

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Old Dominion Electric Cooperative
New Dominion Energy Cooperative

Docket Nos. EC05-1-000
EC05-1-001

OPINION NO. 491

ORDER AFFIRMING INITIAL DECISION

(Issued December 21, 2006)

1. This matter is before the Commission on exceptions to an Initial Decision involving whether the proposed reorganization and associated assignment of Old Dominion Electric Cooperative's (Old Dominion) jurisdictional wholesale power contracts to newly created New Dominion Energy Cooperative (New Dominion), which would then become the Member Cooperatives' full requirements power supplier,¹ would adversely affect rates.² The issues are whether Old Dominion's slight credit downgrade by one rating agency could raise rates, and, if so, whether the downgrade was due to the proposed transaction.³ We will affirm the Initial Decision's conclusion that it has not been shown that the credit downgrade could raise rates, as discussed below. Accordingly, we will approve the proposed transaction.

¹ Member Cooperatives include: A&N Electric Cooperative; BARC Electric Cooperative; Community Electric Cooperative; Choptank Electric Cooperative; Delaware Electric Cooperative; Mecklenburg Electric Cooperative; Northern Neck Electric Cooperative; Northern Virginia Electric Cooperative (NOVEC); Prince George Electric Cooperative; Rappahannock Electric Cooperative; Shenandoah Valley Electric Cooperative; and Southside Electric Cooperative.

² *Old Dominion Elec. Coop.*, 114 FERC ¶ 63,019 (2006) (Initial Decision).

³ *Old Dominion Elec. Coop.*, 110 FERC ¶ 61,274, at P 23 (2005) (Hearing Order).

I. Background

2. The transaction at issue here is described in detail in the Hearing Order. Briefly, Old Dominion and New Dominion (jointly, Applicants) filed an application under section 203 of the Federal Power Act (FPA)⁴ requesting Commission authorization to assign Old Dominion's wholesale power contracts with its twelve electric distribution cooperative members to New Dominion, which would then become the Member Cooperatives' full requirements power supplier. The Member Cooperatives own Old Dominion and are also its customers, purchasing substantially all of their power requirements from Old Dominion. All of Old Dominion's costs and expenses are recovered through charges to its Member Cooperatives. New Dominion will buy all of the output of Old Dominion's electric generation facilities and, as did Old Dominion, re-sell the power to the Member Cooperatives at cost-based rates. New Dominion also expects to make other wholesale electric power sales.⁵

3. The Commission reviewed the application to determine whether the proposed change would be "consistent with the public interest" under section 203(a) of the FPA.⁶ The Commission assessed (a) the effect on competition; (b) the effect on rates; and (c) the effect on regulation.⁷ The Commission concluded that the proposed transaction will not adversely affect competition or regulation.⁸

4. However, because Old Dominion's credit had been downgraded from A+ to A by one of the three rating services,⁹ the Commission set two issues for hearing: whether the

⁴ 16 U.S.C. § 824b (2000), *amended by* Energy Policy Act of 2005, Pub. L. No. 109-58, § 1289, 119 Stat. 594, 982-83 (2005) (EPAAct 2005). EPAAct 2005 did not become effective, however, until after this application was filed.

⁵ In a related proceeding, the Commission granted New Dominion authority to sell to third parties and Member Cooperatives at market-based rates. *Old Dominion Elec. Coop.*, 110 FERC ¶ 61,275 (2005). As part of the Settlement Agreement reached in that proceeding among all parties except NOVEC, Old Dominion will file to withdraw its market-based rate authority if the partial, contested settlement and the reorganization are approved by the Commission. Settlement Agreement § 3.05.

⁶ 16 U.S.C. § 824b(a) (2000).

⁷ *See Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595 (Dec. 30, 1996), FERC Stats. & Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997).

⁸ Hearing Order, 110 FERC ¶ 61,274 at P 13-14, 26.

