

MEMORANDUM

To: Justin Johnson, Secretary of Administration; Christopher Recchia, Commissioner of Public Service

From: Ed McNamara, Regional Policy Director, DPS

Date: June 6, 2016

Re: TransCanada Hydro Sale and Potential Acquisition Strategies

Summary

This memorandum presents an overview of the sale of the TransCanada hydro assets, the potential acquisition structures and potential partners in such an acquisition, and discusses some issues regulatory issues that should be considered.

The TransCanada assets for sale consists of 16 dams¹ totaling 579 MW; three gas plants totaling 3,800 MW, with one each located in Rhode Island, New York, and Pennsylvania; a 132 MW wind facility located in Maine, and a power marketing company that provides retail supply and demand response in states with retail choice, headquartered in Massachusetts.

Enactment of H. 577 provides a clear structure, through the creation of the Vermont Hydroelectric Power Authority, for the State to acquire an interest in the assets, and also creates a Vermont Hydroelectric Power Acquisition Working Group to provide recommendations by August 1, 2016. However, as described below, the sale process has already commenced and the initial bids are expected to be due in early July. Accordingly, if the State is interested in acquiring an ownership interest it must move very quickly.

Given the short deadline, it would be extremely difficult for the State to enter a bid on its own. The State could partner with a company with acquisition experience and some companies have already reached out to the State in this regard. Other options for providing value to ratepayers include having the Vermont utilities enter into a partnership or having the DPS or individual utilities enter into a power purchase agreement with the eventual buyer.

Background

TransCanada is buying Columbia Pipeline Group for \$10.2 billion and is looking to sell its Northeast generation assets in order to finance the purchase. The assets for sale include the following:

¹ Three dams are for storage only.

Hydroelectric Assets for sale

Hydroelectric Station / Water Storage Reservoir	Capacity (MW)	In Service	Location
Connecticut River Facilities			
Second Connecticut Lake Dam	Storage only	1914	Pittsburg NH
First Connecticut Lake Dam	Storage only	1915	Pittsburg NH
Moore Station	192	1957	Littleton NH & Waterford VT
Comerford Station	167	1930	Monroe NH & Barnet VT
McIndoe Station	11	1931	Monroe NH & Barnet VT
Wilder Station	41	1950	Lebanon NH & Hartford VT
Bellows Falls Station	48	1928	Walpole NH & Rockingham VT
Vernon Station	36		
Deerfield River Facilities			
Somerset Dam	Storage only	1911	Somerset VT
Searsburg Station	5	1925	Searsburg VT
Harriman Station	41	1925	Readsboro & Whitingham VT
Sherman Station	5	1927	Rowe & Monroe MA
Deerfield No. 5 Station	14	1974	Rowe & Florida MA
Deerfield No. 4 Station	5	1913	Buckland & Shelburne MA
Deerfield No. 3 Station	7	1912	Buckland & Shelburne MA
Deerfield No. 2 Station	7	1913	Conway & Shelburne MA

Additional generation assets for sale

Plant	Fuel Type	Capacity (MW)	In-Service Date	Location
Ocean State Power	Natural gas and #2 fuel oil	560	1990, 1991	Burrilville, RI
Ravenwood Generating Station	Natural gas, fuel oil, kerosene	2,480	1963, 1964, 1965, 2004	Queens, NY
Ironwood Power Plant	Natural gas	778	2001	Lebanon, PA
Kibby Wind Farm	Wind	132	2010	Kibby, ME

In addition to the physical assets, the sale includes TransCanada Power Marketing, which provides retail electricity supply and demand response in restructured states. It has a retail portfolio that consists of large commercial and industrial customers with over 1,000 MW of load.

Process

TransCanada is a publicly traded corporation and is therefore obligated to conduct an open solicitation process that results in the maximum value from the sale of the assets. TransCanada has informally indicated that it is willing to consider selling the hydro assets separately, although they have made clear that they will not carve out individual stations from this category. TransCanada has engaged JP Morgan to conduct the sale and the sale is expected to be conducted through the following multiple steps.

On May 26, JP Morgan sent to interested parties a brief description of the assets for sale and also a non-disclosure agreements that bidders must sign before gaining access to any additional information, including details on the process such as the deadline for submitting an initial bid. Once a bidder signs the non-disclosure agreement, it would not be able to prepare a bid with another bidder absent approval from TransCanada, and a representative of JP Morgan indicated informally that the process of approving would likely take longer than the process for submitting a bid.

