

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 4376

Application for transfer of)
certificate of public good)
of Hydro Current Corporation)
to Ottauquechee Hydro)
Company, Inc.)

Order entered: 01/28/94

PRESENT: Rita A. Barmann, Esq., Hearing Officer

APPEARANCES: Geoffrey Commons, Esq.
for the Department of Public Service

Thomas F. Heilmann, Esq.
Heilmann, Ekman & Associates, Inc.
for Vermont Power Exchange, Inc.

Michael Murphy, Esq.
Christopher Dutton, Esq.
for Green Mountain Power Corporation

*Kurt Janson, Esq.
for Vermont Agency of Natural Resources

Richard Saudek, Esq.
Cheney, Brock & Saudek
for Ottauquechee Hydro Company, Inc.

Martin K. Miller, Esq.
Miller Eggleston & Rosenberg
for MetLife Capital Corporation

INTRODUCTION

This proceeding was initiated by a petition jointly filed by Ottauquechee Hydro Company ("OHC") and MetLife Capital Corporation ("MetLife") on August 27, 1992, requesting the Public Service Board to transfer the Certificate of Public Good ("CPG") currently held by Hydro Current Corporation to OHC. The

***Party of record but did not attend hearing.**

petitioners also seek utilization of the same power sales contract (and power price established in Docket No. 4804) between Hydro Current and Vermont Power Exchange, Inc. ("VPX") since the producer began producing electricity approximately seven years ago.

In addition to the petitioners, the other parties to this proceeding are VPX and the Department of Public Service (the "Department" or "DPS"). All retail electric utilities in Vermont were given notice of this proceeding and none sought intervention as parties. The petitioners objected to VPX's intervention, but I granted it at the prehearing conference on January 8, 1993.

At the prehearing conference, the only issue raised was OHC's continued use of the power sales contract between VPX and Hydro Current. VPX requests the Board to condition approval of the CPG transfer to OHC on substitution of the current contract with its own "model" long-term levelized contract. The petitioners strenuously objected to this replacement. In a procedural order issued after the prehearing conference, I directed VPX to explain the differences between its model contract and the current contract that the petitioners seek to continue using, and I further directed the petitioners to comment on VPX's filing and provided an opportunity to VPX to reply to the petitioners' filings and for the Department to comment on all of these filings. Docket No. 4376, Procedural Order of 2/24/93.

Because the parties have all had several opportunities to detail their respective positions on which contract should be used for the project that OHC would now operate, I decided that

no evidentiary hearing was necessary.

For the reasons detailed below, I recommend that the Board grant the requested CPG transfer to OHC. I further recommend that OHC be permitted to use the existing contract, rather than requiring them to use the VPX model contract.

FINDINGS OF FACT

In accordance with 30 V.S.A. §8, I hereby report the following findings of fact to the Public Service Board.

1. On June 6, 1979, the Board granted to White Current Corporation a CPG to construct and operate a hydroelectric generating plant on the Ottauquechee River in the Town of North Hartland, Vermont. On March 28, 1983, the Board granted White Current a new CPG to modify that plant. Docket No. 4376, Order of 10/24/85 at 1.

2. In August of 1985, White Current and Hydro Current Corporation informed the Board that Hydro Current intended to lease the Ottauquechee hydro project. Hydro Current thereafter reconstructed the plant, and Hydro Current sought the Board's permission to transfer White Current's CPG to Hydro Current. The Board granted this request on October 24, 1985. Id. at 2.

3. At present, the nameplate capacity of the Hydro Current hydroelectric plant is 2.06 MW. VPX Schedule A (on file with the Public Service Board).

4. With financing obtained from MetLife, Hydro Current entered into the lease with White Current and made certain improvements to the project. Subsequently, Hydro Current entered into a secured lending relationship with MetLife to secure financing for acquisition of the leasehold interest and to make

the planned improvements to the plant. Docket No. 4376, Petitioners' Application for Transfer to Ottawaquechee Hydro Company, Inc., filed August 27, 1992, at 2.

