

STATE OF VERMONT  
PUBLIC SERVICE BOARD

Docket No. 6140

Investigation into the Reform of Vermont's )  
Electric Power Supply )

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CONSOLIDATED POSITION PAPER OF  
ASSOCIATED INDUSTRIES OF VERMONT  
CENTRAL VERMONT PUBLIC SERVICE CORPORATION,  
CITIZENS UTILITIES COMPANY, AND  
GREEN MOUNTAIN POWER CORPORATION

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I. Introduction.

On September 15, 1998, the Vermont Public Service Board (the "Board" or "PSB") issued an Order opening this investigation into the reform of Vermont's electric power supply and ordered all Vermont electric utilities to participate. That Order also requested that participants to the investigation file with the Board position papers that address the scope of the investigation and present substantive proposals for consideration. This filing constitutes the consolidated position paper for Associated Industries of Vermont, Central Vermont Public Service Corporation, Citizens Utilities Company, and Green Mountain Power Corporation (together the "Parties").

## II. Scope.

This investigation should be targeted to explore the reasonable and appropriate strategies to lower power costs to all classes of Vermont's electricity customers. Appropriately, the Board opened this investigation to seek proposals on methods that can be implemented to reduce the cost of committed supply resources now in service and used to meet Vermont consumers' demands for energy. Principally, these resources are the Hydro-Quebec/Vermont Joint Owners Contract, the Vermont Yankee Nuclear Power Generating Station and the portfolio of contracts entered into by and between independent power producers ("IPPs") and Vermont's Purchasing Agent pursuant to the Public Utilities Regulatory Policy Act of 1978 ("PURPA") and PSB Rule 4.100. While the costs of these resources are reasonably predictable, they are, at least for the moment, higher than the prevailing spot market price of other available resources.

Simply identifying the costs to be reduced is not enough, however. Since these resources have been developed to meet Vermont's long-term power supply requirements, this investigation will need to determine the specific actions that the many affected Vermont constituencies will take, acting in concert. Utilities will have to play a key role in managing this process -- but they cannot do it alone. Vermont, through its Governor, the Board, the Vermont Department of Public Service (the "DPS"), its agencies and ideally the Legislature, will have to work with the Vermont utilities to help to bring about meaningful power cost reductions.

As described herein, there are a variety of strategies that must be considered if we are all to be successful in materially reducing committed power costs. These include: (1) the renegotiation of committed power contracts, including the buy-out or buy-down of those commitments; (2) the auctioning of power supply resources, including power contracts and

generating plants and facilities; (3) the positioning of potential increased transmission capability in order to create value and attract mitigation partners; and (4) the pursuit of other creative and coordinated financial arrangements that may be deployed to help to access the capital necessary to implement the mitigation strategies to meaningfully reduce the committed power costs discussed herein.

Moreover, in order to effect many of these strategies, it will be incumbent on Vermont to decide how and to what extent it is willing to support these strategies in order to create the sense of surety necessary to induce power suppliers, third parties and lenders to participate in these efforts. If these interests are not provided with a high degree of certainty that Vermont's utilities will be able to fund their residual renegotiated obligations, or that the state will not otherwise disrupt any arrangement that is struck, we cannot reasonably expect that they will participate to help to lower power costs. This is particularly relevant to any new financing arrangements that should be considered as part of an integrated power supply cost reduction package. These could include asset-backed securitization, issuance of rate orders or, more effectively, enactment of legislation that creates binding obligations to support credit arrangements, and the use of public funding and financings in order to obtain the least cost sources of capital necessary to effectuate power cost mitigation and to lower the cost of service.

As the Board is aware, Vermont's existing power supply portfolio is made up largely of premium, clean, price-stable supply resources developed consistent with historic policies. However, the power supply world has changed and those policies did not contemplate the possibility of electric industry reform, restructuring or the introduction of direct retail access. If, as the Order suggests, these resources are to be used by third parties "who could derive greater

efficiencies or economic value from Vermont's power supply resource than presently exists", Vermont will have to decide if it is willing to rely upon a different portfolio of resources to meet customers' demands for power. This could mean greater reliance on fossil fuel and other different supply sources. Moreover, to the extent that the incumbent supply portfolio provides a hedge against fossil fuel price volatility, Vermont will have to decide how much and what type of risks it is willing to assume as part of this process. The current portfolio of supply resources has served Vermont consumers well. Changing that supply will necessarily require that the Board reconsider the economic and environmental trade-offs inherent in new portfolio arrangements as well as other least cost integrated planning considerations.

