competition in the local markets for telecommunications,
7 deployment of advanced services, enhancement of services to rural areas, protection of
8 consumers, and advancement of special services. I served as President of the National
9 Association of Regulatory Utility Commissioners ("NARUC") during a challenging time
10 in the industry, which was marked by wholesale market manipulation and flawed market
11 designs.

12 Prior to my appointment to the PA PUC, I was Acting Executive Director of the
13 Regional Performing Arts Center in Philadelphia, a \$200 million arts and economic
14 development initiative. Previously, I served as the Senior Vice President for Meridian
15 Bancorp, Inc.'s Corporate Affairs Unit and, prior to joining Meridian in 1987, I was
16 Deputy Executive Assistant to former Pennsylvania Governor Richard Thornburgh.

17 I currently serve on the boards of ONCOR, Comverge, Times Publishing
18 Company, and Spectra Energy Partners. Previously, I served on the boards of Leaf Clean
19 Energy Company, Millennium Bank, Foundation of Architecture, Philadelphia Free
20 Library, and the Philadelphia Regional Performing Arts Center. I was also previously a
21 member of the GridWise Architecture Council. In addition, I have lectured at the
22 Vermont Law School's Institute for Energy and the Environment, the Michigan State

1 University Institute of Public Utilities, and at the University of Idaho, Wharton Energy
2 Club, among others. I attended Syracuse University.

3

4 Q. Have you ever testified before this commission?

5 A. No.

6

7 Q. On whose behalf are you testifying in this proceeding?

8 A. My testimony is submitted on behalf of Vermont Electric Power Company, Inc.

9 (“VELCO”).

10

11 Q. What is the purpose of your testimony?

12 A. I describe the federal regulatory framework in which VELCO operates; the requirements
13 imposed on electric transmissions companies by FERC to assure the provision of reliable
14 transmission service at reasonable rates, including requirements for open and

15 nondiscriminatory access to transmission services; and the mechanisms available to

16 enforce those requirements. I also describe some general principles of good governance

17 applicable to private for-profit corporations, including public service corporations.

18 Finally, I review and comment on the governance proposal offered by Professor Dworkin

19 for the Department of Public Service and offer for consideration standard mechanisms

20 used to address the single governance issue raised by the proposed merger that I believe

21 would better serve the interests of the citizens of Vermont, as well as those of VELCO

22 and its shareholders, than would Professor Dworkin’s proposal.

23

24

1 FEDERAL REGULATORY FRAMEWORK

2 Q. Please describe the federal regulatory framework in which electric transmission
3 providers like VELCO operate.

4 A. In the electricity sector, FERC's primary responsibility is to regulate wholesale sales of
5 electricity and transmission of electricity in interstate commerce. FERC is also
6 responsible for overseeing mandatory reliability standards for the bulk power system.
7 FERC's policy objectives are to prevent transmission owners from creating barriers to
8 entry, unduly discriminating in providing access to the transmission grid, and
9 preferentially determining to whom electricity can be transported in interstate commerce.
10 In addition to having jurisdictional authority over the Vermont bulk power transmission
11 system, FERC is also the sole regulator over the ISO-New England regional transmission
12 system. I will discuss the role of ISO-New England below, but it should be noted that
13 VELCO is significantly interconnected with regional transmission providers and thus
14 VELCO must comply with FERC's rules and orders to assure VELCO does not harm or
15 impact commercial or reliable transmission services of neighboring systems.
16 VELCO's role as a bulk transmission owner is subject to FERC's authority on
17 transmission planning, access, service requests, interconnection processes, and rates,
18 terms and conditions. VELCO is required to participate in the ISO-New England
19 transmission planning process and to adhere to federal reliability standards for the bulk
20 power transmission system.

21 FERC's authority is codified in the Federal Power Act and periodically the
22 authority changes. As FERC identifies policies, rules, or mandates that no longer cure

1 infirmities, FERC will issue new directives mitigating market and transmission concerns.

2 VELCO is responsible for modifying its operations, tariffs, and compliance plans to
3 remain in compliance with FERC directives. Below I will discuss consequences of non-
4 compliance with FERC rules, orders and mandates.

5
6 Q. In particular, what FERC rules and policies govern access to the transmission grid?

7 A. FERC Order No. 888, which requires open-access, non-preferential treatment, and
8 reciprocity in transmission access and service, and Order No. 889, which requires
9 transparency in reporting transmission data and service requests, are foundational FERC
10 orders addressing open access. These orders require all FERC jurisdictional transmission
11 owners and providers, such as ISO-NE and VELCO, to hold and implement an open
12 access transmission tariff, or “OATT”, and to comply with the premise of the open-
13 access policies codified in Section 205 of the Federal Power Act. Essentially, the policies
14 are intended to prevent transmission owners and providers from giving preferential
15 treatment to themselves, their affiliates or their corporate owners. In some cases, pre-
16 existing contracts can differ from the rates, terms and conditions in OATTs on file with
17 FERC. An example is VELCO’s FERC Rate Schedule No. 1, otherwise known as the
18 “1991 Vermont Transmission Agreement,” a transmission services rate agreement
19 between VELCO, its distribution utility owners, and the Department of Public Service.
20 With that said, all new transmission service agreements and new transmission service
21 requests entered into post-1996 are executed in compliance with the transmission
22 provider’s open access schedule in the RTO’s OATT.

1 Since issuing Order Nos. 888 and 889, FERC has issued additional landmark
2 orders, including Order No. 2003¹, which standardizes rules and processes for the
3 interconnection of generation resources that are 20 megawatts (“MW”) and larger, and
4 Order No. 2006², which standardizes the rules and processes for the interconnection of
5 generation resources that are 20 MWs and smaller. The purpose of these two Orders was
6 to provide uniformity, clarity, and certainty for all generation assets interconnecting with
7 the transmission grid, regardless of whether the generation asset owner owned the portion
8 of the transmission grid at the point of interconnection. These Orders were intended to
9 prevent a transmission provider from discriminating against a generation developer that
10 may or may not serve that transmission provider’s load. Thus, these orders prevent
11 VELCO from inhibiting generators from accessing transmission assets that it owns or
12 favoring its affiliates in granting access.

13
14 Q. Please continue.

15 A. In August of 2005, the Energy Policy Act of 2005 (“EPA 2005”) was passed and the
16 Federal Power Act was amended giving FERC greater authority over transmission access,
17 mandating reliability standards, offering transmission incentives and increasing FERC’s
18 civil penalty authority, among many other changes. EPA 2005 was intended to further

¹See FERC Order 2003 for Large Generators issued July 24, 2003.

²See FERC Order 2006 for Small Generators issued May 12, 2005.

1 encourage competition in the wholesale power market and spur transmission investment
2 to reduce congestion and prevent future large-scale power outages. EPA 2005 also gave
3 FERC more authority over enforcement matters to encourage compliance with FERC
4 mandates. Particularly noteworthy was the increase in FERC's civil penalty authority to
5 up to \$1,000,000 per violation per day. FERC implemented these changes through
6 various rulemaking proceedings while I served as a FERC Commissioner.

7 As a transmission owner, VELCO is required to comply with all FERC orders,
8 rules and regulations that stem from implementing the Federal Power Act, is prohibited
9 from acting unilaterally and contrary to FERC directives, and must seek FERC's
10 approval for any proposed change in how the transmission grid is accessed and how
11 transmission service is provided. If VELCO takes action that transmission users,
12 neighboring transmission owners or state commissions deem inconsistent with FERC
13 rules, orders and mandates, one or more of those entities can seek FERC assistance
14 through a variety of forums.

15 More recently, FERC on its own motion issued the order "Preventing Undue
16 Discrimination and Preference in Transmission Service" ("Order No. 890")³, which
17 further refines Order No. 888 by instituting additional open access and transparency rules
18 to mitigate remaining opportunities for undue discrimination. These rules require

³ See *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, 72 FR 12266 (Mar. 15, 2007), FERC Stats. & Regs. ¶ 31,241, *order on reh'g*, Order No. 890-A, 73 FR 2984 (Jan. 16, 2008), FERC Stats. & Regs. ¶ 31,261 (2007), *order on reh'g and clarification*, Order No. 890-B, 73 FR 39092 (July 8, 2008), 123 FERC ¶ 61,299 (2008), *order on reh'g*, Order No. 890-C, 74 FR 12540 (Mar. 25, 2009), 126 FERC ¶ 61,228 (2009), *order on clarification*, Order No. 890-D, 74 FR 61511 (Nov. 25, 2009), 129 FERC ¶ 61,126 (2009).

