

**Exh. CRM-1T
Docket U-170970
Witness: Chris R. McGuire**

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

**In the Matter of the Joint Application of
Hydro One Limited and Avista
Corporation for an Order Authorizing
Proposed Transaction**

DOCKET U-170970

TESTIMONY OF

Chris R. McGuire

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

Commission Staff Consideration of Recent Events in Ontario

October 4, 2018

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1 **I. INTRODUCTION**

2

3 **Q. Please state your name, current position and business address.**

4 A. My name is Chris R. McGuire. I am Assistant Director of Energy Regulation in the
5 Regulatory Services Division of the Washington Utilities and Transportation
6 Commission (Commission). My business address is the Richard Hemstad Building, 1300
7 S. Evergreen Park Drive S.W., Olympia, Washington 98504.

8

9 **Q. Did you submit testimony in this proceeding?**

10 A. I adopted the testimony and exhibits in support of settlement of Staff witness Mr.
11 Christopher S. Hancock (Exhibits CSH-1T to CSH-7) at the Settlement Hearing held
12 before the Commission on May 22, 2018. I also testified orally at that hearing.

13

14 **II. SCOPE AND SUMMARY OF TESTIMONY**

15

16 **Q. What is the scope of your testimony in this proceeding?**

17 A. In this testimony I discuss Staff's response to the Province of Ontario's intervention with
18 respect to the board of directors at Hydro One. In particular, I contemplate whether these
19 recent politically motivated events in Ontario present new risks to Avista and its
20 ratepayers that the Settlement Stipulation and associated commitments do not adequately
21 protect against.

1 **Q. Please summarize your testimony.**

2 A. Staff concludes that Province of Ontario's intervention with respect to the board of
3 directors at Hydro One does not present material risks to Avista and its ratepayers. Given
4 1) protective governance agreements, 2) strong settlement commitments, including ring-
5 fencing provisions, and 3) Commission jurisdiction over decisions regarding Avista,
6 Avista and its ratepayers are insulated from actions that the Province of Ontario may
7 take. This is true even if the Province were to gain majority or complete control of Hydro
8 One.

9 The demonstrated willingness of the Province to exercise powers as laid out in
10 Hydro One's Governance Agreement is an interesting turn of events, but a willingness to
11 exercise those powers has little impact on Staff's assessment of the proposed transaction.

12 Nevertheless, over the past several weeks Staff and other parties have engaged the
13 Applicants in discussions with the goal of strengthening protections in the Settlement
14 Stipulation. Those discussions resulted in new and revised conditions and a modification
15 to Clause 2 of the Delegation of Authority. Staff supports these revisions, and remains
16 fully supportive of the Settlement.

17

18 **Q. Have you prepared any exhibits in support of your testimony?**

19 A. Yes. I have included as Exhibit CRM-2 the list of updated terms of the Settlement
20 Stipulation, including new and revised commitments, and a modification to Clause 2 of
21 the Delegation of Authority.

22

23

1 **III. STAFF RESPONSE TO THE OUSTER OF HYDRO ONE’S BOARD**

2
3 **A. Introduction**

4
5 **Q. Please briefly describe the salient context of the additional process in this**
6 **proceeding.**

7 A. This proceeding concerns the acquisition of Avista Corporation (Avista), an investor-
8 owned public service company subject to the jurisdiction of the Commission. Through
9 the acquisition of all of the outstanding common stock of Avista, Avista would become
10 an indirect, wholly-owned subsidiary of Hydro One Limited (Hydro One). The Province
11 of Ontario, with its ownership of 47.4 percent of Hydro One’s outstanding stock (diluted
12 to 42.3 percent on closing), is Hydro One’s largest shareholder. As is the case with any
13 major shareholder, the Province of Ontario has certain authorities with respect to Hydro
14 One’s board of directors.