The Order opening this investigation correctly identifies the context for considering reforms of the power supply situation as the historic relationship between electric rates paid by Vermonters and rates paid by customers in other Northeastern states and the need to act quickly to lower costs. However desirable a goal it may be, comparisons of New England and New York electric rates to national average rates is not only unrealistic but harmful to any effort aimed at reform. For many reasons, including the scarcity of economical generation fuel resources, electric rates in the Northeast have never been competitive with rates in regions that have, for example, federally subsidized sources, extensive hydro resources, natural gas supplies or coal-fired sources.

In addition, a direct cost comparison of power costs does not reflect the relative importance assigned by different regions to so-called "societal values" and their resultant costs. New England, and Vermont in particular, give environmental and energy efficiency considerations a far higher value than is assigned to those issues by other regions. Accordingly, it is important at the outset to recognize that the goal of this proceeding, the targeted reduction in power costs,

must be established with realistic views of achievability and of the collateral implications of doing so. It is here that the Board can play a significant role in educating consumers and policy makers so that electric utility industry reforms can proceed in a reasonable and orderly manner and so that all of the components that drive the cost of power supply can be understood by Vermonters.

There are two other strategies for dealing with Vermont's power supply costs. Neither of these requires further investigation under this docket. They are:

- A. Apply cost-based ratemaking principles in the normal course of regulatory business and pass on the higher power supply costs to customers as they occur. Of necessity, this course is being followed parallel to this investigation by the various utilities that need additional rate relief to cover their rising costs.
- B. File for protection from creditors, including those holding power supply contracts, under the federal bankruptcy laws. This strategy would inevitably lead to a cascading of utility insolvencies. (See attached paper of David Wiggs, former CEO of El Paso Electric Company).

Under the first, service quality is maintained but customers do not benefit from the possibility that the mitigation strategies described herein provide. Under the latter, Vermont will lose control over its power industry while costs of the various bankruptcy proceedings or other litigation mount with no assurance that Vermonters will see any savings at all. Moreover, the costs of the process can mean time, uncertainties and difficulties for the power marketplace as well as other critical sectors of the Vermont economy. As such, neither of these strategies represents a constructive solution for Vermont's current power cost situation.

In summary, this proceeding must focus not only on the actions to be taken by Vermont utilities, but also on the actions to be taken by Vermont as a whole. It is only through consensus-building that Vermont will achieve meaningful power cost reductions swiftly. If consensus and

agreement cannot be achieved as quickly as possible, implementation of creative and constructive methods to reduce power costs will not be possible and Vermont, its residents, its utilities and, indeed, its economy all will be short-changed. This outcome should be avoided at all cost for the benefit of the public good.

This investigation is a practical and productive means to advance the study of mitigation alternatives and a significant step toward the development of the necessary public consensus. It is also a way for Vermont to show that it is serious about the prompt development of a reasonable strategy to meaningfully effect and maximize power cost savings. As such, the undersigned parties are committed to making this process successful and to working to implement strategies and agreements that are most likely to result in power cost savings.

### III. Proposals for Consideration.

#### A. Understanding the Regional Power Supply Marketplace.

Understanding the regional power supply context is important as alternatives for power supply reform are considered in this investigation. This will mean that Vermont will have to define the parameters of power cost mitigation that is sufficient. It also is important that Vermonters understand this context and that the Board play a role in helping to educate the public and policy makers on realistic and relevant targets, given Vermont's market size and power.

The public also needs to understand Vermont's current, relative position in regard to rates. While the power supply cost for Vermont utilities is above current New England Power Pool ("NEPOOL") spot market prices (a situation that is also true for every other utility in the NEPOOL and New York markets), the actual rates paid by customers of Vermont's utilities remain at or below the New England average.

For 1996, the last year for which data is readily available, statewide average rates were:

- **Vermont**, 9.81 cents per kilowatt-hour (“kWh”);
- Connecticut, 10.53 cents /kWh;
- Maine, 9.57 cents/kWh;
- Massachusetts, 10.29 cents/kWh;
- New Hampshire, 11.72 cents/kWh;
- New England average, 10.42 cents/kWh;
- New York, 11.52 cents/kWh.

There is a wide dispersion in retail rates amongst the nearly two dozen electric utilities in Vermont, but this rate dispersion should not obscure the important interconnection among these companies. All 22 utilities are tightly linked by history, by operation of the transmission system and, most importantly, by power supply. All or substantial numbers are linked by Vermont Yankee, by the IPPs, through the Vermont Electric power Company (“VELCO”), via the Highgate converter facility, through participation in Phase I/II of the HVDC Transmission Line, through ownership in the McNeil Generating Station and by the Hydro-Quebec contract. Changes in any of these sources would significantly affect all Vermont utilities. Over the years, this close connection of the utilities through common power supplies has greatly benefitted Vermont electric customers, but it also means that financial stress on one of these utilities ripples through the entire system.