1 increased transparency and consistency in the evaluation and calculation of available
2 transmission capacity and increased inclusion of market participants and transparency in
3 transmission planning of the bulk power transmission grid.⁴

4
5 Q. What are the consequences for not complying with a FERC rule, order or tariff?

6 A. If an allegation of a violation were made, either by a market participant or by FERC
7 itself, FERC enforcement staff would investigate the alleged violation. The process
8 FERC relies on during the investigation process is detailed and documented in the Code
9 of Federal Regulations and further discussed in FERC Enforcement Policy Statements.

10 If, after an investigation, FERC finds a violation or multiple violations have
11 occurred, monetary and non-monetary sanctions can be levied by FERC. Monetary
12 sanctions include refunds of ill-gotten gains, disgorgement of profits, and civil penalties
13 up to \$1,000,000 per day per violation. Non-monetary sanctions can include directives to
14 change operational behavior or practices and to change tariff terms and conditions to
15 mitigate any ambiguous language.

16 With the enforcement authority and penalty provisions described above, FERC
17 has a robust set of tools to compel all market participants, including public utilities such
18 as VELCO, to remain in compliance with its orders, rules and regulations.

⁴ VELCO must comply with all FERC orders, rules and regulations as they are issued. For example, in 2011, FERC issued Order No. 1000 amending FERC jurisdictional public utilities' OATTs with the intent to require broader regional transmission planning, among other changes. Order No. 1000 is subject to rehearing and the effective date is pending.

1 Q. In addition to owning the bulk-power transmission assets in Vermont, does VELCO
2 control the transmission system?

3 A. VELCO is responsible for the day-to-day operational control and management of
4 Vermont's high-voltage transmission system under delegated authority from the ISO-
5 New England, but ISO New England Inc. ("ISO-NE") is ultimately responsible for
6 operational control of the entire New England transmission system, with which
7 Vermont's transmission system is interconnected and integrated. ISO-NE is a FERC-
8 approved regional transmission organization with an approved market monitoring,
9 mitigation program⁵, and a FERC approved open access transmission tariff.⁶ ISO-NE
10 provides under its OATT non-discriminatory transmission service over transmission
11 facilities in the New England footprint and conducts regional transmission planning for
12 the expansion and reliable operation of the New England bulk power system.

13
14 Q. In controlling the transmission system, what functions are performed by ISO-NE?

15 A. ISO-NE is responsible for ensuring the day-to-day reliable operation of New England's
16 bulk power generation and transmission system, overseeing and ensuring the fair
17 administration of the region's wholesale electricity markets, and managing
18 comprehensive regional planning processes, including transmission planning. ISO-NE
19 oversees the movement or transfer of electric energy at high voltage levels into, within,

⁵See ISO New England Inc., 130 FERC ¶ 61,054 at PP 116-176 (2010). ISO-NE's market monitoring structure relies on an Internal Market Monitor and an External Market Monitor. The role of the market monitoring function of ISO-NE is described at pages 52-55 of the 2010 Annual Markets Report of ISO-NE, which is available at http://www.iso-ne.com/markets/mkt_analys_rpts/annl_mkt_rpts/2010/amr10_final_060311.pdf.

⁶ Cite to ISO-NE OATT on website.

1 and out of New England, including Vermont, and assures that there are adequate
2 transmission lines and the necessary associated equipment in appropriate locations all
3 through New England so that electric energy can be carried from where it is generated to
4 points where it is transformed for delivery to end-users.

5 ISO-NE oversees the transmission system per the terms and conditions of its
6 OATT on file at FERC. All transmission service requests, rates, business practices,
7 scheduling, rescheduling, outage management and congestion management decisions are
8 performed by ISO-NE in accordance with the OATT, and all information and data
9 pertaining to transmission system operations are posted on the ISO-NE Open Access
10 Same Time Information System (“OASIS”), in compliance with FERC rules and orders.
11 In this way ISO-NE assures that all transmission users have comparable access to
12 information and the transmission system. No one entity can receive preferential
13 treatment under the ISO-NE administered OATT for transmission service.

14
15 Q. Please explain the role ISO-NE plays in regional transmission planning.

16 A. ISO-NE conducts transmission planning studies to support regional load and supply
17 requirements and handles requests to change interconnection and transmission service.
18 ISO-NE ensures transmission owners, including VELCO, comply with requirements
19 regarding changes to capacity or facilities per the transmission planning terms and
20 conditions contained in the ISO-NE OATT. Transmission studies are initiated and
21 completed to ensure the reliability criteria of the bulk power system are met, to evaluate
22 interconnection of new generation and transmission assets, and to support the regional

1 system planning process. Transmission planning processes have changed periodically
2 over time, reflecting transmission planning criteria changes to account for local and
3 regional expansion and congestion concerns. For example, in FERC Order No. 890,
4 FERC required a broader regional planning process and required that all OATTs be
5 modified to consistently and fairly execute transmission plans on this broader regional
6 basis and incorporate state-based policies. Not only are transmission planning criteria
7 codified in the ISO-NE's OATT and business practices, but FERC has also approved six
8 mandatory reliability standards specifically for transmission planning with which
9 VELCO must comply.⁷

10 It should be noted that VELCO is an active participant in the ISO-NE planning
11 process. Representatives of the Vermont Department of Public Service and the Vermont
12 Public Service Board are also involved in the regional stakeholder process.

13
14 Q. Please explain the post-planning steps necessary to obtain ISO-NE's approval for
15 Vermont transmission projects.

16 A. With limited exception, pursuant to § I.3.9 of the ISO-NE OATT, ISO-NE reviews and
17 approves (or rejects) all proposed New England transmission system upgrades,
18 modifications, and additions, including those proposed for Vermont. Pursuant to
19 Schedule 12 of the OATT, ISO-NE determines the appropriate cost allocation treatment
20 of those system upgrades, modifications and additions. For any substantial transmission
21 project, VELCO works closely with ISO-NE and other affected transmission owners,

⁷<http://www.nerc.com/page.php?cid=2|20>. Transmission Planning mandatory reliability standards TPL001-006.

1 with review and input by regional stakeholders through the PAC, to ensure the
2 appropriate reliability solution is selected. VELCO is then required to submit a complete
3 Proposed Plan Application (“PPA”) to ISO-NE, along with supporting information and
4 analysis, including a project cost-estimate, through a complete Transmission Cost
5 Allocation (“TCA”). Market participants and ISO-NE, through peer review task forces,
6 scrutinize the VELCO studies that support the PPA to ensure no significant adverse
7 impact to the system. ISO-NE may need to conduct an independent reliability analysis to
8 determine whether the project poses any potential adverse reliability impacts to the New
9 England transmission system. The PPA and the TCA are also presented to the NEPOOL
10 Reliability Committee for further analysis, discussion, vetting of cost estimates, and,
11 ultimately, the committee’s advisory recommendation to ISO-NE. The ISO-NE either
12 rejects or approves the proposed project by issuing a so-called § I.3.9 letter and the TCA
13 letter.

14
15 Q. Does FERC jurisdiction and the ISO-NE’s predominant role in planning mean that the
16 state of Vermont has no control over electric transmission?

17 A. No. While FERC has sole jurisdiction over the control of and access to the bulk power
18 transmission system, the state of Vermont retains siting authority, and it has very specific
19 statutes that define the powers and duties of the Board with respect to public service
20 companies like VELCO and the approval of transmission projects. Of particular note in
21 this case is 30 V.S.A. § 248, which describes the standards that must be met for Board
22 approval of a transmission project. The requirements of this statute and the process

1 VELCO must go through to get a transmission project approved by regulators in Vermont
2 are described in more detail in Mr. Dutton's testimony.

3 Given the requirements for preapproval under both federal and state regulatory
4 regimes, no transmission can be built in Vermont without a Vermont Public Service
5 Board ("PSB")-issued Certificate of Public Good, completion of the Vermont System
6 Planning Committee review process, and a Proposed Plan Application and approval by
7 the New England Pool Reliability Committee and ISO-NE. This means that VELCO
8 and VELCO owners cannot unilaterally construct and integrate transmission facilities
9 without significant consideration of the proposal by third parties seeking to protect all
10 users of the transmission system and the citizens of Vermont.

11
12 Q. Is it possible for VELCO and VELCO owners to construct transmission projects that
13 originate from outside the state of Vermont, traverse through Vermont and interconnect
14 again outside of Vermont without serving any Vermont load?

