

STATE OF VERMONT
PUBLIC SERVICE BOARD

Amended Joint Petition of Central Vermont Public Service)
Corporation (“CVPS”), Danaus Vermont Corp., Gaz Metro)
Limited Partnership (“Gaz Metro”), Gaz Metro inc., Northern)
New England Energy Corporation (“NNEEC”) for itself and as)
agent for Gaz Metro 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)
the common stock of CVPS; (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.)

Docket No. 7770

PREFILED TESTIMONY OF THOMAS E. KANDEL
ON BEHALF OF
WASHINGTON ELECTRIC COOPERATIVE, INC.

1 Purpose of Testimony

2 Mr. Kandel testifies in support of Washington Electric Cooperative, Inc.’s (WEC”),
3 proposal to restructure Vermont Electric Power Company, Inc. and/or Vermont Transco
4 LLC as a non-profit, tax-exempt, public/quasi public transmission entity.

5

6

7 Exhibits: WEC 1 (TEK-1), CV of Thomas E. Kandel.
8 WEC 2 (TEK-2), Equity Ownership of VTransco.

9

1 1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 1 A. My name is Thomas E. Kandel. My business address is 20701 Cooperative Way, Dulles,
3 Virginia 20166.

4

5 2 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

6 2 A. I am employed by National Rural Utilities Cooperative Finance Corporation ("CFC") as a
7 Senior Accountant, Regulatory Affairs.

8

9 3 Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL
10 EXPERIENCE.

11 3 A. I was awarded a Bachelor of Science degree in Business from Miami University, Oxford,
12 Ohio in 1970 and a Master of Business Administration degree from Xavier University,
13 Cincinnati, Ohio in 1977. I majored in accounting during my undergraduate program at
14 Miami University and concentrated on a management curriculum in the master's degree
15 program at Xavier University.

16

17 I commenced employment with CFC in August 2006 as Senior Accountant, Regulatory
18 Affairs. In this position, I provide accounting and regulatory expertise to CFC and its
19 member cooperatives. This includes (a) reviewing and interpreting authoritative
20 accounting guidance of the Financial Accounting Standards Board (FASB), Rural
21 Utilities Service (RUS), Federal Energy Regulatory Commission (FERC) and the
22 International Accounting Standards Board (IASB) and determining the applicability to

1 the electric utility industry; (b) providing professional ratemaking services including
2 regulatory testimony and (c) participating on industry-related accounting and tax
3 committees.

4
5 Prior to joining CFC, I acquired extensive accounting and financial experience with a
6 number of electric utilities. From 1996 to 2006, I was employed by Southern Maryland
7 Electric Cooperative (SMECO), Hughesville, Maryland. I was initially employed as Vice
8 President, Finance and Administration in 1996 and was promoted to Senior Vice
9 President, Finance and Administration in 1997. Following a reorganization in 2003, I
10 assumed the position of Vice President, Financial Services and Chief Financial Officer.
11 During all or part of the ten years with SMECO, I was responsible for the organization's
12 accounting, financial reporting, cash management, financing, ratemaking, billing, credit
13 and collections, budgeting and financial forecasting activities.

14
15 From 1993 to 1996, I served as Consultant to the Comptroller and as Acting Chief
16 Financial Officer for the Virgin Islands Water and Power Authority in St. Thomas, U.S.
17 Virgin Islands. I was employed as Controller for Indiana Municipal Power Agency,
18 Indianapolis, Indiana from 1983 to 1992. From 1979 to 1983, I served as Administrative
19 Assistant to the Chief Accounting Officer of American Electric Power Service
20 Corporation, Columbus, Ohio. I was employed as Controller for Madison Gas and
21 Electric Company, Madison, Wisconsin from 1977 to 1979. From 1970 to 1977, I held

1 the staff positions of Accountant and Report Accountant with Columbus and Southern
2 Ohio Electric Company (now, Columbus Southern Power Company), Columbus, Ohio.

3 I am a Certified Public Accountant, licensed in Ohio and Virginia, and a member of
4 various professional organizations including the American Institute of Certified Public
5 Accountants, Maryland Association of Certified Public Accountants, Ohio Society of
6 Certified Public Accountants and National Society of Accountants for Cooperatives.

7 I have attached Exhibit WEC 1 (TEK-1) summarizing my professional qualifications and
8 experience as an expert witness in regulatory proceedings.

9
10 4 Q. FOR WHOM ARE YOU PROVIDING TESTIMONY?

11 4 A. I am providing testimony on behalf of Washington Electric Cooperative ("WEC").
12

13 5 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

14 5 A. The purpose of my testimony is to support WEC's request that the Vermont Public
15 Service Board ("PSB" or "Board") consider, as a condition of approving the merger, that
16 Vermont Electric Power Company, Inc. ("VELCO") and/or Vermont Transco, LLC
17 ("Transco") be restructured as a public or quasi-public transmission entity. It is
18 important to take this action to address what would otherwise be a post-merger situation
19 where the resulting combined company could potentially own over 68% of the
20 transmission company, Transco, and 78% of VELCO (See Prefiled Testimony of

1 Michael H. Dworkin at p. 9), and to identify several potential benefits of such a
2 restructuring.

3
4 6 Q. WHAT IS CFC?

