Service Date: December 5, 2018

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Application of HYDRO ONE LIMITED (acting through its indirect subsidiary, Olympus Equity LLC)	DOCKET U-170970
and	ORDER 07
AVISTA CORPORATION For an Order Authorizing Proposed Transaction	FINAL ORDER DENYING JOINT APPLICATION FOR TRANSFER OF PROPERTY

***Synopsis**: The Washington Utilities and Transportation Commission (Commission), acting under RCW Chapters 80.01, 80.04, and 80.12, finds that the proposed transaction whereby Hydro One Limited (Hydro One) would acquire indirectly all outstanding common stock of Avista Corporation (Avista) fails to provide a net benefit to Avista's customers. The Commission accordingly "shall not approve" the transaction, as required under RCW 80.12.020. The Commission finds, in addition, that the proposed transaction "is not consistent with the public interest" in consideration of which "it shall deny the application" under WAC 480-143-170.*

The Commission takes fully into account in making these findings the 81 original and amended commitments, and one additional express commitment, along with amendments, to which Avista, Hydro One and all other parties in this proceeding agreed in a Settlement Stipulation dated March 27, 2018, and subsequently amended on May 7, 2018, and October 19, 2018. The Commission recognizes that these 82 commitments, among other things, emphasize important public service obligations including:

- *Local presence commitments concerning Avista's directors, officers, line employees, and corporate headquarters.*
- *Staffing, management, governance, record keeping requirements, assured access to records, and reporting commitments that protect and promote the Commission's ability to regulate Avista in the public interest.*
- *Rate commitments including beneficial rate credits and other protections for customers from rate increases that might otherwise result following the transaction.*

- *Regulatory and ring-fencing commitments that protect Avista from any financial distress that may be experienced by other companies within the corporate structure.*
- *Financial integrity commitments that protect Avista's financial health.*
- *Reliability and service quality commitments.*
- *Commitments to the communities in Avista's service territories, including Tribal and low-income communities.*
- *Environmental, renewable-energy, and energy efficiency commitments.*

The Commission received into the record during a Settlement Hearing on May 22, 2018, evidence about the commitments and the context in which they were proposed including evidence concerning the risks posed by the Province of Ontario's 47 percent ownership share as Hydro One's largest shareholder. The Commission also heard testimony and received into the record additional evidence concerning certain financial benefits promised by the Joint Applicants, including rate credits to customers and funding for various programs that address customer interests, interests of the intervenors, and community interests in Avista's service territory.

On June 7, 2018, provincial elections in Ontario resulted in the Progressive Conservative Party (PCP) gaining a majority in the Legislative Assembly. The PCP included prominently in its election campaign a promise to fire Hydro One's Chief Executive Officer (CEO) and replace the entire Board of Directors. The PCP majority was seated on June 29, 2018. Less than two weeks later, on July 11, 2018, Hydro One and the provincial government entered into, and made public, a Letter Agreement that provided for the removal and replacement of the entire Hydro One Board of Directors by August 15, 2018, and the immediate "retirement" of the CEO.

This sudden and complete change in Hydro One's leadership at the instance of its former owner and largest shareholder, the Province of Ontario, along with certain legislation passed quickly into law following the change in government leadership, demonstrates that Hydro One remains subject to management control by the province and that the province may not limit itself, or allow itself to be limited, to the role of "shareholder" as had been represented to the Commission. It became clear on and after July 11, 2018, that Hydro One's directors cannot be considered independent and the province's role is not limited to that a minority shareholder in a publicly traded corporation. Nor can the Governance Agreement between Hydro One and the province be considered protective of Hydro One's status as a publicly traded corporation. The record, as supplemented on October 23, 2018, shows that the provincial government retained sufficient power and influence over the Board of Directors following privatization beginning in November 2015 to result in its agreement to resign en masse, and to removal of the CEO, within days after a new majority party was seated in Ontario. This was made possible by the board's

agreement with the province to waive provisions of the Governance Agreement that were meant to protect the interests of all shareholders, not the political interests of the majority party in Ontario at any given time. The board acted without a due diligence review of the potential adverse impacts of the precipitous changes in direction and executive management to which it agreed. These changes, in fact, caused harm to Hydro One and its shareholders, and to Avista and its shareholders.

In addition, the Ontario Minister of Energy introduced on July 16, 2018, Bill 2, the Urgent Priorities Act, 2018, which included in Schedule 1 the Hydro One Accountability Act. The new provincial government passed Bill 2 into law and it became effective on August 15, 2018. This new law gave the province a direct and active role in setting, and continuing oversight of, executive compensation at Hydro One. The law also amended the Ontario Energy Board Act, 1998, to prohibit the inclusion in rates of compensation paid to the CEO and executives of Hydro One. There appears to be nothing that would prevent this level of interference from occurring again if the government leadership becomes dissatisfied in some regard with decisions by the new board of directors or with the new CEO, or simply due to political considerations without regard to sound business practices. Indeed, additional legislation may be forthcoming to effectuate a 12 percent rate reduction promised by the new government. In other words, Hydro One continues to be subject fully to the provincial government and the political will of its leadership.

These sudden and unexpected developments caused the Commission to issue on July 12, 2018, a Notice of Intent to Conduct Additional Process and Opportunity for Parties to Submit Comments. The Commission issued on July 20, 2018, a Notice of Extension of Time for Process and Deliberation as allowed under RCW 80.12.030(2), providing, among other things, that it would enter a Final Order by December 14, 2018. On August 3, 2018, the Commission issued a Notice of Procedural Schedule for the Conduct of Additional Process, which included notice of a hearing scheduled for October 23, 2018.

Following the receipt of supplemental testimony and exhibits, the Commission heard oral testimony on October 23, 2018, in response to its questions concerning the election and post-election events affecting Hydro One and how the impacts of these events should be weighed in considering the Joint Application and the parties' Settlement Stipulation in which they agreed to advocate for Commission approval of the proposed transaction. In the final analysis, the Commission determines that the evidence demonstrates that Hydro One lacks sufficient independence from its former owner and now largest shareholder, the Province of Ontario, to be a reasonable and appropriate merger partner for Avista. The events following the provincial election in June 2018 demonstrate the material and significant risk of the proposed transaction to Avista's customers that results from the Province of Ontario's dominant ownership interest in

Hydro One and the willingness of the provincial government to exert its dominance in ways that are contrary to the best interests of Hydro One and, by extension, Avista, were it to be owned by Hydro One. The financial and other benefits for Avista customers and the broader public promised by the transaction, including rate credits, are inadequate to compensate for the risks of harm Avista's customers would face were we to approve this transaction.

All things considered, as detailed in the body of this Order, the Commission determines that the proposed transaction fails to protect adequately against the risks inherent in the proposed change in Avista's ownership, fails to provide a net benefit to Avista's customers, and fails to protect and further the broader public interest. It accordingly must be denied under the standards established by RCW 80.12.020 and WAC 480-143-170. The Commission, in this Order, denies the Joint Application for Transfer of Property by which Avista would become an indirect, wholly owned subsidiary of Hydro One.

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SUMMARY

1 **PROCEEDINGS.** On September 14, 2017, Avista Corporation (Avista) and Hydro One Limited (Hydro One), acting through Olympus Equity LLC, an indirect, wholly owned subsidiary, filed their Joint Application for an Order Authorizing Proposed Transaction.[1] If approved, Olympus Equity LLC would acquire all of the outstanding common stock of Avista, which would become a direct, wholly owned subsidiary of Olympus Equity LLC. Avista, thus, would be an indirect, wholly owned subsidiary of Hydro One.[2] Avista's shareholders approved the transaction on November 1, 2017. They would receive, upon approval, $53.00 per common share, representing a 24 percent premium to Avista's sale price of $42.74 per share on July 18, 2017.[3] The Joint Applicants initially hoped to obtain all required regulatory approvals and close the transaction by September 30, 2018. This later changed in Washington to December 14, 2018.

2 Avista is an investor-owned utility providing electric generation, transmission, and distribution services to approximately 378,000 retail customers in Washington, Idaho, and Montana, and the distribution of natural gas to approximately 342,000 retail customers in Washington, Idaho, and Oregon. Avista is a public service company subject to the Commission's jurisdiction. Commission authorization is necessary under RCW 80.12.020 for Avista to sell, lease, assign or otherwise dispose of, merge, or consolidate, any of its franchises, properties, or facilities with any other public service company. Under RCW 80.12.040, Commission authorization is necessary before another public service company can, directly or indirectly, purchase, acquire, or become the owner of any of Avista's franchises, properties, facilities, capital stocks, or bonds.[4]

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[1] More specifically, Olympus Equity LLC, a wholly owned Alaska limited-liability company and corporate subsidiary of Hydro One, a Province of Ontario corporation, proposes to acquire all outstanding common stock of Avista, a Washington corporation and a jurisdictional public service company, making Avista a direct, wholly-owned subsidiary of Olympus Equity LLC and an indirect, wholly-owned subsidiary of Hydro One.

[2] We refer to Avista and Hydro One collectively in this Order, as "Joint Applicants" or "Companies."

[3] Morris, Exh. SLM-1T at 7:3-5.

[4] Neither Hydro One nor Olympus Equity LLC is a public service company subject to the Commission's jurisdiction. However, they have effectively submitted to the Commission's jurisdiction for purposes of this proceeding and the Settlement commitments that are central to our consideration of their application include agreements to submit to Commission authority, and

3 Hydro One, operating through its principal subsidiary, Hydro One Inc., was a Crown Corporation until November 2015. It now is an investor-owned electric transmission and distribution utility headquartered in Toronto, Ontario, Canada. Hydro One provides electric distribution service to more than 1.3 million retail end-use customers, as well as electric transmission service to many local distribution companies and large industrial customers. The Province of Ontario remains its largest shareholder, owning 47 percent of the shares outstanding. Under provincial law and Hydro One's Articles of Incorporation, no other shareholder can own more than 10 percent of the common shares outstanding.[5] This has the effect of ensuring that no one other than the Province could potentially have a controlling influence or even a substantial influence on corporate affairs.[6]

4 The Federal Energy Regulatory Commission approved the proposed transaction on January 16, 2018. The 30-day waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 expired on April 5, 2018, meaning that the parties have received anti-trust clearance for the proposed merger. Hydro One and Avista received the Federal Communications Commission's consent on May 4, 2018. The Committee on Foreign Investment in the United States completed its review of the proposed merger on May 18, 2018, and concluded that there are no unresolved national security concerns with respect to the transaction.

5 Avista requires approvals from the state regulatory commissions in Idaho, Oregon, Montana, Alaska, and Washington. The Regulatory Commission of Alaska accepted for filing on April 3, 2018, a proposed full settlement.[7] The Alaska Commission entered its Order No. 8 − Order Accepting Stipulation In Part − on May 1, 2018, in Docket U-17-097(8).[8] After additional process, the Alaska Commission entered Order No. 9 on June 4, 2018, approving the transaction subject to the condition that Avista and Hydro One

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in some circumstances to Washington judicial authorities, as necessary to preserve the Commission's authority over Avista and its operations.

[5] Woods, Exh. TDW-1T at 3:4-13. See also Woods, TR 437:18-438:3.

[6] Woods. Exh. TDW-1T at 438:7-18.

[7] Morris, Exh. SLM-5T at 1:20-21.

[8] The Alaska Commission concluded that: "The Stipulation does not fully address the matters that we must consider in our review of the Application, and therefore, we do not approve the Application with this order. A further order will be issued." Order No. 8 at 7:18-21.

adhere to the Stipulation commitments and several related commitments identified in the order.[9]

6 On May 15, 2018, the Joint Applicants and the City of Colstrip filed their proposed settlement with the Montana Public Service Commission (PSC). On June 12, 2018, the Montana Public Service Commission approved the settlement, with modifications, by majority vote. The Montana PSC issued its final order approving the proposed merger on July 10, 2018.

