

Before the Mississippi Public Service Commission

Docket No. 2012-UA-358

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**MISS. PUBLIC SERVICE
COMMISSION**

Direct Testimony

of

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On Behalf of

Mississippi Public Utilities Staff

June 20, 2013

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Exhibit SH-1: Resume of Scott Hempling95

Qualifications

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2
3
4 **Q. Please state your name and business address.**

5
6 A. My name is Scott Hempling. I am the President of Scott Hempling, Attorney at Law
7 LLC. My business address is 417 St. Lawrence Dr., Silver Spring, Maryland 20901.

8
9 **Q. Please describe your educational and employment background.**

10
11 A. I began my legal career in 1984 as an associate in a private law firm, where I
12 represented municipal power systems and others on transmission access, holding
13 company structures, nuclear power plant construction prudence and producer-pipeline
14 gas contracts. From 1987 to 1990 was employed by a public interest organization to
15 work on similar issues. From 1990 to 2006 I had my own law practice, advising public
16 and private sector clients—primarily state regulatory commissions, and also municipal
17 systems, independent power producers, consumer advocates, public interest
18 organizations and utilities—with an emphasis on electric utility regulation.

19
20 From October 2006 through August 2011, I was Executive Director of the National
21 Regulatory Research Institute (NRRI). Founded by the National Association of
22 Regulatory Utility Commissioners, NRRI is a Section 501(c)(3) organization, funded
23 primarily by state utility regulatory commissions. NRRI's mission, during my tenure,
24 was to provide the research necessary to empower utility regulators to make decisions of
25 the highest possible quality. As Executive Director, I was responsible for working with
26 commissioners and commission staff at all 51 state-level regulatory agencies to develop
27 and carry out research priorities in electricity, gas, telecommunications and water. In
28 addition to overseeing the planning and publication of over 80 research papers by
29 internal NRRI's staff experts and outside consultants, I published my own research
30 papers, advised contract clients (including state commissions, regional transmission
31 organizations, private industry and international institutions), and wrote monthly essays
32 on effective regulation. I also taught several dozen two-day legal and policy seminars
33 hosted by state commissions and attended by commissioners, staff and industry

1 practitioners, and spoke at conferences in the United States, Canada, Central America,
2 Germany, India, Italy, Jamaica, Mexico and Nigeria.

3
4 I have represented and advised clients in diverse state commission cases; and in federal
5 proceedings under the Federal Power Act of 1935 and the Public Utility Holding
6 Company Act of 1935, before the Federal Energy Regulatory Commission and the
7 Securities and Exchange Commission (SEC), respectively, and before the United States
8 Courts of Appeals. I have testified many times on electric industry matters before
9 Congressional and state legislative committees.

10
11 In September 2011 I returned to private practice, to focus on writing books and research
12 papers, providing expert testimony and teaching courses and seminars on the law and
13 policy of utility regulation. I am an Adjunct Professor at Georgetown University Law
14 Center in Washington, D.C., where I teach two practicum seminars: “Monopolies,
15 Competition, and the Regulation of Public Utilities;” and “Regulatory Litigation: Roles,
16 Skills and Strategies.” Students study the fundamentals of utility regulatory law in
17 class, then apply that learning, under my supervision, in externships at state and federal
18 regulatory agencies.

19
20 My book of essays, *Preside or Lead? The Attributes and Actions of Effective*
21 *Regulators*, was published by NRRI in 2010. I will publish a second, expanded edition
22 in July 2013. My book *Regulating Public Utility Performance: The Law of Market*
23 *Structure, Pricing and Jurisdiction* will be published by the American Bar Association
24 in August 2013. This is the first volume of a two-volume treatise, the second of which
25 will address the law of corporate structure, mergers and acquisitions. I have published
26 several dozen articles on electric utility regulation, taught electricity law seminars to
27 thousands of students from all fifty states and all industry sectors, and speak frequently
28 at industry conferences.

29
30 I received a B.A. *cum laude* in 1978 from Yale University, where I majored in (1)
31 Economics and Political Science and (2) Music, and received a Continental Grain

1 fellowship and a Patterson research grant. I received a J.D. *magna cum laude* in 1984
2 from Georgetown University Law Center, where I received an *American Jurisprudence*
3 award for Constitutional Law.

4
5 My resume is attached to this testimony as Exhibit SH-1. Additional information is at
6 www.scotthemplinglaw.com.

7
8 **Q. Have you previously submitted testimony in any state utility commission**
9 **proceedings?**

10
11 A. Yes, I have submitted testimony in proceedings before the state utility commissions of
12 California, Illinois, Maryland, Minnesota, North Carolina, Texas, Vermont, and
13 Wisconsin.

14
15 **Q. For whom do you appear in this proceeding?**

16
17 A. I am appearing on behalf of the Mississippi Public Utilities Staff (MPUS).

18

1

2 **Overview**

3

4

5 **Q. Is the Application consistent with the public interest?**

6

7 A. No. The Applicants have framed this proceeding as an either-or proposition: Either

8 approve the application as is, or continue the status quo unchanged. The Mississippi

9 Public Service Commission (Commission or MPSC) is not bound by this bipolarity.

10 There are at least four options, not two.

11

12 *Option 1. The Commission can accept ITC's proposal unchanged.* That approach has

13 definite negative effects and no definite positive effects. Specifically, the proposal—

14

15 a. will cost Mississippi consumers at least \$100 million (net present value) over

16 30 years,¹

17

18 b. will provide Entergy shareholders with value at least \$400 million more than

19 the unrecovered book value of the transferred EMI transmission assets,

20 representing a gain relative to what they would receive under traditional

21 ratemaking,²

¹ The \$100 million is a minimum estimate of the (a) increase in revenues to be paid by Mississippi ratepayers (retail) over 30 years, net present value, due to shifting the transmission cost of service from the Mississippi Commission jurisdiction to FERC (see MPUS witness Seth Parker's testimony, calculating a \$126 million revenue increase over 30 years (net present value) based on ITC's assumptions for the first 5 years and assuming, unrealistically, no increase in rate base for years 6-30); less (b) a possible \$60 million in rate reduction for the first five years, offered by ITC in a public announcement. As I will explain in Part II.B.1.b, the FERC cost of service is higher than Mississippi's due to a higher authorized return on equity and allowance of a higher equity share in the capital structure. I emphasize the term "*at least* \$100 million," because as discussed in Parts II.B.1.c and II.B.1.d, ITC can raise the amount by adding transmission assets that will earn the higher FERC ROE, and by seeking FERC-authorized adders on top of that ROE.

² This number is based on ITC's calculation of "goodwill" attributable to the transaction of \$2.4 billion (see S-4 at pp. 41, 48), multiplied by 16.8% (representing EMI's

- 1
- 2 c. offers no enforceable commitment to improve service quality,
- 3
- 4 d. leaves unclear the Commission's legal power to establish and enforce
- 5 standards for service quality, and
- 6
- 7 e. eliminates this Commission's power to establish the transmission cost of
- 8 service that retail customers bear.
- 9

10 The last point, arising from the shifting of transmission ratemaking jurisdiction from

11 this Commission to the Federal Energy Regulatory Commission (FERC), leaves the

12 Commission unable to shield ratepayers from rate increases it deems unnecessary.

13 Those rate increases include not only (a) those attributable to FERC's different rate

14 methodologies, but also (b) those that could result should this leveraged company

15 expand into other geographic territories and other lines of business.

16

17 *Option 2. The Commission can approve ITC's proposal, conditioned on ITC agreeing*

18 *to revise it to eliminate the above-stated problems.* That revised proposal would have

19 the following features, at a minimum:

20

- 21 a. ITC's Mississippi subsidiary agrees to file with FERC, and receive approval
- 22 from FERC of, a transmission tariff allowing recovery of only those costs
- 23 approved by this Commission, subject to two exceptions: (a) the
- 24 Commission likely will need to accept any FERC-mandated allocation
- 25 *percentage* applied to Mississippi (although not necessarily the base cost to

share of the EOC transmission asset rate base that will be spun off (see EMI's response to MPUS-EMI/ITC 5-1(c), showing a ratio of EMI assets transferred to EOC assets transferred of 439/2620)). The unrecovered book value of the transferred transmission assets represents the amount that Entergy shareholders would receive under traditional regulatory principles. It is true that the S-4 defines goodwill as the "excess of consideration transferred over the *estimated fair value of the identifiable assets acquired and liabilities assumed*" (S-4 at p.49, emphasis added), not the *book value*. But if market value exceeds book value, my number for goodwill is understated.

1 which the percentage is applied), and (b) extraordinary situations triggering
2 the *Mobile-Sierra* "public interest" exception (discussed in Part II.B.3
3 below);

- 4
- 5 b. EMI provides to its ratepayers a refund reflecting that share of Entergy
6 shareholders' gain (measured as the excess of net consideration received
7 over the transmission assets' net book value) determined by the Commission
8 to represent ratepayers' proportionate contribution to that gain, due to their
9 rate payments over the life of the transmission assets;
- 10
- 11 c. ITC makes commitments on service quality and system improvements,
12 acceptable to the Commission, that are specific, measurable and enforceable,
13 i.e., subject to Commission-imposed financial penalties, cost disallowance or
14 certificate revocation;
- 15
- 16 d. ITC commits to take no action that deviates from its commitment to a
17 "singular focus" on transmission (such actions to include acquisitions of
18 other businesses, or acquisitions by other businesses), without a Commission
19 finding that such action will cause no adverse effect to Mississippi customers
20 or require any additional regulatory attention unaccompanied by any
21 necessary additional regulatory resources;
- 22
- 23 e. The Commission retains authority to revoke ITC's certificate if FERC or ITC
24 ever acts inconsistently with any of these conditions; and
- 25
- 26 f. The Commission establishes other conditions as discussed in this testimony.

27

28 *Option 3. The Commission can reject the proposal (because its features conflict with*
29 *the public interest, for the reasons summarized in Option 1 above, and because the*
30 *conditions necessary to render the proposal consistent with the public interest are not*
31 *all enforceable with certainty). The Commission then would monitor EMI's entry into*

1 the Midcontinent Independent System Operator (MISO), but take no other action to
2 induce improvements in EMI's transmission performance.

3
4 *Option 4. The Commission can reject the proposal, monitor EMI's entry into the MISO,*
5 *and take action to induce improvements in EMI's transmission performance. The*
6 *Commission would do this by establishing and holding EMI to specific expectations and*
7 *standards, compensating EMI as appropriate for its improvements but also making clear*
8 *the consequences should EMI fail to meet those expectations and standards.*

9
10 **Q. What is the purpose and organization of your testimony?**

11
12 A. This testimony seeks to assist the Commission in choosing among these options.
13 Instead of the Applicants' restrictive, either-or-approach, **Part I** recommends that the
14 Commission reframe the case to focus on its legal duties, by asking: "What is the public
15 interest in transmission ownership in Mississippi?" To answer that question, the
16 Commission should articulate its preferences in seven areas: quality of service, rates,
17 competition among power supply options, financial structure, corporate structure,
18 responsiveness to and accountability to the Mississippi Commission, and effects on a
19 non-transmission-owning EMI's ability to serve cost-effectively and reliably.

20
21 **Part II** applies each of these seven factors to the proposed transaction. To justify this
22 transaction, ITC should have to (a) commit to, and be accountable for, an improvement
23 in performance that is (b) unavailable from any other entity (including EMI) at a cost to
24 Mississippi ratepayers lower than what ITC's proposal will cost, and (c) is worth the
25 cost increase. Based on Applicants' own information, their proposal fails this test.

26
27 But the Commission should not stop there. If it views the transmission status quo as
28 unsatisfactory, merely rejecting the proposal leaves a problem unsolved. **Part III**
29 therefore puts the proposed transaction aside, and asks: What steps can the Commission
30 take to promote the public interest in transmission service?

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I. Reframing the Case: What is the "Public Interest" in Transmission Ownership?

A. The legal standards

Q. As the Commission determines the public interest in transmission service, what legal authority does it have and by what legal standards is it bound?

A. The Commission can best assess transmission ownership proposals if it has its own vision for transmission performance. The foundation for that vision is, of course, the Commission's statutory authority. Counsel has informed me that there are three main statutory sources:

Section 77-3-2 is a "[d]eclaration of policy." It focuses on the need to (a) "provide fair regulation," (b) "promote the inherent advantage of public utilities," (c) "promote adequate, reliable and economic service," (d) "provide just and reasonable rates and charges . . . consistent with long-term management and conservation of energy resources by avoiding wasteful, uneconomic and inefficient uses of energy," (e) "encourage and promote harmony between public utilities, their users and the environment," (f) "foster the continued service of public utilities on a well-planned and coordinated basis," and other goals.³ These "ends" are the policies which the Commission is authorized to achieve through the authority provided elsewhere in the title.

Section 77-3-23 establishes the standards for approving the transaction. The Commission must find that

the transaction proposed is in good faith,
the . . . purchaser . . . is fit and able properly to perform the public utility services authorized by such certificate and to comply with the lawful rules, regulations and requirements of the commission, and

³ This is a digest of the provision. Readers should consult the full text.

1 the transaction is otherwise consistent with the public interest. . . .

2
3 On such a finding, the Commission "may" approve and authorize the transaction. The
4 term "may" signals that the parties have no right to an approval merely because the
5 transaction satisfies the standards. This "may" allows the Commission to lead with its
6 own vision.

7
8 If the Commission does choose to approve and authorize the transaction, it may
9 establish "such terms and conditions as it shall find to be just and reasonable and with
10 such modifications as it may prescribe."

11
12 Since the present case "involves facilities that are included in the rate base of a public
13 utility," the Commission also must

14 include, as a prerequisite to its finding that the transaction is consistent
15 with the public interest, a finding that, upon the consummation of the
16 transaction proposed: (a)(i) the native load customers of the public utility
17 will continue to have a first priority to the use and/or benefit of such
18 facilities, or (ii) any loss of such first priority by native load customers to
19 the use and/or benefit of such facilities is not contrary to the public
20 interest; and (b) any native load customers served by any transmission
21 facilities shall be served on the same basis as before the transaction.
22

23
24 The Commission already has approved EMI's request to transfer control of its
25 transmission to MISO. Once the transfer to MISO occurs, all matters of native load
26 priority are subject to FERC jurisdiction, regardless of whether the owner of the
27 Mississippi assets is EMI or ITC. I therefore see no incremental effect on native load
28 priority arising from the ITC transaction. Given the Commission's prior approval of
29 EMI's transfer of its transmission facilities to MISO, I will not address this statutory
30 criterion further in this direct testimony.

31
32 **Section 77-3-21** makes "reasonably adequate service" a condition of a public utility's
33 retaining its certificate to serve:

34 The commission may, after a hearing had upon due notice, make such
35 findings as may be supported by proof as to whether any utility holding a
36

1 certificate under the provisions of this article is rendering reasonably
2 adequate service in any area covered by such utility's certificate. In the
3 event the commission finds that such utility is not rendering reasonably
4 adequate service the commission may enter an order specifying in what
5 particulars such utility has failed to render reasonably adequate service
6 and order that such failure be corrected within a reasonable time, such
7 time to be fixed in such order. If the utility so ordered to correct such a
8 failure fails to comply with such order of the commission and the
9 commission finds that cancellation of its certificate would be in the best
10 interest of the consuming public served by the holder of the certificate, its
11 certificate for the area affected may be revoked and cancelled by the
12 commission.

13
14 **B. Seven public interest criteria**

15
16 **Q. Can you translate these general legal standards into specific public interest criteria
17 the Commission can use to shape its own vision and evaluate the pending proposal?**

18
19 A. Yes. The statutory standards allow and enable the Commission to shape its own vision
20 for transmission service. Doing so gives the Commission a context for comparing ITC's
21 proposal to the status quo of EMI ownership and to alternative approaches. A vision for
22 reliable, high-quality, cost-effective transmission service should have seven public
23 interest components.

24
25 **1. Quality of service:** There should be a commitment to high-quality transmission
26 service throughout the company, from Board members to line workers. See § 77-3-
27 2(1)(c) ("adequate, reliable and economic service"). That commitment should permeate
28 the company's plans and planning processes; its budgets and funding support (including
29 an absence of arbitrary budget caps); its internal indices of excellence; and a system of
30 rewards and penalties for performance by employees, managers and executives.

31
32 Quality of service is not merely "safety, adequacy and reliability," as asserted by
33 Applicants.⁴ Nor is it not only about choosing among "average," "above average,"
34 "excellent" or "first quartile." Quality of service includes creating and innovating,

⁴ Brief of Entergy Mississippi, Inc. and ITC Holdings Corp. on Jurisdictional Issues, at pp. 25-26 (May 20, 2013).

1 anticipating and responding to changing public policy requirements, and empowering
2 consumers to consume efficiently.

3
4 For the Mississippi retail electricity customer, transmission is not an isolated product,
5 any more than sugar and flour are isolated products for a bakery customer. The
6 planning, construction and operating of the transmission system, regardless of who
7 owns and/or operates it, should occur in conjunction with, and as a component of, EMI's
8 generation, distribution, demand response and energy efficiency activities. Quality of
9 service, therefore, depends on an integrated resource plan, a process for producing that
10 plan, and an integrated staff that works seamlessly to form and carry out that plan. See
11 § 77-3-2(1)(f) ("well-planned and coordinated basis").

12
13 **2. Rates:** The rates must reflect prudent cost, and no more than prudent cost, as
14 determined by the Commission. To obtain approval of rates, the company needs to
15 show that it considered all feasible alternatives to a transmission expenditure (including
16 non-transmission alternatives). There should be no risk that customer cost will rise as a
17 result of the transaction, except in accordance with verifiable increases in investment or
18 operating costs that are accompanied by proof of performance that justifies the cost. See
19 § 77-3-2(1)(d) ("just and reasonable rates and charges ... consistent with long-term
20 management and conservation of energy resources by avoiding wasteful, uneconomic
21 and inefficient uses of energy. . . .").

22
23 **3. Competition among power supply options:** The owner's procedures and incentives
24 for planning, investing in, and operating transmission, and cooperating with other
25 entities in the region, should be consistent with an unbending commitment to
26 accommodate all economic options in the region, without regard for the transmission
27 owner's self-interest (other than the interest in having a reasonable opportunity to earn a
28 fair return on prudent, used-and-useful investment). See § 77-3-2(1)(d) (no "unjust
29 discrimination, undue preferences or advantages, or unfair or destructive competitive
30 practices").

1 To ensure fair competition among options, the owner should have no investment biases
2 that conflict with Commission priorities. The owner should be equally committed to all
3 feasible solutions to the region's power supply needs, whether those solutions be
4 generation, transmission, demand response, or other non-transmission alternatives (such
5 as distributed generation and storage). There should be a singular focus on satisfying
6 Mississippi's power supply needs (including transmission) at minimum feasible cost.

7
8 **4. Financial structure:** The capital structure supporting the Mississippi transmission
9 system, whether it is the capital structure of the Mississippi transmission subsidiary, or
10 the affiliates that finance that subsidiary, should reflect a traditional utility capital
11 structure, with variations from that standard as necessary to minimize total long-run
12 costs to Mississippi. The public interest should not include leveraged financing to
13 support new acquisitions, because that is foreign to the traditionally conservative
14 financing of public utilities, see § 77-3-2(1)(b) ("inherent advantage of regulated public
15 utilities"); and creates a risk of disharmony between a company's non-utility business
16 goals and utility consumer needs. See § 77-3-2(1)(e) ("encourage and promote harmony
17 between public utilities, their users and the environment").

18
19 **5. Corporate structure:** In the corporate family controlling Mississippi's transmission
20 system, there should be no investments or activities that conflict with or distract from a
21 singular focus on serving Mississippi customers. See § 77-3-2(1)(e) ("encourage and
22 promote harmony between public utilities, their users and the environment").

23
24 **6. Responsiveness and accountability to the Mississippi Commission:** The
25 Mississippi Commission must have full authority over all aspects of utility service:
26 planning, quality of service, rates and rate structure, corporate structure (of the
27 Mississippi transmission subsidiary and its affiliates), and financial structure. The
28 Legislature set forth its policies in § 77-3-2 specifically so that the Commission would
29 pursue them. See § 77-3-2(2) ("To these ends [meaning the policies declared in the
30 section], therefore, authority shall be vested in the Mississippi Public Service
31 Commission to regulate public utilities in accordance with the provisions of this title.").

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7. EMI's ability to integrate its operations, cost-effectively and reliably without transmission ownership: For EMI's captive retail customers, transmission is not a separable product. If the customers do not like their transmission service they cannot buy it elsewhere. The transmission owner therefore must plan its operations, repairs and expansion in coordination with EMI's generation, distribution, demand response and energy efficiency efforts. The public interest question is whether this need for integration is compromised by placing transmission control in independent hands. See § 77-3-2(1)(f) ("continued service of public utilities on a well-planned and coordinated basis").

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II. The Reframing Applied to This Transaction: The Proposal Is Not Consistent with the Public Interest

Q. What is the purpose of Part II of your testimony?

A. This Part II explains that the proposal fails each of the seven public interest factors, as follows:

- a. ITC makes quality of service claims, but makes no commitments.
- b. Transmission rate increases will cost ratepayers at least \$100 million (net present value) over 30 years, with the Commission having no jurisdiction over the cost.
- c. ITC will bring a pro-transmission bias, inconsistent with the Commission's need to find the most cost-effective mix of generation, transmission, distribution, demand management and energy efficiency and other non-transmission options.
- d. ITC's claimed access to lower-cost financing lacks long-term evidence.
- e. ITC's ability to expand its corporate holdings without review by the Commission is in tension with Mississippi ratepayers' need for, and right to, reliable service at reasonable rates.
- f. The transaction produces a transmission owner less responsive and accountable to the Commission than is EMI.
- g. The proposal offers no facts, let alone guarantees, about EMI's ability to integrate its operations, cost-effectively and reliably, without owning transmission.

1 **A. Quality of service**

2
3 **Q. How does the proposal address quality of service?**

4
5 A. On quality of service, the proposal has four defects: (1) ITC has made no enforceable
6 commitments; (2) it is unclear which jurisdiction, as between this Commission and
7 FERC, will hold ITC accountable for which aspects of its performance, and how; (3)
8 ITC does not explain why a transmission-only company necessarily performs better than
9 the transmission operation within a vertically integrated company; and (4) the
10 Applicants offer no persuasive evidence that EMI cannot improve its performance while
11 still owning the transmission assets.

12
13 **1. ITC has made no enforceable commitments**

14
15 **Q. Why do you say that ITC has made no enforceable commitments?**

16
17 A. ITC talks of actions but not of outcomes. Asked if ITC has "identified a dollar amount
18 of savings that will be attained from the transaction," ITC's Jipping answers: "No, not
19 specifically. To date, we have focused more on how we will go about achieving the
20 savings after the Transaction closes, rather than trying to identify specific cost savings
21 that we can bring to the region." Jipping Direct at p. 60. Before identifying actual
22 savings, he says, ITC must do "more detailed reviews of the existing procurement
23 contracts that Entergy maintains, and then meeting with vendors and suppliers to work
24 on new agreements going forward." *Id.* Similarly, EMI's witness Bunting describes
25 planning and integration activities that are occurring only now, after the merger
26 agreement was signed, meaning that the companies still lack sufficient information to
27 make commitments. See Bunting Direct at pp. 45-49 (describing the "Joint ITC/Entergy
28 Implementation Team[, which] is responsible for developing and managing an
29 implementation plan that addresses organizational designs and staffing, business
30 processes, and related information technology needs").

31
32 Moreover, the Applicants do not commit to implement particular practices, let alone
33 achieve specific outcomes from those practices. Mr. Jipping says, for example, that ITC
34 "will, over time, modify [Entergy's maintenance] plan by imparting ITC's own

1 maintenance approach." Jipping Direct at p. 35. But Mr. Jipping offers no specifics—
2 not about the differences between the two approaches, the costs of the changes or the
3 benefits to flow from the changes.

4
5 **Q. Should the Commission have other concerns about ITC's position on quality of**
6 **service?**

7
8 A. Yes, there are at least two. First, ITC's talk of improvement never identifies the
9 suboptimalities in EMI's performance that need improvement. If there were
10 suboptimalities, there would be no justification for raising customers' rates to improve
11 the performance. In that circumstance, the cost of correction should lie with Entergy's
12 shareholders, not with the customers who paid full rates but received suboptimal
13 service. And if there were no suboptimal practices, there is no clear reason to pay extra
14 to change them. Improving performance goes with the territory of being a public utility.

