

STATE OF VERMONT
PUBLIC SERVICE BOARD

Joint Petition of Central Vermont Public Service)
Corporation, Danaus Vermont Corp., Northern)
New England Energy Corporation for itself and)
as agent for Gaz Métro Limited Partnership and)
Its parents, Green Mountain Power Corporation)
and Vermont Low Income Trust for Electricity,)
Inc. for approval of: (1) the merger of Danaus)
into and with Central Vermont, (2) the acquisition)
by Northern New England of the common stock of)
Central Vermont, (3) the amendment to Central)
Vermont 's Articles of Association, (4) the merger)
of Central Vermont into and with Green)
Mountain, and (5) the acquisition by VLITE)
of a controlling interest in Vermont Electric)
Power Company, Inc.)

DOCKET NO. 7770

**PREFILED TESTIMONY OF
MICHAEL H. DWORKIN
ON BEHALF OF
THE DEPARTMENT OF PUBLIC SERVICE**

January 10, 2011

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I. QUALIFICATIONS

Q. Please state your name, Occupation and Address.

A. My name is Michael Dworkin and I am Professor of Law at Vermont Law School where I direct the Institute for Energy and the Environment. However, I should make clear that this testimony is my own and that neither that Institute nor the Vermont Law School are responsible for my testimony; indeed, to the best of my knowledge, neither has any position on the matters raised by this proceeding. My home address is 385 Powderhorn Glen Road, Montpelier, Vermont

Q. Please outline your educational background.

A. In 1975, I graduated from Middlebury College, where I majored in history and political science. In 1978, I graduated from the Harvard Law School , where I focused on administrative law, federal pre-emption, and civil procedure.

Q. Please state your employment history and professional experience.

A. In 1978 and 1979, I was a law clerk for Judge Catherine Kelly of the District of Columbia Court of Appeals. From 1979 to 1984, I was regulatory counsel and appellate litigator for the U.S. Environmental

1 Protection Agency. From 1984 to 1995, I was counsel, hearing officer,
2 and general counsel for the Vermont Public Service Board. From 1995 to
3 1999, I was a management partner for Riser Management Systems (a
4 venture-capital telecommunications engineering and consulting firm).
5 From 1999 to 2005, I was Chairman of the Vermont Public Service Board.
6 From 2005 until now, I have been Professor of Law and Director of the
7 Institute for Energy and the Environment at Vermont Law School.

8
9 Q. Please describe some of your other professional activities.

10 A. During my tenure as Chairman of the Public Service Board, I also served
11 as President of the New England Conference of Public Utility
12 Commissioners; as a member of the Board of Directors of the National
13 Association of Utility Regulatory Utility Commissioners (NARUC), and
14 served as Chairman of the NARUC Committee on Energy Resources and
15 the Environment. In addition, I was significantly involved in the
16 restructuring of the Independent System Operator of New England (the
17 ISO-NE), an experience that strongly affected the article I co-authored on
18 that topic in Energy Law Journal in the Fall of 2007.

19 In the years since 2005 I have also served on the Boards of Directors of:

- 20 - the American Council for an Energy Efficient Economy (ACEEE),
21 - the Vermont Energy Investment Corporation (VEIC), where I still serve

1 in an unpaid capacity, and
2 - the Electric Power Research Institute (EPRI), where I served six years as a
3 Director and four years as the only non-utility member on the Executive
4 Committee of EPRI's Board of Directors, finishing my term last fall.
5

6 **II. OVERVIEW OF TESTIMONY**

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

8 A. I am presenting testimony in this proceeding on behalf of the Vermont
9 Department of Public Service.

10 Q. Why have you created today's testimony?

11 A. I have created today's testimony for several reasons: I am a Vermonter
12 who cares deeply about the future of our State, I have considerable
13 professional experience with related matters, and have cared enough about
14 them to publish on governance issues involving other transmission
15 organizations, I have been asked to testify by the Vermont Department of
16 Public Service, regarding corporate governance and control issues raised
17 by the merger, and I hope that my testimony will aid the Public Service
18 Board in its consideration of the petition in this proceeding.

19 Q. Please summarize your testimony.

1 A. My testimony addresses governance, accountability, and ownership issues
2 relating to the Vermont Electric Power Company (generally referred to as
3 VELCO) and VT TRANSCO LLC, the affiliate for which it performs
4 management services (generally referred to as “Transco”). I first briefly
5 review the context and the substance of the pending proposal for
6 governance of VELCO and Transco. Secondly, I outline some concerns
7 about the Petitioners’ proposed changes to both the structure and the
8 substance of VELCO governance. Thirdly, I review a range of options for
9 addressing those concerns, ranging from leaving the present system in
10 place to a State takeover of VELCO. Finally, I conclude that the general
11 good of the State would be better served if the Petitioners were required to
12 modify their proposal in several ways. In some of those instances, I
13 suggest both a general principle and at least one specific application of
14 that principle. Of course, as this is my initial testimony, the general
15 principles are paramount, and there may be multiple specific ways to
16 fulfill them, including the proposals contained herein.

17
18 My most important conclusions are:

- 19 1. That Vermont’s electricity transmission system is extremely difficult to
20 bypass and has highly significant effects, not just upon those that buy and
21 sell upon the system, but also upon those that are served by it, and upon
22 those that live around it;

- 1 2. That actual or de facto majority control of those ‘bottleneck’ facilities,
2 even in a highly regulated system, creates a risk of unhealthy market
3 power or of limited recognition of options, alternatives, or concerns of
4 others; and
- 5 3. That the merger proposed by Petitioners, as it relates to the transmission
6 system, will be consistent with the general good of the State if structural
7 measures are put in place to ensure, on an ongoing basis, explicit
8 consideration of the general good of the State in the management of
9 Transco’s assets by VELCO or its successors; and
- 10 4. That an appropriate way to ensure such a consideration of the general
11 good, described in further detail in my testimony, is to:
- 12 - Ensure that the public interest is represented on VELCO Board of Directors
13 through establishment of what I call “General Good Directors” on the Board;
14
- 15 - Ensure that the General Good seats retain their ratio of influence even if
16 further acquisitions occur, and ensure that interests represented on the
17 VELCO Board remain the manager of TRANSCO and its activities by making
18 any necessary structural changes to the corporate structure and/or governance
19 of VELCO and Transco;
20
- 21 - Ensure that General Good Directors of the VELCO Board have sufficient
22 authority to assure that VELCO and Transco operate in the interest of
23 Vermont ratepayers;¹
24
- 25 - Formalize the structure of the VELCO Board, now undefined in the bylaws, to
26 address the representation of all seats, and consider the option of providing
27 currently unrepresented Public Power a seat on the Board to be selected by
28 those public power utilities;
29

¹ It is important to note that my focus is on corporate governance issues, not on the specific corporate form that should be used to further the principle that there be “General Good” seats on the VELCO Board.