15
16 **Q. Please briefly describe the circumstances that gave rise to the Commission**
17 **reopening the record and conducting additional process in this proceeding.**

18 A. On July 11, 2018, Hydro One entered into an agreement with the Province of Ontario
19 whereby the entire board of Hydro One would resign and Hydro One’s CEO, Mayo
20 Schmidt would retire. The Commission found good cause for extending the time for
21 additional process and deliberation given that the Province of Ontario has shown an
22 ability and willingness to disrupt the executive management and board of directors at
23 Hydro One.

1 **Q. In Staff's view, what is the purpose of additional review of the proposed**
2 **acquisition?**

3 A. Staff sees the purpose of this additional review as twofold:

- 4 1. To evaluate whether the removal, itself, of the board should be viewed as
5 a material concern for this transaction; and
- 6 2. To evaluate whether the demonstrated willingness of the Province of
7 Ontario to interfere in the affairs of Hydro One presents material risks to
8 Avista and its ratepayers.

9 Staff's review has necessarily included reevaluating the commitments in the
10 Settlement Stipulation, particularly as they relate to the threat of Provincial interference,
11 given that Provincial interference has been shown to be a very real possibility.

12

13 **B. Removal and Replacement of Hydro One's Board of Directors**

14

15 **Q. Does the removal of Hydro One's board cause Staff to change its view with respect**
16 **to the acquisition, or to question its support of the settlement?**

17 A. No. If parties, including Staff, were to be concerned about the potential consequences of
18 the Province of Ontario's ability to force resignation of Hydro One's entire board, those
19 parties would have objected to this ability prior to entering into the settlement. It has been
20 clear throughout this proceeding that the Province had such authority and yet all parties,
21 including Staff, entered into settlement.

22

1 **Q. Please explain what you mean by your statement “it has been clear throughout this**
2 **proceeding that the Province had such authority.”**

3 A. The Governance Agreement between Hydro One and Her Majesty the Queen in Right of
4 Ontario was introduced by the Applicants as part of the record in this proceeding (see
5 Hydro One Exh. MMS-5). Section 4.7 of that Governance Agreement describes the
6 procedures the Province must follow if it is to remove the board. That the Province had
7 the power to effect the removal of the entire board, which it acted on in July, was no new
8 revelation.

9 The fact that the Province effected this removal (albeit without the need to
10 formally invoke the procedures in Section 4.7 of the Governance Agreement) was
11 unexpected, however, and spurred Staff to reexamine the relationship between the
12 Province and Hydro One. Staff’s conclusion is that the Province did not exercise power
13 beyond those powers Staff already understood the Province to possess.

14

15 **Q. Do the Province’s powers with respect to Hydro One’s board pose too much risk to**
16 **Avista?**

17 A. No. Although the Province can force the removal of the entire Hydro board, and has, it
18 only has authority to nominate 40 percent of the board’s new directors. The remaining
19 directors must be independent of Hydro One and the Province.

20 Moreover, and most significantly, even if the Province legislated additional
21 authority for itself over Hydro One, whatever power the Province may exercise over
22 Hydro One or its board of directors does not extend to Avista’s board of directors due to
23 the construction of the Avista board. We are tasked with assessing whether Avista or its

1 ratepayers are negatively affected by the Province's limited authority over the Hydro One
2 board, or by the fact that the board was indeed replaced, and Staff's conclusion is that
3 they are not.

4
5 **Q. Does Staff have any reason to believe that the new board is incompetent or may be**
6 **unduly influenced by the Province?**

7 A. No. The new board of directors appears entirely competent to Staff. Further, the process
8 by which a new board is selected does not allow for the Province to take control of the
9 board or to have executive authority over the composition of the new board.

10 Moreover, again, the actions of the Province are with respect to Hydro One's
11 board and not Avista's board. The Province, effectively, has zero control over Avista's
12 board of directors.