15
16 Second, not all improvement is cost-effective improvement. EMI states that ITC "has
17 achieved top decile operational performance," which EMI has not.⁵ But performance
18 comes at a cost. Merely moving from one quartile to another without regard to cost, in
19 effect beating out other utilities just for the sake of it, is not prudent. ITC does not
20 describe the metrics it will use to measure improvement. But without such defined
21 metrics, the Commission will be unable to determine whether ITC knows what types
22 and levels of cost it must incur to make these improvements, or the value of those
23 improvements to the customers who must pay for them.

24
25 To determine the exchange rate for their shares, that is, to ensure that both sets of
26 shareholders received value, the Applicants calculated to the 14th decimal point. But
27 for quality of service improvements, the Applicants have calculated nothing. If the chief
28 motivation for this transaction was to improve performance, one would expect the

⁵ See EMI Response to MPUS 2-16. See also Direct Testimony of Richard C. Riley at p. 13 ("the application of ITC's singular focus should help the EOCs' efforts to achieve best-in-class performance"). The inconsistency between (a) the Applicants' argument that a key transaction benefit is "best-in-class performance" and (b) their legal brief's argument that the transaction need not be EMI's best alternative, can be explored at hearing.

1 Applicants, prior to signing a merger agreement, to perform a benefit-cost analysis
2 showing the types of improvements, their costs and their benefits. This did not occur.

3
4 Improvement need not be proven to a certainty; evidence of probabilities of
5 improvement, and of the probable magnitude of benefit, can suffice. But here there is
6 neither. As a result, EMI's customers bear the risk that ITC's performance will not
7 match its unspecified claims. That is the opposite of how regulation should work. In
8 regulation, as in competition, the company should bear the risk that its performance
9 does not meet the Commission's standards.

10
11 In meetings and discovery, ITC has stated that it "would be unable to provide a joint,
12 detailed list of Mississippi infrastructure improvements and associated budgets prior to
13 closing." ITC gave two reasons: "ITC has not generated such a list because of the
14 extraordinary cost and effort that would be required to do so and because of the legal
15 restrictions which govern ITC's institutional independence." MPUS-EMI/ITC 3-17.
16 ITC does not define "extraordinary." So no one knows how this "extraordinary" cost
17 compares to the \$100 million (net present value over 30 years) that ITC expects
18 Mississippi customers to pay in rate increases (at a minimum), and compared to the
19 \$400 million gain the ITC shareholders will receive for the EMI portion of the
20 transferred transmission assets. Further, ITC will have to incur the cost after the
21 transaction. But at that point, ITC's ability to recover the cost from ratepayers through
22 the FERC formula rate makes the cost not so "extraordinary" that the company will not
23 incur it; whereas before the transaction, when the ITC shareholder would have borne the
24 cost, it was presumably too "extraordinary" to incur. Put another way: The cost was
25 not worth causing the shareholders to bear, to verify that real savings will flow from the
26 transaction; but it is worth having ratepayers bear even if those savings never appear.
27 The asymmetry of this position is obvious.

1 As for the “legal restrictions” on creating a joint work list, EMI provides this answer:

2
3 EMI personnel correctly asserted [at a technical conference] a concern
4 about the ability to create a joint list based on advice and counsel of the
5 Entergy Legal Department. The actual issue arises under antitrust laws, in
6 particular the Hart-Scott-Rodino Act (HSR Act) and the Sherman Act, not
7 securities laws. The stated policy of the Federal Trade Commission and
8 the Department of Justice (collectively, the "Government Agencies") is
9 that two companies which plan to merge or form a joint venture with some
10 of their operations must nevertheless think and act as separate entities until
11 the actual date that the transaction is consummated. The Government
12 Agencies are especially rigorous about this principle before and during the
13 transaction antitrust review period. Accordingly, the Entergy Legal
14 Department advised Entergy personnel to exercise the utmost caution
15 when sharing information to conduct additional due diligence or plan for
16 post-closing integration for the proposed transaction in order to avoid
17 anticompetitive coordination or the appearance of such coordination prior
18 to antitrust agency clearance under the HSR Act. Though HSR clearance
19 has been obtained, there remain concerns about sharing of competitively
20 sensitive cost, pricing, and planning information prior to consummation of
21 the transaction.⁶

22
23 EMI then provided confidential information about its own “projected capital budget
24 from 2012 through 2018, as well as the annual incremental funding that EMI and the
25 other EOCs [Entergy Operating Companies] believe would be needed to move the
26 reliability of Entergy’s transmission system to top quartile performance.” This
27 information, of course, indicates only what Entergy would do if ITC had not appeared; it
28 tells us nothing about what Entergy and ITC will do together.

29
30 It is difficult to assess, at a distance, whether the parties’ response to their counsel’s
31 legal advice—that response being a joint decision not to create, or even discuss, joint
32 work plan priorities—was necessary to ensure compliance with whatever legal
33 restrictions exist. It seems unlikely that the law allows prospective merger partners to
34 (a) negotiate financial arrangements in intense detail (including an exchange ratio
35 calculated to the 14th decimal point), and (b) identify the number and types of

⁶ MPUS-EMI/ITC 3-17.

1 employees who will be hired away by ITC,⁷ but then (c) prohibits any planning of the
2 operational improvements that these employees would be essential to producing and that
3 are the asserted purpose of the transaction—especially in a regulatory environment
4 where commission approvals are based on facts and commitments, not hopes and
5 aspirations.⁸ Moreover, it is relevant to the legal concern that the HSR Act’s waiting
6 period has ended.

7
8 Given the information we have, I recommend that if the Commission otherwise
9 approves of this arrangement, it should condition its approval on the submission of a
10 joint work plan and commitments that can become the basis for a proper finding that the
11 transaction’s certain benefits will be worth the certain costs. At that point the lawyers
12 can work to find a way to save the transaction, perhaps with the cooperation and

⁷ See Direct Testimony of Richard C. Riley at 15 (“Approximately 750 active bargaining and non-bargaining employees of the EOCs and of ESI will become ITC employees at closing.”). Mr. Riley states that as of the time of his testimony the employees had not been identified by name. Presumably the Applicants arrived at the 750 number after studying functions and departments, together, and making plans to reorganize them. Indeed, already “[t]eams have been created to determine the number of employees, by function, who will become ITC employees. After the number of employees in each function is determined, the actual individuals who will be chosen to go to ITC will be identified via an agreed-upon selection process.” *Id.* at 16.

⁸ Some form of pre-consummation planning and cooperation must have occurred, prior to consummation and unobstructed by antitrust law, for ITC and Interstate Power and Light (the Minnesota utility owner of the transmission system to be acquired by ITC) to negotiate with intervenors a “settlement,” incorporated into a Minnesota Commission order, requiring ITC to construct a transmission line to reduce congestion in certain Minnesota areas. See *In the Matter of the Joint Petition for Approval of Transfer of Transmission Assets of Interstate Power and Light Company to ITC Midwest LLC*, Docket No. E-001/PA-07-540, “Order Approving Transfer of Transmission Assets, with Conditions” (Minn. Pub. Utils. Comm’n Feb, 7, 2008); and *In the Matter of ITC Midwest LLC Compliance with Commitments in Docket E-001/PA-07-540 to Improve the Transmission System and Relieve Constraints*, Docket No. ET-6675/CI-11-1178, “Order Requiring Filings” (Minn. Pub. Utils. Comm’n May 15, 2012). I assume that the Applicants in the instant case would have the same ability to work with the Mississippi Public Utilities Staff and intervenors, pre-consummation, to design specific plans and commitments for EMI’s territory, without violating antitrust laws. It will be important for the Applicants to clarify that such discussions will be possible, and explain how such fact-intensive planning as occurred in Minnesota differs from the type addressed in the text above.

1 oversight of U.S. Department of Justice lawyers, by defining conversations and
2 commitments that can occur lawfully. If not, if the Commission has no choice but to
3 guess about improvements while placing on the ratepayer the risk of their non-
4 achievement. If ITC continues to insist on FERC-jurisdictional rate increases with no
5 promises of operations-oriented rate decreases, the Commission should reject the
6 transaction.

7
8 I wish to emphasize this last point. If ITC does not know enough about EMI, and about
9 the joint EMI-ITC projects, to be comfortable guaranteeing rate decreases and
10 improved operations, if it will walk away from this opportunity to double its size unless
11 the ratepayers bear the risk that those rate decreases and operational improvements will
12 not occur, then the Commission has its answer: The transaction fails the public interest
13 test.

14
15 ITC makes a separate argument: that according to a FERC order, "ITC must plan its
16 future transmission investments independently from Entergy."⁹ The concern is that
17 reaching advance agreements with Entergy on transmission construction could
18 constitute undue discrimination, given ITC's obligation to treat all transmission
19 customers similarly. *Id.* This response is a *non-sequitor*. The issue is not what
20 commitments ITC has made to provide service to Entergy. The issue is what
21 improvements ITC expects to make in EMI's system and operations, so that the
22 Commission can assign some value to them and create expectations that ITC must meet
23 as a condition of receiving the certificate. The Commission is capable of limiting its
24 condition so as to avoid the discrimination problem. But it cannot craft the condition if
25 ITC declines to produce the necessary information.

26
27 Ultimately, all ITC can offer is this: "ITC is dedicated to making the necessary
28 investments to improve reliability and has demonstrated its ability to do this on its
29 existing systems." *Id.* Good intent is insufficient basis for Commission approval.

⁹ MPUS-EMI/ITC 3-17.

1
2 **2. It is unclear which jurisdiction, as between this Commission and**
3 **FERC, will hold ITC accountable for which aspects of its**
4 **performance**
5

6 **Q. Should the Commission be concerned about ITC's accountability for its**
7 **performance?**
8

9 A. Yes. A utility is accountable for performance when there are (a) clear standards; (b)
10 clarity about who is responsible for complying; and (c) clear consequences for failing to
11 meet those standards, with the consequences sufficiently large to induce compliance.
12

13 With EMI as transmission owner, there is clarity on all three points. MISO, the North
14 American Electric Reliability Corporation (NERC) and this Commission all have
15 authority to impose standards and consequences on EMI. In particular, the
16 Commission's state law authority allows it to establish standards for EMI's transmission
17 performance and assign consequences (both positive and negative). The only federal
18 limit on that authority (separate from the Constitution's requirement of "just
19 compensation") is Section 215(i)(3) of the Federal Power Act, preempting state
20 reliability standards, applicable to the "bulk power system," that are "inconsistent with"
21 NERC standards.
22

23 With ITC as transmission owner, this clarity no longer exists. The Application and
24 testimony fail to answer key questions, such as: (a) Which types of transmission
25 performance remain subject to Commission-set standards, given that ITC will provide
26 FERC-jurisdictional service rather than state-jurisdictional service? (b) Short of
27 revoking ITC's certificate for failure to provide "reasonably adequate service" (as the
28 Commission defines it), what else can the Commission do when performance slips,
29 given that it cannot lower ITC's FERC-jurisdictional rates by disallowing costs or
30 reducing its authorized return on equity?
31

32 **Q. Can you provide some hypotheticals to illustrate your point?**
33

1 A. Yes. The lack of clarity over accountability can be understood through three
2 hypotheticals.
3
4 a. Suppose the Commission finds, after an evidentiary hearing, that ITC is not
5 complying with the Commission’s performance standards, but that (a) FERC has found
6 no violation of ITC's FERC tariff or of any reliability standard, and (b) NERC has found
7 no violation of any reliability standard. The Commission still has its own authority,
8 under Section 77-3-21, to “find[] that [ITC] is not rendering reasonably adequate
9 service,” and to “enter an order specifying in what particulars [ITC] has failed to render
10 reasonably adequate service and order that such failure be corrected within a reasonable
11 time, such time to be fixed in such order.” Then, if ITC fails to correct its failure timely,
12 the Commission may revoke the certificate if doing so is “in the best interest of the
13 consuming public.” The Applicants have not committed *not* to challenge orders under
14 Section 77-3-21 as preempted. Merely saying they will comply with lawful, non-
15 preempted Commission orders gives us no clarity; it only restates the question. Further,
16 the Commission’s revocation authority will have only limited practical value unless ITC
17 agrees, as a condition of this transaction, to sell its assets to the Commission’s chosen
18 successor.
19
20 b. The Commission has authority to impose financial penalties, for violations of “any
21 statute administered by the commission or any regulation or any order of the
22 commission. . . .” Section 77-1-53. As with the preceding example, clarity is necessary
23 as to whether the Commission can penalize performance that FERC and NERC have
24 found satisfactory. Further, since penalties are permissible only for violations of statute,
25 regulation or order, the Commission will need to make clear in its order approving this
26 transaction, and in future orders, what type of performance it requires. Finally, the
27 statute limits penalties to \$5000 per violation (each day of non-compliance being a
28 separate violation). The cost to the public of a quality of service violation, such as
29 unjustified delays in storm outage response, could quickly and easily exceed \$5000 a
30 day. The Commission therefore will need ITC to agree to a condition that lifts this cap,
31 provided that all the attorneys can agree that the Commission’s certificate conditioning

1 authority allows it to find that the transaction would not be consistent with the public
2 interest absent the Commission’s ability to impose penalties not otherwise permitted by
3 statute.

4
5 c. EMI and ITC will have a number of contracts relating to ITC’s performance
6 obligations, including a Distribution-Transmission Interconnection Agreement (DTIA).
7 EMI says that if it has a dispute with ITC under the DTIA, the first step is dispute
8 resolution under the DTIA’s terms. If that steps fails, EMI says, EMI can use the
9 dispute resolution provisions of the MISO tariff “and/or” file a complaint at FERC.¹⁰
10 This statement leaves several questions unanswered. For example: Would EMI also
11 have the right to sue in state court under state contract law? Does the Commission have
12 non-preempted state law authority to order EMI to pursue each of these actions, should
13 EMI fail to do so on its own? (This is a real concern given EMI’s unexplained,
14 imprudent agreement not to contest EMI's rates for five years unless the Commission
15 orders it to, as discussed in Part II.B.1.f below.) Does the Commission have state law
16 authority, not preempted by the Federal Power Act, to find EMI imprudent for failing to
17 pursue contract rights in a particular situation? Does the Commission, the Public
18 Utilities Staff or a Mississippi consumer have any rights to file any of those actions
19 should ITC breach its contract with EMI? Could the Commission require the parties, as
20 a condition of approval, to make the Commission or the Public Utilities Staff a third-
21 party beneficiary of the DTIA? (Section 27.3 of the DTIA expressly states it creates no
22 third-party beneficiary, so an amendment would be necessary.¹¹) Given that ITC has
23 made no enforceable commitments to improving transmission performance, these
24 questions require clear answers before the Commission will know if it can hold ITC
25 accountable for performance.

¹⁰ MPUS-EMI/ITC 4-9.

¹¹ “27.3 No Third Party Beneficiaries. Nothing in this Agreement, express or implied, is intended to confer on any person other than the Parties hereto any rights, interests, obligations or remedies hereunder.”

1 **Q. How do these uncertainties about quality of service jurisdiction under ITC**
2 **ownership compare to the status quo of EMI transmission ownership?**

3
4 A. One might argue that these uncertainties apply now and are therefore unaffected by this
5 transaction. That argument has two errors. First, since the transaction causes rate
6 increases, its only possible selling point (to consumers, as opposed to shareholders) is
7 the possibility of improved performance. If the Commission lacks authority to ensure
8 improved performance, the value proposition to customers diminishes. (This diminution
9 would be less had ITC committed to specific improvements, and to consequences for
10 failure to make those improvements. It is the absence of commitment that makes it
11 necessary for the Commission to preserve its jurisdiction.)

12
13 Second, in the status quo, the Commission has non-preemptible authority over EMI's
14 actions in providing bundled retail electric service (except that, as stated under Federal
15 Power Act Section 216(i)(3), the Commission cannot have reliability standards that are
16 "inconsistent" with NERC standards). If an outage occurs on EMI's system, whether its
17 physical source is generation, transmission, or distribution, and whether its human
18 source was a local lineman or the CEO, the Commission can hold EMI accountable
19 because EMI is responsible for keeping the lights on. Should ITC become the owner of
20 EMI's transmission system, the picture blurs. When an outage occurs there could be a
21 dispute between ITC and EMI over the cause. And if the causer was ITC, ITC could
22 claim that the jurisdiction to investigate and assign consequences is FERC's exclusively,
23 because the contract under which the service was provided was a FERC-jurisdictional
24 contract. (The Mississippi Commission certainly would have arguments in its favor.
25 One argument would be that the action or omission is a violation of the state-granted
26 certificate, even if it was also a violation of the FERC-jurisdictional contract, although
27 there still would be a preemption risk. Another argument would be that if the violation
28 is a reliability violation, Section 215(i) of the Federal Power Act explicitly preserves
29 state regulation of reliability actions, to the extent "not inconsistent" with the federal
30 regime. It is not clear, however, whether a state-imposed penalty on top of, or different
31 from, a federal penalty, for the same action or omission, would be deemed "inconsistent
32 with" the federal regime.)

1
2 **3. ITC does not show that a transmission-only company necessarily**
3 **performs better than a vertically integrated company**
4

5 **Q. What is your reaction to ITC's assertions that a transmission-only company**
6 **performs better than a vertically integrated company?**
7

8 A. They are assertions unsupported by facts. ITC says:

9
10 "Customers' risks associated with failures or delays in transmission
11 upgrades are higher with a state-jurisdictional transmission owner. . . .
12 [T]he risk of failing to complete transmission upgrades in general is lower
13 with an independent transmission owner because of its singular focus on
14 transmission and its financial capability. Since ITC does not own
15 generation or distribution, its resources go solely into building and
16 maintaining a reliable transmission system that avoids the cost and
17 minimizes the risk of outages which impact end-use customers."¹²
18

19 Although this statement uses verbs of certainty ("are," "is," "avoids," "minimizes"), it
20 offers no support for the certainty: no academic or practical study, and no comparison
21 of ITC's performance with the dozens of state-regulated utilities that own transmission.
22

23 The paragraph's reasoning depends not on facts but on ITC's "singular purpose." What
24 is necessary to complete transmission projects is not "singular purpose," but simply
25 "purpose." A vertically integrated utility, whose entire cost recovery depends on
26 pleasing the state Commission, is motivated to satisfy its state's electricity needs. There
27 is no reason to assume that it is any less motivated than would be an expansion-oriented
28 ITC, which will have just doubled its size, added 750 employees to manage, and which
29 will have transmission obligations in 10 states.
30

31 ITC's answer also cites a differential in financial resources, but that claim has a logical
32 flaw. A change in transmission ownership does not create more resources. Capital
33 comes from shareholders and lenders. Capital flows when revenue is available, at a cost
34 and amount which varies with the certainty of the revenue. Whether transmission

¹² ITC's Response to First Set of Data Requests, MPUS-ITC-3-1 (citing response to MPUS-ITC 1-27(a)).

1 ownership is with EMI or ITC, the source of revenue is the same: EMI's retail
2 customers. When capital becomes risk-averse, regulators can lower the risk by making
3 the revenue flow more certain and timely, through riders, surcharges and securitization.
4 These regulatory actions are independent of ownership.

5
6 Even if a single-purpose transmission company is the best way to build transmission,
7 that is a solution to the wrong question. The question relevant for Mississippi is not
8 "How do we get transmission improved and built?" The question is "How do we best
9 integrate transmission, distribution, generation, demand response and energy efficiency
10 so as to produce reliable, high-quality service at lowest reasonable cost?"¹³ ITC makes
11 no showing that a transmission-only company, as a contractor to a load-serving entity,
12 does this job better than a vertically integrated load-serving entity. ITC has crafted a
13 sentence to suit its business model; it has framed the question so that the answer is ITC.
14 But its question is not the right question.

15
16 ITC also omits the risks associated with its model. Due to ITC's "singular focus on
17 transmission," EMI and ITC could become opponents within MISO discussions. EMI's
18 interest could be reducing its customers' demand so as to reduce the need for expensive
19 imports, while ITC's "singular focus on transmission" could cause it to project higher
20 demands so that transmission investment appears to be the preferred solution. Without
21 the transaction, the Commission can direct EMI on what positions to assert within
22 MISO deliberations, without fear that ITC will undermine those arguments.

23
24 In sum: The Applicants are asking the Commission to endorse the transmission-only
25 model as inherently better (i.e., better without regard to company-specific facts) than the
26 vertically integrated model. The record has no facts to support that finding. The

¹³ Cf. EMI's response to MPUS-EMI/ITC 3-1 ("Entergy Mississippi's obligation is to provide reliable electric service at the lowest reasonable cost, not merely to minimize costs to its customers."). It can be economical to transport low-cost gas to load centers and convert it to electricity using small local gas-fired generating plants, as opposed to building large electric generation remotely and building transmission to connect it to load. A transmission-only company would not necessarily view these options objectively.

1 Commission instead should view this transaction for what it is, at best: an experiment to
2 determine whether the transmission-only model is more efficient than the vertically
3 integrated model. There is nothing wrong with an experiment; that is how regulatory
4 and market improvements occur. The problem here, as discussed in Part II.A.1 above,
5 is that in this experiment, the risks of non-achievement (and the costs incurred to
6 attempt achievement) are borne by the customer, who pays more but gets no guarantee
7 of improvement. One can experiment without the automatic rate increase, without the
8 loss of Commission jurisdiction, and with clear expectations for performance, along
9 with fair compensation based on performance. That is not what this proposal does.

10
11 **4. There is no showing that EMI cannot improve its performance while**
12 **still owning the assets**
13

14 **Q. Could EMI make the improvements promised by ITC?**

15
16 A. No one can answer that question because ITC has made no promises. There is evidence,
17 however, that EMI's transmission planning, investment and operations need
18 improvement. SMEPA's Witness Nathan Brown offers data on and analyses of outage
19 problems stemming from EMI decisions, along with recommendations for
20 improvement. FERC has found a series of serious reliability violations, as discussed in
21 Part III.B below. I have not independently studied whether EMI has a need to improve,
22 and am not a quality of service expert. Assuming, however, that the Commission
23 investigates EMI's performance (as I recommend in Part III) and finds a need to
24 improve, there are several implications for this transaction.

25
26 EMI has not suggested that it (or its affiliates) lack the skill, staffing and financial
27 resources to produce the benefits that ITC claims it will produce. (In fact, ITC has
28 acknowledged that its success depends on hiring EMI staff. See Part II.B.2.d below.)
29 And if there were a differential in skill, staffing or financial resources, EMI does not say
30 that it could not acquire those resources at less cost to consumers than could ITC (and
31 without losing the Commission's jurisdiction). EMI could even hire ITC or others as
32 consultants or trainers, or contract out certain operational roles. Further, I am assuming
33 that there are no policies at the Entergy Board of Directors level that deprive EMI of the

1 financial resources it needs to perform well, because if there were such policies, it
2 would be the duty of EMI's executives to inform the Commission so that it could take
3 appropriate action. For it is the Commission, not the Entergy Board, that determines the
4 performance standards, and authorizes the rates necessary to meet those standards.

5
6 If and when there is a specific, verifiable conflict between construction needs and
7 Entergy's financial resources, EMI can, on a project-by-project basis, invite third parties
8 to perform and finance the construction, either taking ownership or providing the
9 finished project to EMI on a turnkey basis, accompanied by whatever type of secure
10 revenue flow the Commission deems reasonable. This approach contrasts with EMI's
11 view that to address all future transmission needs, there is no better solution for its
12 customers than selling the transmission system, at a \$400 billion gain, to an ITC whose
13 rates will be beyond the Commission's jurisdiction.

14
15 **Q. Summarize your concern about ITC's asserted performance advantage.**

16
17 A. The Application assumes that ITC can perform in ways EMI cannot; that the status quo
18 is suboptimal and that only ITC can improve it. There are no facts to support that
19 assumption. Exemplifying the evidentiary gap are two testimonial sources.

20
21 First, to explain ITC's incremental contribution, Mr. Riley compares two approaches to
22 planning: (a) EMI owning its own transmission within MISO and (b) ITC owning
23 EMI's transmission within MISO:

24
25 If the EOCs owned the transmission assets, the EOCs would conduct
26 economic planning under the MISO OATT as follows: *Analyses of the*
27 *Entergy Transmission System, congestion on the system, and the economic*
28 *impact of that congestion would be conducted by ESI transmission*
29 *planning engineers. A significant component of the EOCs' analysis of the*
30 *economic value of a project is adjusted production cost savings. Projects*
31 *identified and believed to potentially provide net benefits would be*
32 *submitted into the MISO MTEP process for analysis as Market Efficiency*
33 *Projects or Multi-Value Projects. Separate and apart from ESI's analysis,*
34 *MISO would analyze and evaluate transmission projects from the*
35 *perspective of benefits to the entire region, including all users of the*
36 *Entergy Transmission System. The projects submitted into MISO's MTEP*

1 process would then be *analyzed and evaluated by MISO's planning staff*
2 and included in an MTEP which ultimately would be either approved (or 1
3 denied) by the MISO Board of Directors.