5 6 A. National Rural Utilities Cooperative Finance Corporation (“CFC”) is a member-owned
6 cooperative association incorporated under the laws of the District of Columbia in April
7 1969. CFC’s principal purpose is to provide its members with financing to supplement
8 the loan programs of the Rural Utilities Service (“RUS”) of the United States Department
9 of Agriculture. CFC makes loans to its rural electric members so they can acquire,
10 construct and operate electric distribution, generation, transmission and related facilities.
11 CFC also provides its members with credit enhancements in the form of letters of credit
12 and guarantees for debt obligations.

13 As of May 31, 2011, the most recent fiscal year end, CFC and its subsidiaries had a total
14 of 972 members and 58 associates including 834 electric distribution systems and 71
15 generation and transmission systems operating in 47 states and one U.S. territory. CFC
16 had \$19 billion of loans outstanding on a consolidated basis at May 31, 2011, of which
17 approximately 96% of the CFC loan portfolio supports electric assets.

18
19 7 Q. HOW DOES THE PROPOSED MERGER AFFECT TRANSCO AND ITS EQUITY
20 OWNERS?

1 7 A. Recognizing that the primary transmission assets are in Transco, Exhibit WEC-
2 TEK-2 identifies the equity ownership amounts and percentages of the various
3 Vermont member utilities in Transco as reported in Transco's end of year 2010
4 Form 1. The first portion of the table depicts the equity owners and their
5 respective equity capital amounts and percentages as of December 31, 2010 and
6 2009. The second portion of the table highlights the combination of Green
7 Mountain Power Corporation (GMP) and CVPS's equity amounts as a merged
8 entity or combined company using December 31, 2010 data. Excluding any
9 implications of the VLITE proposal, the exhibit reflects that on a combined
10 company basis, their aggregated equity percentage would be 68.48%. Individually
11 for 2010, GMP and CVPS had equity interests of 30.06% and 38.42%,
12 respectively. The remaining equity owners had a composite equity share of
13 31.52%.

14 WEC's concern is that the control of Transco post-merger will be inappropriately
15 influenced by the combined entity. The other equity owners are relatively small
16 and generation dependent which makes transmission service an essential element
17 to these owners. Both transmission pricing and access are critical to the other
18 equity owners. The merger potentially changes the dynamics as well as the
19 benefits associated with ownership of Transco.
20
21

1 8 Q. WITH RESPECT TO THE PENDING MERGER, IS WEC SATISFIED WITH THE
2 CHANGES IN OWNERSHIP AND GOVERNANCE PROPOSED BY THE
3 PETITIONERS?

4 8 A. No. The proposed transfer to Vermont Low Income Trust for Electricity (“VLITE”) of
5 approximately 33% of Class B voting common stock in Vermont Electric Power
6 Company, Inc. (“VELCO”) and approximately 31.7% of the Class C non-voting common
7 stock in VELCO, comprising all of Central Vermont Public Service’s (“CVPS’s”) Class
8 C non-voting common stock in VELCO, and the restructuring of the VELCO Board are
9 insufficient actions. See Prefiled Testimony of Avram Patt, General Manager of WEC
10 for further explanation of WEC’s concerns and positions. The newly structured VELCO
11 and Transco organizations as proposed by Petitioners will still be significantly directly or
12 indirectly influenced by the combined company.

13

14 Simply restructuring the existing VELCO Board is only a superficial treatment to a
15 much larger and deeper problem. The new organizations must be far more independent
16 from the influence of such a large member/participant and the potential for more
17 concentrated ownership through additional merger activity in the future. A restructured
18 public or quasi-public entity may best meet the obligation of serving the public interest
19 and public good without competing fiduciary interest of serving the current shareholders.

20

1 9 Q. IS WEC SATISFIED WITH THE PROPOSED CHANGES IN CORPORATE
2 GOVERNANCE RECOMMENDED BY MR. MICHAEL H. DWORKIN IN HIS
3 PREFILED TESTIMONY ON BEHALF OF THE DEPARTMENT OF PUBLIC
4 SERVICE?

5 9 A. Not entirely.

6 Mr. Dworkin's testimony provides a wealth of background information, insights and
7 recommendations. He thoughtfully presents the existing circumstances, emphasizes the
8 underlying "general good of the State" and need for "General Good Directors" on the
9 VELCO Board and provides several additional recommendations to encourage and
10 enhance VELCO's corporate governance including measures to further structure the
11 Board and provide more public transparency. He also notes in the process that he has
12 some fundamental concerns with the existing proposal by the Petitioners. It is
13 particularly noteworthy that one of the most important conclusions is "[t]hat actual or de
14 facto majority control of those 'bottleneck facilities', even in a highly regulated system,
15 creates a risk of unhealthy market power or of limited recognition of options, alternatives,
16 or concerns of others..." See Prefiled Testimony of Michael Dworkin at p. 5.
17 Accordingly, he has made a number of recommendations to seemingly mitigate these
18 concerns.