Accordingly, the Board should first convene a technical workshop to develop a compendium of facts about Vermont’s power supply portfolio and the costs and sources of power now available throughout New England and regionally. This should include enough information

to foster a public understanding of three features of the current situation: the regional context, relative and relevant rate comparisons, and the interconnected financial obligations of the utilities in Vermont.

B. Power Cost Mitigation Strategies.

Because of the legally inseparable economic connections amongst the Vermont utilities, it is impossible to adopt strategies or policies that treat the power supply commitments of incumbent Vermont utilities differently one from another. Therefore, the Parties to this Position Paper have identified strategies that could be applied to all Vermont electric utilities and that hold potential for reducing the overall cost of power. These Parties propose that the Board sponsor separate workshops that will explore each of these options, plus any others that the Board develops through this docket.

1. Bilateral Renegotiation and Management of Supply Contracts.

Bilateral renegotiation and management of supply contracts between utilities and power suppliers represents one strategy for reducing the cost of committed power supply arrangements. The Hydro-Quebec contract and the contracts for power entered into by and between the Board's Purchasing Agent and IPPs could be bought down or, in the case of IPP plants that could not economically be brought to market price, bought out using low-cost refinancing opportunities. If this approach were successful, the cost of committed power contracts would be reduced and, where power contracts are bought out, new lower cost supplies could be introduced into Vermont's supply portfolio.

Accomplishing this strategy requires a combination of low-cost capital and intense negotiations relying on suasion provided by the Board and political leaders. The strategies

described above assume the availability of asset-backed securitization financings that would require legislative and/or regulatory support in order to provide the surety investors would require to provide the low-cost capital necessary to accomplish the projected mitigation. The interest cost of the borrowings to finance the buy-downs and buy-outs, and the resulting power supply cost reductions will, depend directly on the level of legislative and/or regulatory support accorded by Vermont<sup>1</sup>.

When considering this strategy for power cost mitigation, it will also be necessary for the Board to consider the actions that Vermont will be called upon to take in order to effect beneficial contract modifications. Specifically, contracting parties will want to know if the purchasing utilities will have sufficient electric rates as are necessary to live up to their residual obligations under renegotiated contracts. If contract concessions are made, suppliers cannot reasonably be expected to assume the risk that the utilities or the State might not be able to live up to their end of the bargain. Likewise, if the proposal is based on the need to raise capital, no lender can reasonably be expected to make capital available -- let alone at low cost -- if it appears that the utility might not be able to repay the loans necessary to effect a buy-down or buy-out. Since Vermont's energy policy has favored the development of the incumbent resource portfolio, this phase of the Board's investigation should also focus on the steps Vermont will have to take in order to provide contracting parties and lenders with the surety necessary to enable the effective use and the maximization of renegotiation as a mitigation strategy.

Similarly, Vermont's utilities must manage their existing supply arrangements properly for the benefit of their customers. This means that utilities must seize every opportunity to protect their rights

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1. Refinancing options may be particularly successful now given the drop in interest rates and expectation that they may even be lowered.

under existing contracts and, where those rights provide remedies or other enforcement mechanism, utilities must act to maximize these opportunities. Toward this, Vermont utilities are presently pursuing their rights against Hydro-Quebec in connection with the failures attendant to last winter's ice storm.

Accordingly, the Board should convene a technical workshop to consider the pros and cons of contract renegotiation and management strategies as a means to lower committed power costs. That workshop should also focus on the steps Vermont can and should take through Board, executive and legislative means to create the environment where lenders and contracting parties will be able to work together to expeditiously effect beneficial contract renegotiations for the greatest benefit to Vermont stakeholders.

## 2. Power Contract and Generating Plant Auctions.

Recent auctions of generating plants and portfolios in the Northeast have resulted in favorable pricing levels for the selling utilities. This "early mover" premium may still be available in the marketplace, but it will last only until buyers' collective appetites for merchant generation have been satisfied. A sale of resources obviously would produce more favorable results if the power contracts have been optimized through the negotiation/buy-down process outlined above.

An auction would establish a firm market price for the generation resources and, thereby, pinpoint the extent to which Vermont's consumers and utilities would remain obligated under their prior commitments. If the auction resulted in premiums being paid by interested third parties for any of the utility assets or contracts, the auction would offer savings. Such an auction can be conducted economically. However, to provide additional savings for customers, this strategy would also require some form of regulatory and/or legislative assurance to support the post-auction structure of the industry in order to support buyer financings.

The value of the generating assets could be enhanced further by regulatory and/or legislative action. As with any commodity, buyers would be more likely to pay a premium if they knew the rules and regulations of the emerging wholesale and retail power marketplace so that the market can work effectively. Therefore, we believe that a sale into a fully restructured Vermont electricity marketplace with clear, stable and predictable market rules will yield the most successful auction with the greatest benefit for all Vermonters.