4
5 If ITC were to own the transmission assets, ITC's analysis would evaluate
6 whether the projects were potentially beneficial from *the perspective of the*
7 *entire region or adjacent regions. Although MISO, too, would analyze and*
8 *evaluate transmission projects from the perspective of benefits to the*
9 *entire region, including all users of the transmission system – regardless*
10 *of the proposed ITC Transaction – ITC's regional focus and expertise,*
11 *combined with the local engineering expertise acquired as a result of the*
12 *Transaction, would enable a broader perspective to be applied to projects*
13 *proposed in the MTEP process. Put another way, whereas the EOCs as*
14 *transmission owners in MISO would evaluate economic projects*
15 *individually for retail customers, wholesale transmission customers, and a*
16 *broader set of customers through coordinated regional and inter-regional*
17 *planning efforts, ITC analysis would continue, screening for possible*
18 *benefits to other entities, for instance entities such as the Southwest Power*
19 *Pool, the Southern Company, and the Tennessee Valley Authority. While it*
20 *is true that MISO does this, the combination of ITC and MISO looking*
21 *more broadly creates a "MISO plus" structure.*¹⁴

22
23 I have italicized the key passages describing the relative roles of MISO and ITC. To
24 avoid understating the former and overstating the latter, Mr. Riley has chosen his words
25 carefully.¹⁵ But his candor leaves his argument with no weight other than words. Yes,
26 ITC has "regional focus and expertise," but so has MISO (and MISO has it without a
27 for-profit bias toward transmission). Yes, there will be a "combination of ITC and
28 MISO looking more broadly," but this passage tells us nothing about whether that
29 combination will be additive ("MISO plus") or merely duplicative.

¹⁴ Riley Direct Testimony at pp. 37-38 (emphasis added).

¹⁵ As does Mr. Vitez. See his Direct Testimony at p. 9 ("Although MISO performs planning functions collaboratively with its Transmission Owners, MISO *also provides an independent assessment and perspective of the transmission system's overall needs.*") (emphasis added); *id.* at p. 10 ("This MISO planning process assures that the transmission projects developed by individual Transmission Owners, such as ITC, will be properly integrated with other proposed projects within MISO and that these projects will be fully vetted in an open and transparent manner.")

1 And omitted from this above-quoted passage, but appearing a page later (at p.39) is the
2 potential influence of FERC’s Order No. 1000. Mr. Riley correctly states (referencing
3 Mr. Vitez) that Order No. 1000 “establishes a framework for regional and interregional
4 planning.” The purpose of Order No. 1000 is to have every transmission owner, whether
5 a regional entity or a subregional entity, adopt a regional perspective.¹⁶ If Order 1000 is
6 successful, the difference between the EMI perspective and the ITC perspective, if a
7 difference exists, will diminish. Mr. Riley’s point boils down to a prediction: that the
8 ITC-plus-MISO-plus-Order-1000 perspective will get us to regional thinking more
9 surely and rapidly than will the EMI-plus-MISO-plus-Order 1000 prediction. But it is
10 only a prediction, with only words—not facts—to support it.

11
12 Second, Mr. Pfeifenberger describes transmission projects that would produce net
13 savings, asserting that "most of these projects are beyond what the Entergy Operating
14 Companies would likely plan under MISO's planning process."¹⁷ There is no basis for
15 assuming what the EOCs would "likely" do or not do. I assume EMI will do what the
16 Commission lawfully orders it to do.

17
18 The proposed transaction is, therefore, an expensive solution to a problem that has not
19 yet been defined. Instead of approving it, the Commission should (a) investigate and
20 determine whether there is a performance problem, (b) if there is one, prescribe
21 improvements, and (c) provide for the appropriate compensation, penalties and other
22 consequences.

¹⁶ See Order No. 1000 at ¶ 68 (requiring each "transmission provider" to "participate in a regional transmission planning process that produces a regional transmission plan and complies with existing Order No. 890 transmission planning principles."). Mr. Vitez properly recognizes this point. Vitez Direct Testimony at p. 11 (“MISO does not typically initiate transmission plans to be built by the Transmission Owners unless the plans are regional in nature and affect several pricing zones and other MISO member Transmission Owners. More recently, MISO has submitted regional projects to the MTEP for future study consistent with the thrust of FERC Order 1000. Under FERC Order 1000, RTOs are directed to take a more active role in regional planning.”).

¹⁷ Pfeifenberger Direct Testimony at p. 5.

1
2 **5. Conditions on quality of service**
3

4 **Q. Should the Commission establish conditions relating to quality of service?**

5
6 A. Yes, if the Commission chooses to approve this transaction despite its shortcomings.
7 The following conditions will help align ITC's performance with the state's needs,
8 compared to an unconditioned transaction.

9
10 **a. Condition on ITC's certificate:** ITC's right to own and operate transmission in
11 Mississippi should be subject to specific quality conditions determined by the
12 Commission, including compensation for complying with and penalties for violating the
13 conditions. I recommend a separate proceeding to establish these conditions, since this
14 case is not formally an investigation into quality of service.

15
16 **b. Imputation to EMI of ITC imprudence:** The Commission should include a
17 condition that it will impute to EMI (who is seeking rider recovery in retail rates of the
18 MISO tariff charges based on ITC's costs) any ITC imprudence that the Commission
19 finds in expenditures or performance, after ensuring that such a condition itself is not
20 preempted. Other state commissions have used this imputation approach.¹⁸

21
22 Here is the rationale: When EMI owns the transmission, the Commission has direct
23 authority to hold EMI accountable for its performance. The Commission can reduce
24 EMI's return on equity, disallow costs or impose penalties. EMI seeks to change this
25 picture, by having ITC perform a service that was EMI's obligation to perform. A utility
26 should not be allowed to avoid accountability by contracting out key services.

27 Otherwise, the transaction would give EMI's shareholders a \$400 million gain while

¹⁸ See, e.g., *Pennsylvania Public Utility Comm'n v. Philadelphia Electric Co.*, 31 P.U.R.4th 15, 29 (Pa. Pub. Util. Comm'n May 7, 1989) (imputing nuclear plant majority owner's construction imprudence to minority utility owner, due to the latter's "total abdication of responsibility for the management of the construction of . . . the project").

1 shifting the risk of ITC's poor performance to its customers. That risk belongs with
2 EMI.

3
4 Both the Transition Services Agreement and the Distribution-Transmission
5 Interconnection Agreement (DTIA) give EMI opportunities to manage that risk, by
6 taking action to protect its customers. Prudence requires that EMI use these
7 opportunities to their fullest.¹⁹ To ensure that the transaction does not reduce EMI's

¹⁹ See, e.g., the following provisions:

Transition Services Agreement § 4(a): EMI "agrees to supervise the activities to be performed by Service Provider [i.e., ITC or its affiliates] and reasonably cooperate with Service Provider in connection with the performance of the Services."

Transition Services Agreement § 4(b): "A Service Provider shall not be responsible for any loss, damage, fine, penalty, cost, expense, delay, interruption, breach, non-performance or other failure of any of the Services to the extent resulting from or arising out of or in connection with any failure by any Service Recipient to provide access to the extent reasonably necessary or appropriate in connection with the performance of the applicable Service to the Transmission Assets or any other of its properties, facilities or personnel in connection with the performance of such Services on a commercially reasonable basis."

DTIA § 7.1 imposes on ITC a "public utility duty to operate, maintain, plan, design and construct the Transmission System so that the system is adequate to: (i) deliver on a reliable basis the reasonable, projected needs of all loads on the Distribution System connected to and dependent upon the Transmission Owner's facilities for delivery of reliable, low-cost and competitively-priced electricity to such distribution system; and (ii) provide needed support to the Distribution System...."

DTIA § 7.4 grants EMI the right, when EMI believes a project is needed and ITC disagrees, to seek a declaratory ruling on the project from the "applicable Government Authority."

DTIA § 7.5 requires ITC to "plan and install any Transmission System components that may be necessary to accommodate Local Distribution Company's planned load growth and planned reliability improvements."

DTIA § 23.1 authorizes either party to petition FERC for changes in the DTIA, unrestricted by the *Mobile-Sierra* doctrine (which otherwise would bar FERC from considering any change to a contract unless FERC found "serious harm" to the "public interest," as opposed to harm to either of the parties. See *Morgan Stanley Capital*

1 accountability, the Commission should make clear that it will hold EMI responsible for
2 using these provisions to protect its customers. Unless the Commission makes this point
3 in its order explicitly, EMI can argue that the Commission's approval of the transfer
4 relieved EMI of any responsibility for ITC's imprudence.

5
6 This option is not risk-free, however. Before relying on this condition, the Commission
7 should assure itself that it is not preempted by the Federal Power Act.

8
9 **c. Amendment of the FERC-jurisdictional service agreement:** To reduce the risk of
10 preemption, both the EMI-ITC contract and ITC's FERC tariff should include language
11 reflecting the foregoing conditions.

12
13 **B. Rates**

14
15 **Q. Summarize your discussion of the proposal's effect on rates.**

16
17 A. If the Commission approves this transaction, rate increases are certain because
18 jurisdiction over transmission cost of service shifts to FERC, which interprets the
19 statutory phrase "just and reasonable" differently from the Commission. That increase
20 will cost EMI retail ratepayers a minimum of \$100 million (net present value) over 30
21 years, as explained in footnote 1 of my testimony. I said "minimum," because as
22 explained below, the costs can rise with (a) FERC incentives and (b) new investments
23 (all of which would benefit from the FERC-approved return on equity and capital
24 structure).

25
26 My discussion of the rate increase has seven subparts: (a) EMI's profitable sale is the
27 Commission's jurisdictional loss, (b) FERC's present policies on equity return and capital
28 structure promise an immediate increase in rates, (c) FERC's additional rate
29 "incentives" could allow ITC to raise rates without improving performance, (d) ITC's

Group Inc. v. Public Utility District No. 1, 554 U.S. 527 (2008). This provision allows EMI to see positive changes, and defend against negative changes.

1 strategy for rate base growth risks additional rate increases, (e) revisions to the FERC-
2 jurisdictional formula rates are necessary to make prudence challenges at FERC
3 feasible, (f) Mississippi's rate increase risk is increased by EMI's imprudent concession
4 not to contest ITC's rates for five years absent a Commission order, and (g) an EMI
5 rider to recover at retail its transmission payments to ITC would violate test year
6 integrity while relieving EMI of transmission cost responsibility.

7
8 After addressing those seven points in Part II.B.1, I turn in Part II.B.2 to Applicants'
9 efforts to describe possible cost decreases. These efforts are vague, generic and
10 noncommittal. And there are two other problems with any expectation of cost
11 decreases: The FERC-jurisdictional formula rate weakens ITC's incentive to lower
12 operating costs; and EMI has not demonstrated a capacity to monitor ITC's rates or
13 question its cost-effectiveness.

14
15 Should the Commission still find value in this transaction, it is possible to salvage its
16 current power to control transmission costs. Part II.B.3 describes conditions that allow
17 the Commission to direct the cost inputs into ITC's FERC transmission tariff; or to
18 disallow from EMI's rates, as an imprudent cost, the excess of ITC's rates over the
19 amount EMI would have charged had it retained transmission ownership.

20
21 **1. Rate increases are certain**

22
23 **a. EMI's profitable sale is the Commission's jurisdictional loss**

24
25 **Q. How does this transaction cause the Commission to lose its jurisdiction over the**
26 **transmission costs charged to EMI customers?**

27
28 **A.** FERC's Order No. 888 interpreted the Federal Power Act to mean that unbundled
29 transmission service is a FERC-jurisdictional service, regardless of whether the
30 electricity transmitted is retail electricity or wholesale electricity. The U.S. Supreme
31 Court upheld FERC's interpretation in *New York v. FERC*, 535 U.S. 1 (2002). FERC's
32 Order No. 2000 found that when a vertically integrated, load-serving entity (LSE) joins
33 an RTO, with the RTO taking functional control of the LSE's transmission system, the
34 RTO becomes a "public utility" under the Federal Power Act. Transmission becomes an

1 unbundled service, provided by the RTO to the former transmission owners under a
2 FERC-jurisdictional tariff.

3
4 The MISO tariff contains a "bundled load exemption" from FERC jurisdiction.²⁰ Under
5 this exemption, if EMI joins MISO without the ITC transaction, EMI's transmission cost
6 of service would remain subject to state Commission jurisdiction. If ITC acquires EMI's
7 transmission assets, however, the current bundled load exemption does not apply. ITC's
8 charges to EMI would be set by FERC, not by the state commission. And having
9 allowed EMI to place itself in a position of paying FERC rates whose cost basis EMI
10 cannot control, the Commission, absent careful conditioning, would lack justification
11 for excluding EMI's payments to ITC from EMI's retail cost of service.

12
13 As discussed in Part II.B.3 below, there are ways for ITC to draft its FERC tariff so that
14 the costs ITC puts into the FERC formula rate, and thus recovers from EMI, are only
15 those costs approved by the MPSC. In addition, when EMI seeks to recover in retail
16 rates the costs of its transmission purchases from ITC, the Commission has non-
17 preempted authority to disallow any portion of EMI's purchase costs that the
18 Commission deems imprudent. On this latter point, the U.S. Supreme Court has
19 suggested (although not found conclusively) that the Federal Power Act does not

²⁰ Per ITC's response to MPUS-EMUITC4-14:

The MISO Tariff defines "bundled load" as "[t]he aggregate usage by customers who purchase electric services as a single service or customers who purchase electric services under a retail tariff rate schedule that includes Energy and delivery components, as distinguished from customers who purchase Transmission Service as a separate service." Section 37.3 of the MISO Tariff provides that "Transmission Owners . . . taking Network Integration Transmission Service to serve their Bundled Load shall not pay charges pursuant to Schedules 1, 3 through 6 and Schedule 9." This "bundled load exemption" effectively permits vertically integrated utilities to avoid the cash flow issues associated with otherwise having to pay MISO monthly for the cost of network transmission service to deliver generation to their native load customers as a transmission customer, only to have MISO return that money later as payment for use of the same utilities' facilities as transmission owners.

1 preempt a state commission from excluding from retail rates a utility's costs incurred
2 under a FERC-approved rate, if the reason for the disallowance is not that the FERC-set
3 rate is wrong, but that the utility bought a quantity of transmission that exceeded a
4 prudent amount. Numerous other authorities, including FERC, state courts, and the U.S.
5 Court of Appeals, have emphasized the state commission's non-preempted authority to
6 disallow from retail rates costs incurred under a FERC rate. They reason that FERC and
7 the state are regulating different activities—FERC is regulating the wholesale (or
8 transmission service) seller, the state is regulating the wholesale (or transmission
9 service) buyer.²¹ The reply brief of the Public Utilities Staff will discuss these legal
10 concepts in detail, but I am prepared to explain their necessity as conditions, their
11 validity and their limits, so that the Commission can understand its options—
12 particularly if the Applicants are advancing a different legal view, as they do in their
13 brief on legal issues filed May 20, 2013. Absent such condition or circumstance, a rate
14 increase is certain, as discussed next.

²¹ See *Nantahala Power & Light v. Thornburg*, 476 U.S. 953, 972 (1986) ("Without deciding this issue, we may assume that a particular quantity of power procured by a utility from a particular source could be deemed unreasonably excessive if lower cost power is available elsewhere, even though the higher cost power actually purchased is obtained at a FERC approved, and therefore reasonable, price."); *Kentucky West Virginia Gas Co. v. Pennsylvania Public Utilities Comm'n*, 837 F.2d 600 (3d Cir. 1988) ("Since the question here of whether the retailer acted with economic prudence in purchasing from one wholesaler rather than another is never before FERC, the PUC is not regulating the same activity."); *Pike County Light & Power Co. v. Pennsylvania Public Utility Comm'n*, 465 A.2d 735, 737-38 (Pa. Commw. Ct. 1983) (same); *Central Vermont Public Service Corp.*, 84 FERC ¶ 61,194 (1998) (clarifying that FERC's approval of a wholesale rate schedule does not preclude the New Hampshire Commission from determining whether Connecticut Valley [the wholesale buyer and retail utility] acted imprudently by purchasing from CVPS rather than using available lower-priced power).

1 To carry out this mandate, FERC issued Order No. 679.²³ This order invited
2 transmission owners to seek the following incentives: return on equity adders; inclusion
3 of 100 percent of prudently incurred transmission-related Construction Work in
4 Progress (CWIP) in rate base; recovery of prudently incurred pre-commercial operations
5 costs through expensing rather than capitalizing; hypothetical capital structure;
6 accelerated recovery of depreciation expense; recovery of all prudent costs associated
7 with projects abandoned due to factors beyond the public utility's control; cost deferrals;
8 and recovery of costs prudently incurred to comply with mandatory reliability standards.
9 Additional incentives, such as ROE adders, are available to independently owned
10 transmission companies and investors in "advanced technologies."

11
12 The sky is not the limit, however. FERC has emphasized that all transmission rates, as
13 supplemented by incentives, are subject to the "zone of reasonableness" created by the
14 statutory "just and reasonable" standard. At the same time, the Court of Appeals has
15 found that FERC's incentives are lawful even if they are not necessary to produce more
16 or improved transmission.²⁴

17
18 To decide when to award incentives, FERC uses a sequential analysis.²⁵ As of May
19 2011, FERC had evaluated "more than 85 applications representing over \$60 billion in

²³ *Promoting Transmission Investment through Pricing Reform*, 116 FERC ¶ 61,057 (July 20, 2006).

²⁴ *Connecticut Dep't of Public Utility Control v. FERC*, 593 F.3d 30, 33-34, 37 (D.C. Cir. 2010) ("Certainly the Commission's failure to pinpoint specific actions that utilities would take only because of the incentive is of no moment."). The Court cited, without concern, a transmission owner witness's statement that "I can't sit here and give you a shopping list now, looking forward, to exactly what we are going to do, specifically in response to this incentive." It was enough, FERC said (upheld by the Court), to find that "utilities can be expected to respond to financial motivations and, in so doing, to expend the time and effort necessary to sell the importance of their projects at the local level." *Id.* (quoting FERC opinion).

²⁵ See Adam Pollock, *How Can FERC Improve the Transmission Incentive Policy? Ways to Improve Clarity, Transparency, and Performance* (National Regulatory Research Institute 2009).

1 potential transmission investment."²⁶ In November 2012, FERC issued a Policy
2 Statement tightening access to these incentives, by "refram[ing] the nexus test to focus
3 more directly on the requirements of Order No. 679...." FERC "expects applicants to
4 take all reasonable steps to mitigate the risks of a project, including requesting those
5 incentives designed to reduce the risk of a project, before seeking an incentive return on
6 equity (ROE) based on a project's risks and challenges...."²⁷

7
8 **ii. Application to the ITC transaction**

9
10 **Q. What is the relevance of FERC's transmission "incentives" to the EMI-ITC**
11 **transaction?**

12
13 A. FERC expects each applicant for incentives to show "demonstrable consumer benefits
14 of the proposed project and its role in promoting a more efficient, reliable and cost-
15 effective transmission system." 2012 Policy Statement at ¶ 22. To meet this
16 requirement, an applicant can show that—

17
18 its project was, or will be, considered in an Order No. 890 or Order No.
19 1000-compliant transmission planning process that provides the
20 opportunity for projects to be compared against transmission or non-
21 transmission alternatives

22
23 [or]

24
25 its project was considered by a local regulatory body, such as a state utility
26 commission, that evaluated alternatives to its proposed project
27 (transmission or non-transmission alternatives) and determined that the
28 proposed transmission project is preferable to the alternatives evaluated.

29
30 2012 Policy Statement at ¶ 26. Although FERC does not commit itself- if a state
31 commission finds that there are preferable alternatives to an applicant's proposed
32 project, FERC could reject incentives or at least require the applicant to prove there
33 were no preferable alternatives. Further, it is not clear that FERC's incentives (other

²⁶ *Notice of Inquiry, Promoting Transmission Investment Through Pricing Reform*, Docket No. RM11-26-000 (May 19, 2011).

²⁷ *Promoting Transmission Investment Through Pricing Reform Policy Statement*, 141 F.E.R.C. ¶ 61,129 (Nov. 15, 2012) (hereinafter cited as "2012 Policy Statement").

1 than the independent transmission owner incentives) are or should be available for
2 existing transmission assets. The point of Section 219 and Order 679 is to encourage
3 new investment (and, for Order 679, to encourage transfers to independent transmission
4 companies). An asset that already exists does not need an incentive.²⁸

5
6 This situation suggests two conditions the Commission should include on any certificate
7 it grants to ITC. First, ITC should commit to seek no facility-specific incentives for
8 existing assets, because no incentive is necessary to bring them into existence. Second,
9 ITC should commit to seek no FERC incentive for a project whose costs would be
10 allocated to EMI customers (whether that project is located inside or outside
11 Mississippi), without a prior Commission finding that there are no lower cost
12 alternatives and that the incentive is necessary to get the project built (i.e., but for the
13 incentive no one, including ITC, could build the project). To reduce the risk of
14 preemption, the condition would include an ITC obligation to include this condition in
15 its tariff and obtain FERC approval of it.

16
17 Finally, as discussed further in Part III, the Mississippi Commission will be best
18 positioned to make these judgments about a transmission project's benefits if it has an
19 integrated resource planning process that gives comparable consideration to all options,
20 especially demand response and energy efficiency.

21
22 **d. ITC's strategy for rate base growth risks additional rate**
23 **increases**

24
25 **Q. Is there a risk of additional rate increases by ITC, besides those attributable to (a)**
26 **applying FERC's ROE and hypothetical capital structure to EMI's existing assets**
27 **and (b) FERC's "incentives"?**

28
29 A. Yes. ITC's "singular focus" on transmission means that the company's main path to
30 profit growth is to build or buy more transmission. (Unless ITC invests in non-
31 transmission businesses, as discussed in Part II.E below.) This building and buying of

²⁸ Cf. Order No. 679-A at ¶ 93 (finding that hypothetical capital structures "can be an appropriate ratemaking tool for fostering *new* transmission in certain relatively narrow circumstances") (emphasis added).

1 transmission can take place inside or outside Mississippi. Either way, Mississippi
2 ratepayers are at risk of higher rates. In the case of a regional project, i.e., one that
3 FERC finds produces benefits across a multi-state area, MISO's tariff can allocate costs
4 to Mississippi customers whether the project is located inside or outside Mississippi.
5 (The reverse is true also; a project located inside Mississippi, if it produces regional
6 benefits, would be eligible for regional cost allocation, thereby reducing the cost for
7 Mississippi residents.) It is true that these allocations could occur even if ITC does not
8 buy EMI's transmission, once EMI's transmission becomes subject to MISO's tariff. But
9 ITC's "singular focus" on transmission means that its shareholders will expect to see
10 higher profits from continued increase in transmission ownership. That expectation
11 creates risks of higher rates for Mississippi ratepayers.

12
13 Mississippi is vulnerable to excess cost because it does not conduct an integrated
14 resource planning process outside the context of certificate proceedings for specific new
15 utility generation. A distinct integrated resource planning process would cause a
16 periodic evaluation of, and a continuous, transparent contest among generation,
17 transmission and other options. In particular, absent a way to dampen demand, and a
18 process for causing comparisons among generation, transmission and demand-
19 dampening options, EMI and ITC will be bringing to MISO load growth scenarios that
20 make the state vulnerable to more allocated transmission cost.

21
22 There is no reason to question ITC's acknowledgment that it is "obligated to propose
23 transmission projects that it believes are prudent. Thus, before proposing a project, ITC
24 considers whether there may be other alternatives to that project." ITC Response to
25 Third Set of MPUS Joint Data Requests, 3-11(c). But ITC also admits that "as an
26 independent transmission company, ITC is not in a position to determine whether
27 generation or demand side management or other alternatives might better address a
28 particular system need. That is the role of MISO's open planning process wherein
29 stakeholders can propose alternatives to transmission projects." *Id.* Actually, that is also
30 the responsibility of EMI, which, as a vertically integrated company with an obligation

1 to serve, is "in a position," in terms of its responsibility and expertise, to determine the
2 best alternative.

