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OFFICE OF THE STATE TREASURER

TO: House Committee on Ways and Means
House Committee on Corrections and Institutions

Senate Committee on Finance
Senate Committee on Institutions

FROM: Beth Pearce, Vermont State Treasurer *Beth*

RE: Act 73, Section 25 – Public Good Payments – Legislative Report

DATE: January 15, 2018

Pursuant to Act No. 73 of the 2017 Legislative Session, the State Treasurer was directed to recommend to the House Committees on Ways and Means and on Corrections and Institutions and the Senate Committees on Finance and on Institutions whether public good benefits payments made to the State for water quality as a condition of a certificate of public good issued by the Public Service Board provide sufficient revenue to leverage the issuance of a revenue bond to fund water quality improvements in the State through the Clean Water Fund.

In making this recommendation, the State Treasurer was directed to review all final and proposed public good payments for water quality required by the Public Service Board, including all payments for pollution abatement in, restoration of, and enhancement of State waters and what is necessary to ensure their deposit in the Clean Water Fund.

Having consulted with staff from the Public Utility Commission (Commission),¹ the Office of the State Treasurer has identified two public good payments that meet the criteria set forth in Act No. 73—the Lake Champlain Pollution Abatement and Restoration Fund and the Lake Champlain Enhancement and Restoration Trust Fund—both of which were approved by the Commission in association with its approval of the proposed New England Clean Power Link (NECPL or Project) in early 2016.

¹ Pursuant to Section 9 of Act 53 of the 2017 legislative session, the Vermont Public Service Board's name was changed to the Vermont Public Utility Commission, effective July 1, 2017. Consistent with the Commission's practice, activities of the Vermont Public Service Board that occurred before the name change will be referred to as activities of the Commission unless that would be confusing in the specific context.

Ultimately, it is the position of the State Treasurer’s Office that at this time, when construction has not yet begun, it is premature to consider the possibility of issuing revenue bonds based on future uncertain public good payments. However, even assuming the Project is constructed as proposed, the proposed public good payments, as presently structured, do not provide a sufficient basis upon which to issue revenue bonds rated highly enough to make interest rates attractive to the State. Further, the costs associated with issuing such bonds and ongoing need to fund clean water investments counsel strongly against relying on them for the purpose of issuing revenue bonds.

Background

The Project

In late 2014, TDI New England (TDI-NE or Company) filed a petition with the Commission for a certificate of public good (CPG) under 30 V.S.A. § 248 authorizing the installation and operation of the Project—a high-voltage direct current underwater and underground electric transmission line with a capacity of 1,000 MW, a converter station, and other associated facilities. The Project is to be located within the Vermont portion of Lake Champlain and in the counties of Grand Isle, Chittenden, Addison, Rutland, and Windsor, Vermont.² The Project has an expected life span of at least 40 years.³ The financial model for the Project is a privately funded, merchant transmission project that will sell transmission rights at negotiated rates.⁴ TDI-NE will not have captive customers that are required to pay for the Project, and so it takes all market risks associated with the Project.⁵

The petitioner, TDI-NE, is a limited liability company organized and existing pursuant to Delaware law.⁶ TDI-NE is a special purpose entity created for the purpose of developing and financing the NECPL. TDI-NE is wholly owned indirectly by Blackstone Group, L.P., a publicly traded global investment and advisory firm with more than \$330 billion under management as of September 30, 2015.⁷

Commission Approvals

On January 5, 2016, TDI-NE received a CPG under 30 V.S.A. § 248 for the Project, subject to a number of conditions.⁸ Among those conditions, TDI-NE will make four different types of public good benefits payments over the life of the Project. Two of those payments are relevant here:

² *Petition of Champlain VT, LLC, d/b/a TDI New England*, Docket No. 8400 Final Order, issued 1/5/16, at 3-4 (TDI-NE 248 Final Order).

³ *Id.* at 14.

⁴ *Petition of Champlain VT, LLC d/b/a TDI New England*, Docket No. 8704 Final Order, issued 4/14/16, at 6 (TDI-NE 231 Final Order). TDI-NE notes the potential for the Project to be funded under a regional cost-sharing mechanism, but if that is the case, it commits to indemnify Vermont’s share of regionally allocated costs and will not seek recovery of any such costs from Vermont ratepayers. *Id.* at 11.

⁵ *Id.* at 10.

⁶ *Id.* at 6.

⁷ *Id.*

⁸ TDI-NE 248 Final Order at 3.