13
14 **Q. You assert that Avista's board of directors is entirely shielded from Provincial**
15 **influence. Please explain how that is the case given that Hydro One would be the**
16 **sole owner of Avista, and the Province is the largest shareholder of Hydro One.**

17 A. As mentioned above, although the Province may force the resignation of the entire Hydro
18 One board, the Province may only nominate 40 percent of the new board members. A
19 single shareholder cannot enact an agenda with a minority of the board votes.

20 Even if the Province were to control 100 percent of Hydro One's board, and even
21 if the Province were to attempt to infect Avista's board of directors (and with the
22 assumption that the Province were a bad actor or had malicious intent), the governance
23 documents with respect to Avista's board of directors deprives the Province of an ability

1 to do harm. Under the proposed arrangement, Hydro One will nominate its own
2 employees for only two of Avista's nine board members while Avista will nominate four
3 of the nine. The remaining three must be independent consistent with New York Stock
4 Exchange guidelines. Further, as discussed in Section IV, below, amendments to the
5 Delegation of Authority create a failsafe mechanism protecting Avista in the event of a
6 Provincial takeover of the Hydro One board – if the Province were to gain control of
7 Hydro One, Hydro One would automatically lose its ability to replace, even temporarily,
8 any of the independent board members with its own executives or employees.

9 In short, both Hydro One's and Avista's governance agreements, independently,
10 provide substantial insulation from Provincial influence on business operations. The
11 Province would not have any direct control over Avista, and the two governance
12 agreements in combination protect Avista from the effects of any influence the Province
13 may be able to exercise over Hydro One.

14
15 **C. Provincial Meddling, More Generally**

16
17 **Q. In Section III(a), above, you mention another purpose of this additional review is to**
18 **evaluate whether the demonstrated willingness of the Province of Ontario to**
19 **interfere at all in the affairs of Hydro One creates a new, material risk to Avista and**
20 **its ratepayers. Please describe what you mean.**

21 **A.** To Staff, the most interesting part of the recent Provincial interference is not that the
22 board was replaced, it's that the Province interfered at all. During discussions between

1 the Applicants and the Commissioners at the Settlement Hearing, the likelihood of
2 Provincial interference was represented by the Applicants as exceedingly remote.

3 If support for this transaction had rested on taking that representation at face
4 value, then recent intervention by the Province would have eroded that support.

5 Therefore, it's important to give parties a chance to revisit their support in light of these
6 changed circumstances, given that Provincial interference now cannot be represented or
7 accepted as a non-existent risk.

8
9 **Q. Does Staff view the risk of Provincial influence on Hydro One as a material risk to**
10 **Avista and its ratepayers?**

11 A. No. Avista and its ratepayers are shielded from the risk of Provincial interference by
12 numerous layers of protections. Those protections have been solidified through 1) power-
13 limiting governance agreements, 2) commitments developed and agreed to through this
14 proceeding, and 3) Commission jurisdiction over Avista's Washington operations.

15
16 **Q. Please comment on the protections afforded by power-limiting governance**
17 **agreements.**

18 A. I discuss these protections in more detail, above. In summary, Hydro One's Governance
19 Agreement limits Provincial control of Hydro One's board, while Avista's governance
20 documents prevent Hydro One control of Avista's board. The combination of the two
21 governance documents provides substantial protection of Avista's board from Provincial
22 interference.

1 **Q. Please describe how commitments developed and agreed to through this proceeding**
2 **protect Avista and its ratepayers from Provincial influence.**

3 A. First, I should note, the commitments developed through settlement negotiations largely
4 pertain to the relationship between Avista and Hydro One, and do not specifically
5 contemplate protection from Provincial influence.

6 In order for the Province to have any meaningful degree of influence over Hydro
7 One's relationship with Avista, the Province would need to first gain control of Hydro
8 One. So, for the sake of considering whether the Settlement Stipulation and agreed-upon
9 commitments protect Avista and its ratepayers from Provincial influence, let us assume
10 for the moment that the Province manages to wrest complete control from Hydro One.