- 1 - Ensure that the \$1 Million of annual low-income benefits referred to in
2 Petitioners' proposal flows to low income Vermonters in a manner consistent
3 with VELCO's obligation to promote the general good;
4
5 - In addition to the evergreen provisions on the General Good ratio of
6 representation and VELCO management control noted above, consideration
7 should be given to providing that the State may participate in the ownership of
8 the transmission assets in the event of any further acquisition of distribution
9 utilities or material change in the upstream ownership structure of the
10 Petitioners' proposed Company, perhaps in the form of a right of first refusal
11 triggered by such an event.
12
13 Q. How have you structured your testimony?
14 A. I have structured my testimony as follows:
15 1. Background;
16 2. Overview;
17 3. Context, including existing regulation and preclusions on transmission
18 ownership (sometimes called 'structural separations') in many states
19 and the current structure of the VELCO/Transco relationship;
20 4. The substance of Petitioners' proposal ;
21 5. Concerns regarding the Petitioners' proposal;
22 6. A range of options/modifications considered;
23 7. Recommendations; and
24 8. Conclusions.
25

26 III. CONTEXT

- 27 Q. You said that you would begin by briefly reviewing the context and

1 background of the pending proposal for governance of VELCO and Transco.

2 Please do so.

3 A. Throughout the United States, most utilities that serve retail customers must
4 obtain their electricity through transmission lines that they do not own. In
5 many cases, those transmission lines are owned by other utilities with which
6 they compete or by some, but not all, of the generators from which they may
7 seek to purchase power. Because of the economics of bulk transmission and
8 the difficulties of siting new transmission lines, it is very difficult for retail
9 utilities or retail customers to bypass the existing bulk transmission lines, or to
10 find alternatives to using them. Thus, the owners and managers of those
11 transmission lines can wield great economic and operational influence over
12 those that need their services for purchases or sales, as well as over those
13 seeking to connect new facilities or to promote alternative locations for siting.
14 This power is referred to in various ways, but typical terms include "essential
15 facilities" or "wires industries" or "monopoly bottlenecks." See, for example,
16 Felix Hoffler & Sebastian Kranz, *Imperfect Legal Unbundling of Monopolistic*
17 *Bottlenecks*, Bonn Econ Discussion Paper No. 16/2007 (2007); *Deregulatory*
18 *takings and the regulatory contract : the competitive transformation of*
19 *network industries in the United States*, J. Gregory Sidak; Daniel F Spulber,
20 Cambridge University Press, (1998); Jean-Jacques Laffont, Idei Gremaq, Jean
21 Tirole and Idei Geras, *Creating competition through interconnection: Theory*
22 *and Practice*, Journal of Regulatory Economics; 10:227-256 (1996); Alfred

1 E. Kahn & William Taylor, *The Pricing of Inputs sold to Competitors: A*
2 *Comment* 11 Yale J. on Reg. 171, 225 (1994).

3
4 This pattern also applies to all Vermont utilities seeking to buy power from
5 outside the State and to most utilities seeking to buy power from within
6 Vermont. Indeed, this system has applied for a century to some degree, since
7 electrification started. It approached its current form in the mid 1950's, when
8 VELCO was formed, in 1956, as a "State-wide transmission-only company to
9 consolidate in a single entity the ownership and operation of all of the major
10 transmission facilities in Vermont (i.e., transmission facilities operating at 115
11 kV and above)." (Petitioners' FERC Merger application at page 8).

12
13 The impetus for VELCO's formation may have been largely to coordinate the
14 transmission needs and bargaining opportunities for all Vermont utilities as
15 they sought to make bulk purchases from the emerging, federally-sponsored,
16 Niagara Power hydro projects. However, the institution clearly was valuable
17 for the State as a whole on an ongoing basis. In the half century since then,
18 the VELCO system has changed in some ways, including a 2006 separation of
19 financial aspects of ownership (lodged in Transco) from management and
20 control rights (lodged in VELCO and its Board). However -- and vitally -- the
21 core concept has remained constant and fundamental: *a state-wide*
22 *transmission entity, uncontrolled by any single company and operating under*

1 *a certificate of public good issued under the ‘general good of the State’*
2 *provisions of Title 30.*

3
4 Vermont’s high voltage electric transmission network is owned by Transco
5 and managed and operated by VELCO. VELCO is Vermont’s statewide
6 electric transmission-only company that is jointly owned by all Vermont
7 electric utilities, including CVPS, GMP, municipal distribution systems and
8 cooperatives. CVPS owns 48.5% of VELCO and GMP owns 29.5%, with
9 slightly smaller percentages of Transco ownership (41.2% and 31.1%
10 respectively, including indirect ownership through VELCO). Thus, the
11 Combined Company’s post-merger ownership share of Transco and, absent
12 changes to current structures, of VELCO would be 72.3% and 78%
13 respectively.

14
15 In the absence of any other outcome through this merger docket, the
16 Combined Company would own more than 70% of Transco and exert
17 effective control of management decisions and on the VELCO Board. This
18 would be a radical change from the existing balance of power over Vermont’s
19 electricity grid. In today’s framework, each retail customer in the State of
20 Vermont receives electricity from one of 18 utilities. In one sense, those
21 utilities do not compete with each other, because each has its own exclusive
22 territory. However, they do compete with each other in some important ways,

1 including discussions with potential new customers, potentially departing
2 customers, some power purchase agreements with generators, and in the
3 loosely defined sense of “yard-stick competition,” i.e. comparative practices
4 and rates, used to justify the quality of their decision-making and prospects.
5 And, each of those utilities relies upon VELCO-operated transmission lines to
6 carry most of the power that it ultimately delivers to its customers, both
7 wholesale and retail. The cost, design, and timing of transmission line
8 approval and construction means that the managers of the VELCO system
9 have an economic and operational power vitally affecting those that buy and
10 sell electricity throughout Vermont.