- Lake Champlain Pollution Abatement and Restoration Fund: Annual contributions to the Clean Water Fund established by 10 V.S.A. § 1388, to be directed towards addressing excess phosphorous in Lake Champlain and other uses related to the Lake Champlain watershed.
- Lake Champlain Enhancement and Restoration Trust Fund: Annual contributions to a fund to be created to restore and enhance aquatic habitat and improve recreational access to or opportunities in Lake Champlain. The Fund will be administered by a diverse group of Lake Champlain-based stakeholders in the public, private, and non-profit sectors.⁹

Additionally, TDI-NE requested, and was granted, a CPG under 30 V.S.A. § 231 with *de minimis* regulation.¹⁰ Whereas a section 248 CPG allows a company to construct a project, a section 231 CPG allows a company to engage in certain business activities related to public utilities. The section 231 CPG issued to TDI-NE will allow the Company to operate in Vermont, and it will remain subject to the Commission's jurisdiction regarding matters contemplated in 30 V.S.A. §§ 107 and 109, concerning, respectively, the acquisition of a controlling interest in a company subject to Board jurisdiction or the sale or lease of property located within Vermont and used for transmission services.¹¹ However, the Commission has relieved TDI-NE of obligations under 30 V.S.A. § 108, which pertains to prior Board approval of debt financing, including the mortgaging or pledging of corporate property or the issuance of stocks, bonds, notes, or other evidences of indebtedness. The Commission's decision to relieve TDI-NE of these obligations is expressly conditioned on such *de minimis* regulation remaining in the public good of the State, and it may be rescinded by the Commission for good cause shown.¹²

Following the issuance of a section 231 CPG to TDI-NE, the Commission required TDI-NE to provide additional information as to the specific nature of the ownership and controlling interests of TDI-NE, as among the myriad investment funds within the Blackstone Group.¹³ On August 31, 2017, TDI-NE made a filing in which it described the ownership structure following a recent corporate restructuring. On September 14, 2017, the Commission acknowledged TDI-NE's August 31 filing, and determined that no further action was warranted.¹⁴

The Public Good Payments

As a condition of the Project's section 248 CPG, the Commission required two Public Good Benefits Payments related to water quality. These two Public Good Benefits Payments

⁹ *Id.* at 37.

¹⁰ TDI-NE 231 Final Order at 17.

¹¹ *Id.* at 15.

¹² *Id.* at 17.

¹³ *Petition of Champlain VT, LLC d/b/a TDI New England*, Docket No. 8704 Order Requesting Further Clarification, issued 7/24/17, at 6.

¹⁴ *Petition of Champlain VT, LLC d/b/a TDI New England*, Docket No. 8704 Corporate Restructuring Order, Order of 9/14/17.

were contained in a stipulation between TDI-NE and the State Agencies (State Agencies MOU), which the Commission incorporated into TDI-NE's section 248 CPG.¹⁵

1. *Lake Champlain Pollution Abatement and Restoration Fund (Pollution Abatement Fund)*

TDI-NE will deposit the following amounts into the Pollution Abatement Fund, which is a dedicated account in the Clean Water Fund established pursuant to 10 V.S.A. § 1388:

- (i) \$1 million on the fiscal close of the Project;
- (ii) \$6 million on July 1 of the initial year of commercial operations of the Project; and
- (iii) \$5 million on July 1 of each year thereafter for 39 years.¹⁶

Conditions pertaining to the Pollution Abatement Fund include the following:

- (i) Funds deposited into this account shall be managed in accordance with and used for the purposes established in 10 V.S.A. Chapter 47, Subchapter 7 except that the use of the funds shall be limited to the Lake Champlain watershed;
- (ii) ANR and TDI-NE may enter an agreement to accelerate payments to the Fund; and
- (iii) If monies required by this Section 3.a.iii. are used for any purpose other than the purposes established by 10 V.S.A. Chapter 47, Subchapter 7 or as otherwise agreed to in writing by the Parties, TDI-NE shall not be required to make additional payments under this Section 3.a.iii.¹⁷

Payments to the Pollution Abatement Fund are for a span of 40 years, which is the estimated useful life of the Project. After that point, the parties to the State Agencies MOU agreed to negotiate in good faith regarding whether any additional payments are appropriate.¹⁸

2. *Lake Champlain Enhancement and Restoration Trust Fund (Enhancement Fund)*

The Enhancement Fund is established for the following purposes:

- (i) to promote recreational access to Lake Champlain;
- (ii) for acquisition and development of lands and facilities associated with municipal, state, and non-profit public recreation opportunities and habitat conservation within the Lake Champlain watershed;
- (iii) for recreational, cultural, historical, environmental, and educational activities, programs and opportunities associated with the Lake Champlain watershed; and

¹⁵ *Petition of Champlain VT, LLC, d/b/a TDI New England*, Docket No. 8400 Certificate of Public Good, issued 1/5/16, at 2 (TDI-NE 248 CPG). The State Agencies include the Department of Public Service, Agency of Natural Resources, and the Vermont Division for Historic Preservation.