In the absence of restructuring, the power supply resource portfolio's value under an auction could be materially increased with a "bridge" to competition, possibly in the form of a transition power contract back to the selling utilities or their customers. An auction with this feature could be structured with a fixed price contract and competitive bids for the generation portfolio, or a fixed portfolio price with competitive bids on the power contract pricing.

Accordingly, the Parties recommend that a technical workshop be established to consider the auction approach and to determine the specific actions that Vermont must take if it chooses this strategy to lower committed power costs.

### 3. Sale or Closure of Vermont Yankee.

While we still believe that it is a viable and cost-effective resource for Vermont consumers, the sale or closure of the Vermont Yankee Nuclear Generating Plant may provide another option for mitigating committed power resource costs. Since Vermont Yankee is a federally regulated nuclear plant and Vermont's most significant in-state supply resource, it warrants special attention apart from the consideration of the generating plant auction approach discussed above. Moreover, Vermont Yankee has been a major Vermont employer and taxpayer. Changes in its ownership or operations may impact these matters as well.

Note that Vermont Yankee has committed itself since 1996 to conduct a shut-down analyses at

the time of each refueling or significant capital commitment. Presently, the DPS is conducting its own assessment of the cost-effectiveness of this resource.

Accordingly, the Parties urge that a technical workshop be convened to consider the special public policy considerations that surround the options that relate to Vermont Yankee.

4. Special Issues Attendant to Vermont's Rule 4.100 Contracts with IPPs.

Vermont's system for the sale and purchase of power from IPP facilities pursuant to PURPA is unique and may present special opportunities for effecting low-cost buy-outs or buy-downs of these significantly above-market power resources.

To implement PURPA, the PSB adopted Rule 4.100 which provides that IPPs developed in Vermont may opt to sell the output from their facilities to a Purchasing Agent under contract to the Board who, in-turn, allocates its purchases pro rata to all of Vermont incumbent utilities. A significant majority of Vermont IPPs elected this option and, as a result, all incumbent Vermont utilities are presently forced to take and pay for this power resource even though it is presently priced more than 300% above prevailing market costs. The PSB's Agent, and not the Vermont utilities, entered into the IPP contracts. The terms and conditions of each contract were also established by the Board, and the prices for the energy output were determined based on filings made and supported by the DPS on a statewide basis.

Given the special nature of these contracts and the opportunities for mitigation that they present, the Parties urge the Board to convene a technical workshop to consider mitigation strategies for this category of power supply resources. The potential for savings from renegotiation with the IPPs may be improved if the Board also reopens the dockets under which the original PURPA rates were established through Rule 4.100.

5. Transmission Access and Expansion.

Increased capacity in the VELCO system could add value to the other mitigation strategies, including contract renegotiation, power supply portfolio auction, or a marketplace bridge for electric sales to Vermont customers. The value of transmission expansion to merchant generators and marketers needs to be explored, particularly in light of the physical constraints of the transmission network in the Northeast.

While it is not possible for Vermont utilities to link their power marketing activities with their transmission operations under the requirements of Federal Energy Regulatory Commission (“FERC”) Rule Nos. 888 and 889, there may be creative ways that allow Vermont consumers to benefit from an expansion of the transmission system. Thus, it is Vermont and VELCO (and not the utilities) that have a significant role to play in this potential mitigation arena.

Accordingly, the Parties urge that the Board devote a technical workshop to the exploration of the issues attendant to a possible upgrade of the VELCO system and the means that Vermont may employ to derive the maximum benefit for Vermont consumers from such a mitigation strategy.

C. Access to Capital Considerations.

In order to effect the above mitigation strategies available to help reduce committed power costs, this investigation will of necessity have to consider the means and methods available to raise the capital required to effect mitigation. If the utilities cannot finance the buy-down or buy-out of their contracts, no matter how beneficial the mitigation afforded, these opportunities will be forfeited. In addition, there may be refinancing opportunities for existing indebtedness that could further reduce the cost of service for consumers if lower cost securities can be issued.

1. Asset-Backed Securitization.

One method for accessing low-cost capital in connection with utility restructuring initiatives

that has received a lot of attention is so-called “asset-backed securitization”. Under this method, the utility conveys its rights to a portion of its future customer revenues (*i.e.*, wires charges) through a “true sale” to a third-party, single purpose trust that would not be affected by a future bankruptcy of the utility. That trust then issues bonds secured by its right to receive the assigned portion of the utility’s revenue stream. The proceeds from the bond issuance may then be used by the utility to finance the buy-down or buy-out of its power supply obligations. The collection over time of the assigned portion of the utility revenues is used to pay the interest and principal requirements of the trust’s debt obligations.