11 The Settlement Stipulation was negotiated, in part, to address the risk associated
12 with having a single shareholder and, more to the point, the risk that that shareholder
13 sacrifices Avista's financial and operational health for its own profit. So, in a very real
14 sense the settlement has already contemplated a bad actor. As a result, it does not matter
15 whether the Province wrests control from Hydro One. The protections embedded in the
16 settlement remain very strong regardless of who controls Hydro One, and regardless of
17 how malevolent that entity is.

18 Regardless of who owns and controls Hydro One, the settlement establishes
19 Avista as a functionally independent, ring-fenced company with independent
20 management and diverse board of directors. Staff remains very confident that the
21 combination of Avista's diverse board of directors (only two of which would be Hydro
22 One executives) and commitments established through settlement provide ample
23 protection from a potential bad actor and promote the ongoing financial integrity of the

1 company. The parties negotiated those commitments very thoughtfully and deliberately,
2 and the recent actions of the Province do not erode Staff's assessment of the strength of
3 those commitments.

4
5 **Q. Please briefly summarize the commitments that insulate Avista from potentially**
6 **detrimental interference from Hydro One.**

7 A. The Governance Commitments seek to maintain Avista's current executive management
8 and ensure a diverse board of directors, with Hydro One's control of the board limited to
9 two of its own employees. The Business Operations Commitments seek to maintain
10 Avista's current control of its own operations. The Regulatory Commitments ensure that
11 Avista and its holding company will comply with all applicable laws and all existing
12 Commission orders. The Financial Integrity Commitments ensure that earnings cannot
13 flow upward to the parent company (i.e., the shareholder) unless Avista remains
14 financially healthy, as demonstrated by a number of objective measures. The Ring-
15 Fencing commitments ensure that Avista is shielded from financial risks of the parent
16 company, including bankruptcy, and prohibit Avista from making loans to the parent or
17 pledging assets to the parent.

18
19 **Q. Are these Commitments legally enforceable?**

20 A. Yes. Should the Commission adopt the Settlement Stipulation, the Commission's final
21 order can be enforced in the Washington courts. As discussed below, the revised
22 regulatory commitments provide that Hydro One as well as Avista and its direct parent,
23 are subject to the jurisdiction of Washington courts for purposes of enforcement of the

1 Commission's order. In addition, noncompliance with the Commission's order is subject
2 to administrative penalties at the Commission. Penalties are not recoverable from
3 ratepayers and must be borne by the shareholders or, in this case, shareholder.

4
5 **Q. Please explain how Commission jurisdiction over Avista protects the company and**
6 **its ratepayers from potentially detrimental actions on the part of the parent**
7 **company.**

8 A. Besides the power-limiting governance agreements discussed above, and besides the
9 protective provisions of the Settlement Stipulation and commitments discussed above,
10 decisions regarding Avista's operations in the State of Washington will remain subject to
11 the Commission's jurisdiction. This means that the Commission will continue to evaluate
12 the prudence of business decisions, will continue to audit any proposal to increase Avista
13 rates and will only approve rates that are fair, just, reasonable, and sufficient under
14 Washington law. Additionally, as discussed in Section IV below, the amendment to
15 Commitment 31 makes it explicit that Hydro One and its subsidiaries must submit to the
16 jurisdiction of Washington State for the enforcement of Commission orders.

17 In short, the Commission provides a legally enforceable line of defense against
18 action, including by Hydro One, that is counter to the interests of Avista and its
19 ratepayers.

1 **IV. AMENDMENT TO THE PROPOSED GOVERNANCE**
2 **AGREEMENT AND NEW COMMITMENTS**

3
4 **Q. Have the Applicants made any additional commitments in response to recent events**
5 **in Ontario?**

6 A. Yes, in supplemental testimony, the Applicants proposed a modification to the
7 Delegation of Authority and a new commitment regarding compensation of Avista
8 employees. In addition, the parties have negotiated new or revised commitments to be
9 incorporated into the Settlement Stipulation. Attached to my testimony as Exh. CRM-2 is
10 a document prepared by the Applicants that contains the new provisions to which the
11 Applicants have agreed.