5. Thereafter, Hydro Current defaulted under the terms of its lending agreement with MetLife. In order to continue operation of the project without interruption, MetLife took over the project, including all right, title and interest in and to the lease with White Current and the other assets and interests of Hydro Current in the project. Id.

6. Most recently, MetLife and OHC entered into an agreement under which, upon obtaining certain approvals, including this Board's approval of the transfer of the CPG to OHC, MetLife was to assign the project lease and sell the other assets relating to the project to OHC. Id. (A copy of the document that details the terms of this assignment was attached to OHC's response to VPX, filed 11/13/92.)

7. Hydro Current's contract with VPX does not prohibit assignment. Moreover, the other contractual party, VPX, expressly agreed to the contract's assignment to MetLife, in connection with MetLife's financing of the project. MetLife Submittal filed 1/28/93.

8. MetLife is primarily an insurance and lending institution and with the exception of default situations like the lending transaction with Hydro Current, is not in the business of owning or operating hydroelectric facilities. In contrast, owning and operating such facilities is precisely and exclusively what OHC and its parent company, Consolidated Hydro, Inc. ("CHI"), specialize in. Id.

9. OHC is a wholly owned subsidiary of CHI. CHI is the largest independent owner and operator of hydroelectric projects in the United States, and it is currently responsible for the operation of more than 70 hydropower projects in 14 states, including Vermont. Id. at 3; prefiled testimony of Jason D. James at 5-6.

10. The Ottauquechee project will be serviced by a full-time on-site operator, who will have the support of the full CHI team. Its regional operations offices located in Sanford, Maine, can provide support services to meet the operational, engineering, mechanical, electrical and manufacturing needs of hydroelectric projects. CHI's corporate headquarters is located in Greenwich, Connecticut. Administrative support for operation of the Ottauquechee project will be provided by the Greenwich office. Prefiled testimony of Jason D. James at 6.

11. OHC's purchase and operation of the plant will be 100 percent financed by its parent company CHI. Hence, there will be no first mortgage holder over the plant. OHC Submittal of 3/10/93 at 3.

12. At present, the Ottauquechee project is operated by Mr. Jerry Reid under a contract with MetLife. OHC intends to continue retaining Mr. Reid's services, either under the terms of his existing contract or as an employee of CHI. Id.

13. OHC's immediate short-term goal for the Ottauquechee project is to improve operational efficiencies through the use of CHI company-wide resources. In addition, within the next five years OHC intends to resurface the downstream face of the dam.

Id. at 7.

14. It is OHC's understanding from MetLife that the Ottauquechee project is in full compliance with all rules and regulations governing the project. Likewise, OHC understands from MetLife that the project is not in default under any of its contractual obligations. Id. at 8.

15. For purposes of this proceeding, VPX has identified the differences between the current power sales contract, dated June 30, 1986, between Hydro Current and VPX, and VPX's "model" power sales contract. Submittal by Vermont Power Exchange, Inc. of Comparative Assessment of Long-term, Firm and Levelized Purchase Agreement By and Between Vermont Power Exchange, Inc., and Hydro Current Corporation with Vermont Power Exchange, Inc.'s Model Long-term, Firm Purchase Agreement, filed January 19, 1993.

16. VPX does not allege that the current contract contains any specific enforcement problem or difficulty that VPX has encountered under that contract. Id. at 2-3. The current contract consists of 18 pages and four attachments. VPX's model contract is 48 pages, with 5 attachments. Id. (attachment); Docket No. 4376, Contract between VPX and Hydro Current, dated 6/30/86.

17. VPX had extensive conversations with OHC, CHI and MetLife before the petitioners filed their Application with the Board. These discussions were not successful in the sense that the contract issue was left unsolved. VPX Submittal, 1/19/93, at 12.

18. Chief among the areas about which the petitioners identify as forcing a radically different arrangement on OHC and

MetLife are those model contract provisions that would mandate more costly and extensive security requirements from the producer. Submittal of OHC, filed 3/10/93, at 2.