15 A. Regardless of origin or termination points, before any transmission provider begins
16 construction of a new transmission line within, into, or from Vermont, that transmission
17 provider must first apply to the Public Service Board for a Certificate of Public Good,
18 which requires a finding by the Public Service Board that the transmission facility
19 promotes the general good of the state. While it is theoretically possible that the Public
20 Service Board could make such a finding even if none of the power being carried by the
21 line served Vermont load, I expect that there would need to be clear, significant and
22 demonstrated benefits to the state in hosting the line to support such a finding.

1 Q. Is it possible for VELCO and VELCO owners to provide higher quality of service or
2 provide lower priced transmission service to affiliates or any other transmission
3 customer?

4 A. No. As I described earlier, FERC Order Nos. 888 and 890 require uniform terms and
5 conditions to prevent preferential treatment in the provision of transmission service. All
6 transmission service in New England must be priced and sold according the rates, terms
7 and conditions in tariffs approved and on file at FERC. If a transmission customer
8 believes that discrimination is occurring, there are ample opportunities to seek redress at
9 FERC, and FERC can impose stiff penalties for violations. Also, because ISO-NE has
10 control over the New England transmission system, VELCO and its affiliates have no
11 ability to offer, sell, or transmit electricity over their transmission assets without going
12 through ISO-NE. Thus, VELCO and its affiliates, regardless of ownership structure, are
13 incapable of thwarting any load serving entity's or other transmission system user's
14 ability to access and transfer power on the transmission system.

15
16 Q. Are you aware of any potential impact the merger transaction could have on the
17 operations of or access to the Vermont transmission system?

18 A. No.

19
20 Q. Please explain.

21 A. FERC objectives are to assure open access and non-discriminatory service and therefore
22 FERC has promulgated orders, rules and regulations with which public utilities must

1 comply. Because ISO-NE controls the grid, the type of ownership of the public utilities
2 is immaterial and does not affect how service is granted or denied. If any neighboring
3 transmission owner, transmission customer, market participant or the Vermont Public
4 Service Board or Department has a concern or observes any impropriety in connection
5 with accessing information, interconnecting to the grid or requesting transmission
6 service, that entity can file a formal complaint at FERC, call the FERC enforcement
7 hotline, or contact the ISO-NE internal market monitor for an investigation and
8 determination of violations. FERC has a variety of vehicles for these entities to pursue
9 allegations and seek relief.

10
11 GOVERNANCE

12
13 Q. What in your experience constitutes “good governance” of a corporation? How does a
14 private for-profit utility operate within that paradigm?

15 A. In examining the concept of “good governance” one must examine the construct of the
16 “Board of Directors” and its purpose. Boards of directors, of both private and public
17 companies, enjoy a special niche in the operation of an organization. The National
18 Association of Corporate Directors (“NACD”) and the New York Stock Exchange
19 (“NYSE”) are respected organizations on which corporations rely to define roles and
20 best-practices of boards. These practices reflect years of case law and the consensus of
21 the courts in state and federal jurisdictions. The NACD was founded in 1977 as the only
22 national membership organization created for and by directors. Today, more than 11,000

1 directors and key executives from public, private, and non-profit companies rely on the
2 NACD” to provide guidance and education to strengthen board leadership.⁸

3 The NACD defines the role of the board in its Custom Research Memo Key:

4 The board’s role is to act as a fiduciary on behalf of all the shareholders.”
5 In addition the board of a public utility must act in the public interest in
6 accordance with federal and state law. *To ensure effective boardroom*
7 *operation, however, board members must act as advisors, question-askers,*
8 *problem-solvers, and decision-makers.”* (emphasis added)⁹
9

10 Therefore, the board of an organization must also be able to act independently to ensure
11 that the above goals are met and realized.

12 VELCO’s board members have, as any other board members of a for-profit
13 shareholder owned entity do, the traditional fiduciary duties of care and loyalty to the
14 shareholder. These duties are also codified in Vermont statutes at 11A V.S.A. § 8.30.
15 These duties have evolved over the last century in the common law of the United States
16 and in the decisional law of each state. They are the primary tools for shareholder
17 protection.

18 The duty of loyalty essentially demands that directors act without any self-dealing
19 and only in the interests of the company and shareholders.¹⁰ The duty of care is
20 relatively simple: directors must make careful, well-informed decisions with regards to

⁸ National Association of Corporate Directors, <http://www.nacdonline.org/AboutUs/>. Accessed January 12, 2012.

⁹National Association of Corporate Directors (NACD). Custom Research Memo, “The Role of the Board.”2010. Pg. 1

¹⁰ *Professor Bernard S. Black*, Stanford Law School, “The Principal Fiduciary Duties of Boards of Directors, Presentation at Third Asian Roundtable on Corporate Governance Singapore”, 4 April 2001. P. 6. Accessed: January 10, 2012.

1 the business situations with which they are presented.¹¹ This is generally known as the
2 “business judgment rule.”¹² These duties also embody a duty of disclosure, requiring
3 directors to act with candor toward shareholders. In the past few years since the collapse
4 of Enron and the passage of the Sarbanes-Oxley Act of 2002, courts have increasingly
5 noted the duty of directors for full-disclosure of their actions to the shareholders in
6 situations where conflict of interest may be at play.¹³ I mention this to point out that any
7 corporate board must act in the best interests of shareholders and therefore take the
8 success of the company into consideration in all of its actions.

9 VELCO and its board not only have a fiduciary duty to consider the interests of
10 shareholders, but labor under even more demanding strictures due to the high degree of
11 regulation that exists for utility companies that operate under the regulatory authority of
12 FERC and the State of Vermont. Indeed, NACD and other experts agree, boards must
13 respect and abide by applicable rules and regulations,¹⁴ and, although the regulatory
14 environment itself does not create fiduciary duties to other constituencies (ratepayers, for
15 example), an essential element of the directors’ fiduciary responsibilities is to ensure that
16 the corporation is operated in compliance with all laws and regulations. In VELCO’s
17 case, this means that the board of directors is responsible for strategic decisions and the
18 VELCO management is responsible for day-to-day operations and decisions to assure

¹¹ Ibid.

¹² Ibid.

¹³ Sarbanes-Oxley Act of 2002, PL 107-204, 116 Stat 745.

¹⁴ “The Role of the Board.” National Association of Corporate Directors, Custom Research Memo. P.3. 2010.

1 VELCO is meeting all FERC and Vermont regulatory requirements, including those that
2 directly and indirectly benefit Vermont citizens.

3 There are unique historical reasons why the regulatory environment exists and has
4 operated successfully for over 100 years, which I could discuss in depth. In short,
5 however, in return for a monopoly franchise, public utilities' rates, tariffs, services and
6 other significant actions, like construction of facilities, are highly regulated. Even as the
7 regulatory model has evolved, the transmission and distribution networks remain
8 regulated. Transmission and distribution public utilities, since they operate under a
9 public service standard, have their for-profit nature substantially constrained by
10 regulation. This creates a dynamic whereby the directors of a public utility do have an
11 additional duty—to accommodate the public interest - because meeting the applicable
12 regulatory requirements is an essential element of operating a regulated company. That
13 reality, however, in no way alters the fundamental fiduciary responsibilities of the board
14 members to shareholders.

15
16 Q. How do these concepts of fiduciary responsibility translate into specific responsibilities?