7 The Public Utility Commission of Oregon, on May 25, 2018, accepted for filing an all-parties, all-issues settlement agreement, as did the Idaho Public Utilities Commission on April 13, 2018. These are pending as of the date of this Order.

8 The Commission has jurisdiction over transactions such as this one where it is proposed that "the control of a plainly jurisdictional public utility [will change] through a corporate transaction for the transfer of the whole or a controlling interest in the company."[10] The parties filed a Settlement Stipulation in Washington on March 27, 2018.

9 **PARTY REPRESENTATIVES.** David Meyer, Vice President and Chief Counsel for Regulatory and Governmental Affairs, Avista Corporation, Spokane, Washington, represents Avista. Elizabeth Thomas and Kari Vander Stoep, K&L Gates LLP, Seattle, Washington, represent Hydro One. Lisa W. Gafken and Nina Suetake, Assistant Attorneys General, Seattle, Washington, represent the Public Counsel Unit of the Office of the Washington Attorney General (Public Counsel). Jennifer Cameron-Rulkowski, Assistant Attorney General, Olympia, Washington, represents the Commission's regulatory staff (Staff).[11]

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[9] The Alaska Commission's approval of Hydro One's acquisition of an indirect controlling interest in AEL&P included five express conditions. The order provided in addition that "[a] failure to fulfill these commitments may result in a show cause proceeding under AS 42.05.271(5)." Order No. 9 at 9.

[10] *In the Matter of the Application of PacifiCorp and Scottish Power PLC*, Docket No. UE-981672, Second Supplemental Order at 9 (March 1999).

[11] In formal proceedings such as this, the Commission's regulatory staff participates like any other party, while the Commissioners make the decision. To assure fairness, the Commissioners, the presiding administrative law judge, and the Commissioners' policy and accounting advisors do not discuss the merits of this proceeding with the regulatory staff, or any other party, without giving notice and opportunity for all parties to participate. *See* RCW 34.05.455.

10 Simon J. ffitch, Attorney at Law, Bainbridge Island, Washington, represents The Energy Project. Matthew Gerhart, Staff Attorney, Sierra Club Environmental Law Program, Oakland, California, represents Sierra Club.[12] Jeffrey D. Goltz, Cascadia Law Group, Olympia, Washington, represents the NW Energy Coalition, Renewable Northwest, and Natural Resources Defense Council (NWEC/RNW/NRDC). Tyler Pepple, Davison Van Cleve, P.C., Portland, Oregon, and Patrick J. Oshie, attorney, Zillah, Washington, represent the Alliance of Western Energy Consumers (AWEC).[13] Danielle Franco-Malone, Schwerin Campbell Barnard Iglitzin & Lavitt LLP, Seattle, Washington, and Scott H. Strauss, Spiegel & McDiarmid LLP, Washington, D.C., represent the Washington and Northern Idaho District Council of Laborers (WNIDCL).

11 **COMMISSION DETERMINATIONS:** The Settlement Stipulation before us in this case, with its 82 commitments, is modeled after, and builds upon, agreements the Commission has considered and approved in connection with similar transactions over the past two decades. In two important respects, however, this is a case of first impression. First, as we discuss in more detail below, the standard under which the Commission must consider this transaction changed in 2009 from the "no harm" standard to a "net benefit" standard. Briefly, we must weigh the inherent risks of the transaction against its promised benefits and determine that the benefits more than compensate for any unavoidable risks so that customers are better off with the transaction than without it.

12 Second, we were confronted very late in this case with developing facts that undermined more or less completely assurances we had been given earlier concerning political risks associated with the large ownership interest in Hydro One retained by the Province of Ontario. Hydro One's witnesses testified that the Governance Agreement between Hydro One and the province would protect Avista going forward because it protected Hydro One's independence as a publicly traded commercial corporation that would not be

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[12] Mr. Gerhart gave notice of his appearance and his substitution as counsel for Sierra Club on October 11, 2018, substituting for Ms. Gloria Smith, who withdrew as counsel, having previously entered her appearance and notice of substitution for Sierra Club's former counsel, Mr. Travis Ritchie, who withdrew as counsel on September 18, 2018.

[13] The Northwest Industrial Gas Users (NWIGU) merged into the Industrial Consumers of Northwest Utilities (ICNU) on March 31, 2018, and ICNU changed its name to Alliance of Western Energy Consumers (AWEC) on April 1, 2018. Both ICNU and NWIGU were original parties to this docket. Mr. Pepple entered his appearance representing ICNU. Chad M. Stokes and Tommy A. Brooks, Cable Huston LLP, Portland, Oregon, entered appearances representing Northwest Industrial Gas Users (NWIGU).

subject to interference from the provincial government in Ontario.[14] Events that followed a change in the majority government in the province during June 2018, however, demonstrated manifestly that the Governance Agreement does not provide such protection.

13 Within days after a change in the majority government in Ontario on June 29, 2018, the new majority entered an agreement with Hydro One's Board of Directors to waive important protections in the Governance Agreement. Effectively ignoring the letter, and the spirit and intent, of the Governance Agreement, the entire Board of Directors agreed with the province to waive the protections provided to all shareholders under section 4.7 of the Governance Agreement in favor of one shareholder, the province. The entire board agreed to resign by mid-August 2018. In addition, again contrary to the Governance Agreement, the province effectively ousted Hydro One's Chief Executive Officer, causing him to retire immediately. The province also involved itself, through legislation, in management decision-making and ongoing oversight ordinarily reserved to the board of directors and executive officers of a private corporation. The provincial government also promises to lower Hydro One's rates by a specific percentage apparently without having first considered the impact this could have on the safety and reliability of services Hydro One provides, or financial implications that conceivably could affect Avista's financial decisions and operations as a subsidiary of Hydro One.[15]

14 The combined effect of the sudden and unexpected retirement of Hydro One's CEO and the announced resignation of the entire board of directors within days after the new government was seated in Ontario, and the new legislation involving the Province directly in Hydro One's management decisions and oversight, unquestionably harmed Hydro One and Avista. It cannot credibly be maintained that these actions by the province and resulting changes at Hydro One were in the best interests of Hydro One or

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[14] Exh. MMS-5 (Governance Agreement between Hydro One and the Province of Ontario, dated November 5, 2015). Mr. Scarlett described the Governance Agreement as a "carefully thought through and structured arrangement" necessary to the success of privatization. *See* Scarlett, TR 325:9-326:8.

[15] Looking to the future, it is easy enough to imagine that actions by the province that strain Hydro One's revenue could result in pressure being brought to bear on Avista, whose directors would have a fiduciary duty to their shareholder (*i.e.*, Hydro One) to limit expenditures so as to maximize the retained earnings available to dividend up to Hydro One. Mr. Dobson testified that Hydro One will be able to use dividends from Avista to support its operating costs and to contribute to Hydro One's capital needs. TR 478:20-479:5.

Avista.[16] These actions caused significant losses of shareholder value at both corporations, downgrades to Hydro One's credit ratings, downgrades by equity analysts, and disruption of the regulatory processes in three states concerning whether Hydro One's acquisition of Avista should be approved. In addition, the new government controls and the potential for further interference by the province in Hydro One's affairs could have an adverse effect on earnings and Hydro One's ability to attract and retain talented leadership. All of this raises fundamental concerns about Hydro One's suitability as a merger partner and owner of Avista. The unavoidable risks of the proposed transaction associated with the province's evident intent and ability to participate directly in the direction and management of Hydro One in ways that are harmful to the enterprise, which would include Avista, are significant.

15 Applying the net benefit standard under these unique circumstances, the Commission must determine first whether the proposed transaction protects customers adequately from the potential harm that might follow from the inherent risks it poses. Beyond that, we must find that the proposed transaction provides a net benefit to Avista's customers. We find that it does neither. The risks and potential consequences for Avista of political interference in Hydro One's commercial operations are simply too great relative to the marginal benefits offered through the Settlement Stipulation. Moreover, the proposed transaction cannot be said to be consistent with the public interest when it is evident that decisions affecting Hydro One's and Avista's business operations and financial integrity are subject to political considerations that may motivate one provincial leader or another to make decisions and take actions in the future that may cause harm instead of

[16] Asked whether he believed that "the sudden resignation of the board of directors and CEO of Hydro One was in the best interest of either" Hydro One or Avista, Mr. Woods, the new Chairman of the Hydro One Board, responded as to both with a straightforward: "No." Mr. Morris, asked the same question relative to Avista's best interests also answered: "No." TR 368:21-369:6. Although Mr. Scarlett testified to his belief that the board and CEO took these actions because they were in Hydro One's best interest, neither of them offered any testimony explaining this perspective other than to suggest it expedited what they considered to be an inevitable result. *See* Scarlett, TR 401:6-402:18. The Joint Applicants did not bring forward any witness who had first-hand knowledge of the board's, or Mr. Schmidt's, thinking on the subject, or any written evidence, such as minutes from a board meeting, that would provide illumination. *See* Scarlett, TR 406:4-408:13. Mr. Scarlett testified, however, that to the best of his knowledge there was little or no discussion before the July 11, 2018, press release announcing the board's resignation and the CEO's retirement of the potential impacts such an announcement might have. *See* Scarlett, TR 408:14-411:4; *see also* Dobson, TR 479:6-481:17.

promoting the best interests of Avista, its customers, and Hydro One's non-government shareholders.[17]

MEMORANDUM

I. Background and Procedural History

16 Avista and Hydro One filed their Joint Application for an Order Authorizing Proposed Transaction on September 14, 2017. The Joint Applicants filed simultaneously testimony and exhibits sponsored by seven witnesses, four of whom were Avista executive officers and three of whom were Hydro One executive officers. The Companies also filed their Joint Motion for Protective Order asking the Commission to enter a standard form of protective order to promote discovery considering that this type of proceeding sometimes calls for the production of sensitive commercial information. The Commission entered Order 01, Protective Order with "Highly Confidential" Provisions, on September 28, 2017.

17 The Commission gave notice on September 28, 2017, that it would convene a first prehearing conference on October 20, 2017. During the prehearing conference, the Commission granted petitions to intervene by ICNU, NWIGU, The Energy Project, NWEC, RNW, NRDC, and the Sierra Club.[18] The Commission memorialized these interventions in Order 02, Prehearing Conference Order; Notice Of Hearing, entered on October 25, 2017. Order 02 also established a procedural schedule and set May 22, 2018, as the date for an evidentiary hearing. The Commission granted intervenor status to WNIDCL in Order 03, on November 20, 2017.

18 The Commission entered Order 04 on January 25, 2018, denying a late-filed petition to intervene by Lauren Fink and Chadwick Weston, two Avista shareholders. The

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[17] We note that Hydro One's former leadership made commitments to all investors who bought shares when the company ostensibly was privatized. Faced with political pressure driven by the heated rhetoric leading up to an election, the board of directors agreed to set aside express protections in the Governance Agreement between Hydro One and the province to effectuate promptly election promises, elevating the interests of the province over all other stakeholders. Promises such as are included in the settlement commitments are only as good as the willingness of those who made them to keep them, and defend them from political or other influences that have nothing to do with sound business practices. We have no confidence that Hydro One will defend itself, or Avista, in the face of political interference from the Province as a shareholder whose will is perceived by Hydro One executive leaders to be unavoidably dominant.

[18] As previously noted, NWIGU and ICNU, since April 1, 2018, are part of a single organization, the Alliance of Western Energy Consumers (AWEC). *See supra* n. 13.