11
12 This situation is paralleled on the regional level within New England and on a
13 national level between and among other states across America. Indeed, many
14 American states have passed laws “restructuring” the vertically-integrated
15 electric industry. Such laws often prohibit utilities that own generating plants
16 from also managing transmission lines that serve both themselves and other
17 utilities.

18

1 For these fundamental reasons, electrical transmission has been recognized for
2 many decades as deeply “affected with the public interest”² and it has
3 consistently been the subject of close regulatory and statutory scrutiny. This
4 has become increasingly true in the decade since the end of the last century.
5 The most important reason for increased regulatory oversight may well be in
6 the area labeled reliability concerns. The bombing of the World Trade Center
7 in 2001 highlighted the significance of reliability and infrastructure risks, but
8 reliability problems also exist even when no evil intent is evident. This was
9 made obvious at a regional level in the 2003 summer electricity blackout,
10 which led to a loss of electricity by almost 50 million Americans for almost 4
11 days.

12
13 A direct result of the 2003 blackout was the passage of the Energy Policy Act
14 of 2005, which included provisions authorizing the Federal Energy Regulatory
15 Commission (FERC) to impose mandatory criteria for reliability. In the
16 following years the FERC delegated that authority to the North American
17 Electric Reliability Corporation (NERC). NERC, in turn, set standards for
18 reliability by the regional transmission organizations, including the ISO-New
19 England. ISO-New England in turn imposed those constraints or reliability
20 requirements upon regional groups such as VELCO.

² “Affected with the public interest” is the phrase that has been used by the U.S. Supreme Court since the 1870s to describe the situations where private property can be regulated so as to serve the general good. *See, e.g., Munn vs Illinois*, 94 U.S. 113, 126 (1877).

1 VELCO, thus, must comply with reliability criteria specified by the ISO-New
2 England pursuant to authority delegated by NERC which itself received that
3 authority from the FERC under federal statutes. Those reliability criteria are
4 now mandatory and carry significant daily penalties for failure to comply.
5 Overall, the federal requirements and regulatory structure are a constraint on
6 what can be done; a risk to the owner and manager of a transmission system;
7 *and* a reason for significant public interest in the management of transmission
8 facilities.

9
10 Transmission facilities in Vermont currently function under two closely
11 related, but legally separate, entities. One, “Transco,” owns the actual
12 transmission assets such as poles, wires and signaling systems. The second,
13 VELCO, is by agreement the manager and operator of Transco’s facilities.³
14 Most indicia of ownership, such as the right to earn a return on investment, lie
15 with Transco and ownership in Transco is essentially proportionate to the
16 investments made by each Vermont utility. Very importantly, ownership
17 shares in, and revenue shares from, Transco will be diluted if calls for capital
18 investments are not met in the same ratios. In contrast, all managerial
19 decisions about the operations of the system are made by VELCO, pursuant to
20 its management contract with Transco. Significantly, as presently set forth in

³ A third company, VETCO, was created by Vermont utilities “to finance, construct, and operate the Vermont portion of the 450 kV DC transmission line (the Hydro-Québec Phase I and II line) connecting Québec and New England.” FERC Merger Application at 9.

1 the bylaws, membership seats on VELCO's Board of Directors are not related
2 to ownership shares in Transco; instead, there are no criteria in the bylaws
3 regarding Board seat allocation and by voluntary practice they have been
4 assigned roughly – very roughly – proportionate to ownership shares, but are
5 consciously designed to give several smaller Vermont utilities a presence
6 somewhat great than their actual investment shares.⁴ In addition, by practice
7 the VELCO Board currently includes three non-utility members who are
8 commonly referred to as “Independent Members,” although their
9 independence is limited by the fact that they are chosen by, and serve at the
10 pleasure of, the utility members of the VELCO Board.

11
12 It is also very important to recognize how the current system treats the net
13 earnings of Transco. Those earnings can be significant since their primary
14 source is a tariff for wholesale services filed at the FERC, which authorizes
15 returns of up to 14% (or more if tax-affected) on equity in a conscious effort
16 to attract investments in transmission infrastructure. (FERC, not the states,
17 sets transmission rates of return and approves transmission tariffs.)

18

⁴ The specific portions are set out in the Petitioners' Merger Application, filed at the FERC. They indicate that Green Mountain Power and Central Vermont Public service currently own 29.5% and 48.5%, respectively, of VELCO. In contrast, they own (directly or indirectly) 31.1% and 41.2%, respectively, of Transco. The companies also own dominant shares in VETCO, “which was formed to finance, construct, and operate the Vermont portion of the 450 kV DC transmission line (the Hydro-Québec Phase I and II line) connecting Québec and New England.” FERC Merger Application at 9.

1 As a first step, because Transco is wholly owned by Vermont utilities, all of
2 its net earnings flow to those Vermont utilities.⁵ The next step is critical,
3 though often under-recognized: *the Vermont utilities that receive Transco*
4 *earnings use those earnings to reduce the costs that they would otherwise*
5 *have to collect from Vermont retail customers.* In other words, Transco's net
6 earnings currently allow Vermont's retail customers to pay lower electricity
7 bills than they would if Transco's net revenues were lower or were not
8 distributed to retail utilities in Vermont. I understand that Department
9 Witness Sean Foley will present testimony quantifying this amount as in the
10 range 3-4% of current retail rates.

11
12 Importantly, financial support for retail customers is not the only reason that
13 the VELCO/Transco system matters to both its direct users and also to the
14 general good of the State around it. Its operations and managerial decisions
15 also have major effects on:

- 16 - the environment, land-use and aesthetics, where VELCO's managerial
17 decisions often set the stage for major construction and where its
18 testimony is often crucial under 30 V.S.A Sec 248 -- both for its own
19 projects and for projects proposed by others and, importantly, where the
20 threat or use of eminent domain proceedings to condemn private land has
21 been vital to the creation of the electricity grid and has consistently been
22 justified by appeals to the general good of the State;
23

⁵ Many of these costs are charged to Vermont utilities which pass them on to their customers; however, Transco receives additional revenues from non-Vermont utilities that use its facilities to transmit electricity through Vermont and/or to send power to or from Vermont utility buyers or sellers.