17 A. Once the duties and the role of the board are understood, the concept of “Good
18 Governance” may be discussed. “Good Governance” cannot be defined so much as
19 delineated. More specifically, if certain business practices are maintained by a board of
20 directors, then there are concrete measures to support the fact that the board of directors
21 is governing well. There are certain practices that the NACD, the NYSE, the
22 Organization for Economic Co-Operation and Development (“OECD”), and credit ratings
23 agencies generally agree constitute “good governance.” Summarizing the work on

1 corporate entities by the American Law Institute, the Business Round Table, NACD and
2 other relevant bodies, board responsibilities should include:

- 3 • Approving a corporate philosophy and mission.
- 4 • Reviewing and approving management's strategic and business plans,
5 including developing a depth of knowledge of the business being served,
6 understanding and questioning the assumptions upon which such plans are
7 based, and management is reaching an independent judgment as to the
8 probability that the plans can be realized.
- 9 • Reviewing and approving the corporation's financial objectives, plans, and
10 actions, including significant capital allocations and expenditures.
- 11 • Reviewing and approving material transactions not in the ordinary course
12 of business.
- 13 • Monitoring corporate performance against the strategic and business
14 plans, including overseeing the operating results on a regular basis to
15 evaluate whether the business is being properly managed.
- 16 • Ensuring ethical behavior and compliance with laws and regulations,
17 auditing and accounting principles, and the corporation's own governing
18 documents.
- 19 • Assessing its effectiveness in fulfilling these and other board
20 responsibilities.
- 21 • Performing such other functions as are prescribed by law, or assigned to
22 the board in the corporation's governing documents.¹⁵

23
24 Effective corporate governance concepts are shared among credit rating agencies,
25 securities exchanges, and the NACD, and are also articulated by the OECD, whose full
26 list of governance guidelines can be found in Exhibit VELCO NMB-1. In addition, the
27 courts routinely pass upon governance practices when they assess directors' compliance
28 with their fiduciary duties in shareholder lawsuits. While these standards are mandated
29 by securities exchanges and government security oversight agencies for publicly traded
30 companies (such as the SEC in the United States), private companies and non-profit
31 boards of directors routinely adopt similar governance practices. NACD states, "given
32 the recent case law that is beginning to impose public company governance requirements

¹⁵ Ibid, p.2.

1 on private companies,...[they] have no choice but to begin to implement some
2 fundamental corporate governance processes including those imposed on public
3 companies by Sarbanes Oxley.¹⁶

4 In my experience on a variety of for-profit, non-profit organizations, and in
5 dealing with governance issues as a regulator, I have found that the most successful
6 boards have a substantive understanding and respect for these standards. They understand
7 their role is not to manage the company on a day-to-day basis, but rather to guide it with
8 respect to strategic decisions, and to ensure that they are honoring their duties of
9 oversight, review, assessment and monitoring. The classic example of public and private
10 corporate failures of the past decades can all be traced, at least in part, to failures in board
11 governance.

12
13 Q. How does VELCO's status as a private for-profit, yet regulated, business impact your
14 analysis?

15 A. As I stated earlier, VELCO is organized as a private for-profit public service corporation,
16 owned by its shareholders. VELCO's corporate form assumes a profit motive and a
17 focus on maximizing value for shareholders. In the context of a business whose purpose
18 is to provide an essential public service, as is the case with VELCO, there is regulatory
19 overlay at the Federal and state levels that has the effect of balancing the corporate focus
20 on profits and shareholders by obligating the corporation to meet certain standards for the
21 benefit of the public or some segment of the public. This approach balances the interests

¹⁶NACD Director's Monthly, 1 January, 2008. "THE GOVERNANCE GAP " by Pascal Levensohn and Kristina Veaco.

1 of the key actors and addresses the fundamental tension between the goals of the
2 shareholders and the public/state - the shareholders' interest in value-creation (in return
3 for the business and financial risks they undertake), the public's interest in having
4 essential services delivered competently and economically, and the state's interest in
5 having those essential services delivered without the state having to undertake the
6 primary business and financial risks associated with delivering those services. The board
7 of directors continues to have all of the fiduciary duties that would be present in any
8 corporation, with a focus on creating shareholder value; however, because the company
9 operates in a highly-regulated environment, the directors are responsible for overseeing
10 the development and implementation of a business model and operating plan that
11 complies in all respects with applicable laws and regulation, which often involves
12 practices that directly and indirectly benefit citizens. It should be noted that the profit
13 motive for VELCO's shareholders, i.e., the distribution utilities, is reduced as the result
14 of ratemaking treatment for transmission investments in Vermont that, while allowing
15 distribution companies to earn their allowed retail rate of return on transmission
16 investments, flows through net earnings from VELCO to reduce rates for Vermont
17 ratepayers.

18 In fact, in the order approving VELCO's application as a corporation in 1956, the
19 Vermont Public Service Commission stated "the general good of the State of Vermont
20 will be promoted" by the authorization to the applicants and went on to define "general
21 good" as the "formation of such a corporation to transmit electric power and energy

1 within the state.”¹⁷

2 The corporation and its shareholders involved in regulated businesses, including
3 VELCO's management team, directors and shareholders, understand how the regulatory
4 overlay affects them and take that into account in developing their business model and
5 executing their operating plans, committing capital and other resources, and forecasting
6 their expected returns or other benefits from executing those plans. They are able to
7 accomplish this because of the existence of the “regulatory compact.” The regulatory
8 compact is defined as “[f]irst, in return for a monopoly franchise, utilities accept an
9 obligation to serve all comers. Second, in return for agreeing to commit capital to the
10 business, utilities are assured a fair opportunity to earn a reasonable return on that
11 capital.”¹⁸

12 The state understands that in order to achieve the public's and state's goals, it must
13 allow these businesses enough leeway to operate on a for-profit basis so they are not
14 discouraged from attracting and committing capital and other resources and undertaking
15 the business and financial risks necessary to provide the services citizens need in lieu of
16 the state directly providing those services. Utilities are enormously capital intensive. If
17 shareholders and investors were not assured that their investments could be recouped
18 through operating the business with a profit motive, how would VELCO go about
19 maintaining and growing its ability to provide services for the State of Vermont? This

¹⁷ Public Service Commission Order. Docket #2735. November 27, 1956. See Exhibit VELCO CLD-1.

¹⁸ Stellzer, I.M. The Utilities of the 1990's. The Wall Street Journal, January 7, 1987, 20 as referenced in Phillips, C.M. The Regulation of Public Utilities, Theory and Practice, Public Utilities Reports, Inc. Arlington, Virginia (1993), Pg. 21.

1 mutually agreed-upon regulatory compact has succeeded since VELCO'S inception in
2 1956. The company's accomplishments have served the citizens, the state and the region
3 well.

4

5 Q. What is the primary regulatory model in this country and why?

6 A. Lessons learned from the country's long history or regulation of private capital devoted
7 to utilities should not be ignored.

8 The earliest private electric companies were first regulated at the
9 municipal level; and then at the beginning of the 20th century, city
10 by city, regulation gave way to state regulation. Regulatory
11 agencies were established with the concept that 'experts' could
12 independently determine the costs necessary to build, operate and
13 maintain the utility systems.¹⁹

14

15 As utilities outgrew municipal and state boundaries, the Federal Power Commission was
16 created and began to play a larger role.²⁰ This agency in turn became the FERC. Most
17 recently the emergence of Regional Transmission Organizations²¹ or RTOs created the
18 opportunity for regional state committees to influence regulatory policies on a regional
19 level. However, regardless of the evolution of the markets and their utility participants,
20 the fundamental principles of both governance and regulation have not changed. This
21 model of governance and its regulatory compact has proven successful for ratepayers,
22 investors, and the economy for many years, so much so, that many other countries have

¹⁹ Branko Terzic, Energy and the Consumer; Lessons from the end of the 20th Century, Speech Before the Royal Science Academy, London. 14 February, 2000.

²⁰ FERC.gov. <http://www.ferc.gov/students/ferc/timeline.asp>

²¹ Pursuant to FERC Order No. 2000, the Commission encouraged the voluntary formation of Regional Transmission Organizations to administer the transmission grid on a regional basis.

1 abandoned the state-owned asset model and adapted some variation of the U.S. regulatory
2 and governance model in order to attract private capital. Not only are other countries
3 creating independent regulatory bodies, they are adhering to the principles articulated by
4 James C. Bonbright, the acknowledged father of electric utility principles, which are:
5 “Capital attraction; which takes the form of a reasonable return for private utility
6 companies; consumer rationing; under which rates are designed to discourage wasteful
7 use and promote all uses that is economically justified; and Fairness.”²²

8 While serving as the President of NARUC, Pennsylvania Commissioner and
9 FERC Commissioner, I worked with USAID and other international development
10 agencies in their efforts to restructure energy policies and introduce regulatory and
11 governance reform in all of the former USSR member countries. I have also presented
12 regulatory models and compacts in Brazil, China, Japan, and at the International Forum
13 on Energy. I was actively involved in many discussions and outreach efforts as these
14 countries developed appropriate regulatory schemes with the goal of attracting private
15 investment. Many, like the United States of 100 years ago, have come to the conclusion
16 that government resources are more appropriately allocated to other critical social needs.
17 The United Kingdom and most of Europe have come to the same conclusion. Many of
18 these countries explored the creation of a regime in which the regulatory compact
19 contains the following principles: fairness, equitable returns, transparency of both
20 decision-making and underlying cost (including subsidies), independence from
21 government interference, consistency, balanced treatment, and a clear legal framework

²² Bonbright, James C., et al. Principles of Public Utility Rates. Columbia University Press. NY, NY. 1961.