Commission found their petition failed to establish good cause for being filed several months after the deadline for such a petition to be considered timely. They also failed to establish that their stated interests as shareholders were within the zone of interests identified by the Commission's governing authority, hence failing to demonstrate that they had a substantial interest in this proceeding.

19 Commission Staff filed a motion on March 12, 2018, to amend the procedural schedule. Staff's motion asked the Commission to extend the deadlines for Response and Rebuttal testimonies, discovery, and the date for submitting Cross-Examination Exhibits, Witness Lists, and Time Estimates for Cross-Examination. Staff's motion stated that all the parties supported the motion because they were actively engaged in settlement negotiations and the availability of additional time for discussion would support the dispute resolution process. The Commission granted Staff's motion in Order 05, entered on March 12, 2018.

20 Staff, by letter to the Executive Secretary dated March 16, 2018, informed the Commission that the parties had achieved a settlement in principle. Avista filed a Settlement Stipulation on behalf of all parties on March 27, 2018, that would resolve all issues in this proceeding, if approved, and filed a motion asking the Commission to enter an Order Approving Settlement Stipulation and Agreement. The Commission suspended the procedural schedule by notice given on March 28, 2018, preserving only the previously noticed hearing date, May 22, 2018, for purposes of a settlement hearing, and the dates for public comment hearings in Avista's service territory on April 23, April 24, May 2, and May 3, 2018, in Spokane, Colville, Othello, and Colfax, Washington, respectively.

21 Avista filed on May 7, 2018, on behalf of all parties, the First Amendment to Settlement Stipulation and Agreement to reflect Order 07, the Commission's final order in Avista's general rate case at Dockets UE-170485 and UG-170486.[19] Specifically, the Parties agreed to amend Commitment 76 to the Stipulation to reduce the amount of deferred federal income tax benefit from $16.7 million to $10.4 million to be used for purposes of accelerating the depreciation of Colstrip Units 3 and 4 to reflect a "useful life" of 2027 for depreciation purposes.[20]

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[19] *WUTC v. Avista Corporation d/b/a Avista Utilities, et al.*, Dockets UE-170485 and UG-170486 (consolidated), Order 07 (April 26, 2018).

[20] This Order rejects the Settlement Stipulation as a proposed resolution of the issues in this proceeding. It accordingly will be necessary to revisit the question of how to treat the "continued deferral of the unprotected excess deferred income taxes of approximately $10.4 million" that

22 The Commission convened its evidentiary hearing concerning the transaction and the proposed Settlement Stipulation on May 22, 2018, as previously scheduled. This provided an opportunity for the Commission to develop a record including pre-filed testimonies and exhibits, and allowed the Commissioners an opportunity to question witnesses about the settlement and, more broadly, the proposed transaction. The Commission initiated its deliberations shortly after the hearing.

23 While the Commission was engaged in deliberations, the Province of Ontario held its elections on June 7, 2018. Following the elections, and the assumption of power by a new majority on June 29, 2018, the Commission learned from media reports on July 11, 2018, of the immediate retirement of Hydro One's Chief Executive Officer, Mayo Schmidt, and of the subsequent resignations of the entire Hydro One board of directors. It was not immediately clear how these sudden and unexpected developments might bear on the Commission's ongoing consideration of the proposed transaction. The Commission anticipated, however, that additional process would be required to develop a record concerning how these changes in executive management and the board of directors at Hydro One should be considered in weighing the merits of the proposed transaction. The Commission gave notice on July 12, 2018, of its intention to conduct additional process and required Hydro One and Avista to file comments, including any recommendations they might have with respect to what specific process should be conducted.[21]

24 Avista and Hydro One filed joint comments in response to the Commission's notice.[22] Staff, Public Counsel, and The Energy Project each filed comments. These parties

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was left for resolution in Docket U-170970 "utilizing the accounting petitions [in Dockets UE-171221 and UG-171222]" that were consolidated with Dockets UE-170485 and UG-170486 (consolidated), Avista's most recent general rate case. *See id.* ¶ 22. In this Order, we direct Avista to work cooperatively with Commission Staff and any interested parties to determine how best to bring this matter before the Commission for further consideration within 60 days after the date of this Order.

[21] Other parties were invited to file such comments, if they elected to do so.

[22] Their comments included a proposed amendment to Commitment 2 with the stated purpose of providing additional protection to Avista's employees, as follows:

> Avista Employee Compensation: Any decisions regarding Avista employee compensation shall be made by the Avista Board consistent with the terms of the Merger Agreement between Hydro One and Avista, and current market standards and prevailing practices of relevant U.S. electric and gas utility benchmarks. The determination of the level of any compensation (including equity awards) approved by the Avista Board with respect to any employee in accordance with

observed, among other things, that Hydro One had committed to completing the transition process to a new board of directors by August 15, 2018. This would fall one day after the statutory deadline for a Commission order in this proceeding, unless the Commission gave notice of cause for an extension of as much as four months beyond that date, as authorized by RCW 80.12.030(2). Considering that Hydro One's as yet unannounced new board members would be responsible for appointing a new CEO at Hydro One on or after August 15, 2018, and that other uncertainties would continue to be present after August 14, 2018, the Commission found it necessary to invoke the "for cause" provision of RCW 80.12.030(2) and gave notice that it would extend the time allowed for it to enter an order in this proceeding until December 14, 2018. [23]

25 The parties discussed among themselves and subsequently communicated to the Commission their proposed additional process and a schedule for the conduct of such process. The Commission, on August 3, 2018, issued its Notice of Procedural Schedule for the Conduct of Additional Process, including a hearing date of October 23, 2018. The Commission gave notice that it was reopening the record to receive additional evidence from the parties and additional written comments from members of the public.

26 Avista and Hydro One filed supplemental testimony on September 6, 2018, sponsored by two Avista executives and three Hydro One executives, the new Chairman of the Hydro One Board of Directors, and one outside consultant.[24] Staff and a number of the

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> the foregoing shall not be subject to change by Hydro One or the Hydro One Board.

[23] The Commission's Notice noted that:

> Avista and Hydro One state in their comments that Hydro One and Avista also acknowledge that:
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> > Given recent events in Ontario, additional time may be necessary to understand the implications of those events to Avista. We also acknowledge that additional, or modified commitments related to Avista governance may be necessary to alleviate any lingering concerns that the province of Ontario could affect Avista and its operations. We remain open to addressing those concerns in a manner that satisfies your and our needs.
>
> Staff, Public Counsel, and The Energy Project agree that the record would benefit from such additional time and process as the Commission deems appropriate and required to understand fully the implications of these "events in Ontario." Public Counsel proposes specific process options including further testimony from the Joint Applicants, response testimony, and further hearings.

[24] Mr. Morris, Avista's CEO and Chairman of the Board, and Mr. Theis, Avista's Senior Vice President, Chief Financial Officer, and Treasurer filed testimony for their company. Hydro One

Intervenors filed response testimony on October 4, 2018.[25] Following an email exchange with the Presiding Administrative Law Judge concerning process matters, Avista and Hydro One elected not to file rebuttal testimony. The Commission convened a hearing on October 23, 2018, which was conducted principally by the three Commissioners, to receive the evidence and to allow for examination of the witnesses by the presiding officers.

II. Standards for Approval

27 RCW 80.12.020 provides that the Commission "shall not approve any transaction under this section that would result in a person, directly or indirectly, acquiring a controlling interest in a gas or electrical company without a finding that the transaction would provide a net benefit to the customers of the company." The requirement that a jurisdictional transfer of property by an electrical or natural gas company must be found to provide a net benefit to the customers of the company was added to the statute by the legislature in 2009. This followed in the wake of the Commission's order approving the acquisition of the largest jurisdictional utility in Washington, Puget Sound Energy (PSE), by a private investor consortium led by the Macquarie Infrastructure Partners, based in Australia.[26]

28 In addition, RCW 80.01.040(3) requires the Commission to "[r]egulate in the public interest," and WAC 480-143-170 reiterates this requirement, as pertinent here, providing that:

> Application in the Public Interest – If, upon the examination of any application and accompanying exhibits, or upon a hearing concerning the

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filed testimony by its acting CEO, Mr. Dobson, its newly appointed CFO, Mr. Lopez, and its Executive Vice President and Chief Legal Officer, Mr. Scarlett. Mr. Woods, the newly appointed Chairman of Hydro One's Board of Directors also filed testimony. Finally for Hydro One, Mr. Reed, Concentric Energy Advisors, filed testimony as an industry expert.

[25] Mr. McGuire, Assistant Director of Energy Regulation, testified for the Commission. Ms. Gerlitz on behalf of NWEC, et al., Mr. Woolridge on behalf of Public Counsel, Mr. Hellman on behalf of AWEC, and Mr. Collins on behalf of The Energy Project each filed testimony. Sierra Club and WNIDCL filed letters in lieu of supplemental testimony.

[26] *In the Matter of the Joint Application of Puget Holdings LLC and Puget Sound Energy, Inc. for an Order Authorizing Proposed Transaction*, Docket U-072375, Order 08, ¶ 115 (Dec. 30, 2008) (PSE/Macquarie Order). Additional significant members of the consortium were pension management firms located in Canada.

> same, the commission finds the proposed transaction is not consistent with the public interest, it shall deny the application.

29 Before the change in law in 2009, the case law that had developed over time construed the standard for Commission approval of a transfer of property under RCW 80.12.020 as being "no harm." This standard required that ratepayers be, at worst, *indifferent* to a proposed transfer of property. In contrast, the net benefit standard requires that the transfer of property leave ratepayers *better off* as a result. The Commission distinguished between the two standards even before the legislature changed the standard. In its Final Order approving the PSE/Macquarie transaction, the Commission said: "To be 'consistent with the public interest,' a transaction need not confer net benefits on customers or the public by making them better off than they would be absent the transaction. It is sufficient if the transaction causes no harm."[27]

30 There arguably is a fine line between "no harm" and "net benefit" but, similar to other standards that the Commission has long experience applying, we recognize in practice that a determination of whether these standards are met is an exercise in informed judgment in individual cases. We agree with Staff witness Mr. Hancock that "[b]enefits can be tangible or intangible; [28] they can be financial or non-financial."[29] There is no simple quantitative or qualitative test that can be meaningfully applied across all circumstances.

31 The Commission recognized this in its first application of the net benefit standard following the amendment of RCW 80.12.020.[30] In approving the corporate reorganization of Northwest Natural Gas Company (NW Natural), the Commission applied the net benefit standard considering both qualitative and quantitative factors. Specifically, the Commission viewed as beneficial the establishment of "safeguards to ensure that other

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[27] PSE/Macquarie Order ¶ 115.

[28] It follows that we do not agree with Public Counsel witness Dahl who testified that "[t]o meet the current statutory requirement of net benefits, the benefits provided to customers must be tangible." Dahl, Exh. CJD-1T at 3:6-7.

[29] Hancock, Exh. CSH-1T (revised) at 28:4-7. We note that Mr. Hancock elected to leave the Commission's employ to pursue another professional opportunity before the time of the settlement hearing. Mr. Chris McGuire adopted Mr. Hancock's testimony, which was stipulated into the record without objection.