- 1 - the interface with ISO-NE, where VELCO, in practice, operates as the
2 primary way in which the Vermont utilities (with a cumulative total of
3 roughly 4% of New England's demand) are able to have a meaningful
4 "seat at the table" for many decisions that strongly affect all Vermonters;
5
- 6 - interconnection decisions, which set out the criteria for, and costs charged
7 to, new additions to the electricity grid; and
8
- 9 - planning decisions that gather, shape and present the data and
10 recommendations that almost all others rely upon to predict, prepare for,
11 and influence Vermont's energy future. Examples of this include
12 efficiency forecasting, geotargeting, and transmission infrastructure
13 decisions that may impact other State priorities, such as preparation for
14 varying rates of transition to plug-in electric vehicles, a key part of the
15 Comprehensive Energy Plan's strategy for meeting the green-house-gas
16 (GHG) emission standards set out by Vermont's legislature;
17
- 18 - operational control of which power plants and which transmission lines
19 are turned on, turned off, or scheduled for maintenance. These decisions
20 are vital for reliability purposes under NERC standards, and they can also
21 have make-or-break effects upon end-use customers, especially the non-
22 utility generators and the marginal customers who might come first if
23 load-shedding were required.
24

25 Collectively, these decisions have an extraordinary effect on those who wish
26 to use existing, new, and potential connections to the grid. Also, and because
27 of that, they constrain and shape the emerging transformation to a twenty-
28 first-century energy system. In addition, they affect (and often define) capital
29 calls and expenditures, land use impacts, and the aesthetic and reliability
30 decisions. All have major impacts on both those who use the system and
31 those who do not buy or sell directly on the system, but who have no choice,
32 no "market alternative," to feeling its impacts upon them.
33

1 Q. Would the Petitioners' proposal to divest 33 percent of VELCO to VLITE
2 provide sufficient mitigation to resolve competitive concerns about its
3 potential dominance of Vermont's high voltage transmission?

4 A. No. While this proposed divestiture would reduce the Company's VELCO
5 ownership share from 78 percent to 45 percent, that ownership reduction by
6 itself is not sufficient mitigation, in my view, to adequately rectify the
7 dominance issue in this case. It is a fundamental mitigation principle that in
8 order to be a meaningful merger remedy, any asset divestiture must be
9 expected to resolve the perceived problem that the merger is expected to
10 create. Here, the problem is control over management issues that affect the
11 transmission system, less so than ownership of the system itself.

12 This issue often comes up on terms of anti-trust situations, which are not
13 directly applicable here because VELCO's de-facto monopoly on transmission
14 is legally sanctioned.⁶ However, it also comes up in cases of fair cost-
15 allocation and protection of minority rights in joint ownership situations.

⁶ As noted above, antitrust analyses are not directly relevant; however the comments of the U.S. Department of Justice on those concerns offer some background guidance. Paramount in this regard, the divestiture must be substantial enough to enable other market participants to compete effectively with the merged entity. As the U.S. Department of Justice states in the *Antitrust Division Policy Guide To Merger Remedies*:

...the Division only considers remedies that resolve the competitive problem and effectively preserve competition. As the Supreme Court has stated, "restoring competition is the key to the whole question of antitrust remedy." (at 3)

1 At the present time VELCO's ownership is shared by CVPS (48.5%), GMP
2 (29.5%), Vermont Electric Cooperative (8%), Burlington Electric Department
3 (6%) and 13 other smaller municipal utilities together with Washington
4 Electric Cooperative (combined 8%). These utilities compete with each other
5 to attract loads to their service areas and they sometimes have competing
6 views regarding transmission planning and design and the allocation of
7 transmission facilities costs. With CVPS and GMP each owning relatively
8 large shares of VELCO, there is greater potential for offsetting counterweights
9 on disputed issues than would be the case with CVPS removed from the mix.
10 That is so because, even though VLITE would under Petitioners' proposal
11 own 33 percent of VELCO, VLITE would likely be a more passive owner on
12 some of these contested issues than would other utility owners, in the absence
13 of an order by the Public Service Board putting additional protections in place
14 that fulfill the goals I discuss in this testimony.

15 Another way of thinking about this is to ask, "what is the size of the second
16 largest utility party on the Board?" With an 8 percent share, the Vermont
17 Electric Cooperative would be a much smaller "number two" than GMP is
18 now.

...if a competitive problem exists with a horizontal merger, the typical remedy is to prevent common control over some or all of the assets. (at 5). *Antitrust Division Policy Guide To Merger Remedies*. In this case competition for Vermont's bulk transmission system has never existed and, thus, cannot be "restored."

Nor is there an reasonable prospect that it can be created. However, as analogy, the DOJ guidelines can be helpful if used with caution.

1 Similar concerns arise if one uses the concept of a “pivotal firm” – one whose
2 consent is necessary in order to allow transactions to proceed.⁷ Petitioners’
3 proposal means that the new Company could assemble a majority vote with
4 the assistance of *almost any of many* other firms; in sharp contrast, no other
5 firm could acquire a majority vote without effective unanimity of all non-
6 Company Directors. In fact, if VLITE’s prospective ownership share is
7 passive and transmission ownership dominance becomes measured using only
8 the ownership shares of VELCO’s *operating* utility owners, concentration will
9 be *greater* after the merger and the Company’s 33 percent divestiture.⁸ In
10 view of the fact that the Company’s VELCO divestiture proposal leaves GMP
11 with a larger ownership share than it has now, and very likely would not
12 sufficiently reduce effective post-merger VELCO management dominance, an
13 alternative plan that places sufficient management voice in those whose
14 interests are aligned with the public’s would likely result in more equitable
15 control and direction for statewide transmission decisions (so greatly “affected

⁷ S. Blumsack, Dmitri Perekhodtsev, Lester Lave, *Market power in deregulated wholesale electricity markets: Issues in measurement and the cost mitigation*, The Electricity Journal, vol. 15, issue 9, pp. 1-24 (2002).