¹⁶ State Agencies MOU § (3)(a)(i-ii).

¹⁷ *Id.* § (3)(a)(iii).

¹⁸ *Id.* § (3)(d).

- (iv) to promote research and development and habitat restoration programs and projects related to the Lake Champlain watershed.¹⁹

Unlike the Pollution Abatement Fund, which is governed by a Clean Water Fund Board comprised solely of administration officials, the Enhancement Fund is governed by an advisory board made up of TDI-NE, Conservation Law Foundation, the FP&R Commissioner, the F&W Commissioner, one at-large member selected by the Governor, and two at-large members selected by TDI-NE.²⁰ Thus, the State does not have a majority membership on this Board, which is tasked with, among other things, approving projects for funding.²¹ TDI-NE agrees to the following schedule of payments into the Enhancement Fund:

- (i) \$1 million on the closing of the construction financing of the Project; and
- (ii) \$1.5 million annually beginning on July 1 of the initial year of commercial operations and continuing annually thereafter for the subsequent 39 years.²²

The State Agencies MOU further states that “[t]his section does not preclude loan structuring opportunities where the payments would be made to service any debt borrowed up front against the collateral of guaranteed ongoing payments. Further, TDI-NE agrees to provide information to a TDI-NE qualified third party as may be necessary to borrow against the collateral of future payments.”²³

Similar to the Pollution Abatement Fund, payments can be accelerated per an agreement between TDI-NE and the advisory board.²⁴

Discussion

Current Status of Project

To date, the NECPL has received various permits and approvals from state and federal agencies, including the CPGs discussed above. However, Project construction has not yet begun. Currently, TDI-NE is pursuing commercial partners through the Massachusetts Clean Energy Request For Proposals (RFP) process.

In brief, the Massachusetts Clean Energy RFP process resulted from a state law requiring the Massachusetts distribution companies to solicit proposals for clean energy generation and to enter into reasonable contracts for clean energy generation for an annual amount of clean energy equal to 9,450,000 MW-hours.²⁵ In March 2017, the RFP was put out to bid, and proposals were submitted in July. The proposals are currently under evaluation by a team composed of the Massachusetts distribution utilities and the Massachusetts Department of Energy Resources. The approved schedule calls for bids to be selected for further negotiation on January 25, 2018, with

¹⁹ State Agencies MOU § (3)(a)(iv)(I).

²⁰ *Id.* § (3)(a)(iv)(II).

²¹ *Id.*

²² *Id.* § (3)(a)(iv)(IV).

²³ *Id.*

²⁴ *Id.* § (3)(a)(iv)(V).

²⁵ *An Act to Promote Energy Diversity*, St. 2016, chap. 188, § 12 (inserting sections 83B, 83C, and 83D into the *Green Communities Act*). Section 83D is the section relevant to the discussion here.

contracts to be executed by March 27, 2018. Executed contracts would thereafter be submitted to the Massachusetts Department of Public Utilities by April 25, 2018 for review and approval.

Massachusetts received 46 bids in total, 2 of which utilized the NECPL to deliver either 100% hydro²⁶ or a mix of hydro and wind²⁷ from Canada to Massachusetts. With the RFP process still ongoing, it is too soon to tell whether the NECPL bids will be selected for further negotiation by the Massachusetts selection team. Consistent with schedule described above, we will know more soon about the status of the NECPL bids.

Accordingly, at this point, the public good benefits payments related to the NECPL are not yet certain to materialize, and it would be premature to rely on them, in any way, as the basis upon which to issue revenue bonds. Further, even if one of the NECPL bids is selected in January 2018, there are a number of steps that must take place prior to the Project reaching commercial operation, including: contract negotiation and approval with the Massachusetts parties, construction financing, project construction, and interconnection.

Because the Project's completion is not imminent, the balance of this report analyzes whether, *in concept*, the above-mentioned public benefits funds provide sufficient revenue to leverage the issuance of a revenue bond to fund water quality improvements in the State through the Clean Water Fund. Accordingly, it assumes that the Project is completed and begins commercial operations and that the public good benefits payments are made in accordance with the terms of the State Agencies MOU, as approved by the Commission.