[30] *See In the Matter of Northwest Natural Gas Company's Application for Approval of Corporate Reorganization to Create a Holding Company,* Docket UG-170094, Order 01, ¶ 14 (Dec. 28, 2017).

affiliates will not harm the utility's capital structure, credit ratings, or cost of capital."[31] The Commission agreed, in addition, that "reorganization will better insulate NW Natural's utility assets, thereby reducing the risk that such assets could be reached by creditors of the non-regulated affiliates."[32]

32 Beyond this, the Commission expressly identified a "net benefit" to the Company's customers because the new corporate structure would "allow the Company to better respond to the changing business environment of the natural gas industry." Finally, the Commission focused on NW Natural's commitment to provide for three years an annual $55,000 credit to customers on an equal percent margin basis concurrent with the Company's purchased gas adjustment, as a quantitative measure of a benefit that went "beyond a 'no harm' standard [and would] result in net benefits to customers."[33]

33 Importantly, the Commission recognized broadly that its "'net benefit' finding was based on the particular facts and circumstances of NW Natural's reorganization request and the negotiated commitments."[34] Moreover, the Commission stated that: "Our decision today does not provide specific guidance for future transactions under RCW 80.12.020."[35] In other words, the Commission recognized that such determinations are by their nature fact specific and must be decided on a case-by-case basis. A corporate reorganization, for example, might be found to require something significantly less in terms of affirmative benefits than in the case of an inherently more risky proposed complete transfer of ownership to a third party.

34 Several witnesses, in addition to Mr. Hancock for Staff, discussed their perspectives on the meaning and application of the net benefit standard.[36] In general, they shared the view that the Commission should consider both sides of the test: the protective measures proposed to reduce the risk that a jurisdictional transaction might do harm to customers and the affirmative benefits offered by the transaction. As expressed cogently by Mr. Dahl for Public Counsel: "Put simply, a transaction must first do no harm before it can

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[31] *Id.* ¶ 11.

[32] *Id.* ¶ 12.

[33] *Id.* ¶ 13.

[34] *Id.* ¶ 14.

[35] *Id.*

[36] *See generally* Dahl, Exh. CJD-1T at 4:11-5:17; Woolridge, Exh. JRW-1T at 10:15-14:13; and Gerlitz, Exh. WMG-1T at 4:17-6:13. Mr. Hancock's full discussion of the standard established by RCW 80.12.020(1) and the public interest standard is at Exh. CSH-1T (revised) at 26:6-30:7.

provide benefits."[37] Strong and comprehensive protective measures coupled with demonstrable benefits to customers weigh in favor of Commission approval. If protective matters are found to be inadequate to protect against an unavoidable risk, the level of affirmative benefits to customers would need to be adequate first to offset fully the potential impacts if the risk is realized and, second, to make customers better off than they would be without the transaction in order for the Commission to find net benefits.

III. Discussion and Decisions

35 Hydro One's proposal to acquire Avista is in many respects quite similar to other transactions the Commission has reviewed since 1999.[38] Most similar here was the Macquarie Group's acquisition of PSE at the end of 2008.[39] Hydro One's proposed acquisition of Avista, as in the case of the Macquarie consortium's acquisition of PSE, would result in a full transfer of ownership to shareholders that reside outside the United States. As in the case of PSE, Avista would no longer be a publicly traded company if the transaction is approved and consummated. Both cases met with substantial public opposition, among other reasons, because they involve transfers of control to foreign owners. This was strongly evident in the public comments the Commission received and made part of the records in the respective proceedings.[40]

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[37] Dahl, Exh. CJD-1T at 5:5-6.

[38] *See, e.g., In the Matter of the Application of PacifiCorp and ScottishPower PLC for an Order (1) Disclaiming Jurisdiction or, in the Alternative, Authorizing the Acquisition of Control of PacifiCorp by ScottishPower and (2) Affirming Compliance with RCW 80.08.040 for PacifiCorp's Issuance of Stock in Connection with the Transaction*, Docket No. UE-981627, Second Supp. Order at 2 (March 16, 1999); *In the Matter of the Joint Application of MidAmerican Energy Holdings Company and PacifiCorp, d/b/a Pacific Power & Light Company for an Order Authorizing Proposed Transaction*, Docket UE-051090 (filed July 15, 2005); *In the matter of the Joint Application of MDU Resources Group, Inc. and Cascade Natural Gas Corporation for an Order Authorizing Proposed Transaction*, Docket UG-061721, Order 06 ¶ 9 (June 27, 2007).

[39] PSE/Macquarie Order ¶¶165-174.

[40] The Commission received 448 public comments in this proceeding through the close of the record on October 23, 2018, including 365 comments opposing the merger, 13 comments supporting the merger, and 70 comments that took no position. *See* PSE/Macquarie Order ¶ 5 (case "distinguished by the fact that there is substantial public opposition to the transaction evident from the considerable volume of written public comments, and the high attendance and predominant testimony in the four public comment hearings the Commission conducted throughout PSE's service territory.").

36 The Commission resolved PSE/Macquarie on the basis of a Settlement Stipulation that included 63 commitments by the Joint Applicants, which were identified in testimony supporting the settlement. These commitments addressed nine basic categories: capital requirements; financial integrity; regulatory and ring-fencing; staffing, management, and governance; local presence; rates; quality of service; low-income assistance; and environmental, renewable energy, and energy efficiency. The Commission approved the Settlement Stipulation, adding 15 significant, multi-part conditions and clarifications.[41] Avista and Hydro One propose to resolve this proceeding with a similar Settlement Stipulation that includes, following amendment, 82 commitments reflecting these same basic categories. These were tailored to facts and circumstances peculiar to the Joint Applicants in this case.

37 Three principal factors, however, distinguish this case from PSE/Macquarie and other similar transactions previously approved by the Commission. First, at the time of our initial hearing in this case on May 22, 2018, all parties supported the Settlement Stipulation and its commitments as satisfying their interests collectively and individually, and argued the transaction would provide a net benefit to customers and be in the public interest. The parties all "[agreed] to support this Stipulation as a settlement of all issues in this proceeding and to recommend approval of the Proposed Transaction in this proceeding subject to the agreed-upon commitments."[42] Moreover, they agreed "to support the Stipulation throughout this proceeding."[43] These obligations became effective on March 27, 2018, and remained effective at the time the hearing record was closed on October 23, 2018.[44]

38 In contrast to the uniform support of the Settlement Stipulation in this case, Public Counsel opposed Commission approval of the PSE/Macquarie transaction arguing, among other things, that its proponents were required to prove there was an affirmative need for the transaction (i.e., a net benefit, as now required by statute). The contested nature of the settlement in Macquarie resulted in the production of a very robust record.

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[41] PSE/Macquarie Order, Attachment B.

[42] Exh. JNT-1T at 5:11-13.

[43] Exh. JNT-3 (Settlement Stipulation) ¶ 16.

[44] Since there were no contested issues among the parties for the Commission to resolve, and all parties supported the Commission's adoption of the Settlement Stipulation in full resolution of the case, we determined that briefs, requested by Joint Applicants at the conclusion of the October 23, 2018, hearing, would add nothing useful to the record.

There was a thorough presentation by the parties of evidence and arguments on both sides of the issues.[45]

39 Second, following approval of Macquarie's acquisition of PSE in late December 2008, the Washington legislature, in 2009, expressly added to RCW 80.12.020 the "net benefit to customers" standard for transactions that involve the transfer of a controlling interest in a jurisdictional gas or electrical company. The PSE/Macquarie merger, in contrast, was subject statutorily to a "no harm" standard. This case represents the first time the Commission has considered this type of transaction under the net benefit standard.

40 Third, as emphasized by the post-election events in Ontario, Canada discussed above, it is important to consider carefully the different nature of the acquiring investors when evaluating the merits of this transaction. The Macquarie consortium was made up exclusively of long-established, privately held equity management companies based in Australia and Canada. The acquiring companies all had significant experience in managing infrastructure investments. All members of the Macquarie consortium were private business people whose decisions necessarily would be driven fundamentally, if not exclusively, by commercial considerations of what would be in the best interests of the utility they wished to acquire. Their individual success would be measured by the success of the business investment they proposed to make, as evaluated by analysts in the financial credit and equity markets, results measured by share valuation and sound dividend policies, and success in delivering safe and reliable service to customers at reasonable rates objectively determined by an experienced regulatory authority.

41 In this case, the acquiring investor is Hydro One. Hydro One was a Crown Corporation, wholly owned by the Canadian Province of Ontario until November 2015. Three years ago, under different leadership, the province began the process of privatizing Hydro One. The privatization process had been under way less than two years when Hydro One and Avista filed their merger application in September 2017. The province had sold off approximately 53 percent of its ownership interest by December 2017. Despite Hydro One's relatively short experience as an investor-owned company, its CEO, Mr. Schmidt, testified that "Hydro One is well prepared to manage a company under the pressure of public markets and meeting investor expectations."[46] He explained that part of the plan in transforming Hydro One into a publicly traded company was to strengthen the company's executive leadership. He testified further that the company "has attracted highly qualified

[45] The contested nature of the case made briefs appropriate and these were filed on September 23 and 24, 2008.

[46] Schmidt, Exh. MMS-4T at 11:10-11.

and skilled directors and senior executives with decades of experience with public company compliance."[47]

42 The Province of Ontario, as a legacy shareholder of this former Crown Corporation, now owns 47 percent of Hydro One's stock. Given this, the province's plans as a major shareholder/owner of Hydro One and Avista, and the effective governance structure of their individual and combined companies, are highly relevant and important to our evaluation of the merits of the proposed transaction.[48] Throughout this proceeding, we received repeated assurances from Hydro One's witnesses that despite the province's large ownership share, Hydro One is a private, publicly traded corporation, fully in charge of its own affairs with the direction of an independent board of directors. We received assurances that the Province of Ontario would not interfere in the direction and management of Hydro One. We were told that the province had "been exemplary in their behavior in not involving themselves in the business of the organization."

43 Since June of this year, however, the province has been anything but exemplary in its behavior, involving itself in direct and substantial ways in Hydro One's business. Now, as result of a change in the majority controlling the provincial government in Ontario, the directors have all been replaced with individuals not previously involved in Hydro One's affairs and they are yet to determine who will take the executive leadership helm as CEO. Moreover, the provincial government has expressed through its leader the belief that Hydro One is not a private corporation.[49] It no longer is clear that Hydro One can be regarded as a private, publicly traded corporation. While not legally a Crown Corporation, Hydro One manifestly is subject to being controlled by the province's legislative power. In addition, while the province does not own a controlling interest in Hydro One, a compliant Board of Directors and CEO, in this instance, avoided this inconvenient fact by agreeing with the province under Section 8.11 of the Governance Agreement to waive provisions in the agreement meant to protect the rights of other shareholders owning 53 percent of the company.[50] It appears that Hydro One's corporate identity as a private, publicly traded corporation depends significantly on the identity of the ruling party in Ontario, or even on the leadership of that party. In important respects we perceive Hydro One today, in light of the full record, to be a different entity than the

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[47] Schmidt, Exh. MMS-4T at 11:14-16.

[48] *See* PSE/Macquarie, Order 08 ¶ 39.

[49] *See* TR 357:-358:10.

[50] *See* Scarlett, TR 412:5-414:16.

Hydro One that entered into a merger agreement with Avista during 2017 and agreed to the terms of a Settlement Stipulation with all parties in our jurisdiction during 2018.

44 Thus, on the one hand, we have before us an all-party Settlement Stipulation that includes numerous Settlement commitments agreed to by the Hydro One directors and its CEO when the provincial leadership was committed fully to privatization and Hydro One's character as an independent, publicly traded corporation was not in question. Yet now, on the other hand, we are evaluating the Settlement Stipulation at a time when the identity of Hydro One as a private, publicly traded corporation is uncertain and has already been demonstrably lost to some extent. Moreover, we find Hydro One today with a completely different board of directors than the one in place at the time of our Settlement Hearing on May 22, 2018, and an acting CEO whose replacement has yet to be identified.

45 We agree with the parties that the Settlement commitments collectively present state of the art ring fencing and other provisions that, to the extent they are allowed to function as written, would provide significant protections to Avista with respect to the specific subject matters they cover. These include financial protections, provisions meant to preserve Avista's independence in terms of governance and strategic planning, and preservation of Avista's local presence in Spokane and other communities the company serves. Were these detailed matters all we had to be concerned about, our record could be seen as supportive in terms of risk mitigation. Point-by-point mitigation of individual risks, however, is neither the first, nor the only, relevant level of analysis given the facts of this case. As the familiar metaphor cautions, we must not miss the forest for the trees. We must consider at a high level the suitability of Hydro One as a potential new owner for Avista in light of everything we know today.

