

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

**LEGAL BRIEF OF**  
**THE TOWN OF STOWE ELECTRIC DEPARTMENT**

NOW COMES the Town of Stowe Electric Department, pursuant to Vermont Public Service Board Rule 2.223, and hereby submits its Legal Brief in the above-captioned Docket.

**MEMORANDUM**

**I. Introduction**

Petitioners seek approval under 30 V.S.A. §§ 104, 107, 109, and 311 to effectuate the proposed merger of Green Mountain Power Corporation ("GMP") and Central Vermont Public Service ("CVPS"). The Town of Stowe Electric Department ("SED") was granted party status and participated in this proceeding particularly with respect to Petitioners' proposed changes to the ownership and control of Vermont's electric transmission system by Vermont Transco, LLC ("Vermont Transco") and its manager Vermont Electric Power Company, Inc. ("VELCO"). As stated in the prefiled direct

testimony of its General Manager Ellen Burt, SED has not taken a position on the merger itself, but has instead focused on the aspect of the Petitioners' proposal likely to have the greatest impact on SED's own operations. (Burt pf. at 4.)

## **II. Analysis of Proposals for Corporate Governance of Vermont Transco and VELCO**

Proceeding solely on the issue of the proposed governance changes to VELCO and Vermont Transco (VELCO and Vermont Transco are referred to collectively as "VELCO," unless stated otherwise or the context so dictates), SED hereinafter addresses the following:

- A. Jurisdiction of the Public Service Board, Scope of Review, and Effect of MOUs.
- B. Summary of Proposals Contained in Petition and GMP/DPS MOU.
- C. Public Policy and Principles of Good Corporate Governance Support Flexibility and Board Representation Reflective of Ownership Share.
- D. The Two-Company Structure of VELCO and Vermont Transco is Unnecessary and Unnecessarily Complicates Governance of Vermont's Transmission System.
- E. Transfer of 38% of VELCO Shares to VLITE Creates a New De Facto Member of Vermont Transco in Contravention of 11 V.S.A. § 3054(c)(7).

### **A. Jurisdiction of the Public Service Board, Scope of Review, and Effect of MOUs**

The proposed changes to VELCO governance should be reviewed under two statutory sections. Directly, pursuant to 30 V.S.A. § 107, the acquisition by VLITE of a controlling interest in VELCO must promote the "public good." And indirectly, the proposed VELCO governance changes must help ensure that the merger of GMP and CVPS "will not result in obstructing or preventing competition" under 30 V.S.A. § 311.

Some have suggested that VELCO governance is beyond the scope of the Board's purview in this proceeding (*see* Mullet pf. at 9); however, issues of VELCO governance fall squarely within the jurisdiction of the Board as set forth under 30 V.S.A. § 209(a)(3), which gives the Board jurisdiction over "[t]he manner of operating and conducting any business subject to [its] supervision...so as to be reasonable and expedient, and to promote the safety, convenience and accommodation of the public." Additionally, the VELCO governance changes were proposed in the Petition as a way to mitigate the impacts of the merger, and VELCO itself has been granted party status, participated in, and not objected to consideration of such matters. That said, SED does believe that if the Board imposes conditions that would require VELCO or Vermont Transco to amend their respective articles a Petition would need to be filed for approval under 30 V.S.A. § 104. SED does not believe the merger should be approved without restricting or limiting the Combined Company's potential control over Vermont's transmission system.

Memoranda of Understanding are advisory rather than binding on the Board and should be given the same weight as other testimony filed in this Docket. The March 26, 2012 Memorandum of Understanding between the Petitioners and the Department of Public Service ("GMP/DPS MOU") itself recognizes this and specifically provides for the circumstance where the Board takes action contrary to the MOU: "In the event that the Board fails to approve this MOU substantially in its entirety or acts to overrule or disapprove of any material portion hereof, each party agrees that their agreement set forth herein may terminate, if such party so determines in its sole discretion, and each shall have the same rights as each would have had absent this MOU." (GMP/DPS MOU at

Section 36 at Page 15.) Ultimately, for the Board to adopt an MOU it must determine that the terms of the MOU meet the statutory criteria that otherwise apply, based on all of the evidence and testimony submitted in this Docket.