JP Morgan will only send the description and non-disclosure agreement to the principal of an entity that can demonstrate that they have access to capital. Based on a discussion with a representative of JP Morgan, the State would need to have the head of the HydroElectric Power Authority contact JP Morgan and explain the financing ability of the authority before the State could receive the non-disclosure agreement. Further, the non-disclosure agreement would not provide the ability for a public entity to make exceptions for state public records law.² After signing the non-disclosure agreement, the State would have access to detail about the sale process and also financial information that would allow for preparation of an initial bid.

From that point there will be a two-stage bid process. In the first stage, bidders submit an indicative bid. After review, TransCanada will select some subset of the bidders from the first stage that are then allowed to conduct additional due diligence, such as physical review of the assets, review of employee contracts and other personnel records, etc. After this review, the short-list of bidders submit a second, more detailed offer. TransCanada can select one or more bidders to begin a round of final negotiations. Since TransCanada is conducting this sale to raise money to purchase another company, it is expected that it will try to conduct the process relatively quickly.

Regulatory approval for the sale of the assets must also be obtained from the Federal Energy Regulatory Commission, the Vermont Public Service Board, and likely agencies in New Hampshire and Massachusetts.

² H. 577 does include a provision that allows for commercial and financial information to be exempt from the Public Records Act.

Options for Acquiring an Interest

There are three primary methods by which Vermont could acquire some beneficial interest in the hydro resources.

Outright Ownership

The State, through the Vermont HydroElectric Power Authority created in H.577, could purchase the hydro facilities outright. Given the deadlines for the sale, the significant interest from other hydro owners, and the expense and time required to perform the necessary due diligence, it is extremely unlikely that the State could put together a legitimate bid within the time frame necessary.

Potential Partners

A partnership can have multiple forms: a percent equity share of all assets or some subset, ownership in some subset of products, an agreement with one or any number of partners, etc. Typically, a 10% or greater share in ownership would be necessary in order to have a seat on the board and ability to influence decisions. A common element of all the partnership models is that Vermont incurs both benefits and liabilities related to ownership. Accordingly, appropriate due diligence would be required before entering into a partnership.

A Vermont presence (either the state or a distribution utility) has some intangible benefits associated with potentially demonstrating public support for the regulatory process; however, a partnership increases the complexity of the acquisition and it's unlikely that regulatory approvals will be particularly difficult to obtain. Additionally, the State should expect to incur very significant legal expenses involving the structuring of any partnership agreement as outside counsel with specific mergers and acquisition experience would need to be retained.

There have been four companies that have reached out to the State of Vermont to express interest in working with the State in the TransCanada sale. Three of the companies have the financial means to acquire the hydro facilities without entering into a partnership, and also the institutional expertise to move quickly through a demanding acquisition process.

It would be possible for Vermont's electric distribution utilities to enter into a partnership with one of the four companies and/or the State to acquire an interest in the assets. Given the timing of the sale, a power purchase agreement is likely to be a more feasible approach than an acquisition by the utilities.

Power Purchase Agreement

In addition to the possibility of an ownership interest, the State could also see some benefit to ratepayers through the execution of a stably and beneficially priced long-term power purchase agreement for the output of the hydro assets – primarily capacity, renewable energy credits, and energy. Such an arrangement would not provide any immediate opportunity for oversight over the operations and management of the assets and associated land; however, it may be possible to include a provision in a PPA that allows for the eventual purchase of the assets or at least provides an option for first refusal in the event of the sale of the assets. To the extent that the eventual owner is willing to include such a provision in a PPA it would provide a more reasonable time frame for consideration of whether acquisition of the assets is in the best interests of Vermont.

While the State could enter into a PPA with the eventual buyer at any point, there is a benefit to the buyer of having a predictable revenue stream when entering into financing arrangements and these potential savings could be reflected in the PPA.

The State, through the Department of Public Service, has two options under existing statute to enter into power purchase agreements with the eventual owner of the assets. Under Section 211, the DPS may enter into contracts with generators and utilities have the option of purchasing from the Department. This is the mechanism used to purchase power from the New York Power Authority. Additionally, under Section 212a, the Department may enter into contracts and then sell the power directly to retail customers. Apparently this mechanism was used to purchase preference power from NYPA and distribute it to Vermont's investor-owned utilities (certain portions of NYPA power is only available to publically owned utilities); the DPS had voluntary arrangements with the utilities where they would sell directly to specific customers.