1 that includes an appellate process. Most countries with successful electricity
2 infrastructure who have succeeded in attracting capital share similar regulatory and legal
3 characteristics. Even as the U.S. and other countries have moved toward competitive
4 generation markets, these characteristics have been respected.

5 The United States regulatory model for investors has been emulated throughout
6 the world. Why? Because it has allowed one of the most reliable, efficient and accessible
7 electrical grids in the world to develop, and expects to attract 30 billion dollars of capital
8 investment in renewable energy this year alone.²³ Investors continue to invest in this
9 sector because they trust the due process and equity afforded to them by a proven,
10 independent regulatory regime. This has served Vermont well.

11 More specifically, this regulatory model has served Vermont well. VELCO has
12 provided Vermont with a reliable and accessible network, and investments in VELCO by
13 its distribution company owners has helped to reduce electric bills for Vermont
14 consumers, as acknowledged by Professor Dworkin. (Testimony of Michael Dworkin, pg.
15 14, lines 1-10). These results would be unachievable if the regulatory compact were
16 abrogated and the governance structure were to be changed in the radical manner
17 proposed by Professor Dworkin.

²³ Andrew Kinross, Renewable Energy Remains Investors' Favorite. Annual Capital Investment, Fig. 2., http://www.elp.com/index/display/article-display/0629192221/articles/electric-light-power/volume-88/issue-4/features/industry-news/electric-utility_industry.html. Accessed January 12, 2012.

1 Q. Do you find the current board governance structure of VELCO effective?

2 A. Yes. I can speak to this issue because of my background as a board member of several
3 utility boards, a regulated bank and other shareholder owned and non-profit boards. In
4 addition to the performance metrics noted before, the simplest method of evaluating the
5 success of a shareholder owned company board of directors may be to examine the credit
6 rating of the company the directors lead. Standard and Poor's says "the utility business is
7 unique in that in no other industry...do legislative and regulatory pronouncements so
8 inform rating agencies opinions. ...S&P's views of the regulatory and policies
9 environment in which a utility operates as one of the most significant factors in assessing
10 the credit worthiness of the regulated utility."²⁴

11 Standard and Poor's considers the following components key to competitive
12 success:

- 13 • Regulation;
- 14 • Markets;
- 15 • Diversification;
- 16 • Operations;
- 17 • Management, including growth strategy;
- 18 • Governance; and,
- 19 • Profitability.²⁵

20
21 In discussing regulation, rating agencies *specifically* mention consistency and
22 predictably of decisions. They add:

23 Regulation is the most critical aspect that underlies regulated integrated
24 utilities' creditworthiness. Regulatory decisions can profoundly affect
25 financial performance. The assessment of the regulatory environments in

²⁴ Shipman, Todd. "Key Credit Factors: Business and Financial Risks in the Investor-Owned Utility Industry." *Standard & Poor's*.

²⁵ *Ibid.*

1 which a utility operates is guided by certain principles, most prominently
2 consistency and predictability, as well as efficiency and timeliness.²⁶
3

4 They also express the importance of “credibility and strong corporate
5 governance.”²⁷ The Fitch metrics highlight these same concerns while looking at the
6 sufficiency and timelines of cost recovery and rate structure, regulatory and political
7 environment.²⁸

8 Moody’s uses a similar methodology, (See Exhibit VELCO NMB-2) but goes
9 further in assigning weight to each factor and assigning of 25% of the total weight to
10 ‘Regulatory Framework’:

11 For a regulated utility company, we consider the characteristics of the
12 regulatory environment in which it operates. These include how developed
13 the regulatory framework is; its track record for predictability and stability
14 in terms of decision-making; and the strength of the regulator’s authority
15 over utility regulatory issues. A utility operating in a stable, reliable, and
16 highly predictable regulatory environment will be scored higher on this
17 factor than a utility operating in a regulatory environment that exhibits a
18 high degree of uncertainty or unpredictability. Those utilities operating in
19 a less developed regulatory framework, or one that is characterized by a
20 high degree of political intervention in the regulatory process, will receive
21 the lowest scores on this factor.²⁹
22

23 Dominion Bond Rating Service (“DBRS”) carefully notes that business and
24 financial risk profiles are interrelated, stressing the importance of stability and regulation.

25 In commenting on energy utility industry regulation, it states,:

²⁶ Ibid.

²⁷ Ibid.

²⁸ Bonelli, Sharon E; Grabelsky, Glen . “Rating North American Utilities, Power, Gas, and Water Companies “ fitchratings.com/dtp/pdf2-11/625129/pdf

²⁹ Moody’s Global. “Regulated Electric and Gas Utilities.” August 2009.

1 “[it] is highly regulated on an economic basis, which is the major positive
2 factor in the overall Business Risk Rating. The industry is already subject
3 to high levels of operational regulation. The trade-off for little or no direct
4 competition (except from alternative sources of energy) and monopoly
5 franchise areas, is that the rates utilities can charge customers are
6 generally set by regulators. While this can place an effective ceiling on the
7 level of profitability, it affords the utility tremendous stability and
8 protection for fluctuations in both revenues and costs.”³⁰
9

10 VELCO has clearly met the standards articulated by all of the ratings agencies. In
11 confirming the ratings assigned to the most recent series of First Mortgage Bonds
12 (“FMB”), the well-respected DBRS gave it an “A” rating. The reasons for the “A” rating
13 are described in the December 14, 2010 report.³¹ Specifically the “Ratings
14 Considerations” noted the following strengths:

- 15 1. Low business risk with strong contractual support
- 16 2. Improved credit metrics during construction phase
- 17 3. Ability to manage large scale construction
- 18 4. *Favorable regulatory environment* (emphasis added)³²

19
20 DBRS did foresee challenges, all of which would be even greater if the proposed
21 “merger remedies” DPS proposed were enacted:

- 22 (1) Continued large construction program
- 23 (2) Free cash deficits require external financing
- 24 (3) Equity injections required from utility owners³³

25
26 DBRS in its discussion of value determination also speaks to other considerations
27 such as the role of board governance:

³⁰ DBRS “Rating Companies in the North American Energy Utilities (Electric and Natural Gas) Industry.” May 2011. DBRS is a full service credit rating agency established in 1976 and is privately owned and operated without affiliation to any financial institution.

³¹ DBRS Private Rating Report, December 14, 2010, p.1. (Exhibit VELCO NMB-3)

³² Ibid.

³³ Ibid.

1 Although assessing governance can be highly subjective and difficult to
 2 gauge, it is viewed as an important part of the credit rating process at
 3 DBRS. Strong corporate governance provides a company with a value-
 4 added board and senior management that can set the foundation for long-
 5 term sustainability by improving the likelihood that the business will be
 6 healthy and productive. It will also reduce the risks of lost time and added
 7 costs that can come from a wide variety of areas if governance is
 8 ineffective. From a DBRS perspective, there is also a correlation between
 9 governance and the extent to which a rating agency can trust the board and
 10 management.³⁴

11
 12 Dramatically altering the board structure and the company's control over any and
 13 all of these metrics will most certainly change how the company will be financially
 14 evaluated. Upsetting what DBRS sees as a "stable" trend does not bode well for the
 15 company, or its ratepayers. The most recent evaluation of VELCO on January 5, 2012
 16 echoes this prior rating and goes onto say "Transco's credit profile continues to improve,
 17 driven by a favourable regulatory environment and strong equity contributions from its
 18 owners."³⁵

19 Additional achievements were also noted by DBRS in its January report, "The
 20 company continues to foster effective working relationships with state regulators and
 21 legislators and other key stakeholders. As a result, there has been a significant reduction
 22 in costs and timelines for project approvals."³⁶ These accomplishments demonstrate how
 23 well VELCO's board is able to operate in the public interest. The fact is that VELCO
 24 was able to maintain its strong credit rating in the current economic downturn,
 25 particularly when viewed against the general declines the investor owned utility industry

³⁴ DBRS. "Evaluating Corporate Governance." March 2010.

³⁵ DBRS. "Private Rating Report Vermont Transco, LLC". January 5, 2012. (Exhibit VELCO NMB-4)

³⁶ DBRS. "Evaluating Corporate Governance." March 2010.