Lastly, with respect to the Board's review and imposition of conditions pertaining to VELCO governance, the Board should be leery about imposing conditions that GMP or others may not be able to accomplish as a result of terms contained in the existing governance documents, statutory requirements, or common law obligations to minority shareholders. This concept is discussed further in Section II(E), below.

**B. Summary of Proposals Contained in Petition and MOU**

With respect to their proposals for VELCO governance, the Petition and the GMP/DPS MOU are quite similar. The Petition proposed reducing the size of the VELCO Board of Directors from 13 to 11, reducing the Combined Company's seats to 4 from what would otherwise be 6, and institutionalizing appointment to the remaining seats in the same manner previously dictated by informal custom: one seat is designated for the VELCO CEO, one seat each is nominated by Burlington Electric Department, Vermont Electric Cooperative, and Vermont Public Power Supply Authority, and three seats are to be comprised of Independent Directors. (Powell/Reilly pf. at 23.) In addition to eliminating the Combined Company's control at the Board level, Petitioners also proposed to eliminate the Combined Company's voting control of VELCO by transferring 33% of the total outstanding Class B voting shares and 31.7% of the total outstanding Class C non-voting common shares of VELCO to the Vermont Low Income Trust for Electricity, Inc. ("VLITE"). (Powell/Reilly pf. at 24.) In addition to receiving

the dividend paid on VELCO shares, VLITE would be responsible for nominating the three Independent Directors to the VELCO Board. The only restriction imposed on Vermont Transco is an amendment to its Operating Agreement preventing the Combined Company from terminating VELCO as the manager of Vermont Transco.

The GMP/DPS MOU largely maintains the VELCO governance structure proposed in the Petition, except that it requires the Combined Company to transfer 38% rather than 33% of the total outstanding Class B voting shares of VELCO to VLITE and would maintain the current Board size of 13, adding two additional Independent Directors over and above those to be appointed by VLITE. (Exh.Petitioners-DPS-1 at ¶¶ 7-14, Pages 3-6.) The two additional Independent Members are to be nominated by the non-investor owned distribution utilities (all of Vermont's distribution utilities other than the Combined Company). (Id at 3-4.)

Under both the Petition and the GMP/DPS MOU, the only restrictions proposed to limit GMPs' control over Transco is a provision prohibiting replacement of VELCO as the manager and elimination of Section 9.3 of the Operating Agreement which prohibits any member from receiving "preferential treatment". Specifically, the GMP/DPS MOU requires that "immediately after closing of the acquisition of CVPS, Petitioners shall take all actions necessary to assure that none of them individually or collectively can unilaterally remove VELCO as the managing member of Vermont Transco LLC or to eliminate or amend Section 9.3 of the Vermont Transco LLC Operating Agreement, including, without limitation amendment of the Vermont Transco LLC Operating

Agreement in a form acceptable to DPS.”<sup>1</sup> (Exh.Petitioners-DPS-1 at Section 13, Page 6.)

**C. Public Policy and Principles of Good Corporate Governance Support Flexibility and Board Representation Reflective of Ownership Share**

The issue of VELCO governance has been of particular importance to SED in this proceeding; and, while the MOU represents a functional solution that makes progress towards conforming the VELCO Board structure to generally accepted governance practices, SED believes the solution is incomplete and does not go far enough. The predominant concern of SED with respect to the VELCO governance proposals contained in the Petition and the GMP/DPS MOU is the failure to provide for Board-level participation by SED or WEC. Neither proposal addresses this concern; instead, without justification or explanation on the record, they both perpetuate a systematic exclusion of two utilities from participating in VELCO and TRANSCO governance at the Board level. Given the small number of distribution utilities in Vermont it is not at all difficult to conceive of ways to afford all utilities an opportunity to serve on the VELCO Board. Following this merger, Vermont will be left with 17 distribution utilities: GMP, BED, VEC, SED, WEC, and the twelve municipals that are represented by VPPSA. No policy reason was advanced during this proceeding to justify giving BED and VEC permanent appointments to the VELCO Board while excluding SED and WEC. Governance experts Dworkin and Brownell testified that there are many viable ways to structure the VELCO

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<sup>1</sup> SED has no reason to believe the documents relied upon are not valid, however, we do note that, even when requested by the Board during the Technical Hearings, signed copies of the VELCO and Vermont Transco governing documents were not produced at any point during this proceeding.

