

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Joint Application of)
HYDRO ONE LIMITED (acting through its) DOCKET U-170970
indirect subsidiary, Olympus Equity LLC))
)
And)
)
AVISTA CORPORATION)
For an Order Authorizing Proposed)
Transaction.)
_____)

**RESPONSE TESTIMONY OF DR. MARC M. HELLMAN
ON BEHALF OF THE
ALLIANCE OF WESTERN ENERGY CONSUMERS**

October 4, 2018

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Exhibit MMH-3 – Hydro One Responses to AWEC Data Requests 108 and 110

1 **I. INTRODUCTION AND SUMMARY**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. Dr. Marc M. Hellman. My business address is 2760 Eagle Eye Ave. NW, Salem,
4 Oregon, 97304.

5 **Q. ARE YOU THE SAME WITNESS WHO PREVIOUSLY PROVIDED**
6 **TESTIMONY IN THIS DOCKET ON BEHALF OF AWEC?**

7 A. Yes.

8 **Q. WHAT IS THE PURPOSE OF THIS SUPPLEMENTAL TESTIMONY?**

9 A. The purpose of this supplemental testimony is to: a) provide analysis and thoughts on the
10 recent events impacting Hydro One’s executive management; and b) express AWEC’s
11 continued support for the settlement terms presented to the Washington Utilities and
12 Transportation Commission (“Commission”) and admitted into evidence at its May 22,
13 2018, Settlement Hearing, as supplemented through additional commitments the
14 Applicants have made in their supplemental testimony and through discussions with the
15 parties in this case.

16 **Q. DID YOU PREPARE ANY EXHIBITS TO YOUR TESTIMONY?**

17 A. Yes. AWEC Exhibit MMH-3 attached to this testimony contains copies of Hydro One
18 responses to AWEC Data Requests 108 and 110.

19 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

20 A. AWEC continues to support Hydro One’s acquisition of Avista. This support is
21 contingent upon the Commission’s adoption of the commitments contained in the initial
22 All-Party Settlement, the additional commitment related to Avista employee
23 compensation the Applicants proposed in their supplemental testimony (discussed

1 below), and the other language provisions the Applicants have agreed to through further
2 discussions with the parties to this case. These other commitments can be found in Staff
3 Exhibit CRM-2.

4 II. ANALYSIS OF RECENT EVENTS

5 **Q. PLEASE DESCRIBE YOUR THOUGHTS ON THE RECENT EVENTS THAT**
6 **TRIGGERED FURTHER COMMISSION REVIEW OF HYDRO ONE'S**
7 **PROPOSED PURCHASE OF AVISTA.**

8 A. As noted in the testimony of Hydro One witness James D. Scarlett, Exhibit JDS-1T, a
9 new Premier of Ontario was elected, Doug Ford, whose campaign included a promise to
10 take certain actions affecting Hydro One. As a consequence of Doug Ford's victory in
11 the election, the Hydro One CEO and Board of Directors resigned and have been
12 replaced. The new Board will essentially be confirmed at Hydro One's 2019 annual
13 shareholder meeting. A new acting CEO is in place pending the selection of a permanent
14 CEO.

15 **Q. ARE THERE OTHER ACTIONS DOUG FORD CAMPAIGNED ON THAT**
16 **AFFECT HYDRO ONE AS WELL?**

17 A. Yes. Doug Ford also campaigned on significantly reducing the salaries of the Hydro One
18 CEO and executives as well as reducing the rates charged to Hydro One customers (at
19 least those residing in Canada.)

20 **Q. DID THE PROVINCE FOLLOW ITS GOVERNANCE AGREEMENT AND THE**
21 **STEPS SPECIFIED THEREIN WHEN IT REMOVED THE ENTIRE BOARD?**

22 A. Not precisely. The steps are discussed and provided in Exhibit JDS-1T, pages three
23 through five. Pages five through seven explain that an agreement was reached where the

1 entire Hydro One Board resigned without going through the steps laid out in Section 4.7
2 of the Governance Agreement.