⁹ The three rating services are: Standard & Poor's (S&P), Moody's, and Fitch.

credit downgrade could raise rates, and, if so, whether the downgrade was due to the proposed transaction.¹⁰ One of the Member Cooperatives, NOVEC, alleged that the credit rating was reduced in part because of the risk associated with Old Dominion's proposed restructuring. The Commission found that there was an issue of material fact as to whether the proposed restructuring would adversely affect rates.

II. Discussion

A. Initial Decision

5. With respect to whether Old Dominion's credit downgrade could raise rates, the Presiding Administrative Law Judge (Presiding Judge or ALJ) found that the record evidence, considered as a whole, did not show that Old Dominion's credit downgrade from A+ to A by one of three rating agencies is likely to affect rates charged to Old Dominion/New Dominion. The ALJ interpreted the Commission's Hearing Order to mean that the test is not whether it is possible that rates will be raised, since anything is possible, but whether there is a "reasonable probability" that the credit downgrade will have that effect.

6. The ALJ noted that it is uncontested that Old Dominion's credit downgrade has had no effect on rates as of the date of the Initial Decision. She examined the downgrade's likely effect on Old Dominion's rates with respect to future debt issuances. She found that Old Dominion's witnesses credibly testified that Old Dominion has no current plans to seek new financing in the bond markets. Moreover, the ALJ noted that Trial Staff witness Marina Kantor accepted the testimony of Old Dominion's witnesses as reasonable. Furthermore, the ALJ said that NOVEC failed to produce any substantial evidence showing that the Old Dominion Board has approved any future project that requires long-term financing; NOVEC's evidence merely showed that the Board has a number of possible projects under consideration. The ALJ found that Old Dominion's overall credit rating remains in the positive "A" category and that unless it is lowered again, there is no reason to assume that Old Dominion/New Dominion will be required to pay more for credit in the future.

B. Brief on Exceptions

7. NOVEC contends that Old Dominion's credit rating downgrade could result in increased rates to the Member Cooperatives. Credit ratings significantly affect the cost of debt. An increase to the cost of debt can lead to increased rates, and Old Dominion and New Dominion are highly likely to issue new debt.

¹⁰ *Id.* P 23 and Ordering Paragraph (A).

8. At the outset, NOVEC contends that section 203 of the FPA places on the applicant the burden of demonstrating that wholesale customers' rates will be adequately protected.¹¹ NOVEC concludes that Old Dominion thus carries the burden in this proceeding to demonstrate that the credit downgrade will not adversely affect Member Cooperatives' rates. The effect on future rates, as well as existing rates, must be evaluated.

9. With respect to whether the credit downgrade could raise rates, NOVEC contends that Old Dominion's credit ratings significantly affect the cost of debt. NOVEC cites testimony that a lower credit rating is likely to increase the interest on new debt and other testimony that credit ratings alone can directly affect the cost of debt.¹² NOVEC maintains that "every single witness recognized that credit ratings are inextricably linked [to] cost of debt."¹³ According to NOVEC, the record also demonstrates that the credit downgrade will have long-term effects. There is no record evidence demonstrating that the effects of the downgrade will have lessened by the time Old Dominion (as New Dominion) issues new debt.

10. NOVEC's witness Tifton Simmons, Jr. testified that, "all else being equal, a credit downgrade will surely result in higher long-term borrowing costs for the future."¹⁴ Moreover, NOVEC cites to testimony of Old Dominion witnesses Paul Neuhedel and Daniel Walker that "generally, lower ratings lead to high cost debt" and a higher cost of debt translates into higher rates.¹⁵ NOVEC states that no party has refuted this direct correlation between the cost of debt and Old Dominion's rates. Further, NOVEC contends that the representative spreads to treasuries on traded bonds, put forth by Old Dominion as evidence that the downgrade is not likely to affect rates,¹⁶ should be given no weight because (1) it is inadmissible hearsay and, even if it were admissible, (2) it only purports to estimate what Old Dominion's bonds would trade at if they were traded, which they are not.