19. The current contract specifically provides that amendments can be made only if they do not materially impair any interest of either of the contractual parties. Docket No. 4376, Contract between VPX and Hydro Current, dated 6/30/86, at Section 13.

Discussion

The petitioners have presented a strong case in favor of granting the transfer of the CPG to OHC. The company, and its parent, CHI, have undisputed expertise in owning and operating hydroelectric projects.¹ Hence, transfer of the CPG from MetLife (an insurance and financial institution) to OHC is clearly in accordance with the general good of the state.

This proceeding revolves around one fundamental issue: should the petitioners be required to utilize a new contract, rather than the one previously approved by the Board in this docket, because VPX believes its newer contract is preferable?

In reviewing the model contract, it is obvious why the petitioners took the position that substitution of that contract for the current contract would "materially impair" their interests. The model contract makes the following changes in the terms of the agreement with VPX:

* It deletes interest on payment delays to the producer.

1. Here in Vermont, since early 1989, CHI has operated the Dewey's Mills project located in Hartford, Vermont, for that project's owner, Hydro Energies Corporation.

- * It reduces the standard meter variance from 2 percent to 1 percent.
- * It increases the insurance burden on the producer.
- * It deletes the producer's right to pay off the cumulative present value difference.
- * It increases the burden on the producer to provide security by requiring additional payments into the escrow or security fund and by requiring the producer to provide a letter of credit.

VPX has presented no persuasive argument in its filings in this case that the existing contract should at this time be abandoned in favor of a new contract that appears to be significantly less advantageous for the producer and more secure for VPX. I agree that the Board may take such action under Rule 4.104 (G). However, forcing the result that VPX urges does appear to violate Section 13 of the current contract. It seems particularly unfair because the security provisions in the current contract have never raised any known problem. I am also sympathetic to the petitioners' argument that the contract substitution sought by VPX would send a troublesome signal to the investors and financial institutions monitoring relevant regulatory activities in Vermont.

I would note that this is not the first time that VPX has attempted to force a producer to sign its model contract before it would agree to a new financial arrangement desired by a producer. See Amended and Restated power sales contracts with Barnet Hydro and Newbury Hydro (new contracts allowed refinancing by producers), Docket Nos. 5084 and 5184, approved by the Board on October 6, 1992. I believe that this is a mis-use of the purchasing agent's powers under Rule 4.100, notwithstanding the

Board's desire to safeguard the cumulative present value difference that has accrued under the producer's contract.

Lastly, I have considered the Department's position supporting VPX's view of the contract issue. I am not persuaded that their conclusion is necessarily better for the ratepayers, especially in light of the adverse consequences on the producer in this case and other producers in like circumstances in the VPX system.

Conclusion

I recommend that the Board approve the petitioners' request to transfer the CPG from Hydro Current to OHC. I further recommend that the existing contract between VPX and Hydro Current be utilized for the balance of the 30-year contract term.

This Proposal for Decision has been served on all parties to this proceeding in accordance with 3 V.S.A. §811.

DATED at Montpelier, Vermont, this 3rd day of December, 1998.

s/Rita A. Barmann
Rita A. Barmann, Hearing Officer

Board Discussion

We have concluded that the Hearing Officer's recommendations should be accepted in part and rejected in part. We agree with the Hearing Officer that the Certificate of Public Good (CPG) should be transferred. However, we also conclude that we have authority to require that the power sale contract between VPX and Hydro Current (now Ottauquechee Hydro Company, Inc. or "Ottauquechee") be amended to reflect a more modern understanding of the protections needed by ratepayers in a long-term levelized contract. Therefore we direct that the CPG be transferred, and that this docket continue, under the direction of a Hearing Officer, to determine whether and in what manner the contract should be amended.