1 has experienced since 1970.³⁷ (See Exhibit VELCO NMB-5.) VELCO has been rated as
2 a stable, well run, company with a strategic vision for the future of electricity in the State
3 of Vermont. DBRS has already considered the current regulatory schematic beneficial;
4 these proposed disruptive changes would be of concern for this agency and would
5 undoubtedly cause it to reevaluate its positive assessment. In fact, an indication that
6 governance proposals could be a concern with respect to creditworthiness is contained in
7 the latest DBRS report on VELCO. The firm notes, “It is unclear what other proposals,
8 including possible changes to VELCO’s governance will be offered by other parties, or
9 what impact such proposals might have on creditworthiness.”³⁸

10
11 ASSESSMENT OF DPS PROPOSAL

12 Q. What is your overall assessment of Professor Dworkin’s proposal?

13 A. There are many moving parts to this unprecedented proposal. The fundamental question
14 is: what is the problem the proposal seeks to resolve? Professor Dworkin’s far-reaching
15 and draconian proposal goes well beyond what is necessary to address the single issue
16 created by the proposed merger, i.e., the potential for the majority shareholder to obstruct
17 the rights of others, which is often referred to as “tyranny of the majority.” In doing so, it
18 ignores the regulatory and legal protections that have successfully governed the tension
19 between for-profit operations of utility companies and their public service purpose for
20 decades, as well as VELCO’s 55-plus years of successful operations. It exposes the
21 company and the State of Vermont to credit risk, which will ultimately result in higher

³⁷ See Edison Electric Institute, Wall Street Briefing. August 10, 2011.

³⁸ DBRS Private Rating Report, January 2012, p.3.

1 rates for the consumer. It fundamentally conflicts with legal standards applicable to for-
2 profit corporations. It would cause confusion among VELCO's directors, its
3 management, its shareholders, its business partners and the public generally. It would
4 create serious disincentives for its current and potential future investors to commit
5 additional capital to the company. To the degree management and the board have
6 transmission project discretion, it would politicize VELCO board analyses and
7 undermine the integrity of their decision-making process. In sum, the proposal would be
8 at best be unnecessarily costly, inefficient and distracting to management, and at worst
9 disastrous.

10
11 Q. Does the governance structure need to be changed?

12 A. The perception is that the combined ownership of the merged companies creates the
13 "specter" of the "tyranny of the majority", and thus could be addressed. However, the
14 solution is not to abrogate the regulatory compact, disrupt the relationship of the
15 company and its financial partners, or repurpose the company. Any changes to VELCO's
16 governance structure must take governance fundamentals into account and be in
17 proportion to the issues the merger creates. Although the proposed Central Vermont and
18 Green Mountain merger impacts VELCO's ownership in a way that can lead to a demand
19 to mitigate the powers of the 70% ownership, how those issues are addressed must
20 account for the very same interests and goals and bear in mind all the Federal, state, and
21 regional requirements and restrictions discussed above, none of which will change as a
22 result of the merger. Any changes should strive for as similar a balance in business
23 operations and customer service as currently exists. Any proposal should attempt to

1 address only the limited issues resulting from the proposed merger; that is the best way to
2 maintain the balance of interests that VELCO's shareholders, Vermont's citizens and the
3 state currently enjoy and that has produced positive results for all those interest
4 groups. The more intrusive the remedy, the more likely it is that this balance will be
5 upset in a way that will adversely affect Vermont's citizens in the future.

6 While raising the issue of the “tyranny of the majority,” Professor Dworkin
7 admits, “[t]he current structure appears to be functioning effectively in terms of reliability
8 of service, and many with whom I spoke during this process indicated that VELCO is
9 today, a well-managed organization that does listen to the concerns of all owners.”

10 (Testimony of Michael Dworkin, page 25 of 40, lines 9-13). In fact, Professor Dworkin
11 even agrees that to the extent there have been issues, the current regulatory model has
12 resolved them. He acknowledges,

13 while the private functioning of VELCO may not be perfect, its
14 imperfections are being addressed through a set of Public Service Board
15 mandates going back to the Northwest Reliability Project and
16 implemented with serious Departmental involvement in recent years.
17 (Testimony of Michael Dworkin, pg. 31 of 40, lines 5-9)

18
19 For reasons that are not clear, Professor Dworkin denies the possibility that this
20 organization can continue its path of good governance and attention to the public interest.
21 He provides no substantive evidence to this effect, just generalizations about potential
22 abuse of majority power, and then goes on to completely ignore approaches to the
23 “tyranny of the majority” problem that are both routinely used and generally accepted as
24 being effective by companies throughout the U.S. in similar positions.

1 Q. What is your reaction to Professor Dworkin's recommendation that VELCO'S
2 governing documents be modified so as to require that "purposes of VELCO be defined
3 as including the general good of the state."

4 A. It seems odd that Professor Dworkin would suggest both structural changes and a
5 substantive redefinition of corporate goals. He acknowledges that,

6 this purpose [the general good] is already implicit in the fact that the
7 company's certificate of public good was issued upon an understanding
8 that it would promote that goal (see 30 V.S.A. Secs 102 and 231, and
9 Citizens Utilities case, Docket Nos. 5841/5859) and because investor's
10 would lose much of the value of their investments if the certificate were
11 revoked for failure to meet that purpose." (Testimony of Michael
12 Dworkin, pg. 32, line 13-18.)
13

14 Yet Professor Dworkin proceeds to suggest that general good be codified in the
15 company's governing documents.

16 I do not believe that such a change is necessary given the regulatory environment
17 in which VELCO already operates. In addition, I have serious concerns about the legality
18 and enforceability of such a requirement. Although I am not an expert in Vermont
19 corporations law and, therefore, would encourage you to consult with an attorney expert
20 in that area, I do have enough experience as a board member of multiple for-profit
21 corporations to know that a fundamental premise of corporations law is that the
22 corporation is managed by the directors for the benefit of the shareholders. Professor
23 Dworkin appears to be suggesting that this premise can be altered by adopting
24 recommended language when he states that "making the [public good] purpose explicit is
25 important in order to make clear that the fiduciary duties of the Directors include
26 consideration of that factor." (Testimony of Michael Dworkin, pg. 32, lines 19-21.) It is

1 my understanding, however, that you cannot legally change directors' fiduciary duties
2 just by including language in governing documents that purports to do so. There must be
3 some authority in the law, and, as I explain in further detail below, I believe that authority
4 does not exist for VELCO as it is currently organized.

5 Some states, such as Pennsylvania, include what is often referred to as "other
6 constituencies" provisions, which *allow* directors to consider interests other than
7 shareholder interests in certain contexts without the directors violating their fiduciary
8 duties to shareholders (e.g., in the mergers and acquisitions context). Except with respect
9 to "benefit corporations" (which are sometimes called "B" corporations), I am not aware
10 of any provisions of V.S.A Title 11A that would appear to allow VELCO directors to
11 consider the interests of "other constituencies" in fulfilling their fiduciary duties. In
12 Vermont, only directors of companies with voting stock registered under section 12 of the
13 Securities Exchange Act are authorized to consider "other constituencies" when making
14 board decisions. Nothing in Title 11A authorizes a privately held Vermont for-profit
15 corporation organized other than as a benefit corporation (which is sometimes called a
16 "B" corporation) to include such a provision in its governing documents.

17 Other states, including Vermont, have adopted separate statutes governing "B"
18 corporations, which are for-profit corporations that are permitted by the statute to include
19 provisions in their governing documents allowing or requiring directors to consider
20 interests other than shareholder interests when exercising their fiduciary duties. The fact
21 that Vermont and other states have deemed it necessary to adopt specific statutory
22 provisions permitting corporations to adopt this alternative form of corporate structure
23 and alternative governing documents provisions so as to allow or require directors to

1 consider non-shareholder interests strongly suggests that the lawmakers believe that the
2 ability of directors to consider non-shareholder interests in fulfilling their fiduciary duties
3 is substantially in doubt in the absence of the legislature adopting such specific
4 empowering statutory provisions. If that is the case, then the provisions Professor
5 Dworkin suggests for adoption by VELCO are likely to put VELCO's directors in a very
6 difficult position – if it is unclear whether or not the provisions are valid, how should the
7 directors act and what protections do they have if they act in accordance with VELCO's
8 governing documents but those governing documents contain provisions that are invalid
9 as a matter of Vermont law. VELCO must be able to maintain or obtain directors' and
10 officers' liability insurance however, given that uncertainty, securing the insurance may
11 be problematic. Additionally, VELCO must be able to make standard representations and
12 warranties in their contracts regarding appropriate board approval of company actions.