¹¹ NOVEC Brief on Exceptions at 11 (citing *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111, at 31,914 (2000), *order on reh'g*, Order No. 642-A, 94 FERC ¶ 61,289 (2001)).

¹² *Id.* at 12 (citing, respectively, to NOVEC witness Simmons, Ex. NV-2 at 11:7-9, and Old Dominion witness Bowman, Tr. 435:12-14).

¹³ *Id.*

¹⁴ *Id.* at 16 (citing Ex. NV-1 at 13:27-28, 14:1-2; Ex. NV-2 at 11:7-10).

¹⁵ *Id.* (citing Tr. 332:2-3 (Neuhedel); 92:17-22 (Walker)).

¹⁶ Ex. ODC-6. This exhibit is a compilation of information provided by Banc of America Securities LLC (Banc of America) titled, "Secondary market representative spreads to treasuries," which is referred to as "representative price analysis" or "risk premium analysis." See ODC-1 at 19:1-8 (Walker) (explaining exhibit).

11. NOVEC next contends that Old Dominion and New Dominion are highly likely to issue new debt. It states that no witness could credibly argue that Old Dominion would not issue new debt in the near future. New Dominion has been granted authorization to guarantee up to \$1.5 billion of Old Dominion's debt, which is \$1.2 billion, thereby leaving \$300 million for new financings. NOVEC points out that, to meet Member Cooperatives' demand increases, Old Dominion has two options: (1) invest in new generation, which would require financing; or (2) increase reliance on purchased power, but such reliance was another factor behind the downgrade. Thus, either Old Dominion was not truthful when it stated that it did not plan on financing any new generation, or it is willing to face another credit downgrade due to increasing its reliance on the market for power supply.

C. Briefs Opposing Exceptions

12. Trial Staff says that the Initial Decision properly places the burden of proof on NOVEC. Focusing on the issue of cross-subsidization, Trial Staff states that NOVEC misconstrues the Commission's policy that the applicant must provide "assurances that the proposed transaction will not result in cross-subsidization or improper pledges or encumbrances of utility assets" or "if such results would occur, how those results are consistent with the public interest."¹⁷ Trial Staff explains that the benefits of any cross-subsidization between a third party and the Member Cooperatives would accrue to both New Dominion and the Member Cooperatives; cross-subsidization concerns in this proceeding are moot. Therefore, since the proposed transaction has no effect on the financial relationships and responsibilities of the interested parties, as they currently exist, NOVEC bears the burden of proving that the proposed reorganization fails to provide adequate rate protection.

13. Trial Staff maintains that the Initial Decision correctly finds that Old Dominion's credit rating downgrade will not affect the rates charged to the Member Cooperatives, quoting the Presiding Judge's determination that "[i]t is uncontested that Old Dominion's credit downgrade by S&P on August 17, 2004, had no effect upon its rates to date."¹⁸ Trial Staff noted that the ALJ accepted Old Dominion's unrebutted testimony that it had no plans to issue new debt.

14. Trial Staff argues that the Initial Decision considered the evidence about the relationship between Old Dominion's credit rating and its current cost of debt. It states

¹⁷ Trial Staff Brief Opposing Exceptions at 6-7 (citing *Transactions Subject to FPA Section 203*, Order No. 669, FERC Stats. & Regs. ¶ 31,200, at P 164 (2005), *order on reh'g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh'g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006)).

¹⁸ Trial Staff Brief Opposing Exceptions at 8 (quoting Initial Decision, 114 FERC ¶ 63,019 at P 32).

that NOVEC did not rebut the testimony of Old Dominion witness Walker that Old Dominion's existing debt cannot be affected by changes to Old Dominion's credit ratings.¹⁹ Trial Staff quotes witness Walker's explanation that most of Old Dominion's debt issuances bear interest at a fixed rate to maturity, and the one variable rate debt issuance resets in accordance with the lending entity's cost of funds, so these issuances are insulated from changes in Old Dominion's bond ratings.