The Board Rule

Board Rules applicable to the original contract between Hydro Current and VPX provide as follows:

Neither the qualifying facility nor the purchaser may unilaterally alter the duration of the sales period or the terms and conditions of the transaction after it has become effective. After notice and hearing, the Board may alter such contracts for good cause but, except to the extent that alteration is permitted by the terms of the contract, no such alteration may be made over the objection of any utility or of the qualifying facility if it would materially affect substantial rights or obligations of either the utility or of the ratepaying public.²

Thus, for good cause, the Board can direct that existing contracts between the state's purchasing agent and qualifying facilities be modified. However, those modifications cannot be made over the objection of the QF or of a utility if they affect "substantial rights or obligations of either the utility or of the ratepaying public." It is noteworthy that this passage does

2. Rule 4.104(G).

not protect the rights of either the producer or VPX. The rule is clear on its face; it merely prohibits contract amendments that would harm the "utility" or the "ratepaying public." "Utility" must mean retail electric utility companies purchasing power from VPX, and "ratepaying public" must mean the customers of those retail electric utilities. Thus under 4.104(G) the Board may direct Ottauquechee, as a qualifying facility, and VPX, as the purchasing agent, to modify their existing contract for good cause, so long as the changes do not impair the "substantial rights" of utilities that are buying power from VPX nor of the ratepayers of those utilities.

The Hearing Officer identified five kinds of changes sought by VPX. Chief among these³ are an increase in the security required against the cumulative present value difference (CPVD)⁴ created by this contract. These changes are intended to improve the protections afforded to utilities and their customers; there is no argument that any of these changes would impair the rights of those entities. Consequently, the issue is whether there is good cause for the proposed amendments.

The original contract was approved in May, 1986 between VPX and Hydro Current Corporation. It authorized 30-year levelized rates.⁵ The Hearing Officer's findings described the security to be provided by Hydro Current, and noted that in the 22nd year of the contract, cash paid in as security, plus accrued interest, would cover only 10.5% of the estimated \$12,000,000 of CPVD. Additional coverage from the maintenance and repair fund were expected to increase the total coverage to 14%.⁶ The claimed CPVD at present is \$2.6 million.⁷

Unlike many other similar projects, Hydro Current did not participate in a joint risk pool operated by VPX. In recommending approval of the contract, the Hearing Officer

3. Tr. 12/8/93 at 49 (representation of counsel).

4. The CPVD arises because in the early years of a levelized contract, a producer receives payments in excess of avoided cost. Repayment is normally expected by below-cost payments in later years. However, if the producer should cease to produce, ratepayers need security that their early payments, amounting to a loan, will be repaid.

5. Docket 5059, Order of 5/2/86.

6. *Id.* at 12.

7. Comments of Vermont Power Exchange, Inc. on Proposal for Decision at 1.

appears to have believed that a low probability of breach, combined with the fact that most failures occur in the first ten years of the power sale contract, justified the low ratio of security to CPVD.⁸

Ottauquechee points out that the typical cost of a letter of credit is one or two percent of the principal amount per year.⁹ Thus, if Ottauquechee had known in advance that a letter of credit would be required, it might have reduced its offer to purchase the project.

We have considered carefully whether imposing a change affecting the economic calculations of current parties should be imposed seven years after the original contract was signed. In general, parties to such contracts should be entitled to rely upon their original reasonable calculations of economic benefit. However, while this policy needs to be accorded great weight, the overwhelming fact is that more than an additional \$9.4 million of ratepayers' money is scheduled to be advanced to this project. These advances will take the form of power payments in excess of avoided cost, plus forbearance from collecting interest now accruing on the account. Repayment of that amount, as well as the \$2.6 million currently on account, is a matter of first importance for ratepayers. Security for that repayment is essential.

At the time the original contract was approved in 1986, the Hearing Officer specifically found that the security provisions were adequate to ensure that the cumulative present value difference would be repaid.¹⁰ However, she also indicated that she had considerable doubt about what should constitute adequate security.

At present there are no fixed standards as to what constitutes sufficient security for the repayment of the cumulative present value difference. The package, as embodied in the contract, represents what is currently the "best guess" of what constitutes sufficient

8. The Hearing Officer's proposal for decision noted that while the amount of security had been a "main area of dispute," she also noted that fixed standards did not exist. She described the security package as a "'best guess' of what constitutes sufficient coverage." *Id.* at 19-20.