3
4 ITC insists it will screen its projects for prudence, but the Commission should ask
5 whether ITC shares its definition of prudence. Rule 21 of the Commission's *Public*
6 *Utilities Rules of Practice and Procedure* prohibits "[e]xpenditures of any kind which
7 the Commission determines not to have been prudently incurred or not incurred in the
8 interest of the public." Nepotism is not a prudent practice, yet ITC practices nepotism.²⁹
9 Nepotism may be appropriate for a small, family-owned business, where the
10 decisionmakers bear the cost and the product prices are subject to competitive forces.
11 Nepotism is not appropriate for a regulated utility whose customers have no choice but
12 to pay its prices, and who therefore deserve employees selected for reasons of merit
13 alone.

14 **e. Revisions to the FERC-jurisdictional formula rates are**
15 **necessary to make prudence challenges feasible**

16
17 **Q. Should the Commission be concerned about MISO's "formula rates"?**

18
19 A. Yes. MISO transmission providers collect their rates through a formula rate, known as
20 Attachment O to the MISO tariff. Under the formula, a transmission owner can raise
21 rates each year as its reported costs rise, without seeking and obtaining formal FERC

²⁹ The S-4 states (at p.78): "With the approval of ITC's nominating/corporate governance committee, Clayton Welch, Jennifer Welch, Jessica Uher and Katie Welch (each of whom is a son, daughter or daughter-in-law of Joseph L. Welch, ITC's chief executive officer) were employed by ITC as a Senior Engineer, Fleet Manager, Manager of Warehouse and Logistics, and Senior Accountant, respectively, during 2011 and continue to be employed by ITC. These individuals are employed on an "at will" basis and compensated on the same basis as ITC's other employees of similar function, seniority and responsibility without regard to their relationship with Mr. Welch. These four individuals, none of whom resides with or is supported financially by Mr. Welch, received aggregate salary, bonus and taxable perquisites for services rendered in the above capacities totaling \$420,877 during 2011."

It is only fair to note that "ITC denies that "nepotism" is a policy of ITC. Rather, there are several instances of ITC employee familial relationships of individuals who were hired for positions for which they are qualified." ITC Response to MPUS-EMI/ITC 3-15. But see www.merriam-webster.com (defining "nepotism" as "favoritism (as in appointment to a job) based on kinship").

1 approval for the increase. The reason is that, legally speaking, it is the "formula"—in
2 effect an empty spreadsheet containing all the cost categories—is the "rate" that FERC
3 already has approved. The transmission owner annually "populates" the formula with
4 its reported costs, the spreadsheet calculates the new charge and customers then must
5 pay that charge. No FERC intervention is necessary for the charge to rise or fall.

6
7 The concern is whether the cost inputs that produce the charges are subject to sufficient
8 review. ITC's Bready asserts that under Attachment O, "[c]ustomers and stakeholders
9 have access to information about the formula inputs under tariff protocols and have the
10 right to file a complaint [under Section 206 of the Federal Power Act] with FERC if
11 they feel a rate is unjust or unreasonable." Bready Direct p. 32.

12
13 But FERC recently found that MISO's formula rate protocols, and the formulas of each
14 MISO transmission owner, were unlawful.³⁰ FERC made three main findings. First,
15 transmission owners were excluding some parties from participating in the review of
16 input costs. Second, the protocols did not provide all the information necessary to
17 ensure the accuracy of the inputs or the prudence of the costs. Third, there were not
18 clear procedures by which intervenors could challenge costs. Because of these
19 infirmities, FERC ordered MISO and each transmission owner to submit, by July 16,
20 2013, compliance filings revising their protocols in three main ways.³¹

21
22 *a. Scope of participation:* The protocols must "include all interested parties in
23 information exchange and review processes, including but not exclusive to
24 customers under the Tariff, state utility regulatory commissions, consumer
25 advocacy agencies, and state attorney generals."
26

³⁰ Midwest Independent Transmission System Operator, et al., "Order on the Investigation Of Formula Rate Protocols," Docket No. EL12-35-000, 143 FERC ¶ 61,149 (May 16, 2013).

³¹ This is only a summary. The order has more details.

1 *b. Transparency:* The protocols must "provide interested parties with the
2 information necessary to understand and evaluate the implementation of the
3 formula rate for either the correctness of inputs and calculations, or the
4 reasonableness of the costs to be recovered in the formula rate. Such revisions
5 should enable interested parties to replicate the formula rate as implemented by
6 the transmission owners." *Id.* ¶ 83 (footnote omitted). Owners also must hold
7 "an annual meeting open to all interested parties, where the transmission owners
8 can explain and those parties can review and discuss the transmission owner's
9 calculations." *Id.* ¶ 86. Further, "interested parties must have the right to serve
10 reasonable information and document requests on the transmission owner,
11 provided that they are relevant to the implementation of the formula rate." *Id.* ¶
12 91.

13
14 *c. Challenges:* The protocols must "set out a procedure through which
15 interested parties can informally challenge transmission owners' proposed inputs.
16 . . . for a reasonable period of time after transmission owners initially propose
17 their annual updates." A transmission owner "senior representative" must be
18 available to work toward resolution. *Id.* ¶ 119. Absent resolution, the protocols
19 must allow parties "to raise a formal challenge with the Commission, in which
20 the transmission owner as the utility proposing to charge the updated or true-up
21 rate would bear the burden of demonstrating the correctness of its update or true-
22 up." *Id.* ¶ 120. In these challenges, the transmission owner enjoys a
23 presumption of prudence. The presumption means that the challenger must
24 produce evidence that "create[s] serious doubt as to the prudence of the
25 expenditure before the burden of proof shifts to the transmission owner." *Id.* ¶
26 121 (footnote omitted). Parties are free to use an on-call settlement judge or the
27 FERC's Dispute Resolution Service.
28

1 Until we see the compliance filings due July 16, 2013, we will not know if ITC's and
2 MISO's revisions are sufficient to protect Mississippi customers from excess costs.³²

3

³² Prior to FERC's May 16 Order, ITC had opposed any change to the current MISO protocols. In its brief to the FERC in EL12-35 (June 22, 2012), ITC stated that it is sufficient for intervenors to have a Section 206 complaint and the MISO Attachment HH dispute resolution procedures. ITC also stated at the May 17 settlement discussion in the instant proceeding that its protocols already provided all the protections FERC was seeking. ITC's May 17 statement was wrong, for at least the following reason: Under Section 206, the complainant has the burden of proving imprudence (proving imprudence, not merely producing evidence of imprudence); whereas under Section 205, the transmission provider has the burden of proving justness and reasonableness (although FERC historically has awarded utilities a presumption of prudence, meaning that the intervenor has the burden of going forward to produce evidence of imprudence; if the intervenor carries that burden, then the utility no longer benefits from the presumption of prudence and must produce its own evidence of prudence rather than rely on the presumption).

As for the MISO Attachment HH on dispute resolution, the Organization of MISO States believes it insufficient:

. . . [T]he generic dispute resolution process described in MISO's Attachment HH is ill-suited to deal with challenges to, or disputes over, formula rate updates. That process appears to be largely designed to deal with unusual or unique events and requires the use of committees and other procedural steps that are specifically tailored to each individual dispute. . . . [F]ormula rate updates are not unusual or unique events but, rather, routinely occur at least once a year for each transmission owner. Moreover, the rules and procedures under Attachment HH are not explicit or codified and therefore the dispute resolution process could be different for each case, depending largely on how the arbiter or judge charged with overseeing the resolution process decides to proceed. Indeed, a transmission owner facing multiple challenges to its formula rate update could be involved in a different process for each challenge and receive a different outcome in cases sharing the same set of facts. As such, it would be more practical to develop a comprehensive set of formula rate protocols to deal with rate update challenges within the formula rate review process than to rely upon the generic dispute resolution process under Attachment HH that would effectively necessitate developing new processes every time a party may wish to challenge an element of a formula rate update.

OMS brief in EL12-35 (June 20, 2012).

1 **f. Mississippi's rate increase risk is increased by EMI's**
2 **imprudent concession not to contest ITC rates for five years**
3 **absent a Commission order**
4

5 **Q. Should the Commission be concerned about EMI's agreement to accept ITC's rates**
6 **for five years without protest, unless the Commission orders EMI to challenge the**
7 **rates?**
8

9 **A. Yes. Under Section 5.13 of the Merger Agreement, each Entergy Operating Company**
10 **forfeited for five years its Federal Power Act right to file complaints against ITC rates,**
11 **unless its state commission directs it to file a complaint.**
12

13 EMI accepted this language without knowing the cost implications to its customers.
14 The ITC-EMI arrangement is not a fixed rate agreement, where buyer and seller know
15 what the price will be, and agree not to seek any change in that price, up or down, for a
16 specified time period. As explained in the immediately preceding subsection, the FERC
17 formula does not produce a fixed rate. Whatever dollars ITC incurs (or predicts, in the
18 context of a future test year), whatever return on equity, capital structure and
19 depreciation schedule FERC authorizes in advance, those are the dollars that EMI has
20 agreed not to challenge—without knowing what they will be. (ITC does state that
21 Section 5.13 "would not prevent Entergy from challenging a future ITC Mississippi
22 filing at FERC under FPA 205 that requests project-specific incentives under FERC
23 Order 679." MPUS-EMI-ITC 6-5.)
24

25 EMI's state law duty is to ensure that its customers' rates are reasonable. Given this
26 duty, it was not reasonable for EMI to cede its federal statutory right to challenge those
27 costs, particularly given the open-endedness of ITC's ability to raise its rates. Even
28 assuming that the divestiture of EMI's transmission to ITC would have net benefits to
29 consumers, it is unlikely that this provision was essential to ITC; unlikely that ITC
30 would give up a chance to double its size if its new largest customer insisted on
31 preserving its opportunity to seek review of ITC's rates at the very forum that ITC trusts
32 to set its rates.
33

1 Section 5.13 does free EMI to file a complaint if the Commission tells it to. But there is
2 no guarantee that EMI would comply with such an order (as opposed to challenging its
3 lawfulness). Furthermore, the Commission cannot force EMI witnesses to testify for
4 positions they do not support. Circumstances may arise wherein the interests of EMI
5 and ITC are aligned to the detriment of Mississippi ratepayers. Thus the value of this
6 exception is unclear.

7
8 ITC witness Welch asserts that the provision allows ITC to avoid "a big distraction."³³
9 Were ITC operating in a competitive market, a customer's pricing protest would not be
10 a "distraction"; it would be a problem to solve. What ITC views as a "big distraction"
11 is a legal process for holding a regulated monopoly accountable. In any event, ITC
12 could easily avoid this "distraction" (from its newest, largest customer holding it
13 accountable) by committing to a fixed rate plan. That way, EMI would know what it
14 was giving up. Instead, ITC left EMI literally unable to defend itself from whatever rate
15 increases ITC seeks. Those rate increases could be an equally "big distraction" for EMI
16 and its customers.

17
18 EMI's duty is to scour ITC's costs for imprudence, just as state commissions expect their
19 local gas distribution utilities to review and challenge pipeline gas rates. The risk is that
20 Section 5.13 makes EMI passive, unalert, and unprepared to challenge ITC's rates when
21 the Commission orders EMI to do so. And the consequences are likely long-term,
22 leaving EMI's prudence-review muscles atrophied. EMI's should not have accepted this
23 provision, and neither should the Commission.
24

³³ Welch Direct Testimony at 58.

1 g. **An EMI rider for transmission costs would violate test year**
2 **integrity while relieving EMI of transmission cost**
3 **responsibility**
4

5 **Q. Should the Commission be concerned about EMI's request for a transmission rider**
6 **to recover EMI's transmission payments to ITC?**
7

8 A. Yes. EMI wants a rider to recover its transmission payments to ITC. EMI's Lewis
9 states (Direct at p. 37):

10 [I]n a subsequent filing, the Company will be requesting that the
11 Commission authorize the implementation of a transmission rider that
12 would be used to recover transmission charges incurred by the Company
13 following the ITC Transaction. Such a rider would be appropriate due to
14 the fact that the costs paid to ITC will be determined pursuant to a FERC
15 tariff that will be adjusted annually and, in turn, will be included in the
16 Company's rates at costs. This rate plan for recovery of transmission costs
17 from retail customers is the most appropriate way to assure that retail
18 customers pay the correct level of costs associated with the anticipated
19 benefits of improved transmission service—no more, no less.
20

21
22 The proposed rider raises two distinct concerns: test year integrity and rate levels.

23
24 *i. Test year integrity:* A test year revenue requirement is a prediction of the costs in the
25 rate year. Some costs, like those embedded in rate base, are fixed in advance. But for
26 other costs, predictions placed in the test year revenue requirement are often wrong.
27 The theory behind a test year is that the over-estimates balance out the under-estimates,
28 so that the return on equity actually earned resembles the level authorized.
29

30 A rider removes certain costs from the test year revenue requirement and recovers them
31 separately. Doing so can upset the test year balance, i.e., the likelihood that the mis-
32 predictions cancel each other out—especially if the rider costs tend to increase rather
33 than decrease. For this reason, riders should be restricted to special cases: costs that
34 themselves upset the test year balance because they are large and non-routine.
35 Transmission costs do not usually satisfy these criteria. The better approach is to
36 request a rider when the project is unusual, at which time the Commission can examine
37 the risk of imbalance.

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ii. "Correct level": Mr. Lewis describes the rider as "the most appropriate way to assure that retail customers pay the correct level of costs associated with the anticipated benefits of improved transmission service. . . ." He misuses the term "correct." The costs passed through to Mississippi customers will be "correct" only if someone determines that they are correct. They are not "correct" just because EMI paid them, they are not "correct" just because ITC incurred them, they are not "correct" just because MISO audited them for accuracy before they entered the FERC formula, and they are not "correct" just because they flowed through a FERC formula. They are "correct" only if they are prudent, verifiable and properly allocated according to cost-causation principles.

EMI remains responsible for ensuring that the rates it charges to its customers are just and reasonable. It must vouch for the underlying costs; i.e., present evidence that they are just and reasonable. But if EMI has committed not to challenge these costs at FERC, it will have trouble critiquing them objectively for purposes of Mississippi Commission approval. Had EMI considered this point, it would have promised to recover through the rider only those costs that EMI has confirmed are accurate and prudent. That way, the burden on verifying the prudence of the costs, and challenging them at FERC, would be where it belongs—on EMI, the entity responsible for serving Mississippi customers at reasonable cost. This approach treats the transmission costs like they would be treated in any rate case, where the utility has the burden of proving reasonableness.

If the Commission does allow the rider, it should include a condition requiring that EMI vouch for the accuracy and prudence of the costs. This condition must be coordinated with the condition proposed in Part II.A.5 above, that the Commission impute to EMI any ITC imprudence. Finally, although Mr. Lewis says the request will appear in a separate case, the Commission should make clear its views now, so that Entergy has full information before deciding whether to stay in this transaction.

1 **2. Rate decreases are uncertain**

2
3 **a. Applicants' cost decrease talk is vague, generic and**
4 **noncommittal**

5
6 **Q. Does ITC commit to any cost decreases?**

7
8 A. No. The certainty about rate increases is unmatched by any certainty about rate
9 decreases. The Applicants' witnesses fill pages with possibilities, but make no
10 commitments. Consider a few examples, in two categories: operational efficiencies and
11 market efficiencies.

12 **i. Claims about operational efficiencies**

13
14
15 **Q. Does ITC commit to produce operational efficiencies?**

16
17 A. No. Here is a partial list of claims made by ITC and EMI on operational efficiencies,
18 with brief comments on their lack of value to Mississippi customers.

19
20 The transaction "creates the *opportunity* for *greater* economies and
21 efficiencies...." Bunting Direct p.25; response to Question No. MPUS-EMI 1-29
22 (emphasis added). It's only an opportunity, and he doesn't say how much
23 "greater."

24
25 "There *may be* opportunities to leverage contracting, purchasing, and
26 support services, among others." Response to Question No. MPUS-EMI
27 1-29 (emphasis added). It's only a possibility; we don't know the
28 probability and we don't know the magnitude.

29
30 "ITC *believes* that the company's buying power has increased with
31 previous transactions, along with economies and efficiencies." Response
32 to Question No. MPUS-EMI 1-29 (emphasis added). "Belief" is faith, not
33 fact. And belief is usually about something that might happen in the
34 future. Here ITC uses "belief" to refer to something that has already
35 occurred, meaning that ITC couldn't or didn't measure it. If "buying
36 power" means getting better prices because the buyer is bigger, one can try
37 to measure it, then explain the attempt and its outcome. ITC did none of
38 this.

39
40 "As a result of ITC's larger volumes, it has been able to negotiate a
41 reduction in some electrical material distributor mark-ups." *Id.* Here we
42 have a statement of fact. But how large was the reduction? Can we

1 actually trace it to larger volumes, as opposed to other causes (like seller
2 surplus or a slow economy)?
3

4 "Another benefit is ITC's negotiated lead times and reserved production
5 slots which guarantee much shorter times than those offered to their
6 nonalliance suppliers for poles, conductor, breakers, insulators, etc." *Id.*
7 Again a fact, but no information about magnitude or causation.
8

9 "ITC has not specifically quantified such benefits...." *Id.* Why not, if the
10 heart of ITC's case is the improvements it will bring? Its transaction
11 planners managed to calculate the share exchange ratio down to the 14th
12 decimal point. Someone should have been able to quantify benefits.
13

14 ". . . ITC *believes* it will be able to obtain better pricing for equipment and
15 services through increased leverage of purchasing power and efficiencies
16 in supply chain management." *Id.* (emphasis added). More "belief."
17

18 The rest of this passage from discovery is more of the same (emphasis added, bracketed
19 comments supplied):
20

21 For example, as a result of ITC's large volumes, ITC *may* be able to reduce
22 the need for sales representatives/middlemen and purchase directly from
23 the manufacturer thereby ultimately reducing the cost of materials
24 purchased. Supplier mark-ups for these types of sales services are *often*
25 between 1-3% of sales. In addition, efficiencies in supply chain
26 management are driven by ITC's model to standardize equipment and
27 services, *as much as possible*, across its footprint in order to efficiently
28 manage and inventory critical spare parts and to leverage efficiencies with
29 contractors. Increased leverage in purchasing is obtained through
30 standardization and forecasting efforts across a combined larger footprint
31 than either ITC or Entergy alone. This allows ITC suppliers to obtain
32 better rates on their raw materials and efficiently plan their production
33 and, therefore, gaining economies of scale with larger orders. Forecasting
34 will enable ITC's contractors to ensure manpower and equipment
35 availability. Due to ITC's key supplier and contractor alliances' open book
36 nature, these savings [*How much?*] will be realized by ITC and ultimately
37 passed on to ITC's customers by lowering the formula rates. In addition,
38 these standards in materials allow for standards in designs. Over a period
39 of time, this increases efficiency in designing new projects and in new
40 construction and maintenance of equipment.. [*By how much?*] In previous
41 transactions, as is the case in this transaction, ITC has not had access to
42 the confidential cost and pricing information from previous owners of the
43 transmission assets.
44

1 These passages are all about theoretical possibilities, about what might happen but
2 devoid of real prediction based on facts and statistical analysis. One could substitute
3 any company name for "ITC" and get the same beliefs, opportunities and possibilities,
4 as if economies and efficiencies occur regardless of context. And "may" or "might"
5 definitionally includes a "may not" or "might not," the latter phrases cancelling out the
6 former phrases, leaving us with nothing. This is, in a word, speculation.

7
8 **ii. Claims about regional market efficiencies**

9
10 **Q. Do the Applicants commit to produce regional market efficiencies?**

11
12 A. No. EMI lists as a benefit the "access to lower-cost generation through participation in a
13 Day 2 market that will be improved upon by the regional approach to planning the ITC,
14 as an independent transmission company, can provide." Response to MPUS 2-2
15 (discussing the purpose of "build[ing] on the benefits of MISO's Day 2 Market"). EMI
16 does not explain what the "benefits" are, what their value is, or how the transaction will
17 "build on" those benefits. Further, the phrase "build on" is too vague to constitute
18 substantial evidence. EMI's vagueness thus is both quantitative and qualitative.

19
20 FERC's Order 1000 already requires a "regional approach." And MISO, which EMI is
21 joining, has a "regional approach." The Applicants' presentation contains no evidence
22 that ITC adds value. In fact ITC could subtract value, since its "singular focus" on
23 transmission conflicts with FERC's insistence in Order 1000 that all "regional
24 approaches" give comparable consideration to "non-transmission alternatives." A
25 "regional approach" requires unbiased consideration, planning and integration of
26 transmission, generation, distribution, demand resources and energy efficiency. In that
27 effort, there is a risk that a for-profit transmission-only company, unlike the neutral
28 nonprofit MISO and unlike the vertically integrated EMI, will be expert in, and
29 favorable toward, transmission only.

1 **b. The FERC-jurisdictional formula rate weakens ITC's**
2 **incentive to reduce operating costs**

3
4 **Q. Does a formula rate reduce ITC's incentive to reduce operating costs?**

5
6 A. Yes. Even if FERC fixes the MISO formula rate protocols to facilitate challenge (see
7 Part II.B.1.e above), prudence disputes are labor-intensive and expensive. Parties must
8 hire consultants, and are likely to do so only when prudence involves major cost items.
9 More routine operating expenses, the nuts and bolts of utility service, are likely to go
10 unchallenged, weakening ITC's incentive to keep those costs down.

11
12 **c. EMI has not demonstrated its readiness to monitor ITC's**
13 **rates or question its cost effectiveness**

14
15 **Q. Should the Commission be concerned about EMI's readiness to hold ITC**
16 **accountable?**

17
18 A. Yes. For decades, EMI has been a monopoly seller of transmission service, bundled and
19 unbundled, to captive customers. The proposed transaction makes EMI a captive
20 customer of ITC. Asked about its preparedness for this new role, EMI's answer is too
21 general to give the Commission confidence. EMI says there will be office and work
22 teams, but says nothing about the team's skill sets, experience, training, mission or
23 executive expectations. See EMI response to MPUS 2-10. Perhaps the absence of
24 detail is because its transmission expertise, in the form 750 employees, will be moving
25 to ITC. The record does not indicate who, with what experience, will be left at EMI to
26 defend against those rate increases.

27
28 **d. Although Entergy will profit by transferring to ITC essential**
29 **employees whose training and experience was paid for by**
30 **EMI ratepayers, EMI has offered no compensation to its**
31 **ratepayers**

32
33 **Q. How does the transfer of EMI employees relate to the possibility of rate decreases?**

34
35 A. Entergy has agreed to transfer hundreds of its ESI employees, including very senior
36 individuals, to ITC. MPUS asked ITC: "Without these transferred employees, could
37 ITC plan, maintain, and operate the transferred transmission system? If the answer is
38 'yes,' how would ITC hire the necessary employees and ensure they had the necessary

1 Mississippi-specific expertise?" ITC responded: "In time, ITC would be able to fill
2 positions, however given the size and complexity of the system, this would be difficult
3 to do so in the short term. ITC believes it is important to have EMI employees with the
4 historic knowledge of the system and expertise planning, maintaining and operating the
5 system in order to ensure a successful transition." MPUS-EMUITC 6 3.

6
7 ITC does not define the phrases "in time," "difficult" or "short term" or "important." It
8 avoids answering a clear yes-no question with a clear yes or no. It is fair to say,
9 however, that doubling the size of its asset base without having, from the very
10 beginning, employees knowledgeable about the asset base, would make prudent
11 operation impossible. The Entergy employees are not merely "important"; they are
12 essential.³⁴

13
14 Why is this fact relevant? In the same data response, ITC says that the purchase price it
15 is paying Entergy (i.e., the predicted value of the ITC stock) "reflects the agreed-upon
16 value for the Entergy transmission *business*, which would include the 'value' of
17 personnel transferring to ITC as part of this transaction" (emphasis in original). In other
18 words, Entergy's shareholders' gain is in part due to the value ITC places on the
19 transferred employees whose experience, training, management and skill are essential to
20 ITC's success. And although ITC does not say so, these ESI employees not only are
21 necessary to this transaction; they will become a persuasive selling point when ITC
22 seeks its next acquisition.

23
24 That employee value is attributable, at least in part, to EMI ratepayers' payments,
25 because the retail revenue requirement for decades has reflected their recruitment costs,
26 human relations department expenses, salaries, pensions, training and medical costs and

³⁴ See ITC's response to MPUS-EMI/ITC 3-1, containing correspondence from ITC to EMI ("To ensure our immediate success in providing reliable service to the Company post-closing, we anticipate employing existing employees of the Company (or an affiliate as appropriate) whose job responsibilities relate to the assets to be acquired, including Operations, Engineering, and System Planning.").

1 employment taxes. In analogous contexts, such as where a utility's employees are
2 transferred to an affiliate to be used for non-state jurisdictional purposes, the California
3 Commission has required a royalty payment.³⁵ I recommend that the Mississippi
4 Commission do the same.