15. Further, the three agencies' credit ratings for Old Dominion are more similar now than they were before the downgrade occurred; in Trial Staff witness Kantor's words, the "downgrade has most likely been observed by investors as realignment of the credit agencies' views, rather than a sign of [Old Dominion's] increased default potential, thereby leaving unaffected the present cost of debt to [Old Dominion]."²⁰ To highlight investors' perception, Trial Staff quotes witness Kantor, who notes that the risk premium analysis prepared by Banc of America "show[s] that the spreads were generally decreasing before the S&P downgrade occurred and continued to decrease after the downgrade."²¹ This indicates that investors perceived Old Dominion's credit risk after the downgrade as declining, rather than increasing.²²

16. Trial Staff further argues that the Initial Decision considered evidence as to whether an increase in the cost of debt would be likely to increase rates. It admits that there is an indirect correlation between the market cost of debt and Old Dominion's rates. However, unless Old Dominion's lowered credit rating causes Old Dominion's actual expenses to increase, and, accordingly, Old Dominion files to change its rates, there is no connection between the credit downgrade and the rates Old Dominion charges to NOVEC.

17. Trial Staff next argues that the Initial Decision properly allowed and relied upon evidence concerning the effect of the credit downgrade on the trading of Old Dominion's bonds. With respect to risk premium analysis prepared by Banc of America, the ALJ correctly found that the issue is not whether it is hearsay, since hearsay is admissible in administrative proceedings. Rather the issue is whether the evidence is relevant.²³ Trial Staff states that the Commission should affirm the ALJ's ruling that the risk premium analysis is "quite relevant."²⁴

¹⁹ *Id.* at 10 (citing Ex. ODC-1 at 18).

²⁰ *Id.* at 11 (citing Ex. S-1 at 9:10-13).

²¹ *Id.* at 12 (citing Ex. S-1 at 8:4-5).

²² *Id.* (citing Ex. S-1 at 8:5-7).

²³ *Id.* at 14 (citing Tr. 59:5-9, 291:9-10).

²⁴ *Id.* (citing Rule 509, 18 C.F.R. § 385.509; *Entergy Services Inc.*, 109 FERC ¶ 61,108, at P 7-8, 11 (2004)).

18. Next, Trial Staff argues that NOVEC failed to rebut the testimony that Old Dominion does not plan to issue new debt in the near future. NOVEC's contentions that Old Dominion *could* issue new debt do not demonstrate that Old Dominion is *likely* to issue new debt. Trial Staff cites testimony that New Dominion's conditional approval to issue new debt was obtained only to allow New Dominion to guarantee the existing debt obligations of Old Dominion, not to issue new debt or finance new projects.²⁵

19. Trial Staff also argues that the Initial Decision correctly concludes that the effect of the credit downgrade on future financings is speculative. Trial Staff states that even NOVEC witness Simmons admitted that he did not know when Old Dominion might issue new debt or what Old Dominion's credit rating will be if that occurs.²⁶

20. Applicants, in their brief opposing exceptions, maintain that the ALJ correctly found that there is no substantial evidence that the credit downgrade will result in higher rates. The Initial Decision does not improperly shift the burden of proof to NOVEC. Applicants concede that, as a general matter, the initial burden rests on the proponent. However, once the party having the burden of proof on an issue has established a *prima facie* case as to that issue, the burden shifts to the other side.²⁷ Applicants contend that they have proffered the substantial evidence necessary to make the case in favor of the application and that the evidentiary burden thus shifted to NOVEC to go forward with its evidence of any insufficiency in the case.