13
14 Q. What are your views regarding Professor Dworkin's suggestion that restructuring
15 VELCO as a "B" Corporation be given consideration if his other governance
16 recommendations are not implemented? What about Professor Dworkin's
17 recommendations with respect to an L3C corporate structure?

18 A. Initially, I would note that Professor Dworkin's recommendations, and in particular his
19 recommendation that VELCO's governing documents include "good of the State"
20 purposes, clearly contemplates imposing on VELCO key characteristics of "B"
21 corporations without actually requiring VELCO to go through the corporate steps (i.e.,

1 approval by the majority of shareholders, rather than simply some agreement by one or
2 two shareholders) necessary to change the company so fundamentally.

3 As I discuss earlier in my testimony, I believe that significant changes to
4 VELCO's governance structure that are likely to change its fundamental purpose as a for-
5 profit, but closely regulated, business will likely cause adverse economic consequences
6 for VELCO, its shareholders and Vermont citizens who rely on VELCO for transmission
7 services. I believe that "B" corporations are an interesting concept and may be a viable
8 choice for *de novo* corporations whose investors, at the outset, understand that their
9 expected returns will likely be affected by that choice of corporate structure. However,
10 imposing such a fundamental change on VELCO's shareholders and investors is not
11 warranted when there are less intrusive, readily available and widely accepted means to
12 address the "tyranny of the majority" issues.

13 In addition, I note that Professor Dworkin's testimony appears to be somewhat
14 inconsistent on this matter. In his remarks regarding other possible corporate structures,
15 he clearly states his conclusion that "an L3C corporate structure would not be suitable"
16 (Testimony of Michael Dworkin, pg. 26, lines 7-9) and goes on to explain that the L3C
17 structure "is largely aimed at allowing the deliberate attraction of capital from investors
18 who knowingly will accept lower returns in order to pursue a socially beneficial
19 purpose." (Testimony of Michael Dworkin, pg. 26, lines 12-13.) He also explains that
20 this approach "requires many special technical elements about notice to investors and
21 internal deliberations that might, collectively, make it less efficient for VELCO to either
22 attract capital or to implement operational decisions swiftly." (Testimony of Michael
23 Dworkin, pg. 26, lines 12-13.) But Professor Dworkin's governance recommendations –

1 from the “general good” directors, to the “good of the state” charter provisions, to the
2 concept that certain directors would owe duties to certain constituencies over others – not
3 only reflect many of the underlying tenets of the “B” corporation and the L3C corporate
4 structure approaches that he purportedly rejects, they actually exaggerate the concept and
5 attempt to move the company further away from a for-profit corporation operating in a
6 highly regulated environment. Also in my view, adopting Professor Dworkin’s
7 recommended approach will result in lower returns to the detriment of ratepayers, create
8 disincentives for existing or new investors to contribute capital, and fundamentally
9 interfere with VELCO’s ability to implement operational decisions in a manner
10 consistent with good operating practices.

11
12 Q. Professor Dworkin suggests that in the future a politically appointed state committee
13 select a significant percentage of the board of directors. Is this an appropriate role for
14 government in a privately held company?

15 A. No, it adds an element of uncertainty that the entire regulatory system is designed to
16 prevent and ignores the fact that this is not a state-owned entity. Furthermore, it creates
17 an inherent tension on the board itself. Professor Dworkin expresses concern that “a
18 fiduciary duty to investors means that considerations of the general good might not play a
19 role in decision making by the VELCO board.” (Testimony of Michael Dworkin, pg. 25,
20 line 9), which, of course, ignores the effect of the Federal and Vermont regulatory
21 regimes on VELCO’s operations and the board’s decision-making. It would seem that
22 Professor Dworkin’s proposal for different classes of directors would also suggest

1 different standards of fiduciary responsibility and different fiduciary constituencies --
2 shareholders and non-shareholders. That is a double standard that is not recognized
3 anywhere. According the NACD, “The board’s fiduciary responsibility is long-term
4 value creation for the corporation; governance form and processes should follow.”³⁹
5 There is no other definition. Board members cannot legitimately serve under two
6 different regimes and two different masters.

7 Boards function best when each director shares the vision and strategy of the
8 company as is the case with VELCO currently. Professor Dworkin’s proposal would
9 render that impossible. There would appear to be two sets of directors with entirely
10 different sets of responsibilities and loyalties. This could potentially make the board
11 unable to undertake the simplest of actions or perhaps make them unable to be insulated
12 from liability.

13
14 Q. How would the proposal affect the relationship between the board and the management?

15 A. Under the proposal as described, the responsibilities between “general good directors”
16 and management would be blurred, rather than enjoying the distinct roles that are the
17 hallmark of a successful company. Ignoring the commonly held principle that the board
18 of directors exists to “oversee” management, not to interfere with the day-to-day
19 decisions affecting a company, the proposal actually suggests, “An alternative plan that
20 places sufficient management voice in those [general good directors] whose interests are
21 aligned with the public’s...” (Testimony of Michael Dworkin, pg. 19 of 40, lines 13-14)

³⁹ NACD. “Key Agreed Principles to Strengthen Corporate Governance.” January 1, 2009.

1 Board members, regardless of their experience, are not equipped nor expected to
2 play a management function. Moreover, giving some class of board members (“general
3 good”) more authority than others and different goals is a recipe for disaster. Under this
4 scenario, boardroom dynamics are, at best, likely to be fraught with tension, as would be
5 the relationship between and among the board members and management. It would
6 certainly create challenges for the attraction and retention of qualified managerial talent.
7 It is also likely that Director’s and Officer’s insurance would be difficult if not impossible
8 to obtain (or, perhaps worse, impossible to collect on in the event of a claim).

9
10 Q. What are the other risks of the changes contained in this proposal?

11 A. As discussed, the governance model advanced by Professor Dworkin is contrary to more
12 recent governance recommendations advanced by regulators and financial institutions
13 with governance concerns. His proposal would increase the risk profile of the company
14 with the likely outcome of a negative impact on ratepayers and the State of Vermont

15 Professor Dworkin’s proposal also has greater ramifications. It suggests, in spite
16 of significant evidence to the contrary, that the current regulatory system is broken or, at
17 least, that the proposed merger would somehow render that system ineffectual. It ignores
18 VELCO’s strong historical operating and financial performance under the existing
19 regulatory scheme and the lack of fundamental problems that have occurred during the
20 55-plus years VELCO has been operating -- all of which would suggest that the
21 combination of VELCO’s governance practices and the regulatory protections outlined in
22 Section I have served VELCO’s shareholders, Vermont and Vermont’s citizens well.

1 Instead, Professor Dworkin’s recommendations would impose a political process
2 on top of (or possibly in substitution for) the regulatory process. The impact of this
3 exposes VELCO and its ratepayers to the increased costs of uncertainty. It also may well
4 expose the State of Vermont to credit and liability risk if it controls the selection of
5 members of the board, as the state becomes a potential “deep pocket” in any adverse
6 litigation.

7 The proposal explores and rejects the concept of state ownership, correctly
8 acknowledging the property rights of the Fifth Amendment to the Constitution under
9 which the federal government may not take a private asset without adequate and just
10 “compensation.” And yet, his plan of restructuring the board of VELCO with political
11 appointees in the majority and repurposing of the privately held assets to a new and
12 undefined standard would seem to do exactly that. It also does not solve the simple
13 problem this merger causes— how to manage disproportionate ownership.

14
15 Q. Do you believe that the changes proposed to the governance structure of VELCO would
16 adversely impact its ability to maintain its good credit rating? How does this affect
17 DPS’s goal in promoting the public interest?

18 A. I do believe that the proposed changes to the governance of VELCO would change the
19 credit rating outlook for the company, which would adversely affect shareholders and
20 ratepayers alike. The proposed governance regime, which is so drastically different from
21 any other regulatory schematic I have seen, in all probability lowers the ceiling of
22 profitably and could eliminate the floor and any associated stability. Ignoring credit and

1 financial rules not only does not solve the problem, it creates a myriad of new ones,
2 including the risk of financial failures.