Individual utilities could also enter into PPAs with the eventual owner of the assets. One benefit of having the State enter into the PPA is that the owner would be dealing with one contractual party; however, utilities have worked out individual contractual arrangements with sellers in previous circumstances.

Regulatory Considerations

Federal

Under the Federal Power Act, the Federal Energy Regulatory Commission has authority to ensure that wholesale rates (the rates paid to generators by distribution utilities) are just and reasonable. At this point, FERC largely defers to the competitive markets run by ISO-NE to ensure that rates are just and reasonable. Consequently, the eventual buyer of the TransCanada assets will need to fully understand the ISO-NE wholesale market in order to effectively maximize revenues. The likely bidders that have reached out to Vermont all have a significant presence in the ISO-NE market and are active in the NEPOOL stakeholder process where market rule changes are considered.

The eventual purchaser must also obtain approvals from FERC in order to purchase the assets (Section 203 of the Federal Power Act) and to obtain authority to sell at market-based rates (FERC Orders 697, 816, and 652 – designed to prevent market manipulation). Finally, any entity selling wholesale power is subject to FERC auditing provisions under Section 301(c) of the FPA.³

State Authority

Under Vermont law the transfer of certain generation and transmission assets requires the PSB to find that the transfer promotes the general good of the state.⁴ TransCanada sought and received permission from the PSB, with the DPS support, in 2005. Additionally, before a company can do business in Vermont related to the PSB’s jurisdiction, the PSB must find that the operation of the business will promote the public good.⁵

TransCanada has received PSB approval under Section 248 for certain changes to transmission infrastructure associated with the assets; presumably the future owners would need to obtain approval for any similar upgrades. Additionally, to the extent that a Vermont distribution utility enters into a long-term contract with the new owner of the assets for a period greater than ten years and representing more than ten percent of its historic peak demand, the utility would be required to obtain approval under Section 248 from the PSB. Approval for a PPA is not required if the facilities are located within Vermont – there are two facilities located entirely within Vermont, with a collective nameplate capacity of 46 MW, and three facilities where the powerhouses appear to be located within Vermont, with a collective nameplate capacity of 125 MW.

To the extent that the DPS enters into a contract under Section 211, regardless of whether the contract is with facilities within or outside Vermont, it must receive approval from the PSB. To the extent that the DPS enters into contracts in order to sell energy directly to retail customers under Section 212a, it must receive approval from a retail sales review board specified in Section 212b, prior to seeking approval from the PSB.

New Hampshire and Massachusetts may have similar regulatory requirements with respect to ownership transfers and transmission siting requirements.

State Participation in an Acquisition or PPA

Presumably the HydroPower Authority created through H.577 would be responsible for State participation in any partnership. Under the bill, the Board of Directors of the Authority consists of five appointees of the Governor, the State Treasurer (who serves ex officio) and “a representative of the Department of Public Service, appointed by the Commissioner, who shall

³ FERC has “authority to examine the books and records of any person who controls, directly or indirectly, a jurisdictional public utility insofar as the books and records relate to transactions with or the business of such public utility.” 152 FERC ¶ 62016 at 4.

⁴ 30 V.S.A. § 109

⁵ 30 V.S.A. § 231.

serve at the pleasure of the Commissioner.” This creates potential regulatory conflicts to the extent that the DPS is an active participant in the Authority.

To the extent that a Vermont utility acquire an ownership interest or even enter into a PPA with the new owner, State involvement in an acquisition creates a potential conflict. The DPS is responsible for “representing the interests of the people of the State”⁶ before the PSB. To the extent that the DPS, through membership on a HydroPower Authority or other mechanism, is involved in the acquisition or PPA, it would be part of the entity seeking approval from the PSB for certain actions and also tasked with representing the public interest.

This situation currently arises when the DPS exercises its authority to contract for power with the New York Power Authority under Section 211. In these circumstances, the Attorney General or a member of the Vermont bar is requested by the PSB to represent the interests of the public.⁷ Such a process could be used to address potential conflicts. Alternatively, if a partnership is entered into, the DPS could decline to participate in any decisions concerning any matters that would require it to appear before the PSB.

Additionally, to the extent that the State becomes a participant in the ISO-NE wholesale market it creates the potential for conflict in any advocacy regarding market rules that have the potential to benefit generators.

⁶ 30 V.S.A. §2(b).

⁷ 30 V.S.A. §212e.