Board. They also testified that it is not typical for a company to allocate Board seats to its customers at the expense of its owners and that typically owners with greater equity in a company are afforded an opportunity to serve on its Board. The fact that BED and VEC have fixed permanent representation on the VELCO Board while SED and WEC are systematically excluded is inconsistent with these generally accepted principles of corporate governance.

It is true that both BED and VEC have more customers than SED and are therefore larger customers of VELCO; however SED currently owns twice as many Vermont Transco membership units than VEC and a percentage point more than BED. (Exh.WEC Cross 13 at 4.) While it is absolutely true that SED's ownership share of Vermont Transco is currently higher than at times in the past as a result of its purchase of LCP membership units and that its share may decrease in the future, that fact does not lead us to conclude that SED should be denied representation on the VELCO Board altogether, but rather, that the Board structure should be flexible enough to adapt to such changes in respective ownership. Of course, the Board could also resolve the issue of flexibility by adopting Commissioner Brownell's recommendation that the entire VELCO Board be comprised of independent directors.

Indeed, the relative shares of Vermont Transco owned by BED, VEC, and SED are likely to fluctuate further in the future. Recently VEC's percentage ownership has dropped substantially as a result of its inability to obtain financing to respond to equity calls. SED on the other hand has expressed an interest in increasing its ownership share in Vermont Transco. The proposed VELCO governance structure rewards utilities that

do not or cannot respond to equity calls and provides a disincentive to those that would like to invest more in VELCO. This structure contradicts principles of good corporate governance and is bad public policy that will have detrimental and unintended consequences.

SED cannot fault BED and VEC for fighting to maintain the representation they presently have on the VELCO Board; though it does tend to show the value of those appointments and the need for the Board to take affirmative steps to ensure minority owners such as SED have an equal opportunity to participate. Increasing the number of independent directors and transferring shares to VLITE are positive steps in VELCO governance, but there are additional steps that could be taken to ensure the proposal does not just promote the “general good” of the state, but that the solution implemented is the best possible. We believe the ratepayers of the State of Vermont deserve the best solution to this problem that the Board can fashion rather than a political compromise.

**D. The Two-Company Structure of VELCO and Vermont Transco is Unnecessary and Unnecessarily Complicates Governance of Vermont’s Transmission System**

The two-company structure of VELCO and Vermont Transco approved by the Board in Docket No. 7174 (2006) is not necessary and creates additional and unnecessary complexity in considering appropriate resolutions to the VELCO governance questions posed in this Docket. VELCO and Vermont Transco have the same owners and function as one entity, as such no liability protection flows from the structure. The tax benefits which formed the core justification for creating Vermont Transco could readily be achieved by a member-managed LLC which would allow for the elimination of VELCO.

The proposed VELCO governance changes contemplated in this Docket, in the context of the two-company structure, further distances investment in the transmission system from its management contrary to principles of good corporate governance.