5 6 3. Conditions 7

8 **Q. Assume the Commission wishes to condition the proposed transaction on, among**
9 **other things, retaining control of rate levels. What do you recommend?**

10
11 A. The Commission has two options—one directed to ITC and the other to EMI. I will
12 give a summary here. A full explanation of the legal foundation will appear in the
13 Public Utilities Staff's brief on legal issues, but I will be prepared to discuss these
14 options at hearing, because they are necessary to any Commission finding that the
15 transfer is in the public interest.

16
17 *The ITC option:* The Commission should condition its approval of this application on
18 ITC's agreeing to recover under the FERC tariff only those Mississippi-related costs
19 approved by the Commission. This constraint would apply to all components of the
20 transmission cost of service—rate base, expenses and capital costs. The Federal Power
21 Act can accommodate this result through the following reasoning.

- 22
23 a. If ITC becomes the supplier of transmission service to EMI, FERC has
24 exclusive jurisdiction over ITC rates. ITC will be allowed to charge only
25 the rate on file at FERC.
26
27 b. FERC does not tell ITC what rates to file. ITC is therefore free to agree,
28 as a condition of the Commission's approval of this transfer, to file at

³⁵ See *Standards of Conduct Governing Relationships between Energy Utilities and Their Affiliates*, Decision No. 97-12-088, 1997 Cal. PUC LEXIS 1139 (requiring, when a utility employee transfers to an affiliate, that the affiliate pay the utility 25% of the employee's base compensation unless the affiliate can prove the appropriateness of a lower percentage (with a 15% minimum)).

1 FERC only those rates that have first received the Commission's
2 approval.

3
4 c. This condition would be stated in the Commission's approval order.

5
6 d. Comparable language would need to go into ITC's FERC tariff and its
7 contract with EMI, so that FERC's approval of those documents would
8 constitute approval of the condition, thereby preventing any preemptive
9 conflict between the FERC-filed rate and the Mississippi Commission's
10 requirements.

11
12 e. It is possible that the Commission's ability to order the cost inputs for
13 ITC's FERC tariff will be limited in two respects. First, if FERC has
14 fixed an *allocation percentage* for certain regional or common costs, the
15 Commission may need to accept that percentage before applying its own
16 decisions on the reasonable cost of service to which the percentage
17 applies.³⁶ Second, as explained in the following paragraph, FERC retains
18 an "indefeasible" power to adjust ITC's filed rates, if, for example, the
19 Commission orders cost inputs that are so low as to cause "serious harm"
20 to the *public* interest (as distinct from ITC's private interest). The Public
21 Utilities Staff's brief on legal issues will detail these points, and I will be
22 available to discuss them on the witness stand so that the Commission
23 understands its options. Should the Commission intend to approve the

³⁶ This limitation derives from the U.S. Supreme Court decisions in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988). Each case dealt with the special situation of FERC's allocation among utility affiliates of entitlement to (*Nantahala*) or cost responsibility for (*Mississippi Power & Light*) power sources arising from a centrally planned holding company system. The extent to which these preemptive cases apply to ITC's charges to EMI will depend on the type of costs at issue. As the Public Utilities Staff will explain in its brief on legal issues, the Applicants' discussion of these cases in their brief omits key distinguishing facts (along with skipping entirely the *Kentucky West Virginia-Pike County-Central Vermont* line of cases).

1 transaction while also requiring this type of condition, it will be
2 necessary for the Public Utilities Staff and the Applicants to draft the
3 details carefully.
4

5 Should the Commission require this ITC option, it should be aware of four factors.
6 First, because the transmission rates are exclusively FERC-jurisdictional, the
7 Commission's condition would not and could not eliminate what courts have described
8 as FERC's "indefeasible" power to find that the Commission-imposed cost of service
9 was so low as to harm the "public interest" (such as if the Commission forced ITC to
10 limit its ROE to 3 percent or to absorb half its capital costs).³⁷
11

12 Second, ITC must file its rates at FERC voluntarily, not under coercion. According to
13 one Court of Appeals, under defined circumstances (although not necessarily all
14 circumstances) a state may not order a utility to file a rate at FERC.³⁸ In this EMI-ITC
15 situation, ITC's FERC filings would be voluntary because ITC, by accepting the
16 certificate condition, would be agreeing to file at FERC only those costs approved by
17 the Commission. If at any point ITC later resisted filing rates at FERC as directed by
18 the Commission, it would violate the certificate and risk revocation, as well as an
19 enforcement suit in state court.

³⁷ See, e.g., *Papago Tribal Utility Authority v. FERC*, 723 F.2d 950, 953 (D.C. Cir. 1983) (FERC has an "indefeasible right . . . to replace rates that are contrary to the public interest"); *Northeast Utilities Service Company (Re: Public Service Company of New Hampshire)*, 66 FERC ¶ 61,332 at n.12 (Mar. 22, 1994) (parties cannot "waive the indefeasible right of the Commission under section 206 to replace rates that are contrary to the public interest, "as where [the existing rate structure] might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory" (quoting *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956)).

³⁸ See *Commonwealth of Massachusetts v. United States*, 729 F.2d 886, 887-88 (1st Cir. 1984) (opinion by Judge, now Justice, Breyer). The Applicants' legal brief, in citing this case as an obstacle to this type of condition, omits key facts in that case that distinguish it from our situation. The legal brief to be filed by the Public Utilities Staff will address the point. I will be available on the witness stand as well to clarify matters for the Commission, since I am responsible for proposing the condition.

1
2 Third, while the Commission under this approach would be nearly free of FERC
3 preemption, its authority would remain bounded by state law. If the Commission
4 insisted on cost inputs that were not just and reasonable, or if it acted arbitrarily or
5 capriciously or without substantive evidence when determining cost inputs, ITC could
6 appeal to the state courts. But under the condition, it could not seek recovery at FERC
7 for costs not approved by the Commission.

8
9 Fourth, the Commission approval also would depend on FERC approving this
10 arrangement in advance. Given that FERC wants to encourage independent ownership,
11 which ownership involves a loss of state jurisdiction, it is a safe bet that FERC will find
12 this approach satisfactory.

13
14 *The EMI option:* As noted at Part II.B.1 above, the Commission can attach a condition
15 reserving its power to find that EMI was imprudent for substituting higher-cost purchase
16 of transmission service from ITC for the lower-cost provision of transmission service to
17 itself. The Commission then would disallow that difference as the measure of EMI's
18 imprudence. EMI bought an excessive quantity—greater than zero—from an expensive
19 FERC-regulated vendor (ITC), when a lower-cost option (EMI's MPSC-regulated
20 ownership under the MISO bundled load exemption) was readily available.³⁹ Again, the
21 Public Utilities Staff's brief on legal issues will address this option and I will be
22 prepared to discuss at hearing.⁴⁰

³⁹ See *Nantahala Power & Light v. Thornburg*, 476 U.S. 953, 972(1986) ("Without deciding this issue, we may assume that a particular quantity of power procured by a utility from a particular source could be deemed unreasonably excessive if lower cost power is available elsewhere, even though the higher cost power actually purchased is obtained at a FERC approved, and therefore reasonable, price.").

⁴⁰ While I have provided a means for preserving the Commission's ability to control the cost inputs to EMI's FERC formula, I recognize that doing so would maintain a potential competitive inequality in the status quo. EMI's wholesale customers pay an unbundled, FERC-jurisdictional transmission rate that is higher than what EMI's retail customers pay for comparable transmission service on a bundled basis. While the wholesale customers can, in theory, argue at FERC for a lower rate on grounds of price squeeze, see *Federal Power*

1
2 **C. Competition among power supply options**
3

4 **Q. The Applicants claim that divesting Entergy's transmission to a non-generation-**
5 **owning entity will benefit consumers by making generation competition stronger.**
6 **How should the Commission weigh that claim?**
7

8 A. Where the cost function for a product or service indicates that a market can
9 accommodate multiple suppliers without raising unit costs, competition can benefit
10 consumers by disciplining prices and improving quality. This theory lies behind a three-
11 decade effort by federal policymakers to encourage competition among electric
12 generation sources.
13

14 In carrying out those efforts, policymakers have recognized that generation competition
15 is hindered when a generation owner also owns the transmission highways that
16 competing generators need. The transmission owner has an incentive to raise rates and
17 deny service to its generation competitors, who have no other means to move their
18 product. FERC sought to address this situation in Order No. 888, which required all
19 transmission-owning public utilities, if subject to FERC jurisdiction (i.e., mostly
20 investor-owned utilities), to file tariffs making transmission service available
21 nondiscriminatorily. (Under the so-called reciprocity provisions in Order Nos. 888 and
22 889, transmission-owning entities that are not subject to FERC jurisdiction, such as
23 government-owned utilities and certain rural cooperatives, had to file comparable tariffs
24 at FERC if they wanted nondiscriminatory access to the transmission systems of
25 investor-owned utilities.) FERC has recognized, however, that Order Nos. 888 and 889
26 still left vertically integrated utilities with opportunities to discriminate, and has made
27 other attempts to limit these possibilities.⁴¹

Commission v. Conway Corp., 426 U.S. 271 (1976), the prospects for such a complaint are uncertain. The problem would diminish, of course, if FERC lowered the authorized return on equity to a level closer to the state-authorized level, and rejected the 60-40 capital structure, at least in situations where the rate differential affects competition adversely.

⁴¹ See, e.g., FERC Order No. 890 (finding that the existing open access tariff “provides wide discretion in implementing some of its basic requirements, . . . [which] wide discretion, when coupled with a transmission provider’s incentive to discriminate, creates opportunities for

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The Antitrust Division at the U.S. Department of Justice has expressed concerns about Entergy's use of its transmission and generation facilities to discriminate against interconnecting and interconnected generators. While Entergy concedes no competitive wrongdoing (viewing it as a problem of “perception” only⁴²), it argues that divesting its transmission to ITC will benefit Mississippi customers by improving those perceptions. As explained in Part III.C below, the Department had made clear that its comfort depends on Entergy both joining MISO *and* divesting its transmission to ITC. The Department has not revealed its next move should the ITC transaction fail.

Assuming that Entergy's transmission divestiture will increase generation competitiveness and thereby benefit Mississippi consumers, there is no reason to make customers pay for that benefit through higher rates charged by ITC. If EMI joins MISO without selling its transmission to ITC and concerns about its anti-competitive practices persist, it is likely that the FERC and/or the Department of Justice will look into the allegations. If not, the Commission itself can start an investigation. Furthermore, it is likely that the Department of Justice has a "Plan B" for Entergy should the ITC transaction fail. There is no need for EMI to propose an ITC-paid premium to its shareholders, or for its customers to pay more for transmission, to solve the problem.

discrimination. . . .”; and that “inadequate transparency requirements, combined with inadequate compliance with existing OASIS [Open Access Same Time Information Service] requirements, increases the opportunities for undue discrimination . . . and makes instances of undue discrimination more difficult to detect”). The full cite to Order No. 890 is *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, 72 FR 12266 (Mar. 15, 2007), FERC Stats. & Regs. ¶ 31,241, *order on reh’g*, Order No. 890-A, 73 FR 2984 (Jan. 16, 2008), FERC Stats. & Regs. ¶ 31,261 (2007), *order on reh’g and clarification*, Order No. 890-B, 73 FR 39092 (July 8, 2008), 123 FERC ¶ 61,299 (2008), *order on reh’g*, Order No. 890-C, 74 FR 12540 (Mar. 25, 2009), 126 FERC ¶ 61,228 (2009), *order on clarification*, Order No. 890-D, 74 FR 61511 (Nov. 25, 2009), 129 FERC ¶ 61,126 (2009).

⁴² See Bunting Direct Testimony at 9-10 (“the perception of bias remains on the Entergy Transmission System, and the proposed merger is the best way to eliminate that perception”).

1 **D. Financial structure**

2
3 **Q. Should the Commission accept ITC's assertions of favorable financial structure?**

4
5 A. Not without more clarity and commitments. ITC says its financial profile compares
6 favorably to Entergy's, leading to higher bond ratings and lower borrowing costs for the
7 transmission function. Whether this differential exists, and its magnitude, I leave to the
8 financial experts. But assuming there is a differential, its factual support is based solely
9 on a comparison of current ratings reflecting only current conditions. Those current
10 conditions do not inform the long term. The long term offers no guarantees of a ratings
11 differential favoring ITC because of uncertainty related to ITC's future business plans
12 and future FERC policy.

13
14 ITC, at the holding company level, is an acquisition company. Its business model is to
15 leverage and acquire. (See S-4 of Feb. 27, 2013 at p. 64: "ITC is highly leveraged and
16 will assume and incur substantial additional leverage in connection with the merger,
17 which may have an adverse effect on ITC's business and the value of ITC common
18 stock.") With each leveraged acquisition, it pays premiums to the target company based
19 on the assumption that transmission will be (a) relatively free of competition and (b)
20 well-compensated under FERC ratemaking, at levels exceeding state ratemaking. If
21 those assumptions prove unfounded, ITC's ratings advantage could reverse itself.
22 Transmission's current monopoly role could be disrupted by new technologies like
23 storage and other "non-transmission alternatives," which FERC's Order 1000 seeks to
24 encourage. The high compensation levels could come down, as FERC is signaling in its
25 2012 Policy Statement on Transmission Pricing. (As discussed in Part II.B.1.c above.)
26 There could be more challenges to the prudence of transmission investments, as FERC
27 is signaling in its May 2013 Order requiring revisions to formula rates for MISO and all
28 its transmission owners, including ITC. And ITC could face competition to build
29 transmission even within the territories it officially serves, due to the regional process
30 required by FERC Order No. 1000.

1 Given these risks, ITC makes no promises, or even assertions, about financial
2 advantages in the long term. Its ratings comparison is bounded by facts about the short
3 term, but this is a transaction for the long term. Short-term facts do not support a long-
4 term decision.

5
6 **Q. What about EMI's argument the transaction will reduce financial uncertainties**
7 **and risks?**

8
9 A. It is only argument, lacking facts. EMI states that one purpose of the transaction is to
10 "mitigate the significant financial and regulatory uncertainties and risks that are
11 anticipated in the electric industry over the next 20 years. . . ." Response to MPUS 2-2.
12 Using the passive voice ("are anticipated") EMI fails to reveal who is doing the
13 anticipating, and based on what evidence. EMI identifies none of these "financial and
14 regulatory uncertainties and risks" over the next one year or the next five years, let alone
15 the next twenty years. Nor does EMI explain, technically, how the transaction will
16 "mitigate" these "uncertainties and risks," or why ITC's acquisition orientation is not
17 itself a source of "uncertainties and risks." (See Part II.E below for a discussion of ITC's
18 acquisition options.) EMI offers no explanation why the "financial and regulatory
19 uncertainties and risks" it faces are any more "significant" than they are for the dozens
20 of other utilities in the country that are not proposing to raise their customers'
21 transmission costs by divesting their transmission assets to FERC-jurisdictional entities.

22
23 EMI sees a benefit from transferring the transmission assets to a company that will have
24 "a separate, financially strong balance sheet. . . ." Response to MPUS 2-2. This benefit
25 has meaning only if ITC commits to take no action that would weaken its balance sheet.
26 ITC would need to agree, as a condition of the certificate, to abide by Commission-
27 established criteria for financial ratios and credit ratings, and to forego transactions,
28 whether as acquirer or acquiree, that the Commission finds have the potential to weaken
29 ITC. Otherwise, EMI's argument would be only words, not evidence.

1 **Q. Does ITC face risks?**

2

3 A. Yes, because part of its market value depends on FERC's policies rather than its
4 fundamental business characteristics (such as its leadership or operational skills). Using
5 corporate structure and financing techniques, ITC's business plan "unlocks" the profit
6 potential in transmission by first (a) converting assets historically used for bundled
7 state-jurisdictional service into assets used for unbundled FERC-jurisdictional service,
8 then (b) providing that FERC-jurisdictional service through subsidiaries whose equity
9 comes from debt incurred by the holding company.⁴³ ITC thus earns high FERC returns
10 on equity financed with lower-cost debt. Without making a single change (or
11 commitment) in transmission planning, maintenance, repairs or operations, ITC not only
12 increases the market value of the assets it acquires (thus allowing it to pay a price for the
13 assets that produces a gain for the selling company's shareholders); it also locks in an
14 opportunity to earn the new higher FERC profits on future investments within the
15 selling company's service area. (Those future investments are certain to occur, due to
16 load growth, replacements and/or upgrades.) This latter profit opportunity comes not
17 only from FERC's base return on equity and its capital structure policies (allowing a
18 return on equity financed in part with holding company debt, with the return on equity
19 applied to a 60-40 equity-debt ratio), but also from the "incentives" potentially available
20 under FERC's Order No. 679.

21

22 To reiterate: The basis for these FERC-generated profit increments is not operational
23 skill or business risk (other than the normal operational skill and risk that already exists
24 when the transmission is under state jurisdiction); the basis for these profit increments is
25 the ratepayer, who has no choice but to pay for the higher FERC rates that support the
26 new profit.

27

⁴³ The term "unlock" has been used by rating agencies in this context. See *Announcement* from Moody's Investment Service (Dec. 5, 2011), which affirmed ITC's credit rating: "[W]e observe one of the central benefits to the transaction is the ability to unlock transmission investments from state regulation and place them under more credit supportive federal regulation") (attached to ITC witness Bready's Direct Testimony as Exhibit CMB-6).

1 ITC's dependence on this "FERC construct"—a construct that allows ITC to grow
2 shareholder wealth without promising customer benefit—comes with its own risks, due
3 to three sources of uncertainty. First, as discussed in Part II.B.1.c above, the path to
4 FERC incentives is now less clear, because applicants first must "take all reasonable
5 steps to mitigate" a project's risks. Second, as discussed in Part II.B.1.e above, all
6 MISO transmission owners must provide clearer procedures for customers to expose
7 imprudence. Third, FERC's Order 1000 creates the risk that proposed transmission
8 projects will not receive cost recovery if they emerge from regional processes that do
9 not give "comparable consideration" to "non-transmission alternatives." The financial
10 strength that ITC offers this Commission—a strength that ITC gets by raising its
11 customers' rates—depends on FERC continuing a policy that is now undergoing
12 change.

13
14 ITC argues that its uniqueness lies in its performance, a performance resulting from its
15 "singular focus" on transmission. But the profitability associated with its "FERC
16 construct" has nothing to do with performance. FERC grants these higher rates based
17 on what the company proposes, not on what it achieves. And that is ITC's risk. Having
18 engineered and financed a corporate structure based on its expectation that the "FERC
19 construct" would remain a means of unlocking transmission profits, ITC is now at risk
20 of financial trouble should FERC change its policy.

21
22 **Q. What about the Applicants' argument that the transaction will free EMI's**
23 **transmission efforts from competition for capital?**

24
25 A. EMI asserts that ITC "will not have internal competition for the capital needed to meet
26 the above-identified future risks and uncertainties. . . ." EMI Response to MPUS 2-2.
27 There is no evidentiary basis for assuming that Mississippi's transmission needs will not
28 face competition for capital within a leveraged, acquisition-oriented company with
29 transmission operations in 10 states. There is always "competition for capital" because
30 capital is always scarce; otherwise it would be cost-free. For an acquisition-oriented
31 company like ITC, there is unavoidable competition between using the next \$300
32 million to improve service on existing properties, versus using that same \$300 million to

1 purchase another company. EMI's statement that ITC "will not have internal
2 competition for capital" can be true only if ITC commits that (a) it will make no further
3 acquisition without the Mississippi Commission finding that the acquisition will not
4 create an "internal competition for capital" that affects Mississippi's transmission needs,
5 and (b) it will never oppose a request from its Mississippi subsidiary for capital to fund
6 necessary improvements, or an order from the Mississippi commission to make
7 specified investments, on grounds of insufficient capital. ITC has not made this
8 commitment.

9
10 There is no reason to dispute EMI's statement that within its own corporate family its
11 "significant future needs for transmission investment . . . will compete for capital against
12 generation and distribution." MPUS 2-8. But that fact does not support this transaction.
13 Competition for capital exists among many industries and within industries. The
14 competition, here among transmission, generation and distribution, exists not only
15 within Entergy but within the capital markets themselves—capital markets that ITC will
16 face no less than EMI does. If EMI is suggesting that ITC will not have to compete for
17 capital, EMI is wrong. And if EMI is saying that within its corporate family, it has to
18 compete for sufficient capital to meet its legal obligations, then it is admitting to a
19 divergence of goals between its holding company controllers and its duties to this
20 Commission. If such a divergence exists, the Commission can address it by issuing
21 orders and imposing fines. A sale of the transmission assets at a gain to EMI
22 shareholders with a rate increase to EMI's customers is not a necessary answer.

23
24 **E. Corporate structure**

25
26 **Q. Should the Commission be concerned about ITC's corporate structure?**

27
28 A. Yes. ITC intends to expand beyond Entergy. That expansion goal introduces conflict
29 between shareholders and ratepayers. Because of the 2005 repeal of the federal Public
30 Utility Holding Company Act of 1935, there is no legal limit on number, type or
31 location of ITC's future acquisitions—or acquirers.

1 **1. ITC intends to expand**

2
3 **Q. Explain what you mean by ITC's intent to expand.**

4
5 A. The proposed acquisition is not ITC's first. It has acquired transmission in Illinois,
6 Iowa, Kansas, Michigan, Minnesota, Missouri and Oklahoma. Nor will it be ITC's last:

7
8 In the ordinary course of business, ITC periodically reviews and evaluates
9 industry developments and strategic alternatives to enhance shareholder
10 value, including assessing transmission systems that would be potential
11 acquisition candidates and considering various transaction partners that
12 would be able to provide ITC with an ability to expand ITC's transmission
13 business.

14
15 S-4 at p.118. Indeed, ITC seeks Entergy's assets not only for their own profitability but
16 because they will support additional acquisitions:

17
18 The addition of Entergy's Transmission Business expands ITC's
19 geographic reach from the Midwest to the Gulf Coast region and will add
20 sizable new markets to ITC's current operating and development business
21 both enhancing and diversifying ITC's growth prospects.

22
23 S-4 at p.94. ITC expects that "the introduction of sizeable new markets will provide
24 ITC with a stronger operational platform and strengthened financial resources from
25 which to pursue additional development initiatives, which should significantly broaden
26 and de-risk ITC's capital investment opportunities and enhance ITC's ability to pursue
27 new acquisition and investment opportunities. . . ." S-4 at p.127. See also *Crain's*
28 *Detroit Business* (May 3, 2013) (referring to reports that ITC CEO Welch said that "ITC
29 is in various stages of talks with other utility companies").

30
31 **2. Business expansion goals introduce conflict between shareholders**
32 **and ratepayers**

33
34 **Q. Explain how ITC's expansion goals can create conflicts between shareholder**
35 **interests and consumer interests.**

36
37 A. The shareholder-customer conflicts caused by ITC's expansion goals are of three types.

1 *a. Conflict over rate base growth and sales growth:* A utility that is subject to the
2 Mississippi Commission's jurisdiction should be minimizing ratepayer costs, subject to
3 reliability and quality standards, by avoiding unnecessary construction and unnecessary
4 sales. ITC's goals and incentives conflict with this obligation, because ITC seeks to
5 maximize profit by growing its FERC-jurisdictional rate base. These goals can be made
6 consistent through integrated resource planning, and rate designs like decoupling profits
7 from sales. But FERC does neither of these things, and the Commission does not yet
8 oversee an integrated resource planning process that could discipline ITC's proposals by
9 continuously vetting them against generation and DSM alternatives. Therefore, the risk
10 of conflict remains.

11
12 *b. Conflict between corporate expansion and financial stability:* As explained in Part
13 II.D (Financial Structure), ITC's hoped-for connection between its acquisitions and its
14 economic strength depends on two key assumptions: transmission's relative freedom
15 from competition and FERC's ratemaking policies. Both sets of assumptions could
16 change, leaving ITC with leveraged debt insufficiently supported by revenue. Further,
17 ITC's desire to become "one of the largest electric transmission companies in the United
18 States" is a corporate goal, endorsed by its shareholders, who accept the risk of failure
19 voluntarily. But becoming "one of the largest" has no visible value to Mississippi
20 customers, who are not voluntary risk-takers. There could be a point at which an
21 independent transmission company's "large size" becomes a negative attribute, where
22 the failing business requires ratepayer or taxpayer funds to survive. ITC has offered no
23 information on where that point is.