3 **Q. DID THE PROVINCE’S ACTIONS RAISE ADDITIONAL CONCERNS FOR**
4 **AWEC?**

5 A. To some extent, yes. AWEC always understood that the true “independence” of Hydro
6 One as a new privately-owned company was questionable. However, AWEC may not
7 have fully appreciated the degree of control the Province continues to exert over Hydro
8 One. It appears that the threat of legislation and the ability to take unilateral action to
9 remove the entire Board can cause Hydro One leadership to enter into voluntary
10 agreements to do so, as desired by the Province.

11 **Q. GIVEN THESE RECENT EVENTS, HAS HYDRO ONE PROPOSED**
12 **ADDITIONAL COMMITMENTS TO ENSURE AVISTA HAS ADDITIONAL**
13 **PROTECTION FROM THE POLITICAL VAGARIES OF THE PROVINCE?**

14 A. Yes. Exhibit JDS-1T, beginning on page 25, includes a new commitment to ensure that
15 compensation for Avista employees is market-based and set exclusively by the Avista
16 Board. In response to AWEC Data Request 110, attached as Exhibit MMH-3, Hydro
17 One confirmed that this commitment extended to the Avista CEO.

18 **Q. WHAT PROTECTION DOES THIS NEW COMMITMENT PROVIDE?**

19 A. Having the ability to offer market compensation provides Avista a greater likelihood to
20 find the best candidates to fill executive positions. It is possible to find excellent staff at
21 less than market pay rates, but Avista is much more likely to get more qualified
22 candidates to consider at market-based rates. This is standard demand and supply
23 economics. To better ensure that Avista has well-qualified and high-performing

1 executive management, for the benefit of both its investors and customers, offering
2 market pay is a key principle.

3 **Q. DID THE APPLICANTS MAKE ANY OTHER PROPOSALS IN RESPONSE TO**
4 **THE RECENT EVENTS IN ONTARIO?**

5 A. Yes. They originally proposed to modify the Delegation of Authority between Hydro
6 One and Avista with respect to the composition of the Avista Board of Directors.
7 Specifically, the Delegation of Authority (and Commitment 3 in the Stipulation) provides
8 that the Avista Board will be composed of nine members, four of which are designated by
9 Avista, two of which are executives of Hydro One or its subsidiaries, and three of which
10 are independent directors from the Pacific Northwest. Avista always has the ability to
11 replace the four Avista directors, but Hydro One has the exclusive ability to replace the
12 independent directors. Further, Hydro One has the ability to fill the independent
13 directors' seats with its own executives for a six-month period while it identifies
14 permanent replacements. This raises the possibility that all three independent directors
15 could resign or be removed simultaneously and replaced with Hydro One executives,
16 meaning that such executives would fill five of the nine Avista Board seats. The
17 Applicants have proposed to eliminate Hydro One's ability to replace the independent
18 directors with its own executives for this six-month period if Ontario takes some action
19 that would result in the Province appointing a majority of the Hydro One Board of
20 Directors.

1 **Q. WHAT WAS THE APPLICANTS' RATIONALE FOR PROPOSING THIS**
2 **CHANGE TO THE DELEGATION OF AUTHORITY?**

3 A. Mr. Scarlett testifies that this change "is designed to protect the independence of the
4 Avista board in the event that the Province takes some action in the future to control a
5 majority of the Hydro One Board."^{1/}

6 **Q. ARE THE RECENT EVENTS IN ONTARIO AN EXAMPLE OF THE**
7 **PROVINCE TAKING AN ACTION TO CONTROL A MAJORITY OF THE**
8 **HYDRO ONE BOARD?**

9 A. Not according to Hydro One. In response to AWEC Data Request 108, a copy of which
10 is included Exhibit MMH-3, Hydro One confirmed that, despite forcing the entire Hydro
11 One Board to resign, Ontario does not control a majority of the new Hydro One board
12 because it is only allowed to nominate 40% of the directors under the Governance
13 Agreement between Ontario and Hydro One. Consequently, the only circumstances in
14 which Hydro One's proposed changes to the Delegation of Authority between it and
15 Avista would come into effect is if Ontario and Hydro One mutually agreed to modify the
16 Governance Agreement or if Ontario unilaterally passed legislation to modify this
17 agreement.