There are several findings of fact relied on in Docket No. 7174 that are no longer applicable to the two-company structure. For example, the Order in Docket No. 7174 contemplated that “the owners of VELCO would also be the owners of Vermont Transco,” “[a]side from VELCO’s initial involvement in the funding of Vermont Transco, the proposed ownership structure of Vermont Transco would mirror the current ownership of VELCO, ” and that “[t]he equity interests of CVPS, GMP and all other Vermont electric distribution companies in Vermont Transco are anticipated to be in proportion to each electric distribution companies’ average network load in 2005.” (Docket No. 7174 Order at 8,10, 11; internal citations omitted.) Not only has proportionate ownership deviated from load share, but under the VELCO governance proposals contained in the Petition and the MOU, ownership of VELCO and Vermont Transco will no longer be the same. While additional equity in Vermont Transco is now being offered relative to respective transmission cost, not load share, VELCO governance holds onto load share as the metric used to set a threshold for participation in governance. (Dutton pf. at 10.) Fixing a governance structure based on 2005 load share, which is essentially what adoption of the existing VELCO governance model does, ignores the current reality of the investment structure that now exists for the Vermont transmission system. SED believes that relying on the two-company structure approved in Docket No. 7174 to determine an appropriate governance structure for VELCO is a mistake.

**E. The Transfer of 38% of VELCO Shares to VLITE Creates a New De Facto Member of Vermont Transco in Contravention of 11 V.S.A. § 3054(c)(7)**

The cornerstone of the VLITE proposal and GMP's divestment of its ownership share of VELCO is amending the Vermont Transco Operating Agreement to prevent Vermont Transco from replacing VELCO as the manager. After all, without such a restriction, the Combined Company could use its 70% ownership of Vermont Transco to terminate VELCO as manager and dispense with the restrictions intended to limit its influence. The combination of these two actions, prohibiting termination of the manager and transferring majority ownership of the manager to a third-party non-shareholder, runs afoul of the ownership rights of Vermont Transco's members.

As the owner of membership units in Vermont Transco, SED is the beneficiary of certain rights and protections afforded by the LLC statute. (*See* Chapter 21 of Title 11.) One of the rights afforded to minority owners under Title 11 is that admission of a new member requires the consent of all of the company's existing members. 11 V.S.A. § 3054(c)(7). Petitioners are using the two-company structure to exploit this right of the other Vermont Transco members by transferring ownership shares of VELCO to VLITE rather than Vermont Transco membership units. At the same time, Petitioners are also proposing to foreclose any ability to terminate the manager, further uniting VELCO and Vermont Transco. Petitioners should not be permitted to make changes to the governance of whichever company it is easiest to manipulate and the Board should not impose conditions on the merger that leaves open legal issues unresolved.

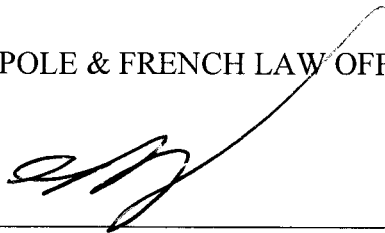
**III. Conclusion**

The VELCO governance solution reflected in the MOU represents a political compromise rather than the best possible solution to the issue before the Board. Petitioners have proposed significant value to their ratepayers through guaranteed costs savings of \$144m during the first ten years following the merger; this level of benefit is difficult to refute, but it also taints consideration of the other issues before the Board. If the Board were to review VELCO governance on its own merits as an isolated matter rather than part of a package deal, SED is convinced that neither the governance proposal contained in the Petition nor the proposal contained in the GMP/DPS MOU would be determined the best possible solution. For that reason, we encourage the Board to look beyond the four corners of the GMP/DPS MOU and to resolve the issue of VELCO governance in a manner that will best serve Vermont and its utilities for the decades to come.

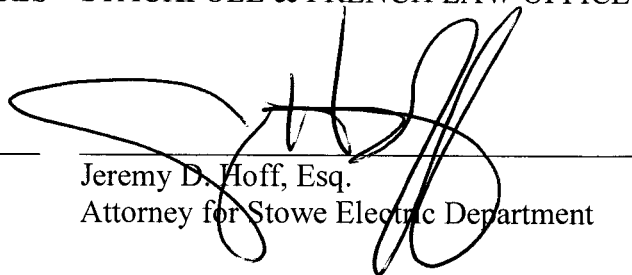
WHEREFORE, for the reasons set forth herein, the Town of Stowe Electric Department respectfully requests this Board take such necessary steps to ensure equal access to Vermont's transmission system and equal participation in the governance of VELCO by all of Vermont's distribution utilities.