46 We focus our discussion below at this higher level, finding the relevant facts discussed there dispositive. We find no particular need to discuss the individual Settlement commitments because the evidence in this proceeding undermines our ability to trust that the provincial government in Ontario will not interfere in the business of Hydro One in ways that undercut these commitments.[51] Hydro One cannot make commitments that bind the province and the province has not been at the negotiating table. Considering events that already have transpired, we cannot trust that the province will not take additional actions without regard to the harmful consequences they may have for Hydro One and

[51] We note that the province is not a party to the merger agreement or the Settlement Stipulation. It had no role in negotiating either agreement and it has not publicly endorsed the proposed transaction or the Settlement Stipulation.

Avista.[52] This would be a continuing risk that no provision in a settlement agreement between Hydro One and Avista can adequately protect against. We discuss these points and the evidence concerning them in some detail below.

A. Risks of the Proposed Transaction

47 The parties in this proceeding filed joint and individual testimonies and exhibits on April 10, 2018, advocating approval of the proposed transaction, as they expressly committed to do in the Settlement Stipulation.[53] In his testimony, Hydro One CEO Mayo Schmidt acknowledged that in some jurisdictions with regulatory approval authority over the proposed transaction, parties had expressed concerns about the Province of Ontario's role as Hydro One's largest shareholder and thus its post-merger control over Avista.[54] Mr. Schmidt said these concerns were not "valid" because: "The Province's role is limited to being Hydro One's largest shareholder, and the Governance Agreement between Hydro One and the Province of Ontario establishes this role for the Province."[55] He described the Governance Agreement in the following terms:

> [It] is a binding contract that was a pre-requisite for Hydro One's successful Initial Public Offering ("IPO"). It establishes the Province's role as a shareholder—a role separate and distinct from Hydro One's business activities—and ensures that Hydro One will operate like any other investor-owned utility. Under the Governance Agreement, the Hydro One board of directors (the "Board") is responsible for the management of, or supervising the management of, Hydro One's business and affairs. (Governance Agreement ("GA") 2.1.2). The Governance Agreement states that the Province will be involved in Hydro One as an investor and not as a manager. (GA 2.1.3). The Province does not have a role with the Hydro One Board in the processes of appointment, removal, replacement, and compensation relating to executive officers or over related succession planning. Hydro One neither takes direction nor seeks consent for its

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[52] As we discuss below, actions taken by the province following the Ontario election on June 7, 2018, caused substantial harm to both companies, causing the value of Avista's shares to drop 4.5 percent and the value of Hydro One's shares to drop as much as 8 percent in a single day. Morris, TR 364:17-365:1; 369:7-19. The province's careless disregard for the harm done by taking politically motivated action to remove the Hydro One board and CEO is illustrated powerfully by the fact that the value of the province's own Hydro One shares dropped by hundreds of millions of dollars. Morris, TR 379:9-15.

[53] Exh. JNT-3 (Settlement Stipulation) ¶ 14.

[54] Schmidt, Exh. MMS-4T at 7:21-8:3.

[55] *Id.* at 8:7-9.

> operations from the government of Ontario, outside of the defined regulatory and oversight authority that the government has over the electricity sector generally. (GA 2.1.3; 2.2).[56]

48 Mr. Schmidt testified briefly concerning the Province's "rights and limitations as a shareholder," as defined by the Governance Agreement, and offered the reassurance that the Province would not "control Avista post-merger."[57] He mentioned that the agreement could be terminated by mutual agreement of Hydro One and the province.[58] He did not point out, however, that these parties also could waive any provision of the agreement or any breach of the agreement if they memorialized any such waiver in writing.[59] This waiver ability became significantly relevant vis-à-vis the testimony quoted above and Mr. Schmidt's follow-on testimony that, despite the province being Hydro One's largest shareholder:

> Hydro One is not any more vulnerable to political change than any other investor-owned utility in Canada, or the United States for that matter, because of the Governance Agreement between Hydro One and the Province. As explained above, the Governance Agreement establishes that the Province cannot interfere in the management or operations of Hydro One. The only influence it conceivably has is through the selection of 40% of the Hydro One board members. However, those board members must be independent of both the Province and Hydro One, and they must meet the high qualification standards set by Hydro One's Nominating and Governance Committee. As a result, Hydro One is no more subject to the influence of the Province's politicians than any other investor-owned utility is subject to the political influence of elected and appointed officials in the jurisdiction in which it operates.[60]

49 The reassurances Mr. Schmidt offered in his testimony may have been given sincerely at the time it was filed but they turned out to be materially incorrect, as we discuss below. First, however, some additional context is required.

50 During late April and early May we heard a considerable number of public comments during four hearings in separate locations in Avista's service territory, and received

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[56] *Id.* at 8:10-9:3. *See also* Exh. MMS-5 (Governance Agreement (GA)).

[57] *Id.* at 9:4-10:5.

[58] Id. at 9:23-10:2.

[59] GA 8.11.

[60] Schmidt, Exh. MMS-4T at 10:6-19.

numerous written comments opposing the proposed transaction.[61] Concerns about Hydro One's status as a Province of Ontario corporation figured prominently in comments opposing approval of the proposed transaction. The Commission was aware, as well, that Hydro One's move toward privatization remained controversial in Ontario and was a highly visible issue leading up to the province's June 2018 elections in which three political parties vied for majority control and control of the opposition party.[62]

51 Specifically, the party in the majority in Ontario's government for four terms beginning in 2003 remained committed to its original goal of putting 60 percent of Hydro One into private hands, while planning that the province would retain a 40 percent interest as a shareholder. The province owned a 47 percent share of Hydro One at the time the Joint Application under consideration in this docket was filed and would continue to have that level of ownership interest at the time of the election. If Hydro One completed its proposed acquisition of Avista, the province's ownership share would be diluted to approximately 42 percent.

52 In campaigning for the June 2018 elections, the Progressive Conservative Party candidate was running on a platform that included prominently a threat to fire Hydro One's CEO and to replace its board of directors. The party also committed to a 12 percent reduction in Hydro One's rates on top of a 25 percent reduction already in place following privatization. These were central themes in campaign speeches and other public statements.

53 The Ontario New Democratic Party (NDC) proposed to return Hydro One to public ownership. The NDC also committed to a 30 percent reduction in rates and to bringing time-of-use pricing to an end.

54 With reference to these matters during the Settlement Hearing on May 22, 2018, Commissioner Rendahl asked Mr. Schmidt to address the "issue of concern about foreign ownership [a]nd the role of the Province, which was addressed in the public hearings as well, in terms of having significant ownership of the company and how that could play out, especially with the potential change in the political landscape."[63] Mr. Schmidt testified that the starting point for his response was the Governance Agreement.[64] Consistent with his prefiled testimony on this subject, he said that:

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[61] By the end of the hearing proceedings, the Commission received 365 comments opposing the merger, 13 comments supporting the merger, and 70 comments that took no position.

[62] *See* TR 312:23-327:15.

[63] TR 308:13-14.

[64] Schmidt, TR 309:14-15.

> The governance agreement structurally is that the Province and the company have a contract. And that contract is that the shareholder -- which, of course, in this case is a Province -- is a shareholder and is not a manager of the business.[65]

He testified in addition that:

> [T]he Province has been exemplary in their behavior in not involving themselves in the business of the organization and, quite frankly, has found the work of the organization to be, simply put, outstanding.[66]

55 Commissioner Balasbas followed up with reference to the then impending election in the Province of Ontario and the need to consider the possible outcomes. In response, Mr. Schmidt described the diverse platforms of the principle parties concerning their respective visions about the future of Hydro One, as discussed above. Commissioner Balasbas asked in addition about provision 8.4 in the Governance Agreement that provides for termination of the agreement by mutual consent. Mr. Schmidt responded, however, with reference to section 4.7 of the Governance Agreement, which established a detailed process by which the province could seek to remove and replace the board of directors, but not the CEO.[67]

56 Chairman Danner, in turn, followed up on this colloquy, observing that it was important to "get a handle on what kind of volatility, if any, we're stepping into" because, as had been reported in the financial press "investors [should] pay attention because 'policy shifts and promises of retribution could impact the stock of the company.'"[68] He identified specifically concerns about section 4.7 of the Governance Agreement and stated that its terms "[sound] to me like the Province still has potential to have large sway over the policies and direction of the company."[69]

57 Mr. Schmidt testified that he was well familiar with section 4.7. Without describing the process established by section 4.7 for removal of the board, Mr. Schmidt offered several reassurances, testifying that:

> The board of directors currently today, of course, is fully independent of the Province and they act commercially. And as I mentioned, the Province

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[65] Schmidt, TR 310:2-6.

[66] Schmidt, TR 310:13-18.

[67] Schmidt, TR 315:19-25.

[68] TR 315:17-21.

[69] TR 316:1-13.

> has not weighed in on any matters associated with the commercial operations of the organization.
>
> Secondly, to your reading, is that should the Province determine that they want to change the board of directors − and in fact the early design was to not be in a position for a [sic] Province to change a few or certain members of the board because they might be more commercially or independent from the Province, is that it would have a higher bar to change the entire board and yet an even higher bar to bring back another yet fully independent board of directors who has no connectivity with the provincial government. So therefore it's a net zero-sum gain of not gaining any particular influence over the commercial operations of the organization, and all through that being that we have a contract with the Province that they in fact will operate as a shareholder but not a manager of the business.
>
> So structurally, they can remove the full board of directors, not the CEO. Then they would be compelled to vote for another fully independent board of directors and, again, not having the ability to terminate the CEO, who would be running the commercial operations of the business. If that's helpful.[70]

58 Following additional colloquy between Mr. Schmidt and the bench, Chairman Danner said he wished to understand at a high level the risks associated with the province's large ownership share in Hydro One. He asked: "Is there a scenario under which the Province could undo the privatization of Hydro One, or is there a scenario by which the Province could gain control of the company going forward?"[71] Mr. Schmidt responded that:

> We would view it clearly as they have a contract and that that contract between the two parties, as earlier mentioned, would need the participation of both parties. Short of the province with a majority simply saying for whatever purpose we are going to go through the effort of changing the law and in fact affecting that contract, which, you know, of course, goes to any other commercial organization doing business in the Province thinking can the contract be set aside. And it would be our view that that

[70] Schmidt, TR 316:20-317:21.

[71] TR 321:21-322:1.

> would not be the outcome. And I could let our counsel [Mr. Scarlett] speak to it in greater depth if you would like, Commissioner.[72]

59 Responding to the question Chairman Danner had just posed to Mr. Schmidt, Mr. Scarlett testified:

> The simple answer is: Absent a government passing new legislation to undo a lot of what's being done, the short answer is no. We have a contract with the government, the governance agreement . . . with the Province of Ontario. It's a binding contract. [The] Province of Ontario respects its contracts, and *if they tried to breach the contract we can go to court*. But I don't expect any of that to happen.
>
> The contract is very intentionally and carefully crafted to control the power of a major shareholder. So right now they have 47-odd percent. It will be diluted to 42-odd percent if our deal goes through. But remember, this contract was in place when they owned 85 percent at the time of the IPO. And it constrains their ability. It constrains their ability. In a public-traded company, you don't have to have over 50 percent of the shares to vote the entire board. You can do it quite effectually at a much lower number.
>
> What this agreement does is constrains the Province of Ontario to 40 percent of the board. Period, full stop. It has other language that prevents it from what we would say in Canada as acting jointly and in concert with another party.
>
> So one of your questions was could they team up with somebody else to combine to get over 50, and I would say, no, that's prevented in the contract. And, B, they really wouldn't have to anyway if they wanted − if it wasn't for the other provisions in the governance agreement.
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> I think Mr. Schmidt took you through how the change of the board works. Again, it's a complicated procedure that's meant to make it difficult for the Province to weigh in at the board. It would have to be something dramatic, and even then the new board itself would have to be at the same standard of independence as the board that currently sits.[73]

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[72] Schmidt, TR 322:8-19.