18 **Q. WOULD IT BE REASONABLE TO CONCLUDE THAT ONTARIO**
19 **CURRENTLY EXERCISES EFFECTIVE CONTROL OVER HYDRO ONE**
20 **DESPITE ONLY HAVING THE ABILITY TO NOMINATE 40% OF THE**
21 **HYDRO ONE DIRECTORS?**

22 A. Yes. While the previous Board resigned in lieu of being removed, Section 4.7 of the
23 Governance Agreement (Exh. MMS-5) continues to give Ontario the unilateral right to
24 remove the entire Hydro One Board anytime the Province wants. Therefore, it would

^{1/} Exh. JDS-1T at 27:4-6.

1 seem that one could reasonably conclude that a majority of Hydro One Directors could
2 not be installed over Ontario's objections, giving the Province effective control of Hydro
3 One. I would note, however, that Hydro One's response to AWEC Data Request 108,
4 subpart c, indicates that it does not agree with this position.

5 **Q. DESPITE THIS DISAGREEMENT, HAVE THE APPLICANTS AGREED TO**
6 **ADDRESS THIS CONCERN ANYWAY?**

7 A. Yes. As shown in Staff Exhibit CRM-2 at page 5, the Applicants have agreed to further
8 modifications to the Delegation of Authority. These modifications ensure that employees
9 or executives of Hydro One or its subsidiaries cannot fill a majority of the Avista Board
10 at any time and under any circumstances. AWEC supports this addition to the Delegation
11 of Authority because it further insulates Avista from potential interference from Ontario.

12 **III. CONTINUED SUPPORT FOR MERGER**

13 **Q. GIVEN THE ADDITIONAL COMMITMENTS THE APPLICANTS HAVE**
14 **MADE, DOES AWEC CONTINUE TO SUPPORT THE MERGER?**

15 A. Yes. While the recent events in Ontario have illuminated the degree of control the
16 Province continues to exercise over Hydro One, AWEC does not consider these events to
17 be an intervening circumstance that materially impacts the transaction with respect to
18 Avista's customers, particularly with the additional commitments the Applicants have
19 made.

20 As noted above, at least with respect to AWEC, the possibility that the Hydro One
21 CEO might change, or that the Province might influence activities at Hydro One, was
22 anticipated. An owner with forty-percent-plus voting-rights ownership of a company,
23 even without the rights the Province possesses, has the ability to exercise significant

1 influence on a company if the large owner decides to take an active role in company
2 management or direction. In this instant case, the largest shareholder is a political entity
3 that is responsive to its voters.

4 There are risks with all mergers and new ownership. That is the basis for the
5 ring-fencing, rate credits and all of the other commitments: to address and mitigate risks,
6 and to provide benefits to Avista's customers, in part, to offset risks that cannot be fully
7 mitigated. Typically, we do not see the risks come to fruition for several years, if ever,
8 but that is not the case here, as the risks have been observed even before the transaction is
9 closed. Yet, even if the Commission determines that the entity with ultimate control over
10 Avista is Hydro One or is Ontario, the ring-fencing and governance commitments in the
11 All-Party Settlement are no less effective. For instance, Avista must continue to adhere
12 to the safety and reliability metrics the Applicants have agreed to (Commitment 15); the
13 Applicants cannot flow transaction costs through to customers (Commitment 18); Avista
14 must maintain separate books and records (Commitment 22) and is prohibited from cross-
15 subsidizing other affiliates of Hydro One (Commitment 24); and it is prohibited from
16 reducing the equity level in its capital structure below 44% (Commitment 26). Further,
17 the Commission continues to have ultimate regulatory authority over Avista. Thus, even
18 if Ontario attempted to take an action through Hydro One that is against the public
19 interest and would harm Avista's customers, the Commission continues to have its
20 statutory authority to protect Avista's customers, including the ability to require remedial
21 action as needed. In other words, even if one were to conclude that it is really Ontario
22 that will be Avista's ultimate parent, that does not change the protections in the All-Party

1 Settlement, as supplemented through additional discussion with the Applicants, as they
2 relate to Avista and its customers.

3 **Q. DOES THAT CONCLUDE YOUR TESTIMONY?**

4 A. Yes.