This financing method is desirable because it affords access to low-cost capital -- capital that might not otherwise be available to the utilities in light of the long-term nature of the incumbent supply commitments and the magnitude of the funding that could be necessary in order to achieve a reasonable buy-down or buy-out. Moreover, since it is the third party trust in reliance on its property right to a portion of future utility revenues, the creditworthiness of the utilities is not considered when determining the cost of capital to the trust. This should result in a AAA bond rating for the trust’s securities -- a rating far superior to those today or in the future of the incumbent Vermont utilities. What has made this approach controversial is that ideally it requires a pledge by the regulators, and in turn the legislature, that they will not take action in the future that will impair the ability of the trust to collect the amounts necessary to repay the bonds. Since this method will likely require legislative action to access this low interest rate capital, it represents an option that cannot be unilaterally adopted by Vermont’s utilities in the effort to reduce power costs.

Accordingly, the Parties request that the Board devote a technical workshop to consider the merits of asset-backed securitization as a financing option to be used in connection with the mitigation strategies discussed above.

2. Other Utility Financing Options.

In the absence of asset-backed securitization, utilities will have to pursue other, more costly, means to raise the capital necessary to effect mitigation of their committed power supply resources. Under these arrangements, the utility itself issues debt securities which are recognized on the utility's books and accounts as its legal obligations. However, given the limited borrowing capabilities of the incumbent utilities and the fact that they need to continue to access the capital markets in order to maintain their systems and facilities to meet customer service demands, this approach raises feasibility concerns.

To ameliorate these concerns, it will be necessary to provide debt holders with assurances that the utility will be able to meet any new and expanded debt service requirements in the future. This will require a concerted effort by all interested stakeholders, including Vermont acting through the DPS, the Board and other affected agencies. If it can be demonstrated that Vermont will allow utilities to collect the revenues necessary to pay for the new debt used to reduce committed power costs, and still be able to attract the capital necessary to keep and maintain service quality, the utilities may be able to raise the capital necessary to accomplish meaningful mitigation without asset-backed securitization. Should asset-backed securitization, or other lower-cost financing, eventually become available, these new financing tools might still be employed to improve the value of the mitigation efforts to Vermont consumers, however the terms of the utility financings can limit this opportunity (*e.g.*, call provisions, or pre-payment make whole premiums).

This investigation should focus on the possible use of utility financings to effect power supply mitigation including the specific assurances that can be developed under the existing regulatory framework, in the form of a rate order or otherwise, in order to provide the assurance that investors will require before they can be expected to finance mitigation strategies. This effort should therefore also

be a topic of a technical workshop.

3. Public Financing Options.

Probably the least-cost source of capital that could be used to effectuate supply mitigation strategies would be tax-exempt securities issued by a state financing authority or other state instrumentality or agency. If capital could be raised in this manner, the interest rate applicable would be less than the least-cost non-tax-exempt option. While there are difficulties in accessing tax-exempt funding for power cost mitigation purposes, Vermont has yet to fully consider this option, and this investigation may afford an appropriate opportunity to do so. As such, the Parties recommend that the Board convene a technical workshop in order to review the pros, cons and legal issues that arise in connection with the use of public financing options to fund the above described mitigation proposals.

D. Power Supply, Environmental and Least Cost Planning Considerations.

As Vermont takes steps to reduce the cost of its committed power supply resources, it may become necessary to consider the possible replacement of some existing supply resources. If, for example, an IPP's obligation to provide electricity to Vermont purchasers were extinguished as a result of a buy-out of its Rule 4.100 power contract, in the absence of industry restructuring encompassing retail access, each Vermont utility would have to replace the kilowatt-hours of energy that producer previously provided in order to meet customers' energy demands. This will mean that an above-market, but renewable and green, resource will be replaced with lower cost power purchased at market prices from fossil fired generating facilities. As such, the characteristics of Vermont's electric supply portfolio can be expected to change.

Under the existing regulatory framework, long-term power purchases require PSB approval. Even if the acquisition of new long-term power resources are not implicated by a mitigation strategy, each utility is still required to file an integrated resource plan for the supply of energy and energy

services to customers at least-cost. This requirement specifically entails the recognition of both economic and environmental costs. Should Vermont move away from reliance on the premium resources now included in its supply portfolio toward short-term market based resources, it will have to reconsider the environmental and economic trade-offs that are likely to arise under the new strategy. This investigation should not lose sight of these factors and should be used as a sounding board to consider the policy implications precipitated by the above described mitigation strategies.

Accordingly, a technical workshop should be convened to consider these policy matters and provide advice and “rules of the road” to guide utilities, potential mitigation partners and consumers towards acceptable mitigation and replacement power supply strategies from social and environmental as well as economic perspectives.