24
25 *c. Mississippi transmission's diminished role:* ITC argues that its growing size will
26 benefit Mississippi, through economies of scale in operations and finance (which remain
27 unaddressed by ITC). But there is also a downside. As ITC's acquisitions increase,
28 Mississippi's percentage contribution to holding company revenue and profit decreases.
29 The resulting risks are two-fold. Top management attention is drawn away from
30 Mississippi, and ITC can better afford to be less responsive to Mississippi's needs,

1 because ITC can better absorb financial penalties that the Commission might impose.
2 The Commission will have to work harder to ensure accountability.

3
4 Further, as ITC becomes affiliated with companies doing business in more states,
5 Mississippi's ratepayers face more risk—the risk that other states will issue laws or
6 commission decisions that conflict with Mississippi's own vision for transmission and
7 for ITC. Mississippi's citizens have no influence over these other states' decisions: no
8 say in their legislative processes, no say in their commissioners' preferences, no say in
9 the size and expertise of the commission staff, no say in the expectations those states
10 create for ITC's performance. Yet the decisions made by these other states can affect
11 ITC's financial health, and therefore the quality of service to Mississippi.

12
13 **3. There is no legal limit on the number, type or location of ITC's**
14 **acquisitions or acquirers**

15
16 **Q. Should the Commission be concerned about ITC's future corporate structure?**

17
18 A. Yes, because there is no way to predict it. Until its 2005 repeal, the Public Utility
19 Holding Company Act of 1935 (PUHCA) forbade or limited (depending on the type of
20 holding company) corporate structures having a non-integrated, geographically
21 dispersed mix of utility and non-utility operations. The purpose was to align corporate
22 form with utilities' public service obligations. PUHCA accomplished this goal through
23 the statutory concept of the "integrated public-utility system": each utility holding
24 company had to limit its assets and activities primarily to those necessary to provide
25 electric or gas service to the local public. The integrated system principle limited the
26 geographic dispersion of utility properties, the mixing of utility and non-utility
27 businesses, the layers of corporate affiliates, the type of financing within utility and non-
28 utility affiliates and the pricing of inter-affiliate transactions, among other things.
29 PUHCA applied this principle by running corporate structure proposals through a series
30 of tests, restrictions and reviews in four major areas: mergers and acquisitions, mixing
31 of utility and non-utility businesses, issuances of debt or equity, and inter-affiliate
32 transactions.

1 As long as PUHCA existed (and was enforced), states had less need to worry that the
2 utilities serving their customers could become distracted by investments in other
3 businesses. No longer. With the PUHCA's 2005 repeal, there is no federal law limit on
4 the number, type and location of businesses that could acquire, or be acquired by, public
5 utilities. (There is a required review under the Hart-Scott-Rodino Act, but that review
6 focuses on competition only and does not offer opportunities to intervene; and its
7 intensity depends on the Department of Justice's priorities.)

8
9 These changes are directly relevant to this case. Before the Act's repeal, the
10 Commission could be comfortable knowing that that ITC, after acquiring Entergy's
11 transmission assets, would not

- 12
- 13 a. be an affiliate of utility businesses that were not part of the same
14 integrated public utility system;
 - 15
 - 16 b. be an affiliate of nonutility businesses;
 - 17
 - 18 c. be a part of a corporate family in which inter-affiliate transactions
19 (including transactions anywhere in the family, not just transactions to
20 which EMI was a party) were unbounded by rules on inter-affiliate prices
21 aimed at preventing cross-subsidies; or
 - 22
 - 23 d. be a part of a corporate family in which the holding companies' affiliates'
24 financial structures were unreviewed.

25
26 Since none of these circumstances were permitted in the prior regime, the Commission
27 could make a reasonable prediction about a utility's future activities.

28
29 PUHCA's repeal remakes this picture. Once the Commission approves ITC acquisition,
30 the Mississippi transmission system becomes part of a corporate family that has no
31 limits. ITC could discard its "singular focus" and acquire generation or distribution. It

1 could acquire transmission in remote parts of the United States, completely separated
2 from MISO. It could acquire these assets anywhere in the world. ITC could acquire
3 business unrelated to utility service—or be acquired by one. All these possibilities, and
4 the attendant risks, are relevant to Mississippi's interests, and therefore must be
5 addressed in this case. That these risks are real is not disputed, as evidenced by this
6 discovery dialogue between EMI and the Public Utilities Staff:

7
8 MPUS Question: Does the existence of Entergy's non-utility businesses
9 have any effect on Entergy's ability to deploy or raise capital for its utility
10 businesses?

11
12 EMI Response: Yes. The ratings of individual utilities within a holding
13 company are determined in part by the rating of the parent holding
14 company. The ratings of the parent holding companies are determined by
15 the collective financial strength and flexibility of the utilities and other
16 entities within the holding company.⁴⁴

17
18 In short, ITC is not a static holding company system. The entity seeking to acquire
19 EMI's transmission assets is not just the ITC described in the Application. It is that ITC,
20 plus all the motivations, plans, strategies, tactics, future acquisitions, dispositions and
21 financial arrangements, leadership, and leadership changes that are core to a company
22 that is acquisition-oriented and faces no acquisition limits. Under this proposal,
23 unconditioned, the Commission cannot predict what type of business family will own
24 EMI's transmission assets. To carry out its public interest obligations, the Commission
25 will need to consider not only the ITC it knows but also the ITC nobody knows.

26
27 In short, Mississippi's transmission future will depend on ITC's future. But no matter
28 how many questions the Commission asks of ITC's leadership, no matter how sincerely
29 its current executives promise to make Mississippi's needs their priority
30 (notwithstanding the fact that future acquisitions will diminish Mississippi's role in
31 ITC's profit picture), no one can predict ITC's future.

32

⁴⁴ MPUS-EMI/ITC 3-4.

1 **4. FERC's review of ITC's financings will not necessarily protect**
2 **Mississippi**

3
4 **Q. Is there risk that ITC's future financial decisions could affect Mississippi**
5 **transmission service adversely?**

6
7 A. Yes. Counsel has informed me that unlike many states, the Mississippi Commission
8 does not have statutory authority to review and approve issuances of debt or stock by
9 Mississippi public utilities. Any financings by ITC's utility affiliates, however, will be
10 subject to FERC jurisdiction under Section 204 of the Federal Power Act. (Section 204
11 applies to public utilities whose state commissions lack authority to review securities
12 issuances.) Section 204(a) requires that FERC must find, before approving a utility's
13 securities issuance, that the issuance is

14
15 for some lawful object, within the corporate purposes of the applicant and
16 compatible with the public interest, which is necessary or appropriate for
17 or consistent with the proper performance by the applicant of service as a
18 public utility and which will not impair its ability to perform that service,
19 and (b) is reasonably necessary or appropriate for such purposes.⁴⁵

20
21 If the Mississippi Commission had jurisdiction over financings, it could ensure that
22 ITC's Mississippi subsidiary did not borrow money or issue stock to invest in unrelated
23 businesses that caused risk to the Mississippi transmission business. Without state law
24 jurisdiction, there is a gap, because FERC will not reject a securities issuance merely
25 because its purpose is to finance non-utility businesses. When a Kansas utility made
26 plans to finance non-utility investments with new debt, the Kansas Corporation
27 Commission protested at FERC (because the Kansas Commission, like the Mississippi
28 Commission, did not have statutory authority over utility financings). FERC stated:

⁴⁵ 16 U.S.C. § 824c(a). The Supreme Court has held that the "public interest" mandate in Section 204 is a "broad and impressive one," broad enough to require FERC to consider allegations that the utility applicant would use the issuance proceeds for anticompetitive purposes. *Gulf States Utilities v. Federal Power Commission*, 411 U.S. 747, 756 (1973). The FERC review requirement does not apply if the utility's security issuances are subject to state commission review. See *id.* § 204(f) (exempting issues by a public utility "organized and operating in a State under the laws of which its security issues are regulated by a State commission").

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Section 204 of the FPA does not expressly prohibit public utilities from issuing securities to finance non-utility acquisitions. Rather, the applicable standard is that the issuance cannot impair the utility's ability to perform as a public utility. Given UtiliCorp's interest coverage ratio, that should not be the case here In addition, the Kansas Commission retains authority to protect the interests of Kansas retail customers. In fact, the Kansas Commission has already initiated an investigation into affiliate transactions involving UtiliCorp's regulated and unregulated businesses⁴⁶

Note FERC's reference to the Kansas Commission's retail rate jurisdiction. Since the Mississippi Commission will not have that jurisdiction over ITC, FERC might look more closely at an ITC subsidiary's financing proposal.

FERC has imposed limits on utility financing; specifically, there are four requirements that a utility affiliated with non-utility businesses must satisfy before issuing securities. In FERC's words:

- “First, public utilities seeking authorization to issue debt that is secured (i.e., backed) by utility assets must use the proceeds of the debt for utility purposes only.
- “Second, with respect to such utility asset secured debt issuances, if any utility assets that secure such debt issuances are divested or spun off, the debt must follow the asset and be divested or spun off as well.
- “Third, if assets financed with unsecured debt are divested or spun off, the associated unsecured debt must follow those assets. Specifically, if any of the proceeds from unsecured debt are used for non utility purposes, the debt likewise must "follow" the non-utility assets and if the non-utility assets are divested or spun off then a proportionate share of debt must follow the associated non utility assets by being divested or spun off as well.
- “Last, with respect to unsecured debt used for utility purposes, if utility assets financed by unsecured debt are divested or spun off to another

⁴⁶ *UtiliCorp United, Inc.* 99 FERC ¶ 61,293, at p. 62,243 (2002). I represented the Kansas Corporation Commission in this proceeding.

1 entity, then a proportionate share of the debt also must be divested or spun
2 off.”⁴⁷

3
4 The point is that FERC will use its own criteria to decide the appropriateness of the
5 financing. Further, when a holding company system is involved, FERC reviews
6 financings only by the public utility subsidiaries. Unlike the reviews formerly
7 conducted by the SEC for certain large holding companies under Sections 6 and 7 of the
8 now-repealed Public Utility Holding Company Act of 1935, FERC does not review
9 financings issued by non-utility affiliates of utilities. Further, in any FERC proceeding
10 the Mississippi Commission would be an intervenor only; it would not control the result.

11
12 Because of the gaps in both the Mississippi Commission’s authority and in FERC’s
13 practices, I recommend that the Commission protect consumers by reviewing
14 financings, anywhere in the ITC holding company system, that could affect cost or
15 quality of transmission service in Mississippi. The Commission therefore should
16 condition any certificate on obtaining the necessary state law authority, and/or on ITC's
17 agreement to subject the financings of all its affiliates to Commission approval (subject
18 to exceptions the Commission can design to exclude transactions having no possibility
19 of adverse effect). Otherwise the Commission is at risk of becoming dependent for
20 transmission service on a holding company system that becomes over-leveraged and
21 over-extended, has lost its singular focus, faces internal and external competition for
22 capital, and has sacrificed its ostensible ratings advantage to imprudent risk-taking.

23
24 **5. Access to books and records is a distinct concern**

25
26 **Q. Should the Commission be concerned about its ability to get to the information**
27 **necessary to protect Mississippi ratepayers from excess costs or inadequate quality**
28 **of service?**

29
30 **A. Yes. With subsidiaries in six states currently, and no limit on the number and location**
31 **of its subsidiaries in the future, ITC's performance in Mississippi is affected by its**

⁴⁷ *Westar Energy, Inc.*, 102 FERC 6 61,186, at ¶¶ 20-22 (2003); *Westar Energy, Inc.*, 104 FERC 6 61,018, at ¶¶ 5-6 (2003). I represented the Kansas Corporation Commission in this FERC proceeding.

1 activities elsewhere. There is only so much management attention, capital, and positive
2 reputation to go around. The business activities, investment plans, financing decisions,
3 and operational performance throughout the company matter to Mississippi. To protect
4 Mississippi customers, the Commission will need information on all ITC activities that
5 affect, or could affect, Mississippi, whether those activities are conducted through ITC's
6 Mississippi operating company or through other affiliates).

7
8 And that presents a distinct problem. One might say "the Commission will have the
9 same access to books and records that it has today, nothing changes."⁴⁸ But something
10 has changed. Transmission assets essential to the state's economic health will be under
11 the control of a company whose growth aspirations have no stated limit. With the
12 Commission's rate authority migrating to FERC, the Commission must have the
13 information necessary to know when to act; specifically, when to prevent or condition
14 ITC ventures that could raise customers' costs. Section 77-3-79 statute provides the
15 Commission access to the books and records of a "public utility" only; its literal
16 language does not grant the Commission access to ITC affiliates whose actions could
17 affect the ITC public utility affiliate serving in Mississippi. If current law does not
18 provide that access, there must be a change in current law or ITC must accept a
19 condition ensuring that access. Otherwise there is risk that the Commission will learn of
20 ITC decisions potentially affecting Mississippi transmission service only after the fact.

21
22 **6. To dismiss corporate structure concerns without consideration is to**
23 **speculate without regard to facts**
24

25 **Q. Are these concerns about ITC's corporate structure and activities speculative?**

26
27 **A.** No, they are factual. Consider these five facts:

- 28
29 1. The Commission does not know about what future acquisition activities ITC
30 will undertake.

31

⁴⁸ See § 77-3-79 (granting Commission access to, and the right to "respect and examine all accounts, records, memoranda and property of the public utilities").

- 1 2. Absent conditions, these activities can occur outside the Commission's
2 jurisdiction and control.
3
4 3. Some of these activities can be in tension with ITC's transmission service
5 obligations in Mississippi.
6
7 4. The Commission does not know how big ITC will get relative to Mississippi,
8 how big is too big, how many unrelated affiliates are too many unrelated
9 affiliates, how distracted is too distracted, or how little of the CEO's time
10 will get devoted to ITC's Mississippi service obligations.
11
12 5. The Commission does not know whether it will have the staff expertise, time
13 and budget to detect and eliminate the risks to Mississippi associated with
14 these unknown outside activities.
15

16 This list is not speculative, it is factual. To dismiss these facts is to assume that mixing
17 a company's Mississippi public service obligations with business activities unrelated to,
18 in conflict with and outside the influence and limitations of this Commission's
19 jurisdiction, will leave Mississippi customers unaffected. That is the real speculation.
20

21 **7. ITC's situation is different from Entergy's**
22

23 **Q. You've described the possibility that ITC could engage in business activities**
24 **harmful to Mississippi customers but outside the Commission's reach. Don't we**
25 **already have that problem with Entergy?**
26

27 A. Yes, but there are two key differences. First, the Commission retains jurisdiction over
28 EMI's rates. That jurisdiction allows the Commission to take action, such as
29 disallowing costs or lowering the authorized return on equity, should Entergy's activities
30 threaten or cause harm to Mississippi's customers. The Commission can warn Entergy
31 away from such activities, and back that warning with the possibility of rate
32 consequences. Unless the Commission adopts the rate conditions recommended here, it
33 will not have the same authority over ITC. Second, ITC's main argument for this

1 transaction is its "singular focus" on transmission. Consistency thus requires ITC to
2 maintain that singular focus. That is the purpose of my recommended conditions on
3 corporate structure, discussed next.

4
5 **8. Conditions**

6
7 **a. Options**

8
9 **Q. If the Commission were to consider approving this transaction, what are its options**
10 **for addressing the corporate structure concerns you have described?**

11
12 **A.** In this context of corporate structure, the Commission has three main categories of
13 options.

14
15 1. Approve the transaction as proposed, based on an assumption that the transaction,
16 unconditioned, will cause no risk to Mississippi's interests and will produce all the
17 benefits Applicants have claimed. This assumption requires the Commission to find
18 that ITC's Applicants' business needs will never conflict with, or place pressure on, the
19 Mississippi transmission business. That finding is not possible on the current facts.

20
21 2. Disallow the transaction, on the grounds that there are no practical options for
22 ensuring benefits and preventing harm. This action should be followed by a new
23 inquiry into this question: What are the other options for owning, operating, financing,
24 and regulating the rates and performance of the Mississippi transmission system? I
25 discuss this question in Part III below.

26
27 3. Acknowledge the facts—that there will be unavoidable tensions within the ITC
28 corporate hierarchy—then establish one or more of the following conditions:

- 29
30 i. Condition the transaction on ITC limiting its future acquisitions such that
31 the Mississippi transmission business does not fall below some
32 percentage of ITC's total business activities or threaten certain credit
33 ratings and financial ratios. The percentages, ratings and ratios would be

1 at a level calculated to prevent any harm to ratepayers from a failure of
2 the non-Mississippi transmission business.

3
4 ii. Condition the transaction on Applicants agreeing not to engage in a list
5 of acquisitions and transactions that the Commission defines as risky to
6 the Mississippi transmission business.

7
8 iii. Condition the transaction on Applicants agreeing that any future
9 acquisition is subject to Commission approval.

10
11 Focusing on the long-term through careful conditioning will not only protect consumers;
12 it will also give present and future shareholders information they need to predict the
13 value of a company, to know if they have a buy-and-hold play or something more risky.
14 Investing with this knowledge helps them avoid disappointment—including the type of
15 disappointment that causes declines in stock value, pressure on management to meet
16 earnings expectations and the rise in ratepayer-funded cost of equity that can follow.
17 Clarity in Commission policy can benefit shareholders and encourage transmission
18 investment, by reducing uncertainty over the value of the holding company system
19 whose future would otherwise be hard to predict.

20
21 **b. Enforceability**

22
23 **Q. Should the Commission have concerns about the enforceability of these conditions?**

24
25 A. Yes. There remains a question about whether the conditions are enforceable, from both a
26 legal and a practical perspective.

27
28 *Legal concerns:* There is uncertainty about the Commission's jurisdictional reach.
29 Suppose ITC agrees to a Mississippi condition to obtain Commission permission before
30 acquiring more transmission assets. Now suppose that ITC, at the holding company
31 level, acquires transmission in New Jersey. How does the Commission enforce its
32 condition? It is not clear whether the holding company, which is incorporated and
33 headquartered in Michigan, can be sued in a Mississippi court for such an action, or

1 whether a New Jersey court would have jurisdiction to enforce a Mississippi legal
2 condition. (This is the type of question the Commission would need to address in a
3 second phase of the current proceeding, should the Commission find that the transaction
4 otherwise satisfies the public interest.)

5
6 *Practical concerns:* None of my recommended conditions is self-enforcing. To detect
7 adverse developments, or a trend toward them, the Commission must monitor the
8 company. Harm can arise at multiple times and places. A necessary public interest
9 condition of this transaction, therefore, is a Commission finding that it has the resources
10 necessary to enforce the conditions. For if the possibility of harm is present due to a
11 shortage of regulatory resources, the transaction cannot meet the public interest
12 standard.

13
14 These enforcement uncertainties mean that an ITC action could violate a condition in
15 circumstances where the Commission was powerless to prevent it. The Commission
16 therefore needs to reserve its ultimate authority to (a) revoke ITC's certificate and (b)
17 require ITC to cooperate in a smooth transition to a new certificate holder, including
18 transfer of the transmission assets at book value.

19
20 But this need exposes another problem. Revocation is not a practical possibility without
21 the Commission having a set of attractive alternative certificate holders willing to take
22 ownership on terms favorable to the Mississippi ratepayers. The more limited the
23 universe of possible certificate holders, the more likely they will have the economic
24 power to extract from the Commission conditions that are unfavorable to Mississippi
25 ratepayers (such as the promise of higher rates, whether set by the Mississippi
26 Commission or FERC). Unlike the present situation, where the Commission is free to
27 reject ITC's request for unreasonable rate levels and unclear accountability for
28 performance, if the Commission chooses ITC and then ITC fails to perform or violates a
29 condition, the Commission could find its options limited. This is a key risk of
30 approving this transaction.

1 The hard truth is this: If the Commission finds that a particular condition is necessary to
2 prevent harm, but that the condition is impractical or potentially unenforceable, then the
3 transaction is not consistent with the public interest.

4
5 **F. Responsiveness and accountability to the Mississippi Commission**

6
7 **Q. Should the Commission have concerns about ITC's responsiveness and**
8 **accountability?**

9
10 A. Yes. Beyond the details discussed thus far, there is a broader question raised by this
11 transaction: Given its independence from Commission ratemaking, how responsive and
12 accountable will ITC be to the Commission's priorities and preferences, as they change
13 over time? This question is not answerable on the current record. Here are two reasons
14 why it matters.

15
16 *The reliability-cost tradeoff:* How much ratepayers should pay, and for what level of
17 reliability, is one of a commission's most important decisions. While NERC establishes
18 minimum standards, those standards do not always dictate what actions a transmission
19 provider must take to meet those standards. Nor do NERC standards preclude a state's
20 decisions to exceed the standards. Under the status quo, the Commission can direct
21 EMI in all actions relating to the reliability-cost tradeoff (consistent with NERC's
22 standards). But after the transaction, ITC will control the proposals it makes on the
23 reliability-cost tradeoff, and FERC will decide. It is not clear whether the Commission
24 can order ITC to take particular transmission-building actions.

25
26 *The mix of generation, transmission, distribution, demand management and energy*
27 *efficiency:* Another core duty of state regulators is to determine the most cost-effective
28 mix of resources, then order (if a utility) or attract (if a non-utility) the providers who
29 can contribute to that mix most cost-effectively. When all these functions are performed
30 by state-regulated entities or their contractors, the state commission can achieve its
31 goals. In the status quo, EMI is obligated to pursue those transmission projects
32 consistent with the Commission's specifications, and no other.

1 It is not clear whether ITC sees itself as having the same obligation. Suppose, for
2 example, that the Commission were to examine service quality and find that new
3 transmission investment is required. Its non-preempted power to order ITC to make
4 those investments is unclear. And its power to penalize ITC through rates for not
5 making the investments (on the grounds that EMI's generation costs are higher than
6 necessary because transmission shortages prevented imports from lower-cost sources)
7 would be preempted (absent the conditions described in Part II.B.3 above). Further, if
8 ITC were to obey a Commission order and make the desired transmission investment,
9 but were to over-spend in doing so, preemption would prevent the Commission from
10 disallowing the imprudent costs from ITC's rates.

11
12 **G. EMI's ability to integrate its operations, cost-effectively and reliably,**
13 **without owning transmission**
14

15 **Q. Should the Commission be concerned about EMI's ability to integrate its**
16 **operations, cost-effectively and reliably, without owning transmission?**
17

18 A. Yes, because the industry has little experience with such situations. In the past 25 years
19 many utility companies that were local and vertically integrated have changed their
20 form. Some have divested their generation, others have merged with their neighbors or
21 with more distant entities. There is not much experience, however, with vertically
22 integrated utilities divesting their transmission, including the effect on the non-
23 transmission-owning company left behind. And the Applicants in this case say little on
24 this subject. There is no testimony that Entergy studied the question before signing the
25 agreements with ITC, and ITC has provided no benefit-cost analysis of its prior
26 acquisitions from the perspective of the target companies' customers.
27

28 There are at least two areas deserving attention: economies of integration and economic
29 health generally.
30

1 **1. Economies of integration**

2
3 **Q. What are the concerns with economies of integration?**

4
5 A. The concept of economies of integration refers to whether different steps in a production
6 process are more efficiently performed by a single company than by separate
7 companies. Generation, transmission and distribution are separate inputs to the final
8 product, electricity delivered to the retail consumer. The question is whether there is a
9 loss in economies, i.e., a rise in total cost, when transmission is provided by a separate
10 company.

11
12 Vertical efficiencies can arise at several stages. At the planning stage, company
13 planners determine the best mix and location of generation, transmission, distribution,
14 demand response and energy efficiency. At the operational stage, in normal
15 circumstances, dispatch operators determine hour by hour and minute by minute the best
16 mix of resources based on availability and incremental cost. In storm outage situations,
17 it is necessary to establish locational priorities for restoration, and then coordinate the
18 restoration of each asset type so that transmission and distribution availability exists to
19 carry the generation that is being restored. The question is whether these types of
20 coordination—planning, normal operations and outage restoration—are more efficiently
21 performed by a single company or by separate companies.

22
23 The record shows that the Applicants identified coordination as something to address
24 after consummation rather than before. The witnesses' testimony does not display
25 knowledge about whether economies will be gained or lost as a result of the divestiture's
26 elimination of traditional vertical integration. EMI Witness Bunting appears to address
27 the issue in this passage (Direct at p.50):

28
29 The management of the EOCs, together with ESI, have directed that the
30 remaining organizations, contracts, and processes within ESI and the
31 EOCs be appropriately re-sized to support the distribution- and generation-
32 focused utility businesses resulting from the ITC Transaction. The goal of
33 this initiative is to avoid any negative financial effect to a loss of
34 economies of scale potentially resulting from the ITC Transaction.
35

1 This passage displays a misunderstanding of economies of scale. As I understand his
2 testimony, Mr. Bunting is addressing only the need to eliminate excess resources, i.e.,
3 EMI resources no longer needed due to its divestiture of transmission. But real
4 economies of scale and integration concern whether separating the planning and
5 operation of transmission from distribution and generation will add to total costs. There
6 is no evidence that EMI has studied or will study this question. The risk is that costs
7 will rise and flow through formulas, and no one will know why.