9. Ottauquechee believes the cost of additional security might be as much as \$90,000 per year. Tr. 12/8/93 at 27 (representation of counsel).

10. *Id.* at 12.

coverage and should be approved by the Board.¹¹

Even though some of these levelized contracts have been in place nearly a decade, because they have a lifetime of 20 or 30 years, none has yet come to term. Therefore we still do not have an historical record upon which to predict what proportion of operating projects will make full repayment of their CPVD. In terms of successful operation during the contract term, our experience since 1986 has been mixed.¹² Many projects have been operated without significant difficulty. A few have been troubled from the outset.¹³

As we continue to gain experience in administering this program, VPX has continued to adjust the security requirements for new contracts. If the CPVD of this project is to continue to increase (as was originally countenanced in 1986) from \$2 million to \$12 million, then we now believe that a risk coverage of 10 to 14 percent is too low to be consistent with the public interest. We are also aware that the project's demonstrated need for levelized rates was driven largely by the high costs of capital during the mid-1980's. The cost of capital has dropped significantly since then, thus reducing the financial obligations of the facility as well as the facility's need for levelized rates. However, ratepayers are still being asked to pay rates based on high oil prices and high inflation rates, and to advance payment on a levelized basis. So long as this project continues to receive levelized payments at those historic rates, we believe that it is both reasonable and fair to make adjustments to the

11. *Id.* at 19-20.

12. While there has not been any breach of the power sale contract for this project, there has been a breach of the financing agreement. Indeed, it was that breach that led to ownership by MetLife Capital Corporation.

13. *See, e.g.,* Docket 5394 (Brockways Mill Station).

security requirements surrounding repayment of the CPVD.

This conclusion is strongly dependent upon the industry acceptance of the changes being advocated by VPX. In particular, we understand that the security terms proposed here by VPX are now routine and have been accepted in a number of other recent contracts, without causing undue hardship on producers.

Thus we conclude there is good cause to require alteration of the contract to conform to the modern security provisions in the current model VPX contract. This would be true whether or not a financial default has occurred, and whether or not the holder of the certificate of public good has sought a transfer of that certificate. The fact that this project has experienced a financial default, and a transfer of the certificate to a new owner only has been requested to reinforce our conclusion that good cause has been demonstrated here.

The Contract

Paragraph 12 of the existing contract between VPX and Hydro Current permits the Board to modify the contract if it finds that a provision of the contract is contrary to the public interest. There are two relevant limitations. First, the Board cannot make such a modification if it would lower the price paid on net output of the project. However, increasing the security requirements on the producer, while it may reduce net profit, does not reduce the price paid by VPX, and thus is not prohibited. There are many ways that a producer with a contract to sell power at a fixed price might find its net profit increased or decreased as a result of government regulation. The

contract guarantees only the price, not the profit. Second, the Board cannot modify the contract if that would impair the right of a party having a lien on the property. This limitation does not apply to the current dispute.

Paragraph 12 of the contract permits the Board to require modification of the contract if it determines that one or more provisions of the contract is contrary to the public interest. Thus the only question under paragraph 12 is whether the existing contract is contrary to the public interest. At least as to security for the CPVD, that criterion is met. The same reasons that were persuasive above on the question of whether there is good cause for modification of the contract also support a conclusion that the security provisions of the contract are contrary to the public interest.

Paragraph 13 of the existing contract, titled "Amendments," states that the contract "may be amended upon approval of the Board" when another producer enters into a long-term, firm and levelized purchase agreement with VPX that has terms materially different than that between these parties. Thus, even more than paragraph 12 of the contract, paragraph 13 clearly was intended to permit modernization of the contract as the purchasing agent, through experience, identified areas for improvement in the contract. That is precisely VPX's intention here, although there are additional facts here arising from the transfer. Thus the question is whether paragraph 13 permits VPX, with the agreement of the Board, to require Ottauquechee to accept a contract more favorable to VPX and to ratepayers than the original contract.