#### IV. Recommended Procedure for Technical Workshops.

As set forth above, the Parties to this Position Paper recommend that the Board convene a series of technical workshops to foster the development of a record and to help forge public consensus on the subjects of this proceeding. Having made this recommendation, it is important to elaborate on the need for this proceeding to move forward quickly, and in the absence of burdensome procedure.

Rather than requiring that parties engage in extensive discovery and prepare prefiled testimony and supporting exhibits, this proceeding calls for a dramatically different approach. Instead, parties should be prepared to attend and participate in each technical workshop. These workshops can be convened under oath, although this may not be necessary. If participants believe that printed materials will facilitate discussion at the workshops, such materials should be provided to all participants in advance. Each participant should be able to question other presenters and provide alternative comments. Participants should also be afforded the opportunity to file written comments (and reply comments) at the close of the process, including proposed recommendations and draft reports.

In order to allow the investigation to be completed in a timely fashion, the Parties recommend that a schedule be established that sets the dates and subject matter for the workshops and a date certain for closure of the investigation. Workshops could be convened weekly or bi-weekly in order to keep the process moving. Given the urgency of the issues at hand, this stream-lined approach would appear to be most effective and likely to help build public consensus and agreement. For summary purposes, this Position Paper recommends that the following be treated as workshop subjects:

1. Understanding the Regional Power Supply Marketplace;
2. Opportunities for Bilateral Renegotiation and Management of Supply Contracts;
3. Opportunities for Power Contract and Generating Plant Auctions;
4. The Possible Sale or Closure of Vermont Yankee;
5. Special Issues Attendant to Vermont's Rule 4.100 Contracts with IPPs;
6. Transmission Access and Expansion Opportunities;
7. Appropriate Uses of Asset-Backed Securitization in Power Cost Mitigation;
8. Other Utility Financing Options;
9. The Role of Public Financing in Power Cost Mitigation; and
10. Power Supply, Environmental and Least Cost Planning Considerations.

This effort should be completed by year's end so that actions, including possible legislative actions, can be reported to legislative leaders for their consideration before the commencement of the new biennium.

As the Board is aware, the Governor's Working Group on Vermont's Electricity Future has been investigating the costs and opportunities for reform of the electric industry in parallel with this proceeding. It is anticipated that the workshops called for herein will complement the efforts of the Working Group and allow the participants to share with the Board the ideas that have been presented to

the Working Group. A report from the Working Group is expected by December 15, 1998 -- about the same time suggested for completion of this investigation.

This process should allow all interests to be meaningfully represented without the usual cost and expense necessary to participate in a PSB proceeding. Moreover, this process should limit the need for protective agreements and other procedures that would otherwise arise in light of the confidential commercial and legal issues that are the subject of this investigation. Of course, the specifics of bargaining positions and possible legal actions cannot be fully disclosed in order to protect participant's legitimate legal and commercial rights and these rights will have to be respected as a part of this investigation.

#### V. Conclusion.

The goal of this process should be to establish in Vermont a world-class, competitive electrical power industry that provides the greatest value for consumers by reducing power costs. The undersigned Parties endorse and support the Board's effort to work on the development of strategies to achieve meaningful reductions in the cost of committed power resources. Through consensus building and dedication to this effort, these Parties believe that a solution can be developed that permits the deployment of a successful strategy to mitigate power costs. As noted herein, this effort will require that Vermont cooperate with its utilities to assist them in working with power suppliers and the financial markets to reduce the total cost of power supply commitments to the maximum extent possible. The undersigned Parties are ready to

work on this important issue and are committed to making the Board's investigation an important part of this process.

DATED at MONTPELIER, VERMONT this 5th day of October, 1998.

Respectfully Submitted,

ASSOCIATED INDUSTRIES OF  
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ATTACHMENT

## **M E M O R A N D U M**

**From: David H. Wiggs**  
**Former Chief Executive Officer of El Paso Electric**

**Re: Electric Utility Bankruptcy**

**Date: September 15, 1998**

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### **1. Overview**

I have been advised that a Chapter 11 Bankruptcy proceeding has been raised by several interested parties as a viable solution to the serious regulatory and financial issues facing Green Mountain Power Corporation. As the former Chief Executive Officer of El Paso Electric Company ("EPE"), I personally directed that company through its Chapter 11 Bankruptcy and can assure all concerned stakeholders that bankruptcy for an electric utility is for the most part ineffective, very time inefficient, incredibly expensive and complicated, and in all cases totally unpredictable. The recent rate order for Green Mountain Power Corporation has plunged the company into circumstances somewhat analogous to those encountered by El Paso Electric Company during my tenure as Chief Executive Officer. Among the clear lessons I learned from the EPE Chapter 11 proceeding is that bankruptcy is absolutely the wrong way to protect and benefit the customers, employees, creditors and other investors of an insolvent electric utility.