21. Applicants explain that the Commission's query as to whether the downgrade "could raise rates" calls for a reasonable probability of rates increasing, or, quoting the Initial Decision, "not whether it is *possible* rates will be raised, since anything is possible in the uncertain future, but whether there is a *reasonable probability* that the credit downgrade will have that effect."²⁸ Applicants contend that the statements NOVEC quotes from Applicants' and Trial Staff's witnesses, which acknowledge that the downgrade could have some effect, were using the term "could" in the sense of it being "possible" or "conceivable" that the downgrade could affect rates. Acknowledging that the downgrade could raise rates does not establish a reasonable probability that the downgrade will have such an effect. In short, what effect, if any, the downgrade could have on Old Dominion debt is "simply too speculative."

²⁵ *Id.* at 16 (citing Ex. ODC-12 at 2:1-4; 16).

²⁶ *Id.* at 17 (citing Tr. 389:4-11).

²⁷ Applicants Brief Opposing Exceptions at 11 (citing *Port Petroleum, Inc.*, 47 FERC ¶ 63,033 (1989); *Lantern Petroleum Corp.*, 47 FERC ¶ 61,024 (1989)).

²⁸ *Id.* at 13 (quoting Initial Decision, 114 FERC ¶ 63,019 at P 31 (emphasis in original)).

22. Applicants address NOVEC's challenge to the admission and use of the Banc of America representative price analysis. They concede that the representative price analysis might not be a good indicator of the likely cost of debt in a future filing, but that was not the primary purpose for which the representative price analysis was offered; the purpose was not to quantify "what Old Dominion's bond would trade at." Rather, Applicants explain, the primary purpose of this evidence was to show that Banc of America did not alter the companies in Old Dominion's "peer group" (*i.e.*, the group of companies with ratings and business profiles that Banc of America considered comparable to Old Dominion) after S&P issued its downgrade. This evidence indicates that Banc of America's evaluation of Old Dominion's credit standing did not change. Furthermore, even if it was considered hearsay, Applicants state that it could be considered in an administrative hearing and given appropriate weight. Finally, Applicants remark that there is little indication that this evidence played any substantive or material role in the Presiding Judge's Initial Decision. Thus, if there was any error in admitting that evidence, it was harmless error.

23. Applicants take issue with NOVEC's argument that the Initial Decision mistakenly concludes that Old Dominion's overall credit rating will not affect its cost of debt because the other credit rating agencies have not lowered Old Dominion's rating. Quoting the Initial Decision, Applicants explain that this is not the Initial Decision's finding; rather, the Initial Decision states that unless the rating is lowered again, there is no reason to assume that Old Dominion's credit costs will increase.²⁹ Applicants note that all of Old Dominion's ratings are still in the positive "A" category.

24. Applicants say that NOVEC's claims regarding future Old Dominion financings are unsupported speculation.³⁰ They maintain that Old Dominion has no "current" plans for projects and thus no current plan for new financing. In order to establish that the downgrade could affect future rates, the record would have to include substantial evidence that there will be future Old Dominion financings; the ALJ found that NOVEC had failed to produce such evidence.³¹ Moreover, Applicants contend that everyone involved understood that Old Dominion had no "current," Board of Director-approved plan to embark on a new project and thus no plan to arrange new financing. NOVEC's evidence, Applicants explain, merely showed that the Board has a number of possible projects under consideration.³² Applicants dismiss NOVEC's attempt to draw an inference from the \$300 million New Dominion was authorized to guarantee beyond Old Dominion's current debt, because (1) NOVEC could have questioned the significance (or lack thereof) of this on

²⁹ *Id.* at 22 (quoting Initial Decision, 114 FERC ¶ 63,019 at P 34).

³⁰ *Id.* at 29.

³¹ *Id.* at 27.

³² *See id.* at 28 (citing Tr. 263:6-11 (Walker)).

cross-examination—but did not—and (2) in any case, Old Dominion would have to seek Commission approval to issue any new debt to be guaranteed by New Dominion. While Applicants admit that witness John Bowman, Chairman of the Board of Old Dominion, said that Old Dominion is interested in extending its wholesale power contracts, Applicants contend that an “interest in” something does not connote “active pursuit.”