Issuance of Revenue Bonds based on Public Good Benefits Payments

As an initial matter, the Treasurer's Office believes that the Project represents an exciting opportunity to both the region and Vermont. Regionally, the Project has the potential to deliver a significant amount of renewable energy to market, thereby helping our neighboring states to meet their greenhouse gas reduction goals. In Vermont, the Project provides an additional opportunity of providing a long-term, stable funding source to meet the State's clean water goals. From a review of the Commission orders and the State Agencies MOU, it is clear that this opportunity was arrived at by the successful collaboration of TDI-NE, State Agencies, and environmental groups like the Conservation Law Foundation. This collaborative approach is to be commended, as it is only through different parties working together that our clean water challenges will be solved.

That said, the Treasurer's Office would advise against the State seeking to issue revenue bonds based on the public good benefit payments described above. Not only would it be difficult to issue high credit rated bonds based on these public good benefit payments alone, i.e., without pledging the State's obligation in support of such bonds, issuing revenue bonds based on these payments would also place additional restrictions on the use of this ongoing revenue source.

²⁶ Summary of the 100% hydro bid available at <http://necplink.com/docs/announcements/The%20New%20England%20Clean%20Power%20Link%20100-percent%20Hydro%20Bid%20Executive%20Summary.pdf>.

²⁷ Summary of the wind/hydro bid available at <http://necplink.com/docs/announcements/Executive%20Summary%20v18.pdf>.

Nevertheless, the Treasurer's Office would be open to review the potential for bond issuance again when and if the Project is constructed and the public good benefits payments begin to be made.

Issuing bonds based on the above-described public good benefits payments would seek to leverage the value of these future revenue streams, and could be done in one of two ways: (1) by issuing bonds based solely on the credit of TDI-NE, making clear that State is not backing repayment of the bonds; and (2) by issuing what are referred to as combination bonds, in which the general obligation, or the moral obligation, of the State would be pledged in addition to the revenue streams reflected in the public good benefits payments.

Under either scenario discussed below, it is important to note that any bond issued would likely be limited to a 20-year maturity, even though the public good benefits payments extend for a 40-year term. First, as a matter of law, all bonds issued by the State must mature in no more than 20 years.²⁸ Second, even in the event that 40-year bonds could be issued to coincide with the duration of the revenues, it would likely be very difficult to find buyers for bonds with this long of a maturity.

Scenario 1: Bond Issuance based solely on Credit of TDI-NE

With respect to the first scenario, issuing bonds based solely on the credit of TDI-NE, the Treasurer's Office is skeptical that any such bonds would be rated sufficiently high enough to make interest rates attractive to the State. From a review of the Commission orders and State Agencies MOU, TDI-NE appears to be a technically competent, financial stable entity, with significant regulatory expertise. Moreover, it has proven to be a collaborative partner with the State. Nevertheless, as a general matter, it is difficult to issue a bond based strictly on the pledge of revenues from a company that does not have an extensive history demonstrating its ability to repay the bonds. Any bond issuance that would seek to rely solely on the public good benefits payments as securitization for the bond would essentially require the purchaser of the bond to take the risk that a private entity, TDI-NE, would continue to make the required payments over the life of the bond. Notwithstanding its affiliation with the Blackstone Group, TDI-NE is itself a limited liability corporation. It is also a relatively new entity, and therefore does not have a lengthy bond repayment history. It is therefore unlikely that, on its own, a highly rated security could be issued (thereby reducing interest costs) on the public good payments promised solely by TDI-NE, even where the company is under a Commission order to make such payments.

Moreover, it is important to highlight certain features of the two public good benefits payments that potential bond purchasers may view as concerning. Those concerns are summarized here.

Based on a review of the State Agencies MOU and relevant Board orders, the Pollution Abatement Fund does not appear to provide sufficient revenue certainty to leverage the issuance of a revenue bond to fund water quality improvements in the State.

²⁸ 32 V.S.A. § 952.

First, any bonds issued solely on the credit of TDI-NE would rely on continued payment of the public good benefits payments by TDI-NE over the life of the bonds. The State Agencies MOU and Commission order would require these payments to be made for 39 years after commercial operations commence. While these annual payments are not expressly contingent upon continued commercial operations, a potential bond purchaser would be concerned about the risk of non-payment into the Pollution Abatement Fund if, for example, the Project ceases to operate or generate revenue. While the due diligence process could mitigate some portion of this risk, it would not eliminate it.

Second, per the State Agencies MOU, the schedule of payments is subject to change pursuant to agreement between TDI-NE and ANR. Again, the potential for a restructuring of the schedule of payments into the Pollution Abatement Fund would likely increase the risk seen by potential bond purchasers.