The first issue is what the terms of paragraph 13

actually mean. The operative provision states that the contract "may be amended." This is vague as to the mechanism of amendment. Some might read it as requiring any amendment to be agreeable to both sides. So read, paragraph 13 would give the Board veto power over an amendment sought by both parties, but it would not give either party the right to force change on the other.

Despite the plausibility of this reading, we conclude that "may be amended" means that either party can petition the Board to require that the contract be amended, and that the Board can grant that relief over the objection of the other party. This interpretation seems more consistent with the probable original intent of the Board and of the parties. There would have been little reason to draft a contract provision giving the Board veto power over a change agreed to by its purchasing agent.

The second issue under paragraph 13 is the effect of the last clause that prohibits any amendment that "would materially impair any interest of either of the parties or of any Vermont utility or its ratepayers." Unlike Rule 4.04(G), this language prohibits amendment that would materially impair an interest of Ottauquechee.

Thus the question is what changes would create a material impairment. While the changes sought by VPX would increase Ottauquechee's costs, that fact alone does not create a material impairment. As noted above, the high costs of capital during the mid-1980's are no longer extant. The cost of capital has dropped significantly since then, thus reducing the financial obligations of the facility as well as the facility's need for levelized rates. We consider it a matter of fact, not law, whether the amendment sought by VPX, combined with changes in the

cost of capital and need for levelization, would constitute a material impairment of Ottauquechee's interests. However, since we conclude that the contract can be amended under paragraph 12, we need not reach the interpretation of paragraph 13 at this time.

Further Proceedings

The Hearing Officer described five types of proposed changes to the power sale contract. Our opinion here deals in detail only with security, one of the five. Even as to security, our opinion does not define the details of the contract. Further hearings should be held before a Hearing Officer in this docket to determine in detail how the contract should be amended on these five proposed changes. The Hearing Officer should recommend to us amendments for which there is good cause and as to which **either** an absence of amendment would be contrary to the public interest **or the amendment would not materially impair the interests of either of the parties.**

We express no opinion here concerning the need to amend contracts between VPX and other producers with contracts of similar vintage.

VPX has raised the issue of whether Ottauquechee has made full disclosure of all the terms and conditions of its transactions, including Ottauquechee's capitalization plan. Ottauquechee has offered to disclose any and all information requested by the Board, and to send VPX a complete "closing binder".¹⁴ We see no need to order otherwise, on the assumption

14. Tr. 12/8/93 at 13, 31 (representation of counsel).

that all requirements in the original order will be met.¹⁵

ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. The Findings and Conclusion of the Hearing Officer are adopted, except as noted.

2. Upon proof that it has obtained title and associated rights to the dam located at the Ottauquechee Woolen Mill, and has resolved the contract modification issues discussed herein, the Certificate of Public Good presently held by Hydro Current Corporation shall be transferred to Ottauquechee Hydro Company, Inc.

3. The Certificate of Public Good so transferred to Ottauquechee Hydro Company, Inc. shall not be further transferred without prior approval of the Board.

4. Peter M. Bluhm, Esq. is appointed Hearing Officer to conduct hearings and make a recommendation concerning the extent to which the contract for the sale of electric power between the Vermont Power Exchange, Inc. and Ottauquechee Hydro Company, Inc. should be amended, consistent with this Order, under the authority of Rule 4.104(G) and paragraphs 12 and 13 of the existing contract.

DATED at Montpelier, Vermont this 28th day of January, 1994.

s/Richard H. Cowart)
) PUBLIC SERVICE
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15. For example, this includes maintaining a debt to equity ratio not exceeding three to one. Comments of Vermont Power Exchange, Inc. on Proposal for Decision at 9.

s/Suzanne D. Rude) BOARD
)
) OF VERMONT
s/Leonard U. Wilson)

OFFICE OF THE CLERK

FILED: January 28, 1994

ATTEST: s/Susan M. Hudson
Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board of any technical errors, in order that any necessary corrections may be made.

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.