### **2. El Paso Electric Company Background**

The El Paso Electric Company financial problems can be traced largely to its substantial investment in the three unit Palo Verde Nuclear Generating Station, which proved upon completion to be an expensive source of generation relative to other southwestern US power plants. While EPE's participation in the Palo Verde Station was approved prior to its construction and a CCN granted by the Public Utilities Commission of Texas, over a period of time, it became clear that the company was unlikely to be granted sufficient rate increases to cover Palo Verde's actual costs of service.

When I assumed the role of Chief Executive Officer of EPE (May 1989) the company was rapidly running out of cash and surviving fiscally by drawing down its informal bank lines of credit. In order to "stop the bleeding", I moved immediately to sell off all of the company's money losing unregulated subsidiaries. Further cash was conserved by discontinuing in its entirety the common stock cash dividend, which by that point in time was being financed primarily through additional borrowings. By this time the company had no real access to the long-term capital markets. In addition, several operating initiatives were undertaken in order to strengthen the company's operating and financial performance: most senior management and most of the Board of Directors were replaced and workforce reductions and efficiency initiatives were undertaken that resulted in labor cost reductions in the order of twenty percent. A material amount of the company's indebtedness was restructured and new lines of credit were established to keep the company operating over the next two years. This was designed to give EPE time to pursue rate relief sufficient to avoid pending insolvency.

For over one year, the company advised the Texas commission and the City of El Paso that without adequate rate relief and a proper regulatory order to

enable it to meet FASB 71 accounting rules, EPE would be forced to file for bankruptcy relief under Chapter 11. In order to meet its continuing financial and operating cost obligations, EPE and the commission staff worked out a rate plan providing for a series of rate increases over several years that aggregated over twenty percent. In a parallel effort, the company negotiated a comprehensive restructuring package with lenders also subject to receipt of an adequate rate order. Despite the commission staff and the ALJ recommending the negotiated rate plan for approval, the commission, by a vote of two to one, unilaterally changed the terms of the proposed order. These changes resulted in material accounting write-offs and technical defaults under the company's various debt agreements. In a chain of events triggered by the adverse rate order, the letters of credit backing the equity portion of the Palo Verde capital leases were drawn down in January of 1992 and EPE found itself liable for an additional three hundred million dollars of debt. Having run out of cash and available lines of credit in December of 1991, the company filed Chapter 11 on January 8, 1992 to protect its assets and to preserve its options.

### **3. El Paso Electric Company Bankruptcy**

El Paso Electric Company's greatest source of financial strain related to the "sale and leasebacks" that it had used to finance approximately forty percent of its investment in the Palo Verde Nuclear Generating Station. It was therefore natural to reject these leases and find a way to minimize the resulting damage claim. There was, however, no legal opportunity to successfully execute this strategy, and the company was forced by its creditors and the court to entertain a merger and acquisition based Plan of Reorganization. When EPE had declared bankruptcy, its regional competitors immediately began "circling in the waters" by approaching the unsecured creditors of the estate in order to force the sale of the company. The chapter 11 process left the company and the State with little or no

ability to control the ultimate ownership of the utility.

In the end, Central and South West Corporation ("CSW") out-bid Southwestern Public Service Company. The CSW Plan of Reorganization was premised on a series of rate increases that were less than the stand-alone EPE was entitled to, but above the City and State's expectations. For a variety of reasons, mostly related to changes in the US Electric Utility industry and the financial performance of CSW itself, the merger was canceled by the acquirer and EPE remained mired in bankruptcy.

The creditors now realized that a merger strategy was unlikely to work on a timely basis, and turned their attention to a stand-alone solution. I took the initiative at this point, using the reorganization theory developed and advocated by John G. Paton of New Harbor, Incorporated, (EPE's financial advisor throughout the bankruptcy), to craft a long term rate deal with the new Mayor of El Paso (a businessman by trade rather than a career politician). This rate path gave the company an immediate rate increase sufficient to pay EPE's costs-of-service and service the debt remaining after the restructuring, followed by a long-term rate freeze. A plan of reorganization was then negotiated with the creditors based on a massive \$1.2 billion underwriting of high yield ("junk") securities. In the end, the secured creditors received full recovery, unsecured creditors recovered approximately 80% of their claims, the preferred and common equity holders shared a modest "nuisance" value, and EPE ended up a highly levered company. While the Plan was a great success for the Vulture Funds who had accumulated much of the unsecured debt during the pendency of the bankruptcy, the common equity held by El Paso resident shareholders, including pensioners and former and current employees, was largely wiped out. Approximately \$120 million of professional fees and expenses had been incurred

and paid primarily to out-of-state lawyers and advisors, and electricity rates went up to roughly the same level that they would have been under the staff and ALJ recommended order. El Paso operated under bankruptcy court rules and regulations from January 8, 1992 to February 12, 1996.