Third, and perhaps most important, payments into the Pollution Abatement Fund are subject to discontinuance if the funds are used for any purpose other than those set forth in the statute governing the Clean Water Fund, or as agreed among the State Agencies MOU parties. The purposes of the fund are to “assist the State in complying with water quality requirements and construction or implementation of water quality projects or programs,” including funding agency positions and non-profit organizations to achieve water quality requirements and implement programs.²⁹ While the purposes of the Clean Water Fund are broad, this requirement does place the full 40-year stream of payments at some risk, albeit limited. A determination that any of the funds were used for a non-compliant purpose could lead to the termination of all future payments.

Similarly, based on a review of the State Agencies MOU and relevant Board orders, the Enhancement Fund does not appear to provide sufficient revenue to leverage the issuance of a revenue bond to fund water quality improvements in the State. The first two concerns noted above with respect to the Pollution Abatement Fund exist with the Enhancement Fund as well. Potential bond purchasers would take the risk of non-payment should the Project cease to operate or generate revenues. And per the State Agencies MOU, the schedule of payments is subject to change pursuant to agreement between TDI-NE and the advisory board.

Additionally, unlike the Pollution Abatement Fund, the Enhancement Fund expressly allows for the payments to be made to service any debt borrowed up front against the collateral of guaranteed ongoing payments. However, the Enhancement Fund is governed by a body that is made up, in part, of state officials, but where the State does not have a majority presence. Therefore, the State cannot, by itself, control the fund expenditures or the administration of the funds.

In light of these concerns, the Treasurer’s Office believes that it is unlikely that a sufficiently highly rated revenue bond could be issued based solely based on the public good

²⁹ 10 V.S.A. § 1387.

benefits payments, without some form of State backing, or other form of securitization, such as a pledge of the Project's assets.

Scenario 2: Combination Bond issued on Credit of TDI-NE and the State

Given the difficulty of issuing a bond based solely on the pledge of revenues from a relatively new company that does not have an extensive history demonstrating its ability to repay the bonds, the other option is the issuance of a combination bond, in which the general obligation, or the moral obligation, of the State would be pledged in addition to the revenue stream from a specific company. In the case of a private, for-profit entity, it would be very unusual for the State to pledge the moral obligation of the State. Taking on additional moral obligations could also impact the State's credit rating. Accordingly, moral obligation is generally pledged only to entities such as VSAC, VEDA, or the Bond bank, where the bond-issuing entities are either public or quasi-public and incorporate a State-authorized mission with sufficient Administration and Legislative oversight. The Treasurer's Office would not support the idea of extending the State's moral obligation to support the bond issuances of private, for-profit entities.

The issuance of a combination bond would decrease the risk of repayment of the bonds, making them more attractive to investors, however it would do so by placing the State at greater risk. In addition to putting the State at risk of paying the principal and interest on the bonds in the case of a TDI-NE default, the issuance of a combination bond would also affect the credit ratings of the State by adding to the amount of net tax supported debt.

Regardless of whether the general or moral obligation of the State is pledged, any combination bond issuance would require State oversight and would present a variety of risks, including credit and ratings risk and potential problems surrounding private use or arbitrage issues. Maintaining high credit ratings is important as it lowers the borrowing costs for needed capital projects for the State, and for other entities that rely on the State's credit rating. Accordingly, the Treasurer's Office opposes the idea of extending the State's general obligation to support the bond issuances of private, for-profit entities.

Conclusion

In light of the concerns discussed above, the Treasurer's Office does not believe that it is appropriate to seek to leverage the public good benefits payments associated with the NECPL to support the issuance of State bonds.

Furthermore, evaluating the public good benefits payments within the broader context of clean water funding, the Treasurer's Office believes that there is significant value in retaining the ongoing, unrestricted status of the public good benefits payments. Achieving our State's clean water goals will require significant expenditures over the long-term, and these expenditures will certainly reflect a mix of capital spending and annual appropriations. As a general matter, it makes sense to expend capital dollars in one of three instances:

- The cost of construction inflation is greater than the cost of the borrowing, such that delaying the project is more costly than the debt service and quantifiable economic benefits of building the project now;
- The borrowing can be used to leverage additional funds (e.g., federal grants); and
- Users of a capital project will change over its useful life, such that it is reasonable and fair to spread costs among current and future beneficiaries of the project.

In the near term, the State's focus has been on utilizing capital dollars to fund clean water infrastructure, largely to fund projects that would fall into one of the above-three categories. However, capital spending alone will not solve the State's clean water challenges. Annual appropriations will be required to fund any number of projects and positions necessary to solve our problems. And such appropriations will allow the State the flexibility of funding other important capital project without placing the State's credit rating at risk.