8
9 Further, there is no evidence that before committing to the ITC transaction, Entergy or
10 EMI determined, or even studied, the extent to which its operational losses would be
11 offset by other efficiencies. EMI identifies as one cost \$3.8 million annually "associated
12 with (a) labor, equipment and facilities costs related to new personnel (e.g., linemen,
13 utility operations and compliance) who will be required to maintain safety and
14 operational performance; and (b) labor and non-labor shared services costs." Response
15 to MPUS 2-12. EMI says that those diminished economies "*are expected to be* offset by
16 both the quantitative and qualitative benefits of the transaction. . . ." *Id.* (emphasis
17 added). The passive voice relieves any specific witness of having to defend this
18 statement or provide its basis. The response then adds: "[E]fforts to mitigate these costs
19 . . . and to address these anticipated diminished economies of scale are currently under
20 way," but the "[c]hanges in processes and the estimated savings associated with this
21 effort . . . are not yet quantified." *Id.* A prudent utility would have this information
22 before committing to the transaction. If the Commission otherwise finds the transaction
23 worthwhile, it should withhold final approval until EMI has shown that the benefits bear
24 an appropriate relationship to costs, and that there is a plan in place to ensure that result.
25 The Commission should base its order not on expectations and aspirations, but on facts.

26 27 **2. Economic health generally**

28
29 **Q. Should the Commission be concerned about the transaction's effect on EMI's**
30 **economic health generally?**

31
32 **A.** Yes. Since ITC has already carried out several transmission acquisitions, I would
33 expect that it would have studied the effects on the companies left behind; specifically,

1 how well they carry out their load-serving responsibilities while owning no
2 transmission. I also would expect EMI to have gathered this information. But in
3 discovery EMI said it had no such information; that the question should be referred to
4 ITC. ITC said it had no such information either.

5
6 The upshot is that neither company has studied sufficiently the possible operational and
7 economic consequences to a utility's load-serving efforts when it divests its
8 transmission to ITC, even though data exist from ITC's prior transactions. A prudent
9 utility would consider and address possible negative outcomes now, and take actions to
10 prevent them, rather than wait for problems to occur and then seek rate increases to
11 solve them. If the Commission otherwise finds this transaction appropriate, it should
12 condition its approval on EMI studying the experiences of ITC's other transmission-
13 selling customers, and presenting the results of that study to the Commission, along with
14 any necessary recommendations for adjusting the transaction terms to protect EMI's
15 customers from negative consequences.

16
17 **H. Conclusion: The Commission should reject the proposal**

18
19 **Q. Having applied your seven public interest factors, what do you conclude?**

20
21 A. This transaction is inconsistent with the public interest. It was arranged by Entergy and
22 ITC with no Commission guidance. Pursuing their private interests, the Applicants
23 agreed that Entergy Corp.'s shareholders would receive a \$400 billion gain (for the EMI
24 assets only) even as Entergy faced penalties from NERC and scrutiny from U.S.
25 Department of Justice. ITC was willing to pay this premium because it could use
26 FERC's preemptive jurisdiction to raise transmission rates, while making no
27 commitment to improve transmission performance. EMI chose ITC using a
28 comparative process that made shareholder gain a certainty but customer benefit only a
29 possibility.

30
31 Proposals like this—opportunistic, asymmetrical, unconnected to a commission's
32 priorities—are less likely to occur when a commission has articulated clear policies for

1 transmission ownership and operation. Processing the proposal without establishing
2 those policies leaves a commission and the ratepayers vulnerable to more of the same.
3 The Commission therefore should reject the proposal, based on findings that the
4 transaction does not satisfy the public interest criteria set forth above. This rejection
5 could make clear that once the Commission establishes its own vision for transmission
6 service a return proposal is possible, as long as it lacks the unsatisfactory elements and
7 contains the necessary elements; specifically, commitments to benefits at a cost justified
8 by those benefits.

9
10 ITC might assert that that if the Commission does not say "yes" now, ITC will never
11 return. But ITC has built its Application on the premise that Mississippi customers are
12 better off with ITC's "singular focus" than with EMI's status quo. That premise, if true,
13 does not disappear just because the Commission takes the necessary time to investigate
14 these questions.

15
16 The steps necessary to create the Commission's new vision are discussed in Part III
17 below.

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III. The Reframing Applied Without This Transaction: What Steps Can the Commission Take to Promote the Public Interest in Transmission Ownership?

Q. If the Commission rejects the proposal, then what?

A. The testimony in this proceeding has raised questions about EMI's performance and its fitness to serve. This Part III recommends that the Commission open an investigation, undistracted by the EMI-ITC proposal, to create a vision for transmission service. The Commission's investigation, coupled with its participation in the MISO process once Entergy joins, will provide more information and insight than the Commission has now about appropriate ownership structures for Mississippi's transmission facilities. I recommend, therefore, that the Commission's inquiry focus on the five areas discussed next.

A. The role of transmission in Mississippi's future

Q. What should be the Commission's starting point?

A. The Commission, along with all market participants in Mississippi and the region, needs to consider what long-term role transmission should play in the mix of distribution, generation, demand response and energy efficiency. This central question can be answered only by creating an open integrated planning process that produces and regularly revises alternative plans for obtaining the appropriate mix of resources. The plan will help the Commission answer the following questions:

1. What physical, transactional and ownership arrangements, among transmission, generation and distribution, and between Entergy's generation and independent generation, will carry out the plan most cost-effectively?
2. With whom, and how, should Mississippi's transmission owners transact with each other and with other entities in the region, including but not limited to the other Entergy operating companies?

1
2 **B. Quality of service**

3
4 **Q. In the Commission's investigation of service quality, what should be its focus?**

5
6 A. The Commission should of course consider traditional questions, such as these:

- 7
- 8 1. What statistics best describe the type of transmission performance the
9 Commission wants achieved?
 - 10
 - 11 2. Which existing transmission facilities need to be repaired or upgraded?
 - 12
 - 13 3. What new transmission needs to be built?
 - 14
 - 15 4. What revenue flow does the transmission owner need (need, not want) to
16 acquire and maintain the necessary transmission, given its other capital
17 demands?
 - 18
 - 19 5. What should be the quality-of-service standards, and the reward-and-penalty
20 system, for achieving those standards?
 - 21
 - 22 6. What is it worth, in terms of higher rates, to improve transmission
23 performance by stated amounts?
 - 24

25 The Commission also should be concerned about Entergy's culture, particular
26 concerning reliability. Based on an audit conducted in 2009 and 2010, FERC's Office of
27 Enforcement found that Entergy had violated 27 Requirements of 15 Reliability
28 Standards. The Office added that Entergy "also has a history of past violations of the
29 Reliability Standards. . . ." Entergy had to pay a penalty of \$975,000 and commit to a
30 series of mitigation and compliance measures, accompanied by continued FERC
31 monitoring. FERC's findings involved matters more serious than paperwork error.
32 Taken together, FERC's Office said, Entergy's "violations posed a high risk that it

1 would be unable to prevent, contain, or control a disturbance that could lead to
2 substantial harm."⁴⁹

⁴⁹ See *Order Approving Stipulation and Consent Agreement*, 124 FERC ¶ 61,241 (Mar. 28, 2013). FERC's order notes that Entergy cooperated in the investigation and has instituted improvements. *Id.* at ¶¶ 21, 22. The violations found by FERC's Office included (*id.* ¶¶ 8-18):

failure to "consider certain protection system maintenance activities in its operations studies, . . . thereby operat[ing] in an unknown state, and without validating System Operating Limits (SOLs), system response, and appropriate operator response to unplanned contingencies for the current system conditions . . . [and making its] long-term planning assessments . . . invalid";

failure to have "a documented methodology for developing facility ratings for its transmission lines built before 1994[,] . . . resulting in Entergy us[ing] them without any knowledge of how these ratings were determined or whether they remain technically valid and reflective of current conditions";

inadequate training of "system operators at [Entergy's] regional Transmission Operations Centers (TOCs) despite those operators sharing primary responsibility for the real-time operation of the BPS [bulk power system]; . . . [including] failure to "provide at least five days per year of training using realistic simulations of system emergencies."

use of dispatchers at Entergy's Transmission Operating Centers that not NERC-certified, even though they are "directly responsible for complying with [NERC's] Reliability Standards";

use of "inaccurate operations and operations planning models [that] prevented Entergy from accurately determining [System Operating Limits], operating within accurate SOLs, and determining the cause of SOL violations";

use of a "communications network [that] did not provide adequate and reliable telecommunications"; . . . Data from a significant number of Remote Terminal Units (RTUs) had to pass through a single point on Entergy's communications system in order to get to all of Entergy's control centers. The failure of this single point resulted in the loss of system visibility, monitoring, and control capabilities for a large portion of Entergy's system and the inability to perform real-time contingency analysis for Entergy's overall footprint";

failure to "routinely manage, test, or monitor vital communications facilities by failing to monitor and test backup power supplies (batteries) at such facilities";

"Entergy could not know the status of transmission and generation resources, nor convey the status of its generation and transmission resources to its Reliability

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Should that “substantial harm” occur, it is EMI’s customers—the Commission’s constituents—who will suffer. Paying \$975,000 does not, by itself, fix the problem. The Commission therefore should investigate the details of the NERC infractions to ensure that EMI has addressed each one—not only by correcting the errors themselves but by addressing the organizational structure and culture within which the errors were made. The Commission also should determine whether EMI’s transfer of control to MISO will reduce the likelihood of infractions or leave the contributing factors in place.

C. Anticompetitive concerns

Q. Should the Commission be concerned in this proceeding about allegations that Entergy has engaged in anticompetitive behavior?

A. Yes. Entergy has characterized anticompetitive concerns as mere "perceptions,"⁵⁰ but others see a more serious problem. In September 2010, the U.S. Department of Justice started a civil investigation into whether certain of Entergy's "power generation dispatch, transmission planning and power procurement practices constitute exclusionary conduct under Section 2 of the Sherman [Antitrust] Act."⁵¹ Entergy’s commitment to join MISO and sell its transmission to ITC, said the Department,

Coordinator; could not monitor transmission line status, real and reactive power flows, voltage, load-tap changer settings, and status of rotating and static reactive reserves; could not monitor operating conditions; and, without these monitoring capabilities, could not operate to avoid instability, uncontrolled separation, or cascading outages as a result of the most severe single contingency."

a "plan to continue reliability operations in the event it loses its control center functionality [that] is not viable."

⁵⁰ See, e.g., Bunting Direct Testimony at pp. 9-10 (“the perception of bias remains on the Entergy Transmission System, and the proposed merger is the best way to eliminate that perception”).

⁵¹ See “Justice Department Statement on Entergy Corp.’s Transmission System Commitments and Acquisition of KGen Power Corp.’s Plants in Arkansas and Mississippi: *Department Will Not Challenge Entergy’s Proposed Acquisitions of Hinds and Hot Spring Power Plants; Investigation into Alleged Exclusionary Conduct Remains Open*” (Nov. 14, 2012), available at <http://www.justice.gov/opa/pr/2012/November/12-at-1360.html>. This press

1
2 are significant steps towards restoring competition in the Entergy service
3 area. If Entergy follows through on its commitments, these measures will
4 address the Antitrust Division's concerns by eliminating Entergy's ability
5 to maintain barriers to wholesale power markets, ensuring that all Entergy
6 service area generation is dispatched independently and at lowest cost,
7 increasing market transparency and oversight, and properly aligning
8 incentives for the construction of transmission. Such measures will also
9 directly benefit consumers, who will ultimately enjoy lower electricity
10 prices and improved reliability as a result of RTO integration and the
11 transmission system divestiture.

12
13 The division will closely monitor developments, and in the event that
14 Entergy does not make meaningful and timely progress, the division can
15 and will take appropriate enforcement action, if warranted.⁵²

16
17 The relevance to the ITC transaction is this: Entergy asserts that eliminating
18 perceptions of bias is a transaction benefit, implicitly justifying the rate increase,
19 jurisdictional loss and other customer risks. But if the problem is behavior rather than
20 perception, it does not need a rate increase, a jurisdictional loss and a shareholder gain
21 to solve it. If the Department of Justice insists on Entergy divesting its “transmission
22 system to a third party with the incentive to make efficient transmission investments,”
23 *id.*, that divestiture can occur at book value without a gain, thereby eliminating the need
24 for a rate increase. If the Commission does not approve the transaction, the Department
25 likely has a “Plan B” to address its concerns about Entergy’s practices. Therefore, the

release explains that the Antitrust Division “has been exploring whether Entergy has harmed consumers by exercising its control over its transmission system and dominant fleet of gas-fired power plants to exclude rival operators of low-cost combined-cycle gas turbine (CCGT) power plants from competing to sell long-term power[,] . . . [and] whether [these] practices have effectively foreclosed these more efficient rivals from obtaining long-term firm transmission service, a necessary input for selling long-term power products to wholesale customers in the Entergy service area.”

The Department added that Entergy’s “professed efficiency and regulatory justifications” for its actions “have not been persuasive.” The Department also said that it was closing its investigation into Entergy’s acquisitions of KGen’s power plants in Mississippi and Arkansas; “in light of [the MISO and ITC events, the acquisitions] are unlikely to substantially lessen competition.”

⁵² *Id.*

1 Commission need not approve this transaction to achieve the “perception” benefit that
2 the Applicants describe.

3
4 In the meantime, I recommend that the Commission monitor the Department’s efforts,
5 to the extent publicly disclosed, and ask these questions:

- 6
7 1. Will EMI's joining MISO eliminate the perception and reality that Entergy
8 uses its transmission system anticompetitively?
9
10 2. What role can the Commission play in eliminating concerns over EMI's
11 alleged anticompetitive bias?
12

13 **D. The corporate structure that includes Mississippi's transmission system**

14
15 **Q. What questions should the Commission address in the area of corporate structure?**

16
17 **A.** I suggest the Commission ask these questions:

- 18
19 1. What mix of business activities should exist?
20
21 2. What geographic territories should be encompassed?
22
23 3. How small can the Mississippi share be before the state's needs become
24 unimportant to the corporate hierarchy?
25
26 4. What mix of financing, such as the type of debt, the debt-equity ratio and the
27 type of debt holders, should exist?
28
29 5. What type of management and ownership structure will most likely improve
30 operations?
31

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E. Jurisdiction

Q. What questions should the Commission address in the area of jurisdiction?

A. There is a single, overriding question: Who should have jurisdiction over which actors and actions affecting Mississippi transmission service?

1

2 **Conclusion**

3

4 **Q. What are your concluding remarks?**

5

6 **A.** There are multiple ways for EMI's transmission system to receive an improvement boost
7 without an automatic, jurisdiction-shifting rate increase costing EMI retail ratepayers at
8 least \$100 million over 30 years (net present value) and a \$400 million gain to Entergy
9 shareholders. These ways include:

10

- 11 1. EMI joins MISO, coupled with a Commission-directed improvement
12 strategy accompanied by sufficient regulatory funding.
- 13
- 14 2. EMI joins MISO, coupled with (a) a Commission-directed improvement
15 strategy accompanied by sufficient regulatory funding; and (b)
16 contracting out various functions, when cost-effective, to a competitively
17 selected contractor.
- 18
- 19 3. The Commission replaces EMI, after a fact-based investigation into
20 adequacy, with a new owner-operator selected through a competition in
21 which the primary criterion is best customer service at lowest reasonable
22 cost.
- 23
- 24 4. ITC acquires Entergy's transmission assets at book cost, while agreeing
25 to conditions allowing the MPSC to determine the cost inputs for the
26 FERC formula rate.
- 27

28 As framed by the Applicants, this proceeding has given the Commission no opportunity
29 to explore these other options. Without the knowledge gained from that exploration, the
30 Commission cannot know whether the EMI-ITC proposal is better than all of them.

31 What we do know is that the EMI-ITC proposal precludes every one of them.

32 Furthermore, the EMI-ITC proposal guarantees—

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1. for Entergy shareholders, a \$400 million gain (that is the amount attributable to the EMI assets), attributable in large part to decades of support from EMI ratepayers, support assured by EMI's statutory protection from competition;
2. for ITC, a doubling in size and a new net income stream;
3. for Mississippi ratepayers, rate increases of at least \$100 million over 30 years;
4. for Mississippi ratepayers, no enforceable commitments for service improvements; and
5. for the Mississippi Commission, loss of the most powerful tool for enforcing quality standards, and for balancing quality and cost, innovation and rate stability—its legal control of transmission cost of service.

In short, this transaction takes much and promises nothing. The Commission should reject it, then initiate a study, of how best to combine (a) EMI's MISO entry, (b) EMI's opportunities for improvement, (c) cost recovery policies and (d) an integrated resource planning process, so as to provide Mississippi with high-quality service at the lowest reasonable cost.

If, however, the Commission believes that this transaction can be made consistent with the public interest, the following is a summary of conditions, detailed previously in the testimony, that are necessary for the transaction to be consistent with the public interest. Should the Commission find that, with these conditions, the transaction satisfies the public interest, it should hold a separate hearing phase to determine the specifics.

1

2 **Recommended Conditions**

3

4 **Quality of Service**

- 5
- 6 1. The Commission will set standards for service quality and performance
- 7 improvement, including compensation for complying with and penalties for
- 8 violating those standards.
- 9
- 10 2. The Commission will impute to EMI the cost of any ITC imprudence found by
- 11 the Commission.
- 12
- 13 3. EMI and ITC agree to submit, prior to consummation, a joint work plan and
- 14 commitments that can become the basis for a Commission finding that the
- 15 transaction's certain benefits will be worth the certain costs.

16

17 **Rates**

- 18
- 19 1. ITC agrees not to seek under FERC Order No. 679 (as amended)--
- 20
- 21 a. any facility-specific incentives for existing assets; or
- 22
- 23 b. any incentives for a project whose costs would be allocated in whole or part
- 24 to EMI customers (whether that project is located inside or outside
- 25 Mississippi), without a prior Commission finding that (a) there are no lower
- 26 cost alternatives to the project and (b) but for the incentive no one, including
- 27 ITC, could build the project.
- 28
- 29 2. ITC agrees to recover under the FERC tariff only those Mississippi-related costs
- 30 approved by the Commission, subject to the limits described in this testimony
- 31 (relating to FERC-mandated allocation percentages and FERC's indefeasible
- 32 powers recognized by the *Mobile-Sierra* doctrine).
- 33

- 1 3. EMI and ITC agree that the Commission has non-preempted, state law authority,
2 under the *Kentucky West Virginia-Pike County* line of cases, to: (a) find that
3 EMI was imprudent for substituting higher-cost purchase of transmission service
4 from ITC for the lower-cost provision of transmission service to itself, and (b)
5 disallow the cost difference as the measure of EMI's imprudence, with any such
6 disallowance being subject to the normal judicial review under state law for
7 reasonableness.
8
- 9 4. If EMI uses a rider to recover any ITC-charged transmission costs, EMI first
10 must prove the accuracy and prudence of those costs.
11
- 12 5. The Commission will determine, and assign to ratepayers in the form of a rate
13 reduction, that portion of the premium (over book value) received by EMI
14 shareholders that is properly attributable to the ratepayers' historic financial
15 support.
16

17 **Corporate structure**

- 18
- 19 1. ITC agrees to limit its future acquisitions, of or by others, to those consistent
20 with Commission-set criteria and procedures designed to (a) maintain ITC's
21 status as a transmission-only company, (b) prevent any distraction from ITC's
22 "singular focus" on transmission, (c) prevent an internal competition for capital
23 that affects its Mississippi transmission business, and (d) prevent any risk of rate
24 increase or quality decrease to Mississippi ratepayers.
25
- 26 2. ITC agrees to abide by Commission-established criteria for financial ratios and
27 credit ratings, and to subject the financings of its affiliates to Commission
28 approval (subject to exceptions designed by the Commission to exclude
29 transactions that will have no adverse effect).
30
- 31 3. ITC commits that it will never oppose (a) a request from its Mississippi
32 subsidiary for capital to fund improvements deemed necessary by the

1 Mississippi Commission, or (b) an order from the Mississippi Commission to
2 make specified investments.

3
4 **General**

- 5
6 1. ITC agrees to make available to the Commission and the Public Utilities Staff
7 access to the books and records of any ITC affiliate as the Commission deems
8 necessary to carry out its responsibilities.
9
10 2. ITC agrees to incorporate all the foregoing conditions, using language
11 determined by the Commission, in any FERC-jurisdictional documents as the
12 Commission deems necessary to prevent the conditions from being preempted,
13 and agrees not to assert in any forum that the conditions are preempted.
14
15 3. EMI agrees to present to the Commission, prior to consummation, a study of the
16 experiences of the other utilities that have sold their transmission to ITC.
17
18 4. ITC agrees that the Commission may impose on it penalties for non-compliance
19 with these conditions, or statutes, orders or rules, in excess of current statutory
20 limits, subject to review by state courts for reasonableness.
21
22 5. The Commission finds that it has the resources necessary to enforce the
23 foregoing conditions.
24

25 **Q. Does this conclude your Direct Testimony?**

26
27 **A.** Yes.
28

Resume of Scott Hempling

Scott Hempling has taught public utility law and policy to a generation of regulators and practitioners. As an attorney, he has assisted clients from all industry sectors—regulators, utilities, consumer organizations, independent competitors and environmental organizations. As an expert witness, he has testified numerous times before state commissions and before committees of the United States Congress and the legislatures of Arkansas, California, Maryland, Minnesota, Nevada, North Carolina, South Carolina, Vermont, and Virginia. As a teacher and seminar presenter, he has appeared throughout the United States and in Canada, Central America, Germany, India, Italy, Jamaica, Mexico and Nigeria.

His articles have appeared in *The Electricity Journal*, *Public Utilities Fortnightly*, *ElectricityPolicy.com* and other professional publications, covering such topics as mergers and acquisitions, the introduction of competition into formerly monopolistic markets, corporate restructuring, ratemaking, utility investments in nonutility businesses, transmission planning, renewable energy and state–federal jurisdictional issues. From 2006 to 2011, he was the Executive Director of the National Regulatory Research Institute.

Hempling is an adjunct professor at the Georgetown University Law Center, where he teaches courses on public utility law and regulatory litigation. His book of essays, *Preside or Lead? The Attributes and Actions of Effective Regulators*, was published in 2010. A second, expanded edition will be published in fall 2013. The first volume of his legal treatise, *Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction*, will be published by the American Bar Association in fall 2013. This is the first volume of a two-volume treatise, the second of which will address the law of corporate structure, mergers and acquisitions.

Hempling received a B.A. *cum laude* in (1) Economics and Political Science and (2) Music, from Yale University, where he was awarded a Continental Grain Fellowship and a Patterson research grant. He received a J.D. *magna cum laude* from Georgetown University Law Center, where he was the recipient of an *American Jurisprudence* award for Constitutional Law. More detail is available at www.scotthemplinglaw.com.

Education

B.A. *cum laude*, Yale University (majors: Economics and Political Science; Music), 1978. Recipient of a Continental Grain Fellowship and a Patterson Research grant.

J.D. *magna cum laude*, Georgetown University Law Center, 1984. Recipient of *American Jurisprudence* award for Constitutional Law; editor of *Law and Policy in International Business*; instructor, legal research and writing.

Professional Experience

President, Scott Hempling, Attorney at Law LLC (2011-present)

Adjunct Professor, Georgetown University Law Center (2011-present)

Executive Director, National Regulatory Research Institute (2006-2011)

Founder and President, Law Offices of Scott Hempling, P.C. (1990-2006)

Attorney, Environmental Action Foundation (1987-1990)

Attorney, Spiegel and McDiarmid (1984-1987)

Past Clients

Independent Power Producers and Marketers

California Wind Energy Association, Cannon Power Company, Electric Power Supply Association, EnerTran Technology Company, National Independent Power Producers, SmartEnergy.com, U.S. Wind Force

Investor-Owned Utilities

Madison Gas & Electric, Oklahoma Gas & Electric

Legislative Bodies

Vermont Legislature, South Carolina Senate

Municipal Power Systems

Connecticut Municipal Electric Energy Cooperative, Iowa Association of Municipal Utilities, City of Winter Park, Florida

Public Interest Organizations

American Association of Retired Persons, American Public Power Association, Consumer Federation of America, Energy Foundation, Environmental Action Foundation, Illinois Citizens Utility Board, Union of Concerned Scientists

State Commissions and Consumer Agencies

Arkansas Public Service Commission, Arizona Corporation Commission, Connecticut Department of Public Utility Control, Connecticut Office of Consumer Counsel, Delaware Public Service Commission, Hawaii Public Utilities Commission, Indiana Utility Regulatory Commission, Kansas Corporation Commission, Maryland Energy Administration, Maryland Attorney General, Massachusetts Attorney General, Massachusetts Department of Public Utilities, Minnesota Public Utilities Commission, Mississippi Public Utilities Staff, Missouri Public Service Commission, Montana Public Service Commission, National Association of Regulatory Utility Commissioners, Nevada Consumer Advocate, Nevada Public Service Commission, New Hampshire Public Utilities Commission, New Jersey Division of Ratepayer Advocate, North Carolina Utilities Commission, Ohio Public Utilities Commission, Oklahoma Corporation Commission, Pennsylvania Office of Consumer Advocate, South Carolina Public Service Commission, Texas Office of Public Utility Counsel, Vermont Department of Public Service, Virginia State Corporation Commission, Wisconsin Attorney General.