[73] Scarlett, TR 323:18-325:6 (emphasis added). We note in this connection that the province's respect for its contracts may not be as strong as what Mr. Scarlett believed. Under the omnibus bill of which the Hydro One Accountability Act is one part, or "schedule," the province has

60 Returning specifically to provision 4.7 of the Governance Agreement, Mr. Scarlett testified in addition that:

> [I]t's probably a 90-day process because they file a removal notice. That triggers the need for a shareholders' meeting, which you can do under our corporate law. And that then triggers the need to set up an ad hoc nominating committee, which would then go out under the direction of our chair. Whether he or she is replaced or not, they are in charge of the ad hoc nominating committee. They line up representatives from our five biggest shareholders. . . . And they create a new slate.
>
> And then there is a shareholders' meeting and they vote on the slate. Now, of course, then they would be having the votes, and even then, they only get their 40 percent. They don't get to vote the whole kit and caboodle. Just the 40 percent.
>
> So it's in a very kind of carefully thought through and structured arrangement done intentionally because the Province was selling the deal to the public. And if they went out to public investors and the investors thought that the Province was going to be able to meddle or fiddle around in the business of Hydro One, the view was the deal would not have been successful, nor would they be able to assemble the management team led by Mayo Schmidt, because no one wanted to work for Crown Corporation, to be blunt.[74]

61 Despite all of this testimony suggesting a low probability of interference by the province in Hydro One's affairs, and the ability of Hydro One to stand up for the rights of all its investors and other stakeholders if the province did seek to interfere, it turned out that the viability of the protections built into the Governance Agreement was oversold to a significant degree. Soon after the change in majority leadership resulting from the June 7, 2018, Ontario general election it became apparent that the force of the Governance Agreement as an enforceable contract that would protect Hydro One's independence and freedom from political interference depended less on its language than on the identity of

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cancelled at least one major contract with third parties, the nearly completed 10-year, $100 million White Pines wind project. The omnibus bill, at the same time conferred upon the province and Hydro One immunity from civil liability in connection with any arguable breaches of contract.

[74] Scarlett, TR 325:9-326:8.

the governing party in the province and the willingness of the board to enforce its terms in court, if necessary.

62 Indeed, immediately upon taking power, the new majority party involved itself deeply in Hydro One's business, causing CEO Schmidt to "retire" and the entire board of directors to resign. In doing so, Hydro One's leadership and the new provincial government leadership agreed to waive provisions in the Governance Agreement that nominally prevented the province from removing the CEO and other provisions meant to provide procedural safeguards in the event the province, as shareholder, wished to replace the board. Specifically, the province effectively forced CEO Schmidt to retire and the board of directors to resign *en masse* without consulting, involving, or even informing other shareholders, who own a majority of Hydro One's shares, until after the fact. Absent the waiver to which the board agreed, this violated the letter of section 4.7 the Governance Agreement that provides for notice to all shareholders and a shareholders' meeting to consider any proposal by the province to remove the board.[75] Even with the waiver, this violated the spirit and intent of the Governance Agreement, which was meant to reassure investors at the time Hydro One began privatization that shareholders in the publicly traded corporation would have their rights respected just as in the case of any other publicly traded corporation.[76]

63 Given the testimony we heard on May 22, 2018, which we quote extensively above, the degree of acquiescence by the CEO and the sitting Board of Directors in carrying out the majority's political agenda was surprising and concerning. It appears from the evidence taken on October 23, 2018, that neither the CEO nor the board were willing to defend the integrity of Hydro One as a publicly traded corporation with multiple investors. Indeed, it was the CEO and the board members that took the initiative in waiving the prohibition against the province removing the CEO and the requirements of section 4.7 governing

[75] We note Mr. Scarlett's testimony confirming that the waiver requires only an agreement between Hydro One and a single shareholder, namely the province, and "other shareholders have no say in the decision whether there's going to be a waiver." TR 418:8-20. Having just acknowledged that "the intent of the Governance Agreement was to protect shareholders given the large percentage ownership of the Province" (TR 417:23-418) we find it incredulous that Mr. Scarlett disputed that the waiver provision, which is not limited in scope, "severely undercut the intent of the Governance Agreement to protect shareholders." TR 418:4-12.

[76] *See* Scarlett, TR 325:24-326:8; 413:24-414:4.

what Mr. Scarlett described as the "complicated procedure that's meant to make it difficult for the Province to weigh in at the board."[77]

64 Finally, we are concerned that the province evinced its willingness to pass intrusive legislation to effect campaign promises.[78] Considering the as yet unrealized campaign promise to reduce Hydro One's rates by 12 percent , legislation may be forthcoming to effect such a rate change, as might further intrusive legislation addressing other issues.[79]

65 We find additional reasons for concern over the changes in Hydro One's executive management and direction in light of the fact that it is clear from the record that the personal involvement by Hydro One CEO Mayo Schmidt with his counterpart at Avista, CEO Scott Morris, was central to the results achieved during the merger negotiations.[80] No one expected, and it is indeed concerning, that one of the two key negotiators was forced by the province to "retire" and the entire board that approved the deal resigned under pressure from the province before we could even complete our review of the proposed transaction. At the very least, a consideration pertinent to our evaluation of the proposed transaction is that during the transition in Avista's ownership contemplated under the merger, Mr. Schmidt's absence from his position as Hydro One's CEO, and the absence of any Hydro One board member with first-hand knowledge of the negotiations, will lead to greater uncertainty for Avista and its customers as the company is, effectively, acquired by another company whose leadership is unknown to Avista's leadership. We note further in this connection that for the time being Hydro One is being led by an acting CEO who, it appears, may be replaced by someone whose identity is not known.[81]

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[77] TR 325:1-3. Mr. Lopez testified that it was the board that approached the province initiating discussions that led up to the waiver agreement on July 11, 2018. Lopez, Exh. CFL-6T at 4:1-9.

[78] We note Mr. Scarlett's testimony that avoiding such legislation was one of the board's goals in agreeing with the province to expedite the realization of the new Premier's campaign promises to replace the Hydro One board and fire the CEO. Scarlett, Exh. JDS-1T at 6:13-7:2.

[79] *See* Scarlett, TR 418:24-419:10; *see also* Scarlett, TR 425:10-426:25.

[80] *See, e.g.,* Schmidt, TR 310:19-312:14. We do not disagree with later testimony making the point that "Eventually, executives retire or leave a company to pursue other opportunities" and certain governance and other commitments "are all preserved in contractual documents that continue long past the tenure of any single executive involved in the negotiation of the Proposed Transaction." Exh. JDS-1 at 24:25-25:12. "Eventually," however, is a key operative word here.

[81] Woods, TR. 451:19-452:3.

66 Mr. Morris testified that:

> Through this unique arrangement with Hydro One, Avista's customers can receive the benefits of scale that come with joining a larger organization while also avoiding the risk of a potential subsequent acquisition by another party that may not share Avista's culture and values.[82]

In other words, he viewed Hydro One as representing the best among alternatives because of his personal negotiations with Mr. Schmidt and their "meeting of the minds" with respect to the central importance of Avista maintaining its separate identity and independence "to ensure that Avista's culture and its way of doing business will continue for the long-term, inuring to the benefit of customers."[83] Returning to his point that after the merger Avista would "retain the autonomy that it needs to run the business in the same manner as befits its corporate culture and dedication to customers, employees and the communities it serves," Mr. Morris testified that "[w]ithout those assurances I would never have agreed to recommend to our board of directors to proceed with this transaction."[84]

67 Mr. Morris explained further in his testimony that the assurances to which he referred were the product of his unique interaction with Mr. Schmidt during negotiations. Mr. Morris testified that:

> At the very outset of negotiations with Hydro One, I vividly recall a private conversation with Mayo Schmidt, the CEO of Hydro One, in which I made very clear to him that Avista needed these types of assurances on autonomy for us to run our business as we see fit. Without a moment of hesitation, Mr. Schmidt slid a pen across the table and said, words to the effect, "Scott, you have the drafting pen. Write it up the way you want." This ultimately resulted in a set of conditions styled as a Delegation of Authority, which ultimately found their way into Commitments 1-15, as further revised by the Parties to the Settlement

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[82] Morris, Exh. SLM-5T at 3:9-12. In connection with the first point Mr. Morris made here we had testimony from Mr. Morris and Mr. Schmidt to the effect that neither company expects much, if anything, in the way of synergies from their combination, at least in the near term. Beyond that the prospect for any such benefits is vague, at best. See Schmidt, Exh. MMS-1T at 22:11-15; 33:1-28; Morris, TR 270:23-25; 273:3-4.

[83] Morris, Exh. SLM-5T at 5:22-23.

[84] Morris, Exh. SLM-5T at 6:16-20

> Stipulation. Indeed, to my knowledge, this approach may be unique in the world of utility mergers and acquisitions.[85]

Following this testimony, again emphasizing the trust that had developed between the two CEOs, Mr. Morris reiterated the point that:

> By selecting an acquisition partner (Hydro One) that truly understands this heritage of Avista, we may avoid the potential of someday being acquired by others who might be less appreciative of how we do business.[86]

68 We recognize in this connection that the nature and character of a publicly held corporation that is a potential merger partner are defined largely by its board of directors and executive management, particularly the CEO. It is these individuals who, collectively, determine how the corporation conducts its affairs. The removal of Mr. Schmidt as Hydro One's CEO and the forced resignation of the company's board of directors that approved this proposed transaction means that were we to approve this merger in the wake of the fundamental, material changes on and after July 11, 2018, it would be tantamount to accepting that Avista is "being acquired by others" who might be less appreciative of how Avista does business. We have no convincing evidence, if any at all, that the new board and CEO, whose identity remains unknown, will share the values on which the successful negotiation of the proposed transaction depended. This is particularly concerning considering that the character of Hydro One as a publicly traded corporation is seriously impaired by virtue of the province's interference in the company's affairs.

69 Mr. Schmidt and the former board shared with Avista the perspectives and values of executive management and direction guided by principles that govern the conduct of publicly traded companies. Shareholder interests inform the decisions of such leadership, but the respective CEOs and directors in place at these companies prior to July 11, 2018, did not take direction from, or allow interference in management by, shareholders. Indeed, as Mr. Scarlett testified, had there been such involvement by the province, "Hydro One would not have been able to assemble the management team led by Mayo Schmidt, because no one wanted to work for a Crown Corporation, to be blunt."[87]

70 Nothing in the record of this proceeding through the date of our Settlement Hearing on May 22, 2018, contradicted this. Testimony from Hydro One and Avista witnesses was

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[85] Morris, Exh. SLM-5T at 6:22-7:8.

[86] Morris, Exh. SLM-5T at 7:15-17.