⁸ An HHI index is one way of measuring this. That index, although routinely used in anti-trust cases, (which this case is not) is actually a more general measure of concentration and can be used to roughly quantify comparative degrees of concentration before and after key events, such as the proposed merger. In this case, if Petitioners’ scheme were accepted and VLITE’s Board Members were relatively passive, the resulting HHI of 4,876 would be greater than before the merger (HHI = 3,386). I ground my testimony on more general observations and not on arithmetic alone, but it is helpful to know that this kind of quantitative analysis offers a kind of “reality check” confirming my qualitative concerns.

1 with the public interest”) than could be expected with dominance by a single
2 private company.

3

4 **V. CONCERNS WITH PETITIONERS’ PROPOSAL**

5 Q. Would you please address the next element of your outline, which you
6 referred to as your concerns with Petitioners’ proposal?

7 A. I would like to address this in two ways; first by briefly noting the process that
8 lead to my concerns and then by noting the substance of those concerns.

9 Q. Would you, then, outline the process and background that lead to your
10 concerns?

11 A. After the filing of Petitioners’ case, the Department engaged in an extensive
12 outreach process, consulting with numerous stakeholders about the
13 perceptions and concerns about VELCO’s past, present and potential roles.
14 My participation in many of those meetings gave me a chance to refine the
15 thoughts that I already had on governance of transmission organizations.

16 In addition, many of my perceptions about the governance of transmission
17 organizations in general, and of VELCO in particular, are influenced by:

- 18 - my involvement in the formation of the Independent System Operator for
19 New England (the ISO-NE) and its reformation as a Regional
20 Transmission Organization (RTO);
- 21
- 22 - the preparation (with Rachel Goldwasser) of an article published by
23 Energy Law Journal in 2007 upon the governance of Regional

1 Transmission Organizations.

2
3 My thoughts are also informed by my experience on the Boards of Directors
4 of several organizations, including the American Council for an Energy
5 Efficient Economy (ACEEE), the Vermont Energy Investment Corporation
6 (VEIC), and the Electric Power Research Institute (EPRI), where, for several
7 years, I was also the only non-utility member of the Executive Committee of
8 the Board of Directors. In addition, I reviewed a great deal of the voluminous
9 material produced in discovery and otherwise available regarding the issues
10 set forth in my testimony, including the various ownership documents of
11 VELCO and Transco, and the managerial documents such as the Operations
12 Committee manual.

13 Q. What is the substance of your concerns with the Petitioners' proposal?

14 A. The single most important factor here is that whoever manages the unified
15 single-state-wide transmission system can make decisions that affect the
16 general good of the State, including both those that use the system directly
17 and those that are affected by it (See Section III above). Yet, the many
18 Vermont citizens and institutions affected by VELCO's decisions have few
19 meaningful alternatives to living with those effects. This situation has, of
20 course, existed for many years; however, the proposed acquisition and merger
21 greatly exacerbate the underlying issue. Thus, one primary concern is to
22 institutionalize a role for representatives of the general good within VELCO's
23 strategic decision-making process. I want to stress in the strongest possible

1 terms the importance of long-term stability, freedom from short-term political
2 influence and technical competence in those appointments. In regard to these
3 factors, I am influenced by my years of experience as a Public Service Board
4 member, seeing the potential for stability, competence and insulation from
5 day to day politics.

6
7 A second concern is that VELCO's Board be constituted in ways that ensure a
8 long term, institutionalized path for input from a wider world than its utility
9 members alone. In recent years, that role has been filled with some success
10 by the "independent," i.e., non-utility, members of the Board. However, the
11 recent progress in this area needs to be institutionalized, and made less
12 dependent on the annual decisions of the utility members of the VELCO
13 Board. In this context, I am influenced by my experience on the EPRI Board
14 of Directors, seeing many occasions on which the non-utility Board members
15 brought helpful technical competence and wider perspectives to decision-
16 making.

17
18 A third concern is to make sure that the emerging Company does not
19 dominate the Board in ways that are unfair to a set of far smaller utility
20 members. This is particularly important because the smaller utilities are
21 public-power entities, while VELCO's only large member would be the
22 investor-owned Combined Company. In the current arrangement, public-

1 power entities would be able to appeal to either GMP or CVPS if concerned
2 about the positions of the other; however that system of “countervailing
3 powers” would be gone if the Petitioners’ Proposal were accepted.
4

5 I am also concerned by the fact that certificates of public good for VELCO
6 and its affiliates have been granted upon findings that their issuance will
7 promote the general good of the State, yet some have suggested that a
8 fiduciary duty to investors means that considerations of the general good
9 might not play a role in decision-making by the VELCO Board.
10

11 Another theme that I have heard is the potential use of VELCO as a
12 transmission corridor in ways that would hurt Vermont, despite the careful
13 regulatory oversight of transmission siting. There is also some concern that
14 jurisdiction over some transmission transactions might lie with the FERC,
15 rather than the Vermont Public Service Board, thus reducing the ability to be
16 sure that any such proposals are tested against whether they promote the
17 general good of the State. I have, in the past, spoken in favor of the greater
18 social good achieved by using transmission systems to link power generators
19 with users, thus avoiding the need to create redundant power plants. Thus, I
20 am not, per se, opposed to expanded transmission or useful transmission
21 contracts; however I do strongly believe that the citizens of Vermont should
22 have a firm basis for knowing that considerations of the general good were

1 part of the decision-making process about such siting or contracts from their
2 earliest and most formative stages. Thus, public explanation of how
3 VELCO's decisions benefit the general good of the State is a legitimate
4 concern; and neither that nor institutionalized public involvement is explicitly
5 addressed in the Petitioners' proposals.

6
7 I also believe that it is important to ensure not just that the present situation is
8 acceptable, but also to recognize the need for maintaining that acceptability
9 for a long-term future, including situations that might arise for VELCO and
10 Transco if the Petitioners' corporate parents either sold the Company or were
11 themselves acquired.

12
13 Finally, I note a concern related to the Petitioners' proposed annual
14 contribution to low-income users through VLITE. This concern is that the
15 amount be meaningful in the sense that it be supplemental to what would have
16 been provided anyway as a result of other public service board dockets, rather
17 than merely replicating them.

18 **VI. RANGE OF OPTIONS/MODIFICATIONS CONSIDERED**

19 Q. In formulating your recommendations, did you consider alternatives? If
20 so, what were they?

1 A. Yes. I considered several alternatives, along a broad range from
2 acceptance of the Proposal to very different structures. I discuss each of
3 these in the following sections.