DATED at Stowe, Vermont, this 23<sup>rd</sup> day of April, 2012.

STACKPOLE & FRENCH LAW OFFICES    STACKPOLE & FRENCH LAW OFFICES



Edward B. French, Jr., Esq.  
Attorney for Stowe Electric Department



Jeremy D. Hoff, Esq.  
Attorney for Stowe Electric Department

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Parties:

Geoffrey Commons, Esq.  
John Beling, Esq.  
Vermont Department of Public Service  
112 State Street  
Montpelier, VT 05620-2601  
[Geoff.Commons@state.vt.us](mailto:Geoff.Commons@state.vt.us)  
[John.Beling@state.vt.us](mailto:John.Beling@state.vt.us)

Donald J. Rendall, Jr., General Counsel  
Mari M. McClure, Esq.  
Green Mountain Power Corporation  
163 Acorn Lane  
Colchester, VT 05446  
[rendall@greenmountainpower.com](mailto:rendall@greenmountainpower.com)  
[mccclure@greenmountainpower.com](mailto:mccclure@greenmountainpower.com)

Peter H. Zamore, Esq.  
Benjamin Marks, Esq.  
Charlotte B. Ancel, Esq.  
Sheehey Furlong & Behm P.C.  
30 Main Street, P.O. Box 66  
Burlington, VT 05402  
[pzamore@sheeheyvt.com](mailto:pzamore@sheeheyvt.com)  
[bmarks@sheeheyvt.com](mailto:bmarks@sheeheyvt.com)  
[cancel@sheeheyvt.com](mailto:cancel@sheeheyvt.com)

(For Green Mountain Power Corporation)

John H. Marshall, Esq.  
Lisa A. Fearon, Esq.  
Downs Rachlin Martin PLLC  
90 Prospect Street – P.O. Box 99  
St. Johnsbury, VT 05819-0099  
[jmarshall@drm.com](mailto:jmarshall@drm.com)  
[lfearon@drm.com](mailto:lfearon@drm.com)

(For Central Vermont Public Service Corporation)

Kimberly K. Hayden, Esq.  
Downs Rachlin Martin PLLC  
199 Main Street, P.O. Box 190  
Burlington, VT 05402-0190  
[khayden@drm.com](mailto:khayden@drm.com)

(For Central Vermont Public Service Corporation)

Morris L. Silver, Esq.  
Law Offices of Morris L. Silver, Esq.  
P.O. Box 606  
Benson, VT 05731-0606  
[mlsilver@sover.net](mailto:mlsilver@sover.net)

(For Central Vermont Public Service Corporation)

Dale A. Rocheleau, Esq.  
Central Vermont Public Service Corporation  
77 Grove Street  
Rutland, VT 05701  
[drochel@cvps.com](mailto:drochel@cvps.com)

Leslie A. Caldwell, Esq.  
Gravel and Shea PC  
PO Box 369  
Burlington, VT 05402-0369  
[lcadwell@gravelshea.com](mailto:lcadwell@gravelshea.com)

(For Ampersand Gilman Energy LLC and its Affiliates)

James E. Dumont, Esq.  
15 Main Street  
PO Box 229  
Bristol, VT 05443  
[Dumont@gmavt.net](mailto:Dumont@gmavt.net)

(For AARP)

Karen K. O'Neill, Esq. Vice President  
Vermont Electric Power Company, Inc.  
366 Pinnacle Ridge Road  
Rutland, VT 05701  
[koneill@velco.com](mailto:koneill@velco.com)

Edward V. Schwiebert, Esq.  
David R. Cooper, Esq.  
Kenlan, Schwiebert, Facey & Goss, P.C.  
71 Allen Street  
Rutland, VT 05702-0578  
[evs@kenlanlaw.com](mailto:evs@kenlanlaw.com)  
[dcooper@kenlanlaw.com](mailto:dcooper@kenlanlaw.com)

(For OMYA)