[87] Scarlett, TR 326:1-8.

intended to convince us that Hydro One, despite the large ownership share retained by the Province of Ontario following privatization, was a fully independent, publicly traded corporation that would be guided by its CEO and board of directors without interference from the province. Our understanding changed fundamentally, however, as events unfolded on and after July 11, 2018. On that day and after, it became apparent that Hydro One management and direction were, in fact, subject to decisions by the Province of Ontario just as if Hydro One remained a Crown Corporation with a controlling, or even exclusive, ownership interest held by the Province of Ontario. The Province of Ontario's direct and significant interference in the management and direction of Hydro One beginning July 11, 2018, discredits and impugns the perhaps sincere, but clearly incorrect testimony presented during our settlement hearing to the effect that we should consider Hydro One to be a fully independent, private company. Thus, it is clear that Hydro One is not the same company that its former CEO and directors, and Avista, considered it to be when Avista agreed to the proposed merger earlier in 2018.[88]

71 Indeed, the evidence we received during our hearing on October 23, 2018, included testimony showing that the post-election process that led to the July 11, 2018, Letter Agreement between Hydro One and the province was initiated by CEO Schmidt and the Hydro One board. On July 11, 2018, the first session of the 42nd Parliament of the Legislative Assembly of Ontario commenced. Mr. Lopez testified in his supplemental testimony that the same day, Hydro One "announced that *following an approach by Hydro One to the Province*, they had entered into an agreement for the purpose of the orderly replacement of the Hydro One and HOI boards and the retirement of Mayo Schmidt as the CEO effective July 11, 2018."[89]

72 Expressly referring in his supplemental testimony to the campaign promises to remove Hydro One's CEO and some or all members of Hydro One's board, and to lower rates for Ontario residents, Mr. Scarlett testified that:

> If Premier Ford and his Progressive Conservative Party wished to seek to remove some or all of Hydro One's Board and its CEO, they could accomplish these objectives either (i) through procedures established by Section 4.7 of the Governance Agreement …, or (ii) through legislation.[90]

Mr. Scarlett filed this testimony on September 6, 2018, well after the events of July 11, 2018. Yet, he does not mention here, or elsewhere in his supplemental testimony, the

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[88] *See supra* n. 75.

[89] Lopez, Exh. CFL 6-T at 4:1-6.

[90] Scarlett, Exh. JDS-1T at 3:8-12.

alternative means by which the province actually fulfilled its promise to remove the board and the CEO. It did so by reaching agreement with Hydro One's board to waive certain requirements set out in Section 4.7 and arguably to breach the agreement by ignoring its express limitation against provincial removal of the CEO.[91] Indeed, Mr. Scarlett testified that except for provisions "*principally limited to compensation matters*," the province, in Section 16 of the Letter Agreement, "ratified and reaffirmed its commitment to the Governance Agreement, *which remains in full force and effect*."[92] He quoted Section 16 in full, as follows:

> 16. Reaffirmation: By entering into this Agreement, the Province ratifies and reaffirms its obligations under the Governance Agreement and agrees that, except as specifically set out in this Agreement with respect to the subject matter hereof, (i) the execution, delivery and effectiveness of this Agreement or any other documents delivered in connection herewith *shall not amend, modify or operate as a waiver or forbearance of any right, power, obligation, remedy or provision under the Governance Agreement*, and (ii) such agreement shall continue in full force and effect.[93]

73 Mr. Scarlett's testimony here not only defied common sense—the Governance Agreement manifestly did not "remain in full force and effect" insofar as the July 11 Letter Agreement expressly waived parts of Section 4.7—Mr. Scarlett's reference to "compensation matters" but not to matters concerning the board's removal that required such waivers suggests an effort to mislead us. This is particularly concerning considering that the context of Mr. Scarlett's testimony was the means by which the province could remove the board including "through procedures established by Section 4.7 of the Governance Agreement." Mr. Scarlett undercut his credibility as a key witness in this proceeding by pointing to "compensation matters" as the "subject matter" for which Section 16 provided a general exception to the Governance Agreement allowing for waiver, without mentioning the fact that the *only* "subject matter" waived under the Letter Agreement had nothing to do with compensation matters but, rather, was more

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[91] See Exh. MMS-5 (Governance Agreement) (Section 8.11 expressly provides that "any provision or . . . any breach of any provision of this Agreement" is effective and binding on the province and Hydro One if it meets the requirements of being "made in writing and signed by the party purporting to give such waiver.").

[92] Scarlett, Exh. JDS-1T at 12:4-10 (*emphasis added*).

[93] *Id.* at 12:11-18 (quoting from Exh. JDS-2, §16 (*emphasis added*).

central to the events of July 11, 2018. The *only* waiver in the Letter Agreement set forth in Section 1.c. says, in part:

> For greater certainty, the requirements to provide a Removal Notice or call and hold a Removal Meeting under the Governance Agreement are waived in connection with the replacement of the existing Directors with the Replacement Directors in the manner contemplated under this section 1.[94]

74 This waiver concerns exclusively express requirements found in Section 4.7 of the Governance Agreement that are part of what Mr. Scarlett earlier described as the "carefully thought through and structured arrangement" meant to reassure investors as Hydro One privatized.[95] The protections in Section 4.7 that require among other things a Removal Notice, a shareholder meeting, and a vote in which all shareholders can participate, are central to the Governance Agreement's limitations on the province's ability to interfere with the governance of Hydro One with respect to the CEO and the board of directors. Moreover, as evident from the Commission's inquiry during the hearing on May 22, 2018, Section 4.7 is centrally important to the Commission as a protective measure in the Governance Agreement.

75 Mr. Scarlett's testimony that the resignation of the board and CEO Schmidt's retirement, ignoring the protections afforded by Section 4.7, are explained fully by their determination that these acts would be in the best interests of Hydro One also lacks credibility.[96] As confirmed on October 23, 2018, Hydro One's share price dropped dramatically on July 12, 2018, its credit rating was downgraded, equity analysts lowered their expectations for the stock and ratcheted down their recommendations, and the regulatory review process underway for the proposed transaction was disrupted in three states, including Washington. Testimony by Mr. Scarlett and Mr. Dobson shows a lack of

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[94] Exh. JDS-2, Section 1.c.

[95] See supra ¶ 60.

[96] We note that the phrase "acting in the best interest of the corporation" is most often encountered in the corporate world as a key defense against shareholder lawsuits. Only one Hydro One witness, Mr. Woods, the new Chairman of the Board, acknowledged that the events of July 11, 2018, were not in the best interests of Hydro One or Avista. TR 449:22-450:14. *Compare id.*, with Scarlett, Exh. JDS-1T at 6:13-7:2, and Lopez, TR 463:12-14. Avista CEO Morris and CFO Theis testified these events were not in Avista's best interests. Morris, TR 368:21-369:6; Theis, TR 390:21-391:8.

due diligence by Hydro One in not even considering these predictable impacts before entering into the Letter Agreement with the province on July 11, 2018.[97]

76 In stark contrast to these clearly adverse impacts, we have no testimony or other evidence that explains how, or why, we could consider the CEO's immediate retirement and the board's sudden resignation as being in the best interests of the corporation.[98] Contrary to Mr. Scarlett's testimony, we see no advantage for the company in the CEO's and directors' active facilitation of the provincial government's ability to deliver on its politically motivated campaign promises. Among other things, their actions did not forestall the provincial government from introducing "legislation with potentially intrusive provisions."[99] The Minister of Energy introduced Bill 2, Urgent Priorities Act, 2018, into the Legislative Assembly of Ontario on July 16, 2018. The province proclaimed the Hydro One Accountability Act into law on August 15, 2018.

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[97] Mr. Scarlett testified that given the rushed nature of internal discussions at Hydro One leading up to July 11, 2018, he could not recall any direct conversation about "the potential impact [the board's resignation might have] on this transaction and its regulatory review" and "there weren't a lot of internal discussion about impacts one way or the other." TR 409:17-410:5. Nor could he recall any discussions about what the impact would be on Hydro One's stock. TR 409:8-16. This was despite there being discussions about "what the fiduciary duties are to look out for the best interest of the company." TR 409:12-16. Fiduciary duties, of course, run to the shareholders who take a keen interest in the value of their shares and corporate actions that affect the stock price. Mr. Scarlett testified in addition, however, that "as soon as [the board resignation and CEO retirement] occurred and we did the press release, you know, then we had our conversations, it was clear that it was − the impact would be that it would be troubling to people. My own view was that while the − there was clearly a short-term impact, it was basically on Hydro One, and that we did not believe, and I still don't believe, that the impact is really on Avista. I think that there's a short-term period of uncertainly, but I think that the way we've structured our deal, it's sort of neutral to Avista." TR 410:6-16. In fact, Hydro One's stock remains depressed relative to its value before July 11, 2018, and Avista's stock also experienced lost value that has not been recovered, so far as we know.

Mr. Dobson, then CFO at Hydro One, also was not consulted by the board concerning likely consequences for Hydro One's stock value, the likely reaction of ratings analysts, or the likely impact on Avista's stock value. *See* TR 479:6-481:17.

[98] Significantly, neither former CEO Schmidt nor any member of the former board was offered by Hydro One to provide testimony based on personal knowledge that might support Mr. Scarlett's assertions that the former CEO and members of the board considered their actions to be in Hydro One's best interests.

[99] *See* Scarlett, Exh. JDS-1T at 6:13-7:2.

77 Nor do we find that, having waived certain of the express provisions in Section 4.7 of the Governance Agreement, "the Province and Hydro One complied with the spirit and intent of Section 4.7 of the Governance Agreement."[100] The spirit and intent of the provisions requiring the province to provide a "Removal Notice setting out its intention to request Hydro One to hold a Shareholders meeting [(a Removal Meeting)] for the purposes of removing all of the Directors then in office, including the Provincial Nominees, with the exception of the CEO and, at the Province's sole discretion, the Chair" and the provisions in Sections 4.7.4 and 4.7.5 are perfectly clear. These are meant to protect the rights of all shareholders and to prevent a removal and replacement process for the board that elevated the interests of a single shareholder, the province, above that of all other shareholders. In addition, Section 4.7 makes an express exception for the CEO from the province's removal rights.

78 Mr. Scarlett's belief that it was not necessary to follow the requirements in these provisions of the Governance Agreement because the outcome was a foregone conclusion is beside the point.[101] If CEO Schmidt and every board member shared Mr. Scarlett's belief, this too is beside the point. The point is that all shareholders in a private corporation have equal rights and their rights should be acknowledged in all processes that call for their participation. In this case, their rights were ignored; they were given no opportunity to air any concerns they may have had in connection with the removal of the CEO and the entire board of directors. In addition, waiving these provisions of the Governance Agreement in a singular effort to effect as quickly as possible the results the new provincial government had promised in the run up to the June 7, 2018, election shows that Hydro One remains very much subject to the province's authority and, as a practical matter, in the province's control. It simply cannot be considered an independent, publicly traded company with a board of directors possessed of sufficient independence and power to protect Hydro One from political interference likely to cause harm to the company, much less to protect Avista from the consequences of bad decisions at Hydro One driven by the political whims of the controlling party in Ontario. Premier Ford is known to have said "Hydro One is not a private corporation."[102] Ultimately, the province is in control; it has not relinquished its power and authority over the board of directors and, hence, its power and authority over Hydro One.

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[100] *Id.*

[101] *See* Scarlett, TR 401:24-402:18; 3:13-404:7.

[102] *See supra* ¶ 43.

79 Yet, the province is not the counterparty with whom Avista negotiated and agreed to the transaction proposed by the Joint Applicants in this docket. Nor has the province made any pronouncement of its support for the transaction or commitment to the express requirements of the Settlement Stipulation to which it is not a party.[103] We simply have no assurances that the province will not, using legislative or other powers, exert its control over Hydro One in ways that undercut one or more of the Settlement Stipulation commitments or otherwise cause harm to Avista.