4 Q. What are your views on the advisability of leaving the present structure of
5 VELCO in place?

6 A. Given the Petitioners' offer to cede a portion of VELCO control in the
7 public interest and the concerns raised by concentration of power in the
8 Combined Company that otherwise would be present, I do not recommend
9 leaving the present structure of VELCO in place. The current structure
10 appears to be functioning effectively in terms of reliability of service, and
11 many with whom I spoke during this process indicated that VELCO is,
12 today, a well-managed organization that does listen to the concerns of all
13 owners. However, there is in my view a need to institutionalize some of
14 the good practices that have arisen. Moreover, any merger of the interests
15 of VELCO's two largest current members would radically shift the current
16 balance of decision-making in undesirable ways that all parties, including
17 the Petitioners, recognize. In particular, the current structure does not
18 guarantee an opportunity to consider either the concerns or the wisdom of
19 minority owners or of the public generally, who are often affected by
20 VELCO's decisions. The current structure does not provide an assurance
21 that the dominant owner of Transco's assets will be required to consider

1 the concerns of minority owners and to override those concerns only when
2 the general good of the State so requires.

3 Q. Have you considered requiring the formation of VELCO or its affiliates as
4 Low Profit Limited Liability Corporations “L3C” under Vermont’s laws,
5 or as public benefit “B” corporations?

6 A. Yes. I have concluded that an L3C corporate structure would not be
7 suitable. That form of incorporation was authorized recently by
8 Vermont’s legislature and is largely aimed at allowing the deliberate
9 attraction of capital from investors who knowingly will accept lower
10 returns in order to pursue a socially beneficial purpose. It requires many
11 special technical elements about notice to investors and internal
12 deliberations that might, collectively, make it less efficient for VELCO to
13 either attract capital or to implement operational decisions swiftly. In
14 addition, although it does not literally require a commitment to low
15 returns, its title suggests one. To the degree that VELCO’s earnings are
16 contributing to revenue support for Vermont’s retail customers, it seems
17 undesirable to suggest a corporate structure aimed at limiting those
18 earnings.

19
20 I also do not believe it is necessary to structure VELCO as a “B
21 corporation,” although the possibility deserves consideration. In general, I
22 believe that such a restructuring would add to the technical difficulties of

1 operating the company; however I also believe that the clarification of
2 purpose might be of some value. If the purposes of such a structure can be
3 achieved by the other reforms that I suggest, then I do not think the “B
4 corporation” complexities are justified. In their absence, I think such a
5 structure would deserve serious consideration.

6
7 Q. Please describe your views on the option of creating a new Generation and
8 Transmission Cooperative to buy out VELCO and Transco using its own
9 financing and to operate as Vermont’s transmission company in the future.

10 A. I have some sympathy for this option. However I do not believe it to
11 actually be practicable here in Vermont. For one thing, the funding
12 necessary to buy out VELCO and Transco (whether or not VETCO is
13 included) would be extremely large and would require granting strong
14 influence to the relevant lenders, of which the Rural Utility Services might
15 be the most likely. Vermont had a very unpleasant experience with such
16 paths in the course of the Vermont Electric Cooperative’s investment
17 strategies, its creation of a Generation & Transmission affiliate, and its
18 eventual bankruptcy. Even more importantly, the lenders would have to
19 be repaid and the only likely source of such payments that may exceed
20 current debt load of the utilities lies in the net revenues from VELCO and
21 Transco, revenues that are currently being used to reduce retail rates
22 throughout Vermont. It would take a significant level of subsidy or

1 savings to offset the loss of the current revenue distribution from the
2 State's transmission system and I have not seen any evidence that such a
3 project could be put together and created in the near or mid-term future. I
4 would also note that, to the degree that one puts aside technical
5 requirements and thinks of "a cooperative" as "a company owned by its
6 customers," that is what Transco already is in some important ways –
7 ways that could be formalized and improved in this process.

8
9 Q. Finally, what is your opinion regarding the option of a State takeover of
10 Transco's transmission assets?

11 A. I am, myself, a member of the Washington Electric Cooperative, and I
12 have considered this option with significant sympathy; however, I do not
13 recommend it. I was a regulator for many years, with duties to consider
14 both public-power and investor-owned utility proposals. And I know that
15 deep feelings and long histories arise any time a choice of public-power or
16 investor-power arises. However, I have tried hard to be an "agnostic" on
17 the general question and to focus, instead, on the specifics, in any given
18 case.

19
20 In this case, I start with the observation that the State could not merely
21 "take over" VELCO or Transco. The State would have to actually make a
22 purchase, either voluntarily or through a condemnation proceeding. This

1 is because the Fifth Amendment to the Constitution of the United States
2 provides that the government may not take a private asset without
3 compensation. Transco's current assets are valued at hundreds of
4 millions of dollars; thus, any purchase of the assets themselves would
5 require a significant investment by the State of Vermont at a level that
6 likely would affect the bonding capability and borrowing capacity of the
7 State overall. It seems likely that the limited borrowing capacity of
8 Vermont's State government may be better focused on fundamental
9 infrastructure that finds it more difficult to acquire private investment,
10 such as bridges and highways, etc. To the extent that public financing is
11 available now or diverted from other worthy purposes, it would of course
12 be possible to purchase Transco's assets and to secure the State debt with
13 a pledge of future transmission revenues. However, the borrowed money
14 would have to be repaid and the repayment of those borrowed funds would
15 depend upon revenues, including net revenues which are currently being
16 used to reduce retail rates of Vermont customers at a level that Department
17 Witness Sean Foley estimates as roughly equal to 3-4% of current retail
18 rates. A rate increase to offset those lost revenues seems like a very
19 unattractive option. While ratepayers are also citizens, such that any
20 benefit flowing to citizens may be thought to offset harm to ratepayers, I
21 would note that some ratepayers, particularly commercial and industrial
22 customers that have a higher electricity usage, would be more greatly

1 affected by any such decision.

2

3 A further concern is that continued reliable operation of the VELCO
4 system would require, not just a one-time massive investment, but
5 continuing infusions of capital. Those are estimated to require further
6 hundreds of millions of dollars within the next few years, further stressing
7 the State's financing capabilities. And that does not take into account
8 unanticipated capital needs, such as may occur after significant storm
9 events like we experienced recently in Vermont. Moreover, the State
10 would find itself subject to the reliability and other federal criteria
11 transmission owners must follow, and would presumably face penalties if
12 there were a failure to comply.