12
13 **Q. Can you please discuss the Applicants' proposed revisions to the Delegation of**
14 **Authority?**

15 A. Yes. Hydro One witness Mr. James Scarlett provides proposed language to include in the
16 Delegation of Authority.¹ The purpose of this revision, as Mr. Scarlett describes, is to
17 protect the independence of the Avista board in the event that the Province takes control
18 of a majority of the Hydro One board.

19
20 **Q. Have there been further revisions to the Delegation of Authority language discussed**
21 **in Mr. Scarlett's testimony?**

¹ Scarlett, Exh. JDS-1T, at 26:29 - 27:2.

1 A. Yes. The parties have negotiated strengthening language that is consistent with the spirit
2 of the Applicants' proposal to further safeguard the independence of Avista's board of
3 directors. The new language is contained in Exh. CRM-2.

4

5 **Q. How do the revisions to the Delegation of Authority in the Applicants' supplemental**
6 **testimony together with the subsequently negotiated revisions protect the**
7 **independence of Avista's board?**

8 A. The risk this amendment is attempting to address is as follows: Given the ability of
9 Hydro One to replace its five designees, and given the ability of Hydro One to replace the
10 three independent designees with its own executives or employees during a six-month
11 period in the event suitable independent directors cannot be identified, there is risk that a
12 bad actor could for a limited amount of time control five of Avista's nine board members.

13 The revised language restricts Hydro One's designation of directors during this
14 six-month period to only four of its own executives or employees. This means that at no
15 time would Hydro One employees or executives hold a majority of seats on the Avista
16 board. In addition, with this amendment, if the Province were to gain control of Hydro
17 One, Hydro One would automatically lose its ability to replace, even temporarily, any of
18 the independent board members with its own executives or employees.

19

20 **Q. Does Staff support this amendment?**

21 A. Yes, although Staff believes the risk this amendment aims to protect against is
22 astronomically small. Including additional protections from a governmental body that has

1 shown a willingness to interfere in Hydro One if nothing else provides for peace of mind
2 given that events previously deemed as unlikely have nevertheless come to pass.

3
4 **Q. Do any of the parties oppose this amendment?**

5 A. Not to my knowledge.

6
7 **Q. Can you please discuss the new commitments that the Applicants have proposed?**

8 A. Yes. As presented by Hydro One witness Mr. James Scarlett, the Applicants proposed an
9 additional merger commitment in supplemental testimony.² This commitment explicitly
10 grants Avista's board authority with respect to employee compensation at Avista,
11 including equity awards.

12 The purpose of this new commitment is to make it abundantly clear that although
13 the Province has passed legislation affecting compensation at Hydro One, that new
14 compensation framework does not extend to Avista. Avista's board of directors has sole
15 authority over compensation at Avista. This commitment has since been incorporated into
16 Commitment 2.

17
18 **Q. Does Staff support this new commitment?**

19 A. Yes. Staff does not understand the Province or Hydro One to have any authority over
20 employee compensation at Avista, save for Hydro One's two votes on Avista's board, but
21 there is no harm in making the authority of Avista's board crystal clear in this matter.

² Scarlett Testimony, Exh. JDS-1T, 25:22 – 26:4.

1 Therefore, Staff supports including this commitment in an amended Settlement
2 Stipulation.

3
4 **Q. What other new or revised commitments have the Applicants agreed to?**

5 A. They have agreed to revise commitments related to executive management (Commitment
6 2), the board of directors (Commitment 3), regulatory commitments (Commitments 30,
7 31, and 33), and low income programs (Commitments 67 and 70), and they have agreed
8 to a new commitment regarding reporting and reassessing the protections (New
9 Commitment 82).