Legislative Testimony

United States Senate

Committee on Energy and Natural Resources, May 2008 (addressing the adequacy of state and federal regulation of electric utility holding company structures)

Committee on Energy and Natural Resources, Feb. 2002 (analyzing bill to amend the Public Utility Holding Company Act) (PUHCA)

Committee on Energy and Natural Resources, May 1993 (analyzing bill to transfer PUHCA functions from SEC to FERC)

Committee on Banking and Urban Affairs, Sept. 1991 (analyzing proposed amendment to PUHCA)

Committee on Energy and Natural Resources, March 1991 (analyzing proposed amendment to PUHCA)

Committee on Energy and Natural Resources, Nov. 1989 (analyzing proposed amendment to PUHCA)

United State House of Representatives

Subcommittees on Energy and Power and Telecommunications and Finance, Commerce Committee, Oct. 1995 (regulation of public utility holding companies)

Subcommittee on Energy and Power, Energy and Commerce Committee, July 1994 (analyzing future of the electric industry)

Subcommittee on Energy and Power, Energy and Commerce Committee, May 1991 (analyzing proposed amendment to PUHCA)

Subcommittee on Environment, Energy and Natural Resources, Government Operations Committee, Oct. 1990 (assessing electric utility policies of FERC)

Appropriations Subcommittee on Commerce, Justice, State and the Judiciary, Apr. 1989 (discussing proposals to increase staff administering PUHCA)

Subcommittee on Energy and Power, Sept. 1988 (discussing "independent power producers" and PUHCA)

State Legislatures

Committee on Energy and Public Utilities, California Senate (December 1989) (discussing relationships between electric utilities and their non-regulated affiliates)

Interim Committee on Electric Restructuring, Nevada Legislature (1995-97) (discussing options for structuring the electric industry)

Committees on General Affairs, Finance, Vermont Senate (February-March 1997) (discussing options for structuring the electric industry)

Task Force to Study Retail Electric Competition, Maryland General Assembly (1997)

Electricity Restructuring Task Force, Virginia General Assembly (1999)

Judiciary Committee, South Carolina Senate (Fall 2000)

Publications

Books

Preside or Lead? The Attributes and Actions of Effective Regulators (2d edition 2013) (forthcoming).

Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction (American Bar Association 2013) (forthcoming).

Articles and Papers

“Non-Transmission Alternatives: FERC’s ‘Comparable Consideration’ Needs Correction,” *ElectricityPolicy.com* (June 2013).

“Broadband’s Role in Smart Grid’s Success” in Noam, Pupillo, and Kranz, *Broadband Networks, Smart Grids and Climate Change* (Springer 2013).

“How Order 1000’s Regional Transmission Planning Can Accommodate State Policies and Planning.” *ElectricityPolicy.com* (September 2012).

“Renewable Energy: Can States Influence Federal Power Act Prices Without Being Preempted?” *Energy and Natural Resources Market Regulation Committee Newsletter* (American Bar Association, June 2012).

“Can We Make Order 1000’s Transmission Providers’ Obligations Effective and Enforceable?” *ElectricityPolicy.com* (May 2012).

“Riders, Trackers, Surcharges, Pre-approvals, and Decoupling: How Do They Affect the Cost of Equity?” *ElectricityPolicy.com* (March 2012).

“Regulatory Support for Renewable Energy and Carbon Reduction: Can We Resolve the Tensions Among Our Overlapping Policies and Roles?” (National Regulatory Research Institute 2011).

“Infrastructure, Market Structure, and Utility Performance: Is the Law of Regulation Ready?” (National Regulatory Research Institute 2011).

“Cost-Effective Demand Response Requires Coordinated State-Federal Actions” (National Regulatory Research Institute 2011).

“Effective Regulation: Do Today’s Regulators Have What it Takes?” in Kaiser and Heggie, *Energy Law and Policy* (Carswell 2011).

“Certification of Regulatory Professionals” (National Regulatory Research Institute 2010).

Renewable Energy Prices in State-Level Feed-in Tariffs: Federal Law Constraints and Possible Solutions (lead author, with C. Elefant, K. Cory, and K. Porter), Technical Report NREL//TP-6A2-47408 (January 2010).

Pre-Approval Commitments: When And Under What Conditions Should Regulators Commit Ratepayer Dollars to Utility-Proposed Capital Projects? (National Regulatory Research Institute 2008) (with Scott Strauss).

“Joint Demonstration Projects: Options for Regulatory Treatment.” *The Electricity Journal* (June 2008).

“Corporate Structure Events Involving Regulated Utilities: The Need for a Multidisciplinary, Multijurisdictional Approach.” *The Electricity Journal* (Aug./Sept. 2006).

"Reassessing Retail Competition: A Chance to Modify the Mix." *The Electricity Journal* (Jan./Feb. 2002).

The Renewables Portfolio Standard: A Practical Guide. (National Association of Regulatory Utility Commissioners, Feb. 2001 (with N. Rader).

Promoting Competitive Electricity Markets Through Community Purchasing: The Role of Municipal Aggregation. (American Public Power Association, Jan. 2000 (with N. Rader).

Is Competition Here? An Evaluation of Defects in the Market for Generation. (National Independent Energy Producers 1995) (co-author).

The Regulatory Treatment of Embedded Costs Exceeding Market Prices: Transition to a Competitive Electric Generation Market. (1994) (with Ken Rose and Robert Burns).

"Depolarizing the Debate: Can Retail Wheeling Coexist with Integrated Resource Planning?" *The Electricity Journal* (Apr. 1994).

Reducing Ratepayer Risk: State Regulation of Electric Utility Expansion. (American Association of Retired Persons 1993).

"'Incentives' for Purchased Power: Compensation for Risk or Reward for Inefficiency?" *The Electricity Journal* (Sept. 1993).

"Making Competition Work." *The Electricity Journal* (June 1993).

"Confusing 'Competitors' With 'Competition.'" *Public Utilities Fortnightly* (March 15, 1991).

"The Retail Ratepayer's Stake in Wholesale Transmission Access." *Public Utilities Fortnightly* (July 19, 1990).

"Preserving Fair Competition: The Case for the Public Utility Holding Company Act." *The Electricity Journal* (Jan./Feb. 1990).

"Opportunity Cost Pricing." *Wheeling and Transmission Monthly* (Oct. 1989).

"Corporate Restructuring and Consumer Risk: Is the SEC Enforcing the Public Utility Holding Company Act?" *The Electricity Journal* (July 1988).

"The Legal Standard of 'Prudent Utility Practices' in the Context of Joint Construction Projects," *NRECA/APPAA Newsletter Legal Reporting Service* (Dec. 1984/Jan. 1985) (co-author).

Speaker and Lecturer

American Bar Association; Regulatory Studies programs at Michigan State University, New Mexico State University and University of Idaho; Canadian Association of Members of Public Utility Tribunals; Canadian Association of Regulatory Utility Tribunals; Canadian Energy Law Forum; Pennsylvania Bar Institute; Louisiana Energy Bar; India Institute of Technology-Kanpur; Management Development Institute at Gurgaon, India; Independent Power Producers Association of India; American Antitrust Institute, American Association of Retired Persons; American Power Conference; American Public Power Association; American Wind Energy Association; Chicago Bar Association (Energy Section); New York Bar Association (Energy Section); Electric Power Research Institute; *Electric Utility Week*; Electricity Consumers Resource Council; *Energy Daily*; Executive Enterprises; Exnet; Federal Energy Bar Association; Harvard Electricity Policy Group; Infocast; Management Exchange; National Conference of Regulatory Attorneys; Midamerica Association of Regulatory Commissioners; Mid-Atlantic Conference of Regulatory Utility Commissioners; National Association of Regulatory Utility Commissioners; National Association of State Utility Consumer Advocates; National Independent Energy Producers; New England Conference of Public Utility Commissioners; New England Public Power Association, Southeastern Association of Regulatory Utility Commissioners; World Regulatory Forum, U.S. Department of Energy Forum on Electricity Issues

Community Activities

Member, PEPCO Work Group, appointed by County Executive of Montgomery County, Maryland (2010–2011)

Sunday School Teacher, Temple Emanuel, Kensington, Maryland (2002–2006)

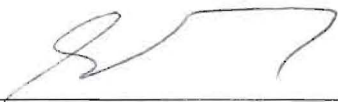
Board of Trustees, Temple Emanuel (2005–2006)

Musical performer (cello), Riderwood Village Retirement Community (2003–present)

STATE OF MARYLAND)

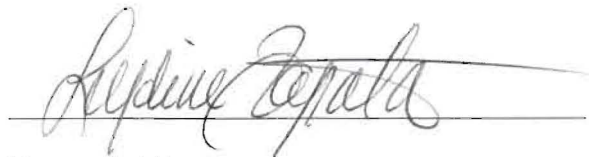
MONTGOMERY COUNTY)

SCOTT HEMPLING, being first duly sworn, deposes and says that the statements contained in the foregoing Direct Testimony of Scott Hempling to the Mississippi Public Service Commission in Docket 2012-UA-358 are true and correct to the best of his knowledge, information and belief.



Scott Hempling

Subscribed and sworn to before me this the 12th day of June 2013.



Notary Public

My Commission Expires: 3/31/2017



Before the Mississippi Public Service Commission

Docket No. 2012-UA-358

Surrebuttal Testimony of Scott Hempling

On Behalf of

Mississippi Public Utilities Staff

Overview

Q. Are you the same Scott Hempling who submitted Direct Testimony in this proceeding?

A. Yes.

Q. What is the purpose of your surrebuttal testimony?

A. Three weeks before the hearing and nine months after submitting their Application, EMI and ITC have recognized that they should not raise rates without raising performance. I will explain how their late-filed amendment, as described in the Rebuttal Testimony of Mr. Bready and Mr. Lewis, violates multiple regulatory principles. MPUS Witness Seth Parker will address the proposal's details.

Q. What is your understanding of the proposal?

A. I have distilled the proposal to four main points, the last two of which the Applicants obscure:

For the first five years, retail ratepayers will experience a minor, unmitigated rate increase attributable to the use of FERC's WACC rather than the PSC's WACC.¹

¹ I say "minor, unmitigated rate increase" based on Mr. Parker's surrebuttal testimony. Mr. Parker explains that Mr. Lewis's Rebuttal (at pp. 33-34) states that \$68.6 million of the

Beginning in Year 6, the rates rise with the net value of ITC's improvements (as defined by ITC and as measured by an outside evaluator whose selection ITC will influence), up to the level produced by the FERC WACC.

Beginning in Year 6, if ITC can show that the net value of the improvements, annualized,² equals or exceeds the annual incremental cost of the FERC WACC (relative to the PSC's WACC), ITC's rates will reflect the FERC WACC forever thereafter, regardless of ITC's subsequent performance.

ITC defines improvement as improvement relative to a base case that assumes EMI would itself make no improvement, other than the plans EMI already has in place.

Q. Why do you say that Applicants obscure the last two points?

A. Mr. Bready states (Rebuttal at 25): "The rate mitigation proposal ensures the alignment of the realization of all of the benefits that this transaction offers to customers and the rate impacts resulting from it." This statement obscures the truth, because while "this transaction" lasts forever, any obligatory "alignment" would reflect only a single year's annualized calculation. As explained in footnote 2, that annualized calculation combines a one-year snapshot for "benefits demonstrated through Improved System Performance," with a 40-year annual average for "benefits demonstrated through Improved System Economics." If later System Performance fails to keep up with the one-year snapshot, and/or if actual System Economics falls behind the 40-year prediction, the higher FERC WACC will remain in place forever. This Commission's only recourse would be to persuade FERC, through a complaint under Section 206 of

proposed \$70.8 million in "rate mitigation" would reduce retail rates, while the difference of \$2.2 million would reduce wholesale rates.

² I use the term "annualized" to refer to ITC's complex calculation. ITC measures the "benefits demonstrated through Improved System Performance" for the given year. In contrast, ITC measures the "benefits demonstrated through Improved System Economics," as a one-year average of a 40-year stream. Moreover, ITC measures the "Annualized Cost of ITC Economic Projects" by dividing the project costs by 40 years. MPUS witness Seth Parker explains these concepts in more detail.

the Federal Power Act (in which the Commission will have the burden of proof), that the FERC WACC is no longer "just and reasonable." In other words, once ITC demonstrates "alignment" it has no further obligation to "ensure the alignment," and the PSC will have no jurisdiction to "ensure the alignment." The rates become subject fully and preemptively to the jurisdiction of FERC, which has not conditioned its WACC on any particular performance.

Similarly, Mr. Bready states (Rebuttal at 25): "Under the proposal . . . ITC Mississippi and EMI will bear rate mitigation risk until the benefits of ITC ownership are calculated and demonstrated." This statement again obscures. The Applicants will "bear the risk" until ITC makes its showing. Forever after, the risk that improvements don't justify the rate increase is fully on the customers, who would have the burden of convincing FERC that the rate is now unjust and unreasonable. There is no guarantee that FERC would find that rate unjust and unreasonable merely because it was unmatched by performance improvement, as defined by ITC or anyone else.

Mr. Bready misuses the term "risk." A risk is the possibility that something bad will happen. ITC's "risk" is merely not earning the higher WACC set by FERC. If that risk comes home to roost, ITC would hardly suffer; it would receive the WACC set by the PSC, a WACC which historically has enabled Mississippi's utilities to attract the investment necessary to serve their customers.

The Applicants have framed their proposal as no-risk for the ratepayer and a gamble for ITC. The truth is the exact opposite. If ITC fails its improvement criteria, it keeps its PSC-granted transmission monopoly and earns the PSC-set returns. If ITC passes its test, it gets all of the above, plus the FERC bonus. (Under either scenario,

Entergy shareholders get billions in bonus—the gain described in the Direct Testimony of Seth Parker.) In contrast, the ratepayers face these options: Continue paying the historic PSC-set profit for performance that ITC implicitly sees as sub-prudent (as I explain in Part I below), or pay the FERC bonus to get service that is merely prudent. Mr. Bready has his "risks" backward.

Q. What subjects will you cover?

A. I will address six concerns:

1. The proposal is unconnected to rational benefit-cost analysis.
2. The Commission cannot assess the proposal without an objective context.
3. The proposal placates customers in the short term while imposing risks in the long term.
4. The "independent" evaluator will not be independent.
5. The proposal charges ratepayers for things they never bought.
6. The need to investigate EMI's performance remains.

I. The Proposal is Unconnected to Rational Benefit-Cost Analysis

Q. Should the Commission be concerned about the Applicants' proposed relationship between increased rates and "improved" performance?

A. Yes. Once ITC makes its demonstration, ITC would charge EMI's customers more than they pay now, for "improvement" as defined by ITC. This concept has four flaws.

1. ITC has not established that the status quo needs improvement. If there is no need for improvement, ITC has no cause to charge for improvement. Theatre-goers content with the balcony are not forced to sit in the orchestra, just because the house wants to make more money. ITC sees it otherwise.

2. Now assume the customers do desire some improvement. In most markets, it is the customer who weighs price and value, deciding whether to buy the burger or the steak, the Volkswagen or the Lexus. By crafting its many metrics, ITC substitutes its value-view for the customer's, assigning to specific improvements a dollar value without learning the customer's view of the value. ITC's presumptuousness aside, the Commission should not accept ITC's view, because ITC is not objective. Ignoring the customer's value-view is one thing. Having a for-profit stake in overstating the value is another. Under no known regulatory principle can the Commission accept ITC's metrics.

3. The base case from which improvement receives a reward should be what a prudent utility would do. A prudent utility, when held accountable by an alert commission, does not sit on its hands, with its performance static forever. Appreciative of its government protection from competition, a prudent utility acts as if subject to competition. A prudent utility improves continuously. Yet ITC's base case assumes that EMI would complete its present plans but make no additional plans. This assumption would be unrealistic if EMI were not joining MISO; it is rendered more unrealistic given the guidance and opportunities for improvement likely to be provided by MISO. ITC assumes that any actions it takes would never have occurred to EMI. Since ITC has not described its improvements as extraordinary, I assume they are what any prudent utility, including EMI, would do. ITC would make customers pay extra for something they should be getting already.

4. The improvements ITC promises necessarily depend on the performance of the 750 Entergy employees it is hiring. No one has suggested that these employees are

performing unsatisfactorily now. If they are performing unsatisfactorily now, ratepayers should not be paying extra to improve their performance. The Commission should be penalizing EMI, not approving a transaction that gives Entergy shareholders a bonus. And if the Entergy employees are performing satisfactorily now, there is no reason for ratepayers to pay more.

To summarize: Performing prudently entitles ITC to a normal ROE—like the ones historically established by the Commission. To make ratepayers pay more, the performance must exceed the prudent level—and the extra quality must be worth the extra cost, from the perspective of the customer. ITC neither recognizes nor solves this equation. At the center of this proposal is a hole in the logic.

II. The Commission Cannot Assess the Proposal without an Objective Context

Q. Should the Commission be concerned about the absence of a context for evaluating the proposal?

A. Yes. Even if ITC's base case (a non-improving EMI) were correct, and even if ITC had determined the value customers place on improvement, we still have no objective basis for assessing whether ITC's improvements come at a reasonable cost. Reasonableness can be determined only by comparison to an objective case. In negligence law, the objective case is the "reasonable man." In utility policy, the objective case is the "prudent utility." We have no evidence of what a prudent utility would offer. We have only what ITC offers.

And ITC's proposal makes customers merely indifferent. ITC promises only that the value of improvement will equal the rate increase. No rational customer says:

"Give me a product priced so that the product's value to me merely equals the price; I want to end up indifferent to whether I buy or not buy." A rational customer seeks purchases that make her better off, that give her value exceeding the price. It is that customer attitude—seeking the most value for the price—that causes competitors to vie for victory by offering the most value for the price.

But that is not the Applicants' proposal. Whatever competition ITC won, it was not a competition to provide the greatest value to the consumer. ITC won because Entergy selected it. Entergy has not told us how heavily it weighed customer satisfaction, but we do know that this weight, if any, was diminished by its desire to get gain for its shareholders. There is nothing wrong with that desire, but its influence on the decision caused bias—no less than if a commissioner in a jurisdiction voting on this proposal held stock in the companies. If the competition to replace EMI were based on "Who can provide the most improvement at the least cost?" rather than "Who can leave customers indifferent between improvement and price while offering EMI shareholders the greatest gain?," this proposal would be different. Because Entergy's competitive process, such as it was, asked the wrong question, it is impossible to know if ITC's answer is the right answer. Unless the Commission can compare the offerings of competitors vying for the exclusive privilege to serve EMI's customers, the Commission has no objective context for assessing this proposal.

To set the proper context, EMI and the Commission would need to take four steps. First, the Commission would need to determine ratepayers' benefit-cost tradeoff, by asking "What level of performance are customers willing to pay for?" Second, the Commission would need to define that level of performance as obligatory performance.

Third, the Commission would need to determine the reasonable cost of achieving that performance. Fourth, the Commission would need then to ask: "Who is available to achieve that performance at reasonable cost?" That is what regulatory law requires: a commission-set standard of performance, and commission-set compensation to support that performance. Nothing in ITC's proposal resembles any of these steps. Instead, ITC has the ROE tail wagging the performance dog. Instead of asking "What is the obligatory performance?," ITC asked "How do we get the FERC 12.38%?" That is what happens when there is no context for comparison.

Compounding the Commission's lack of context is ITC's informational advantage. Already unknowing about other applicants' possible offers, the Commission lacks the information ITC used to design its own offer. To design its offer, ITC used two main categories of information: EMI's infrastructure and ITC's capabilities. This information is locked within the companies, remote from the record in this case. ITC presents its proposal as a gamble: It foregoes the extra FERC dollars if it fails to score enough points. But because ITC controlled the game's design, the Commission cannot tell if the game is rigged (setting aside the unrealistic base case of no EMI improvement). Without "reverse engineering" we will not know whether ITC simply set goals that were well within anyone's grasp. A baseball club designs its stadium to help its batters,; but it still plays half its games on the road, where each opponent has designed *its* stadium to help *its* batters. No such symmetry exists here.

To summarize: ITC wants the question to be "Can ITC improve on an unimproved status quo?" The right question is: "Will ITC improve the status quo more than someone else could?" That someone else could be (a) EMI, (b) some other prudent

utility, or (c) the winner of an objective competition to find the best acquirer. While the correct answer—the one that ensures both objectivity and efficiency—is choice (c), ITC rejected them all in favor of a looser standard that only ITC understands. Worse, consider the oddity of basing improvement on EMI's present performance rather than on an objective standard: The poorer EMI's current performance, the likelier the rate increase. The problem with that proposition is self-evident.

III. The Proposal Placates Customers in the Short Term While Imposing Risks in the Long Term

Q. Should the Commission be concerned about the long term as well as the short term?

A. Yes. Regulation should condition compensation on performance, continuously. The proper approach is to apply the right standard for the franchise's lifetime. Applicants propose the wrong standard, and discard it after a single finding of compliance. Ratepayers then will pay the higher rates forever, without performance promises.

The Applicants defer this self-serving treatment for five years, allowing the current Commissioners to delay the damage until their current terms expire. Applicants thus mate self-interest with cynicism. Their offspring requires rejection.

IV. The "Independent" Evaluator Will not be Independent

Q. Do you have comments on the evaluator's independence?

A. Yes. ITC would have its performance judged by an evaluator, to be chosen, jointly I assume, by the Entergy states and ITC. An evaluator is not "independent" if her selection can be vetoed by the entity being evaluated.

We already have an independent entity—a decisionmaker whose three members swear to be bound by law, to base their decisions on the facts without bias. That decisionmaker is the Mississippi Public Service Commission. If ITC trusts the Commission, then we need no other entity. If ITC does not trust the Commission, it should take its business elsewhere.

V. The Proposal Charges Ratepayers for Things They Never Bought

Q. Should the Commission be concerned about the appropriateness of some of the "benefits" ITC will count?

A. Yes. To justify its higher rates, ITC would count as “non-quantifiable benefits” economic development, jobs, community partnerships and reduced CO2 emissions. These are laudable goals, but I am informed by counsel that they are not ratepayer responsibilities under current law. (Other items in this category, such as “storm hardening” and increased capacity to serve load are ratepayer responsibilities, but ITC does not separate them out.) Ratepayers buy electric service; they do not invest in economic development, jobs, community partnerships, or emissions reduction. Many ratepayers no doubt pursue these other goals in their daily lives. ITC can do so as well, just not with ratepayer money.

VI. The Need to Investigate EMI Remains

Q. If the Commission rejects Applicants' proposal, what should it do next?

A. The Applicants have done us a service. They have acknowledged that compensation should depend on performance. This principle contrasts sharply with the typical formula rate, where the only questions are "What are the costs?" rather than "What is the performance?," or, more bluntly, "What will the Commission do for the utility?" rather than "What has the utility done for its customers?" As discussed in my Direct Testimony (at Part III), merely to reject this Application leaves questions unanswered; most importantly: "What performance should we expect of EMI?" and "How should we condition its compensation on that performance?" By addressing these questions in a separate investigation, the Commission will avoid ITC's error, of rewarding performance based on criteria unmoored from objective standards.

Q. Does this complete your Surrebuttal Testimony?

A. Yes.

STATE OF MARYLAND)

MONTGOMERY COUNTY)

SCOTT HEMPLING, being first duly sworn, deposes and says that the statements contained in the foregoing Surrebuttal Testimony of Scott Hempling to the Mississippi Public Service Commission in Docket 2012-UA-358 are true and correct to the best of his knowledge, information and belief.



Scott Hempling

Subscribed and sworn to before me this the 30th day of July 2013.



Notary Public

My Commission Expires: 03/31/2017