13

14 In addition to those very fundamental financial problems, there are some
15 crucial operational elements to consider: the reliability of the VELCO
16 system is fundamental to modern life in Vermont, and it requires a fully
17 committed set of managerial skills and personnel to provide it. The State
18 of Vermont tried an interesting experiment with the "S. 130 power-
19 purchasing" statute several years ago. At that time the legislature
20 authorized the Department of Public Service to buy and sell power on
21 behalf of the State's retail customers; however, the legislature did not
22 authorize a major increase in personnel to carry out those functions. The

1 effort was essentially abandoned after a few years of trials. The
2 experience suggests that it is difficult, to say the least, to replicate utility
3 services by simply telling State employees to add those duties to their
4 other tasks, yet the temptation to do so would always be in front of future
5 legislatures. Furthermore, while the private functioning of VELCO may
6 not be perfect, its imperfections are being addressed through a set of
7 Public Service Board mandates going back to the Northwest Reliability
8 Project and implemented with serious Departmental involvement in recent
9 years. That path, and an enhanced application of public involvement in
10 ways suggested in my testimony, seems better calculated to ensure that
11 VELCO and Transco promote the general good of Vermont than outright
12 State ownership.

13
14 Q. Please discuss the option of revising the Articles of Incorporation and By-
15 laws of VELCO and the membership documents and associated
16 management agreements⁹ of Transco to require consideration of the public
17 good in their decision making, and reconfiguring the VELCO Board to
18 place directors on the Board whose purpose is to advance these goals.

19 A. I discuss this below, in the context of my recommendations.
20

⁹ I would note that the Petitioners' proposal and the recommendations I have made would require either consent or waiver of the right of first refusal contained in these documents.

1 **VII. RECOMMENDATIONS**

2

3 Q. Please outline the fifth element of your outline, your recommendations?

4 Am I right in remembering that you said you would address each at both
5 strategic and tactical levels?

6 A. I recommend that structural measures be put in place to ensure, on an
7 ongoing basis, the explicit consideration of the general good of the State
8 in the management of Transco's assets by VELCO or its successors. As I
9 note above, there are likely other ways to achieve these goals, but I believe
10 these preliminary recommendation provide a framework for their
11 achievement.

12 1. The first of these structural measures would be to require that purposes of
13 VELCO be defined as including the general good of the State. I believe
14 that this purpose is already implicit in the fact that the company's
15 certificate of public good was issued upon an understanding that it would
16 promote that goal (*see* 30 V.S.A. Secs 102 and 231, and the *Citizens*
17 *Utilities* case, Docket Nos. 5841/5859) and because investors would lose
18 much of the value of their investments if the certificate were revoked for
19 failure to meet that purpose. However, making that purpose explicit is
20 important in order to make clear that the fiduciary duties of the Directors
21 include consideration of that factor. This factor could be included in

1 articles of incorporation, articles of agreement, the Transmission
2 Administration Manual, and similar organizational agreements, such as
3 shareholder's agreements; if necessary, resort to a B corporation structure
4 would be possible.

5 2. A second structural change would be to require an annual report, directly
6 from VELCO's Board of Directors to the Public Service Board and
7 Department of Public Service, summarizing the ways in which VELCO's
8 activities have promoted the general good of the State in the preceding
9 year, along with public dissemination of the budget and strategic plans.

10 3. The third structural reform would be to formalize the membership on the
11 VELCO Board and restructure it such that there are in essence three voting
12 blocs: the Combined Company, Public Power (and any future companies
13 that are smaller than the largest single VELCO member), and "General
14 Good Directors." The General Good Directors should perform a key
15 function on the Board, such that the Combined Company, acting alone,
16 cannot require a VELCO decision without a concurrence of at least a
17 majority of the General Good or Public Power Directors, and vice versa.
18 The General Good Directors can be thought of as a swing vote between
19 the investor-owned and Public Power utilities.

20 4. The General Good Directors will, of course, have to be selected. In that
21 selection process it will be vital that they be technically competent, that
22 they represent the general good, but not be subject to short-term political

1 influence and that their tenure and replacement not cause instability or
2 abrupt shifts in the management of a long-term complex infrastructure.

3 These general principles could be implemented in any of several ways, but

4 I suggest that one possibility would be to:

- 5 - Establish a State Transmission Nominations Board (“TNB”), comprised of
6 individuals appointed by public officials and the utilities. For example, it
7 could be comprised of two representatives of the Senate, two representatives
8 of the House, two representatives of the Governor, and three members of
9 professions dealing with management of electricity transmission;
10
- 11 - The TNB would in turn nominate at least 5 (38%) “General Good Directors”
12 to the board of 13 directors of VELCO, applying criteria to ensure that
13 nominees are qualified and knowledgeable about finance, corporate
14 governance and the industry;¹⁰
15
- 16 - If this model were used, like the judicial nominating board, the Governor
17 could appoint nominees from a slate selected by the TNB, perhaps subject to
18 confirmation by the Senate;
19
- 20 - The “General Good Directors” should serve six-year, staggered, terms
21 removable only for cause. Consideration should be given to also establishing
22 term criteria for the other VELCO Board members, who presently are subject
23 only to a maximum age requirement;
24
- 25 - This process clearly bears some parallels to the appointment of judges and
26 Public Service Board members, a process that has generally been regarded as
27 successful in providing technical competence, significant insulation from
28 short term politics, and stability.¹¹
29

¹⁰ Such criteria have been used for selections to the Board of the ISO-NE, and to the EPRI Board of Directors and, in an informal sense, for selection of “independent,” non-utility, members of VELCO’s board in the past. I recommend 38% in order to help address the power issue noted previously in my testimony, because the offered percentage of VELCO to VLITE may not be adequate to create the counterbalance to the Combined Company that I seek.

¹¹ As I indicated, there are several ways to accomplish the goal of placing “General Good Directors” on the VELCO Board, through use of the public trust Petitioners proposed; through appointment by the Vermont State Planning Committee (VSPC); through restructured organizational documents and/or voting rights; or through legislation. To the extent this process would require legislative action, consideration should be given to imposing interim measures pending legislative approval.