3 Credit rating agency DBRS reiterates that regulatory and contextual factors are
4 key considerations in evaluating credit worthiness. It expands that discussion: “Energy
5 utilities typically operate under a methodology in which the regulator determines an
6 appropriate capital structure for the regulated utility and defines the allowed ROE; these
7 are two of the variables (along with depreciation expense, operating and maintenance
8 costs, interest expense, taxes, etc.) which go into building up a utilities revenue
9 requirement through a “bottom-up” approach”⁴⁰

10 It would appear that Professor Dworkin’s proposal as put forth by DPS would
11 render the current evaluation methodology obsolete. Under Professor Dworkin’s scheme,
12 capital allocation and planning would all be controlled by subjective, ephemeral, and
13 politically influenced policies. Whether this or any other rating agency or financial
14 institution would accept a new paradigm for the utility industry is highly unlikely given
15 the importance of “stability.” It is certainly a tremendous unknown that would
16 undoubtedly erode the credit profile in the interim and in all likelihood the long term.

17 What does the devaluation of creditworthiness mean for a utility? Instability in
18 ratings can potentially affect the ability of VELCO to serve the public interest. Public
19 interest may be generally defined in business as, “Welfare of the general public (in
20 contrast to the selfish interest of a person, group, or firm) in which the whole society has
21 a stake and which warrants recognition, promotion, and protection by the government and

⁴⁰ Ibid.

1 its agencies.... It is approximated by comparing expected gains and potential costs or
2 losses associated with a decision, policy, program, or project.”⁴¹ The Vermont
3 Department of Public Service defines the primary goal of “public interest” as it relates to
4 utilities as, “Secur[ing] the lowest possible rates for ratepayers.”⁴² However, the
5 definition goes on to state, “What serves the public interest may not be the lowest current
6 rates, but rather rates that assure the safe and reliable provision of adequate service over
7 the long term.”⁴³ Professor Roger Morin states in his report regarding the cost of utility
8 capital,

9 It must be understood that both capital attraction and financial integrity
10 standards must be fulfilled in determining a fair rate of return. Despite a
11 deterioration in credit standing, a utility may be able to attract capital
12 temporarily, but at prohibitive costs and under unfavorable terms.
13 Eventually, the utility will face hard funds rationing and/or the costs of
14 financing will become prohibitive, and the utility cannot longer attract
15 capital at a reasonable price.⁴⁴
16

17 This would obviously impact VELCO’s financing ability for maintenance and expansion
18 of power lines for reliability purposes and in response to NERC obligations. If this

⁴¹ Rating Companies in the North American Energy Utilities (Electric and Natural Gas) Industry. May 2011, p.9.

⁴²The Concept of "The Public Interest" as defined by <http://publicservice.vermont.gov/divisions/public-advocacy.html> : “ The Public Advocate’s charge to serve the public interest is broadly understood to mean the long term interest of all Vermonters in reliable, environmentally and economically sound provision of utility services. A primary concern is to secure the lowest possible rates for ratepayers. The public interest, however, encompasses not only the interests of ratepayers, but all parties affected by utility operations, including other consumers, business and industry, and the state as a whole. What serves the public interest may not be the lowest current rates, but rather rates that assure the safe and reliable provision of adequate service over the long term.”

⁴³ Ibid.

⁴⁴ Morin, R.A., Regulatory Finance: Utilities’ Cost of Capital, Public Utilities Reports, Inc., Arlington, Virginia (1994), pg. 12.

1 should happen, a favorable interest rates on bonds, due to rating instability, which
2 VELCO may need to continue serve the Vermont ratepayers public interest, would be
3 jeopardized by Professor Dworkin's proposal.
4

5 Q. What are the possible governance approaches not addressed by Professor Dworkin that
6 you suggest for consideration?

7 A. I suggest considering approaches that address the specific issues created by the proposed
8 merger, with particular focus on the potential "tyranny of the majority," but that address
9 those issues in the least intrusive manner possible so as not to change VELCO's
10 governance in potentially damaging ways. These approaches represent generally
11 accepted and commonly used techniques to address this type of situation and do not
12 fundamentally alter VELCO's existing for-profit structure, its existing legally-imposed
13 obligations to Vermont citizens and its existing approach to financing, operations and
14 management.

15 These approaches include the adoption of certain voting mechanisms at both the
16 board level and the shareholder level designed to ensure that the minority has a voice in
17 important decision-making at both levels and changes to the board of directors, in both
18 the composition of the board and in the way independent directors are selected.
19

20 Q. Please describe the shareholder voting mechanism.
21

22 A. Companies facing "tyranny of the majority" issues often alter their governing documents
23 and institute voting agreements among shareholders that provide for one of two different

1 types of voting mechanisms designed to ensure that the minority has a voice in important
2 decision-making at the shareholder level. These mechanisms are commonly referred to as
3 “supermajority” voting provisions and “majority of the minority” voting provisions. Both
4 the “supermajority” and “majority of the minority” voting mechanisms are widely used,
5 particularly in companies that are not publicly traded and have a small number of
6 shareholders with one shareholder owning a dominant equity position. It is important to
7 note that because “tyranny of the majority” issues impact both shareholder interactions
8 and board of directors interactions, the common approach is to adopt changes to the
9 board structure and governance as well as one of these shareholder voting mechanisms.

10 Supermajority voting provisions are designed to prevent a dominant shareholder
11 from controlling every shareholder vote by requiring a high percentage threshold (greater
12 than a majority and greater than the dominant shareholder’s ownership percentage) to
13 approve certain agreed-upon matters that require shareholder action either under state law
14 or the company’s governing documents. In VELCO’s case, for example, if GMP’s post-
15 merger ownership will be 70%, a vote of not less than 75% might be required to approve
16 certain matters submitted for shareholder approval. Matters that are often subject to
17 “supermajority” voting include dilutive capital raising transactions, mergers and
18 acquisitions, and purchases and sales of significant assets.

19 A second approach that companies use is often referred to as “majority of the
20 minority” voting. Under this approach, two separate approvals are required for certain
21 matters submitted for shareholder approval. The first shareholder approval would consist
22 of a straight majority vote of all shareholders, while the second approval would require a
23 “majority of the minority” vote – meaning that a majority of the shareholders other than

1 the majority/dominant shareholder would be required to approve those matters. In
2 VELCO's case, for example, if GMP's post-merger ownership will be 70%, then under a
3 "majority of minority" mechanism a majority vote of all VELCO shareholders (including
4 GMP) plus a majority vote of the 30% of the shares not held by GMP would be required
5 to approve certain matters.

6
7 Q. Please describe the alternative board of directors composition and election approaches
8 and the board voting mechanism.

9 A. Companies facing "tyranny of the majority" issues also often alter their board
10 composition and governance to ensure that the directors not affiliated with the dominant
11 shareholder have a voice in important decision-making at the board of directors level.
12 The most straightforward and widely-used approach is to implement a board comprised
13 on a majority of independent directors. In addition, the standards for "independence" are
14 usually the more exacting standards now used by public companies in determining
15 independence, and candidates for those director positions are identified and vetted by an
16 outside professional search firm specializing in such searches, based on criteria
17 established by a board Nominating Committee comprised of independent directors. The
18 search firm performs background checks on and interviews potential directors and
19 presents a slate of candidates to the Nominating Committee, which makes
20 recommendations to the board. The board, in turn, presents a slate of candidates to the
21 shareholders for election. This has become the standard approach used by thousands of
22 U.S. public companies and has led to substantially improved governance practices in
23 public companies and private companies alike.

1 Assuming the establishment of a majority-independent board for VELCO, a
2 structure that provides for a designee of each of BED, VEC and VPPSA would make
3 sense, as does allowing GMP, as the majority shareholder, to have more than one director
4 designee, as it is common for key shareholders of private companies to be able to
5 designate certain directors. Having the VELCO CEO be a member of the Board would
6 also be the typical approach.

7 In addition to this composition of the board, it is common to implement a voting
8 mechanism that would require a majority vote of the independent directors to approve
9 certain matters, such as the annual budget, capital raising transactions, mergers and
10 acquisitions, purchases and sales of significant assets, management compensation and
11 management hiring/termination decisions. This type of board structure and board voting
12 mechanism ensure that the independent directors would be able to exert significant
13 influence over the board's agenda and decision-making. In addition, by establishing an
14 "independence" determination and nomination process that is largely free from the
15 influence of the majority shareholder, the independent directors are much more likely to
16 act in a truly independent manner.

17 One common consequence of requiring a majority-independent board is that the
18 board size can become rather large if key shareholders desire to maintain their right to
19 designate directors. An approach that can be used to address this issue is to not require a
20 majority of the directors to be independent, but to require the majority approval of the
21 independent directors to take most board actions.

1 Q. Do you have any other observations that are important to consider regarding this
2 transaction?

3 A. Not at this time.

4