D. Commission Determination

25. We will adopt the fundamental reasoning of the ALJ, as discussed below. At the outset, we agree that the initial burden to establish a *prima facie* case and the ultimate burden of persuasion as to the issues set for hearing is on Applicants. Having examined the record evidence, we find that Old Dominion has carried its initial burden to show that the proposed transaction will be consistent with the public interest. The burden of going forward shifted to NOVEC with respect to these issues to demonstrate any insufficiency in Applicants’ case.³³ In any event, any party making an argument has the responsibility to support its argument with substantial evidence.³⁴

26. With respect to whether Old Dominion’s credit downgrade could raise rates, as an initial matter, we affirm the ALJ’s reading of “could raise rates” in our Hearing Order to mean that there is a reasonable probability that the downgrade will raise rates. An applicant does not have to show beyond a reasonable doubt that a proposed transaction would not result in higher rates, but rather that it is not reasonably probable that higher rates will result. We have examined the record evidence and find that it is unlikely that the credit downgrade (even if caused by the proposed reorganization) is significant enough to lead to higher rates. Old Dominion’s credit downgrade from A+ to A by one of three credit rating agencies is simply a realignment of the credit agencies’ ratings, since S&P’s rating after the downgrade resembles that of Moody’s and Fitch.³⁵ Moreover, even after the downgrade, Old Dominion’s credit ratings remain within the same, relatively high, grade.

³³ See *Union Elec. Co.*, 81 FERC ¶ 61,011, at 61,061 (1997) (acknowledging that applicants have the burden of proving ratepayer protection and that intervenors bear the burden of going forward with sufficient evidence to raise substantial doubt about such protection); see also *id.* at 61,065 (“Under section 203 of the FPA, applicants must show that their merger taken as a whole ‘will be consistent with the public interest.’”); cf. *AEP Mktg. Inc.*, 108 FERC ¶ 61,026, at P 29 (2004) (discussing similar shift of burden from applicant to intervenor under FPA section 205).

³⁴ *Gustavus Elec. Co.*, 111 FERC ¶61,424 (2005).

³⁵ Ex. S-1 at 9 (Kantor); Ex. ODC-14 at 9-10 (Neuhedel); see also Ex. ODC-14 at 8-9 (investors view such credit ratings in the aggregate).

27. In response to Trial Staff, we note that the question of cross-subsidization is not relevant in this proceeding. The contention that, under the proposed reorganization, the Member Cooperatives would share the benefits of any cross-subsidization, and thus, that the proposed transaction has no effect upon the financial relationships and responsibilities of the interested parties as they currently exist, is a distinct question from whether there is an effect on rates due to the credit downgrade. Moreover, the language that Trial Staff quotes with respect to cross-subsidization is not applicable because it comes from EPAAct 2005, which, as noted above, did not become effective until after the application was filed.³⁶

28. With respect to the admissibility of evidence, “[t]he presiding officer should exclude from evidence any irrelevant, immaterial, or unduly repetitious material.”³⁷ While it does not appear that the Banc of America representative price analysis played any substantial or material role in the ALJ’s decision, nor does it in our ruling, we find that such evidence is relevant. As Old Dominion states, the evidence was proffered by Old Dominion to show that Banc of America did not alter the group of companies with ratings and business profiles considered comparable to Old Dominion after the downgrade, not to provide an estimate of the price at which Old Dominion’s bonds would trade.

29. Having examined the evidentiary record, we find that the record supports the conclusion that the credit downgrade will not raise rates. We do not need to address whether the credit downgrade was due to the proposed transaction (i.e., the reorganization).

30. Accordingly, we will affirm the result reached in the Initial Decision.

The Commission orders:

(A) The findings and conclusions in the Initial Decision are hereby affirmed, as discussed in the body of this order.

³⁶ Trial Staff Brief Opposing Exceptions at 6-7. *See supra* notes 4, 17 and accompanying text.

³⁷ Rule 509, 18 C.F.R. § 385.509 (2006).

(B) Old Dominion's proposed transaction is hereby approved, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.