19 In spite of the well-developed recommendations, I believe he stops short of recognizing
20 the potential viability and benefits of a public or quasi public transmission utility.
21 Further analysis on the financial benefits of a public or quasi public transmission utility
22 should be considered. I believe a more permanent and enduring resolution can only be

1 achieved by requiring the divestiture of the Transco/VELCO assets.

2

3

4 10 Q. WHAT ADDITIONAL REMEDY DOES WEC SEEK?

5 10 A. Additional measures should be made to thoroughly evaluate and consider the benefits and
6 viability the benefits of a public or quasi public organization in the form of a state
7 agency, joint action agency, cooperative and/or similar organizational structures. Aside
8 from addressing the organizational benefits of having a governing structure that is
9 focused on serving the general public good, such an organization may also have
10 significant financial benefits such as income tax exemption the potential for lower cost of
11 capital and, at least in certain instances, be subject to federal and state emergency
12 management agency disaster restoration funding.

13

14 11 Q. CAN YOU FURTHER ELABORATE ON THESE OTHER FINANCIAL BENEFITS
15 ASSOCIATED WITH A PUBLIC OR QUASI PUBLIC TRANSMISSION
16 CORPORATE STRUCTURE FOR TRANSCO?

17 11 A. Yes. As previously referenced above, there are several different public transmission
18 structures that should be considered. They could take the form of a state agency, joint
19 action agency, cooperative and/or similar structures. While it should be emphasized that
20 no one specific public transmission structure is presently being recommended at this
21 time, the public transmission option does have several common elements including the

1 potential opportunity to achieve a relatively lower cost of capital. Currently, Transco's
2 blended cost of capital is 5.53%, which is the average interest rate on its existing long
3 term debt as reported on Transco's FERC Form 1 for 2010. This current debt cost could
4 be substantially less if funded by the RUS or Federal Financing Bank ("FFB"), which a
5 cooperative would have access. At January 17, 2012, RUS 30 year rate was 3.75% and
6 FFB was 2.50%.

7 Additionally, as a non-profit, tax-exempt entity, the proposed public transmission entity
8 would not pay federal or state income taxes.

9
10 12 Q. WILL THE EXISTING TRANSMISSION FACILITIES NEED TO BE ACQUIRED BY
11 OR TRANSFERRED IN SOME MANNER TO THE PROPOSED PUBLIC ENTITY?

12 12 A. Yes, in some manner. However, WEC presumes that the revenue received from
13 ISO-NE to Transco would continue to flow to the new entity as well.

14
15 13 Q. WHILE IT IS UNDERSTOOD THAT THERE ARE VARIOUS MEASURES OF
16 VALUE, WHAT IS THE CURRENT BOOK VALUE OF TRANSCO?

17 13 A. Yes. There are various valuation approaches. While there are even various measures of
18 book value, one method would be on the basis of the recorded plant cost less accumulated
19 depreciation. On that basis, Transco's book value would be \$734,388,118 as of December
20 31, 2010 accordingly to their 2010 Form 1. Further examination is needed to determine
21 whether the costs of effectuating public ownership through a taking would be

1 outweighed by the financial benefits identified above. It is noted however, that
2 Transco's current owners would be appropriately compensated for this value if a takings
3 occurred. The distribution utilities or Transco's current owners could utilize such funds
4 to offset their cost of service and generate significant savings to ratepayers.
5

6 14 Q. ARE THERE OTHER BENEFITS TO A PUBLIC TRANSMISSION ENTITY?

7 14 A. Possibly. Transco is currently subject to the jurisdiction of the Federal Energy Regulatory
8 Commission (FERC). In 2005, the U.S. Congress passed an Energy Policy Act that
9 substantially modified the relationship between the FERC and cooperatives. Until 2005
10 the U.S. Congress changed certain language in the Federal Power Act (FPA) that changed
11 the definition of a public utility under the FPA.

12 (f) United States, State, political subdivision of a State,

13 or agency or instrumentality thereof exempt

14 No provision in this subchapter shall apply to, or be

15 deemed to include, the United States, a State or any

16 political subdivision of a State, an electric cooperative that

17 receives financing under the Rural Electrification Act of

18 1936 (7 U.S.C. 901 et seq.) or that sells less than 4,000,000

19 megawatt hours of electricity per year, or any agency,

20 authority, or instrumentality of any one or more of the

21 foregoing, or any corporation which is wholly owned,

22 directly or indirectly, by any one or more of the foregoing,

1 or any officer, agent, or employee of any of the foregoing
2 acting as such in the course of his official duty, unless such
3 provision makes specific reference thereto.¹

4

5 According to Transco's 2010 Form 1, it makes no sales of electricity: hence, if a
6 cooperative structure is considered, it may not be subject to the FERC's jurisdiction and
7 savings could result from the absence of such regulatory costs

8

9 14 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

10 14 A. Yes.

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¹United States Code, Title 16, Chapter 12, Subchapter II, Section 824(f) (2005).