Kimberly A. E. Pritchard  
Senior Paralegal  
Vermont Electric Power Company, Inc.  
366 Pinnacle Ridge Road  
Rutland, VT 05701  
[kpritchard@velco.com](mailto:kpritchard@velco.com)

(For VELCO)

Victoria J. Brown, Esq.  
Vermont Electric Cooperative, Inc.  
42 Wescom Road  
Johnson, VT 05656-9717  
[vbrown@vermontelectric.coop](mailto:vbrown@vermontelectric.coop)

(For VEC)

William B. Piper, Esq.  
Katherine Amestoy, Esq.  
Primmer Piper Eggleston & Cramer PC  
PO Box 159  
St. Johnsbury, VT 05819-0159  
[wpiper@ppeclaw.com](mailto:wpiper@ppeclaw.com)  
[kamestoy@ppeclaw.com](mailto:kamestoy@ppeclaw.com)

(For VPPSA)

William F. Ellis, Esq. (For BED)  
McNeil, Leddy & Sheahan, P.C.  
271 S. Union Street  
Burlington, VT 05401  
[wellis@mcneilvt.com](mailto:wellis@mcneilvt.com)

William Driscoll, Vice President (For AIV)  
Sandra Dragon, President  
Associated Industries of Vermont  
PO Box 630  
Montpelier, VT 05601  
[wdriscoll@aivt.org](mailto:wdriscoll@aivt.org)

Jeremy D. Hoff, Esq. (For Stowe)  
Edward B. French, Jr., Esq.  
Stackpole & French Law Offices  
PO Box 819  
Stowe, VT 05672  
[jhoff@stackpolefrench.com](mailto:jhoff@stackpolefrench.com)

Joshua R. Diamond, Esq. (For WEC)  
Diamond & Associates  
15 East State Street  
PO Box 1460  
Montpelier, VT 05620-1460  
[jrd@diamond-robinson.com](mailto:jrd@diamond-robinson.com)

Adam T. Conway, Esq. (For IBM)  
Leonard H. Singer, Esq.  
Couch White, LLP  
P.O. Box 22222  
Albany, NY 12201-2222  
[lsinger@couchwhite.com](mailto:lsinger@couchwhite.com)  
[aconway@couchwhite.com](mailto:aconway@couchwhite.com)

Parker M. Reihle, Esq.  
Vermont Ski Areas Association  
26 State Street  
P.O. Box 368  
Montpelier, VT 05601  
[parker@skivermont.com](mailto:parker@skivermont.com)

Paul Burns, Executive Director (For Vermont Public Interest Group)  
Ben Walsh, Clean Energy Advocate  
Vermont Public Interest Research Group  
141 Main Street, Suite 6  
Montpelier, VT 05602  
[pburns@vpirg.org](mailto:pburns@vpirg.org)  
[bwalsh@vpirg.org](mailto:bwalsh@vpirg.org)

Vincent Illuzzi, Esq.  
527 Reidgehill Drive  
Newport, VT 05855  
[vincentilluzzi@hotmail.com](mailto:vincentilluzzi@hotmail.com)

(For Vermont residents and ratepayers)

William Alexander Fead, Esq.  
Fead Construction Law, PLC  
P.O. Box 92  
Williston, VT 05495  
[fead@feadlaw.com](mailto:fead@feadlaw.com)

(For IBM)

Caroline S. Earle, Esq.  
Law Office of Caroline S. Earle, PLC  
107 State Street, PO Box 1385  
Montpelier, VT 05601-1385  
[cse@caroline-law.com](mailto:cse@caroline-law.com)

(For International Brotherhood of Electric Workers, Local Union 300)

Gabrielle Stebbins, Executive Director  
PO Box 1036  
Montpelier, VT 05601-1036  
[gabrielle@revermont.org](mailto:gabrielle@revermont.org)

(For Renewable Energy Vermont)

Andrew G. Costello, Esq.  
City Attorney, City of Rutland, VT  
1 Strongs Avenue  
Rutland, VT 05701  
[andrewc@rutlandcity.com](mailto:andrewc@rutlandcity.com)

(For City of Rutland)