#### **4. Risks of Chapter 11**

The primary downside for the bankrupt utility and its stakeholders, including its customers, employees, shareholders, and state regulators is the complete loss of control of the process to the Federal Bankruptcy Court. The Federal judge has fairly complete and unfettered authority in exercising his duty to protect creditors and maximize the value of the bankrupt estate. On the otherhand, nothing in the Bankruptcy Code would require a presiding judge to protect Vermont customers or the employees of a Vermont utility company under his charge. The biggest problem for Green Mountain Power and the State of Vermont would be that there is no way to predict the actions that a particular federal bankruptcy judge assigned to the case might take. (For example, bankruptcy law is far from clear as to who has jurisdiction over electric service rates during the pendency of the bankruptcy proceedings.) As a result, a significant portion of the El Paso Electric case time and cost for the Texas commission was dedicated to fighting various jurisdictional battles - a significant cost not provided for in most state budgets, and a cost which is not recoverable from the bankrupt utility unless included specifically in its Plan of Reorganization.

Bankruptcy court could order a number of actions which would be very detrimental to any or all of a bankrupt utility's customers, creditors, shareholders, politicians and regulators, including:

- Order a sale of the utility or its assets and operations to an out-of-state company

- Freeze rates to protect creditors until all stranded costs are paid for in full, thereby delaying electric competition for years to the possible detriment of the area's ability to attract new businesses
- Order rate increases or freezes and force the state to bear the costs of appeals as far as the U.S. Supreme Court
- Refuse to let the utility company reject specific contracts, or allow very large damage claims for rejected contracts and order rate relief or surcharges to pay such damages. These specific contracts would include special economic development contracts which are of importance to the State and its manufacturing base of employment
- Appoint a trustee to run the company during the pendency of the bankruptcy proceedings who is either unknown to, or not to the liking of state regulators and politicians, and who will unlikely be as sympathetic to Vermont concerns as existing resident employees

In addition to the imposition of a Federal bankruptcy court above all other affected parties, the bankruptcy process itself brings a number of negative implications for utility stakeholders. By far the most directly affected constituency are the employees of the bankrupt utility. Job cutbacks are inevitable, even at the cost of reduced electric customer service (which inevitably results) and possibly system reliability, and employee moral will be crushed. The predictable result is that the most talented personnel at all levels seek opportunities at other companies, or at other utilities in different jurisdictions, again with potentially negative utility service consequences. Furthermore, there is very little ability in a court-imposed sale of a bankrupt estate to protect employees and their employment. The usual result in these circumstances is that older employees may lose their livelihoods, and most significantly, the unvested and unfunded portions of their retirement benefits.

The other group to suffer the most in utility bankruptcies is the common and preferred shareholders. While most of the equity investors are faceless

out-of-state funds, a significant portion of most electric utility common equity is held by local residents of the bankrupt utility's service territory, employees through 401K plans, and ex-employees (often as an essential source of fixed retirement incomes).

From the standpoint of the utility, the creditors themselves may change. The personnel at the financial institutions that have traditionally dealt with, and understand the unique characteristics facing the utility and the state, are replaced by members of "work out" groups whose sole objective is a quick liquidation of their claim at the highest recovery level. As you would expect, many of these claims are sold to so-called "vulture funds" before any Plan of Reorganization is approved by the court. Whereas lending institutions have some residual interest in the debtor and their own institutional reputation within the region, particularly for future post-bankruptcy transactions with the utility, vulture funds have absolutely no such concerns moderating their actions.

The most common fallacy held about bankruptcy is that it enables the filer to abandon or reject without consequence any perceived undesirable contracts, such as the Hydro Quebec purchase power contracts and the outrageously priced QF contracts throughout New England and California. In fact, if such contracts are allowed by the bankruptcy court to be rejected, the contract counterparties will be entitled to damages which in turn become unsecured claims ahead of existing common and preferred equity holders. Hence, in the case of above-market purchase power contracts, the uneconomic portion of such contracts would simply be accelerated into an immediately due liability. In such circumstances, the contract counterparties (Hydro-Québec and the QFs) would join the unsecured creditors of the estate, and, if the damages are sufficiently large, end up controlling the common stock of the Company post-bankruptcy.

## **5. Summary**

My first hand experience at El Paso Electric Company taught me that Chapter 11 Bankruptcy for an electric utility in particular is, simply stated, a very ineffective process that is incredibly expensive and wholly unpredictable, and should be avoided at all costs by everyone involved. I cannot say this strongly enough, and I am confident that the former Mayor of El Paso and the Texas Commissioners who were involved at the time would agree.