10
11 **Q. Please describe the revisions to the regulatory commitments.**

12 A. The changes incorporate some aspects of regulatory commitments that the Applicants
13 made in Oregon, in the spirit of the most-favored-nation commitment (Commitment 81)
14 that the Applicants made in Washington.

15 Most notably, the amendment to Commitment 31, Submittal to State Court
16 Jurisdiction for Enforcement of Commission Orders, makes explicit the fact that Hydro
17 One must submit to the jurisdiction of Washington State. Previously Commitment 31
18 referred only to Olympus Holding Corp. and its subsidiaries. This amendment is intended
19 to recognize that Hydro One is responsible for fulfilling certain obligations pursuant to
20 the Settlement Stipulation and associated commitments, and those obligations are legally
21 enforceable in the state of Washington.

1 **Q. Can you please discuss New Commitment 82?**

2 A. Yes. This commitment requires Hydro One to report any legislation or other action in
3 Canada that would affect Avista and sets out the process for a party to petition the
4 Commission to change the Commission's order in this proceeding. The commitment
5 reads as follows:

6 In the event of the enactment or adoption of any legislation, rule, policy, or
7 directive by government at any level or by any governmental entity or official in
8 Canada (a "Legislative Action") that affects Avista's operations because of
9 Avista's corporate relationship with Hydro One, or affects Hydro One's
10 compliance with any commitment in this stipulation, any of the parties to this
11 proceeding may petition the Commission at any time for a re-hearing that re-
12 opens the record in Docket U-170970 to consider whether the Commission should
13 change its final order, and neither Hydro One nor any of its subsidiaries, including
14 Avista, will oppose initiation of such a proceeding.

15 Hydro One will report to the Commission any such Legislative Action in Canada
16 that, in Hydro One's reasonable judgement, affects Avista's operations because of
17 Avista's corporate relationship with Hydro One, or affects Hydro One's
18 compliance with any commitment in this stipulation, as soon as practicable after it
19 is publicly announced as being effective by the government or governmental
20 entity or official.

21 Nothing in this Commitment 82 shall be interpreted to limit the positions or
22 arguments that Avista or Hydro One may take or advance in any such proceeding,
23 including the right to argue that a petition presents insufficient grounds or
24 evidence. Prior to filing a petition with the Commission under this Commitment
25 82, a party must provide Hydro One and Avista at least 30 days advance written
26 notice and an opportunity to meet and confer about resolutions other than filing
27 with the Commission under this commitment. Nothing in this commitment is
28 intended to restrict the rights of the parties to petition the Commission concerning
29 its order(s) in this docket, or to limit the authority of the Commission.
30

31 **Q. What is the purpose of this additional commitment?**

32 A. The purpose of this commitment is to protect against the risk of governmental actions in
33 Canada that would affect Avista. First, it ensures that the Commission is notified if a
34 governmental body in Canada passes legislation or otherwise enacts an agenda that
35 affects Avista's operations or compromises Hydro One's compliance with the settlement

1 commitments. Second, the commitment ensures that upon such governmental action, any
2 party to this proceeding may petition the Commission for a re-hearing that re-opens the
3 record in Docket U-170970 to consider whether the Commission should change its final
4 order.

5 Effectively, this commitment demonstrates an understanding among all settling
6 parties that the Commission can reconsider its decision on this matter if Avista or its
7 ratepayers are negatively affected by actions on the part of governmental bodies in
8 Canada. And it ensures that the Commission and the parties will receive information that
9 such an action has occurred.

10
11 **Q. Does Staff support these new and revised commitments?**

12 A. Yes.

13
14 **Q. Do any of the other parties oppose these new and revised commitments?**

15 A. Not to my knowledge.

16
17 **Q. Does Staff continue to support the settlement and the underlying transaction?**

18 A. Yes, it does.

19
20 **Q. Does this conclude your testimony?**

21 A. Yes.