1 - It will be important to require and ensure that the selected General Good
2 Directors on the VELCO Board are thoroughly independent of the interests of
3 utility members, both in terms of their traditional financial interests and their
4 affiliations.
5

6 5. The benefits of this process would, of course, be lost if Transco were to
7 end its relationship with VELCO and to enter into a management
8 agreement with a new organization that was not subject to these
9 obligations. Thus, Transco and VETCO should be required to ensure that
10 these provisions be preserved in any future relationship with VELCO or
11 any successor to its contractual managerial role.

12 6. There must be assurance that the \$1 Million in annual low-income benefits
13 referred to in Petitioners' proposal shall be supplemental to amounts
14 currently expected for such purposes pursuant to the low-income support
15 proceedings currently underway before the Public Service Board. The
16 Petitioners' proposal is, at best, unclear on this question and should be
17 clarified. A variety of options should be considered for distributing these
18 funds.¹² In addition, I recommend that the provision of these funds (which
19 presumably would come from the Combined Company's VELCO earnings
20 which might otherwise be used to reduce retail rates generally) should be
21 more closely linked to benefits for the utility system overall. One example

¹² As proposed, VLITE would link the distribution of the funds, the role in management on the VELCO Board, and ownership of the VELCO "general good" shares. It is not clear to me that this is necessary, it may be impractical, and it is certainly complex. It is not clear to me that any such structure is needed. However, if such a need arises, careful consideration must be given to establish the appropriate vehicle that has as its paramount purpose representing the general good on the VELCO Board.

1 might be to use them to accelerate the rate of housing retrofits in areas of
2 stressed transmission or distribution capacity. That policy would honor at
3 least three purposes: homeowner assistance, system reliability, and the
4 legislative target for accelerated conversion of Vermont's housing stock as
5 a way to meet long term sustainability.

- 6 7. There must be assurance that the management stake of the General Good
7 Directors will not be diluted in the future. This requires an ongoing
8 commitment that the influence of the General Good Directors not be
9 diluted, for example by increasing the size of the Board, or by assigning
10 vital powers to sub-committees without representation of the General
11 Good Directors. If additional Board members are added or reduced a
12 proportionate change could be made in the number of General Good
13 Directors so as to continue the fundamental principles that they continue
14 to be a significant swing bloc between investor owned and public power
15 entities. This ratio should also be preserved in the event of further
16 takeovers of utilities within the State, and preserved if any acquisition of
17 the Combined Company were proposed. Similarly, if key functions are
18 assigned to sub-committees, such as the Executive Committee or the
19 Operations Committee, a proportionate share of members should include
20 the General Good Directors. My experience on EPRI's Board of
21 Directors, though one four year term and two extensions, is one of many
22 reasons for believing that committee structures can be fluid, as long as

1 each important sector is included in each process. *See* EPRI governance
2 information, accessible on the internet at
3 <http://my.epri.com/portal/server.pt?open=512&objID=200&&PageID=20>
4 [3&mode=2&in_hi_userid=2&cached=true](http://my.epri.com/portal/server.pt?open=512&objID=200&&PageID=203&mode=2&in_hi_userid=2&cached=true)

5 8. I also believe it is important to formalize the Board's structure in ways
6 that go beyond its makeup and the terms of its members. To a significant
7 degree, this appears to be a process that VELCO already has underway;
8 however a unified review of its existing and newly created organizational
9 documents would be important to transparency. I can think of no better
10 time for this than "at the creation" of its next form of structure. This
11 would include formalizing the seats available to the Combined Company
12 and other utilities presently on the Board. If my suggestion of 5 General
13 Good seats out of 13 were adopted, the remaining ~~6~~8 seats likely would
14 be ~~3~~4 Combined Company (or Combined Company/VELCO CEO) plus
15 ~~three~~4 Public Power (presently BED, VEC and VPPSA).¹³

16 9. I also recommend one additional seat on VELCO's Board for a
17 representative of the smaller utilities not presently represented by the
18 Board; that seat could be filled by joint choice of all the public power
19 utilities but excluding any individual from any company already
20 authorized to name a Director. I recommend this in response to concerns

¹³ The EPRI articles of incorporation and other organizational documents noted above provide an example of such an allocation of seats among utilities upon the basis of attributes of ownership attributes.

1 Although there may be several avenues to achieve this goal, I recommend that
2 the Board add conditions in this proceeding that:

3 1. Ensure that the public interest is represented on VELCO Board of
4 Directors through establishment of what I call “General Good Directors” on
5 the Board, in a proportion that counterbalances adequately the significant
6 influence the Combined Company would otherwise be able to achieve;

7 2. Ensure that the General Good seats retain their ratio of influence even if
8 further acquisitions occur, and ensure that interests represented on the
9 VELCO Board remain the manager of TRANSCO and its activities by making
10 any necessary structural changes to the corporate structure and/or governance
11 of VELCO and Transco;

12 3. Ensure that General Good Directors of the VELCO Board have sufficient
13 authority to assure that VELCO and Transco operate in the interest of
14 Vermont ratepayers;

15 4. Formalize the structure of the VELCO Board, now undefined in the
16 bylaws, to address the representation of all seats, and consider the option of
17 providing currently unrepresented Public Power a seat on the Board to be
18 selected by those public power utilities;

19 5. Ensure that the \$1 Million of annual low-income benefits referred to in
20 Petitioners’ proposal flows to low income Vermonters in a manner consistent
21 with VELCO’s obligation to promote the general good;

22 6. In addition to the evergreen provisions on the General Good ratio of

1 representation and VELCO management control noted above, consideration
2 should be given to providing that the State may participate in the ownership of
3 the transmission assets in the event of any further acquisition of distribution
4 utilities or material change in the upstream ownership structure of the
5 Petitioners' proposed Company, perhaps in the form of a right of first refusal
6 triggered by such an event.

7
8 Provisions such as those that I recommend above will ensure that, on an on-
9 going basis, the governance and operations of Vermont's sole bulk
10 transmission system remain reliable, cost-effective, sustainable and consistent
11 with the general good of the State. They would, thus, be consistent with
12 approval of an otherwise acceptable purchase and merger of the type proposed
13 by Petitioners.

14 Q. Does that conclude your direct testimony?

15 A. Yes.