80 The protective provisions in the Settlement Stipulation unfortunately do not, and cannot, protect Avista from harm that might follow from actions the province may take with respect to Hydro One. The province may be nominally a minority shareholder, but Mr. Scarlett made clear that as a practical matter it retains sufficient power over the board of directors to cause the board to make decisions that are not in the best interest of Hydro One. Despite Mr. Scarlett's protestations to the contrary, it is inescapably true that the board's sudden resignation and the CEO's immediate retirement were hastily agreed to without any due diligence concerning what the consequences might be in terms of shareholder value, credit analysts' ratings, equity analysts' ratings, the status and reputation of Hydro One in the business community, or pending regulatory reviews concerning a proposed multi-billion dollar acquisition.

81 Actions already taken by the provincial government without giving due consideration to the harm it might cause Hydro One demonstrate the potential for harm to Avista that might follow from its acquisition by Hydro One.[104] There is nothing to prevent legislation in Ontario that might undercut by indirect means Avista's ability to provide its customers or the broader community one or more of the benefits promised by the Settlement Stipulation. There is nothing to prevent the province from passing legislation that will prevent Hydro One from living up to one or more of the protective commitments in the Settlement Stipulation. Legislation already has been passed into law giving the province significant authority over executive compensation that may impair the board's ability to attract and retain executives with experience and ability comparable to that of Avista CEO Morris or CEO's at other well-run investor-owned utilities. Legislation may be forthcoming in Ontario to effect the PCP's commitment to reduce Hydro One's rates by 12 percent, or some other amount, thus negatively impacting Hydro One's revenues.

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[103] Woods, TR 460:5-13 (Responding to the question: "has the provincial government stepped up and said in any formal fashion that it stands by this agreement, that it supports this agreement?" Mr. Woods testified: "I can confirm that they have not.")

[104] We note, again, that the events of July 11, 2018, also were taken without regard to the harm that might be caused to Avista.

Were such legislation to affect adversely Hydro One's ability to provide financial protection and support to Avista, the Company's ability to continue providing safe and reliable service to Washington customers at reasonable rates could be impaired.

82 Indeed, the parties recognized after the events of July 11, 2018, the need for an additional commitment to protect against, and provide recourse if, the province or any other governmental entity in Canada took a position or action that affected Avista's operations or prevented compliance with the Settlement commitments. It was Staff's intent that new Commitment 82 would accomplish this goal.[105] Mr. McGuire testified that:

> [A]fter the recent actions in Ontario, we thought it would be useful to the Commission to negotiate another commitment that would allow the Commission to have recourse against some other unforeseeable event.
>
> So in my mind, this commitment is a protection for the Commission in the event that anything else comes to pass, that the Commission or any of the intervening parties here deem to be detrimental to Avista or its ratepayers.[106]

Commitment 82 provides, in part:

> Notice and Petition for Re-Hearing: In the event of the enactment or adoption of any legislation, rule, policy, or directive by government at any level or by any governmental entity or official in Canada (a "Legislative Action") that affects Avista's operations because of Avista's corporate relationship with Hydro One, or affects Hydro One's compliance with any commitment in this stipulation, any of the parties to this proceeding may petition the Commission at any time for a re-hearing that re-opens the record in Docket U-170970 to consider whether the Commission should change its final order.

In Staff's view:

> [Commitment 82] benefits the ratepayers by giving parties and the Commission recourse again in the event that something detrimental happens. Something that the Commission or other parties perceive as being detrimental to Avista or its ratepayers, those parties and the

[105] McGuire, TR 499:9-17.

[106] TR 500:2-10.

> Commission can use this commitment to reopen the record and redecide this issue.[107]

83 This, however, provides recourse without any apparent remedy, or at least none that Staff could identify.[108] Staff contemplated that the Commission might rescind its approval of the proposed transaction following reconsideration under Commitment 82.[109] It is clear, however, that this would be impossible to do.[110]

84 The post-election events that we describe in this Order demonstrate the willingness and ability of the province, in cooperation with the former Hydro One board and CEO, and through legislation, to pursue the realization of political promises and goals without regard to the consequences this might have for Hydro One in terms of shareholder value, even undercutting the province's own interests as a shareholder. The province and Hydro One acted without apparent regard for the impact their actions might have relative to the ongoing regulatory approval process, delaying and putting at risk Hydro One's proposed $5.3 billion acquisition of Avista. There is nothing to forestall the province from passing additional legislation, or again forcing the cooperation of the board of directors by the threat of removal, to elevate the province's political interests above the interests of other shareholders and stakeholders. In the final analysis, considering the legislative power the province wields, there is no commitment Hydro One could make that would protect Hydro One against provincially imposed requirements that would constrain or forestall Hydro One's ability to live up to its commitments under the Settlement Stipulation thereby causing direct or indirect harm to Avista. Avista's ability to protect itself from actions by the provincial government that interfere with Hydro One's ability to live up to the Settlement commitments is questionable and would be limited, at best. The Commission's ability to protect Avista, were we to approve its acquisition by a company that for all practical purposes remains under the control of a sovereign government, would be equally limited, if it exists at all. The risk of harm to Avista is too great and the ability to protect Avista against harm is too slight for this transaction to be considered "in the public interest." The proposed transaction does not meet the threshold "no harm" standard and this determination requires the Commission to deny the transaction under RCW 80.01.040(3) and WAC 480-143-170.

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[107] McGuire, TR 501:3-10.

[108] See TR 501:11-19.

[109] McGuire, TR 503:1-11.

[110] As Commissioner Rendahl rhetorically asked both Mr. Scarlett and then Mr. McGuire: "How do you un-ring a bell?" TR 483:21-23; 501:11-12.

B. Proposed Benefits

85 Our determination in the preceding section of this Order means there is no need to consider in detail the promised affirmative benefits of this transaction that were meant by the parties to satisfy the "net benefit to customers" standard in RCW 80.12.020. However, we consider briefly the extent to which the promised affirmative benefits compensate for the unavoidable risks presented. We find the affirmative benefits promised to ratepayers are, in fact moderate in amount and relatively brief in duration. We must acknowledge the testimony that there will be few, if any, synergies arising from the proposed merger particularly in the short-term. As a result any cost savings cannot be quantified in advance or even assured.[111] Although the transaction promises any cost savings realized will flow through to ratepayers, these will be offset initially, at least in part, against the promised rate credits.[112]

86 The rate credits and other financial benefits promised under the terms of the Settlement Stipulation will be paid largely, if not completely, out of Avista's revenue recovered in rates and otherwise recorded on Avista's books as net income. The Avista Board of Directors has the discretion to treat net income as retained earnings available for dividends to shareholders or to re-invest in the Company. Thus, the source proposed to fund affirmative commitments under the Settlement Stipulation are "shareholder" funds only in the sense that any retained earnings used to provide benefits to customers will not be paid as dividends to Hydro One.

87 Since Avista's independent board presumably would retain discretion over the allocation and use of retained earnings if the merger were consummated, it is more difficult to conceive of the benefits identified in the Settlement commitments as "shareholder funded" net benefits to Avista's customers when the customers paid in the revenue from which the net income was derived in the first place. Effectively, Avista ratepayers, not "shareholders" or Hydro One are paying for the rate credits and other monetary benefits of the Settlement commitments. In principle, at least, these revenues would be available to Avista for the purposes specified in the Settlement with or without the merger. That is, Avista, if it chose to do so, could today propose to confer the same benefits to customers

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[111] *See* Schmidt, Exh. MMS-1T at 22:11-15; 33:1-28; Morris, TR 270:23-25; 273:3-4.

[112] *See* Morris, Exh. SLM-5T at 8:6-15.

and the community using its retained earnings as would be made available under the terms of the Settlement Stipulation.[113]

88 Finally, the rate credits and other financial benefits that total to $73.7 million over five to ten years, depending on the commitment, are neither *de minimis* nor particularly generous when compared against the $450 million to $900 million stream of revenue that will flow from Avista to Hydro One over five to ten years if Avista maintains the level of dividend payments made during recent periods.[114] Certainly, these benefits are not so large as to compensate to any meaningful extent for the risks Avista would face as a subsidiary of Hydro One.

C. Conclusion

89 The inherent risks of the proposed transaction for Avista and its customers are manifest and significant. While we accept that the Settlement Stipulation is "state of the art" in terms of the individual commitments that protect against specific risks, it is the overall risk of this transaction − the risk that the Province of Ontario will exert its power and authority over Hydro One in ways that harm Avista − that overwhelms our ability to approve it. New Commitment 82 in the Settlement Stipulation is not meaningfully protective because there would be no meaningful remedy available after "reconsidering" our approval of the proposed transaction once it is given, even if it is shown in a hearing on reconsideration that the province has taken steps that harm Avista.

90 We cannot overemphasize the importance of the fact that while it may be true that the government of Ontario cannot act directly against Avista in Washington, it is equally true that the province can interfere with Hydro One's affairs in ways that could undercut commitments set out in the merger agreement and Settlement Stipulation that will harm Avista. We will have, if this ensues, no practical means to remedy the harm. The proposed transaction does not meet even the lower bar of the no harm standard that

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[113] We acknowledge that this is not likely because it probably would force Avista to reduce dividends, which could adversely affect its share price.

[114] *See* Exh. JNT-1T (revised) at 14:1 - 15:9 ("[I]f this total shareholder funding of $44.3 million in Washington were applied to other jurisdictions on a 'most favored nations' [(MFN)] basis (see Commitment [81]), the cost to shareholders/quantifiable benefits to customers would approximate $74 million over the five to ten year period (depending on the specific commitment) after the merger closes."); *see also* Theis, TR 387:2-7 ("we pay [out of net income] approximately it's about a hundred million or 90 to a hundred million dollars. I don't know, again, the exact amount is dividends to shareholders. And then the rest is reinvested in the business as part of our retained earnings.").

guided our decisions in cases such as this before 2009. It most certainly does not satisfy the more demanding net benefit standard. We cannot find and conclude on the basis of the record that Avista and its customers will be better off with this proposed merger than without it. We find and conclude, moreover, that the proposed transaction is not in the public interest. It follows from these determinations that we cannot approve the proposed transaction under RCW 80.12.020, RCW 80.01.040(3), and WAC 480-143-170.

FINDINGS OF FACT

91 Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings and conclusions upon issues in dispute among the parties and the reasons therefore, the Commission now makes and enters the following summary of those facts, incorporating by reference pertinent portions of the preceding detailed findings:

92 (1) The Commission is an agency of the state of Washington vested by statute with the authority to regulate rates, regulations, practices, accounts, securities, transfers of property, and affiliated interests of public service companies, including electric and natural gas companies.

93 (2) Avista is a "public service company," an "electrical company," and "gas company" as those terms are defined in RCW 80.04.010 and used in Title 80 RCW. Avista provides electric and natural gas utility service to customers in Washington.

94 (3) Hydro One, formerly a Crown Corporation, has been since November 2015, and is today, an investor-owned electric transmission and distribution utility headquartered in Toronto, Ontario, Canada. The Province of Ontario retains a 47 percent ownership share in Hydro One. Hydro One provides electric distribution service to more than 1.3 million retail end-use customers, as well as electric transmission service to many local distribution companies and large industrial customers.

95 (4) There is a Governance Agreement between the province and Hydro One that was necessary to its transition from being a Crown Corporation to being a publicly held corporation. It was necessary, in significant part, to reassure potential investors that the Province of Ontario would not interfere in Hydro One's affairs. The Governance Agreement, among other things, established detailed requirements and processes that were to be followed if the provincial government

wished to remove and replace the Hydro One Board of Directors, but not the CEO.

96 (5) On June 7, 2018, provincial elections in Ontario resulted in the PCP gaining a majority in the Legislative Assembly. The party featured prominently in its election campaign a promise to fire Hydro One's Chief Executive Officer and replace the entire Board of Directors. The PCP majority was seated on June 29, 2018.

97 (6) On July 11, 2018, the first session of the 42nd Parliament of the Legislative Assembly of Ontario commenced and the new majority government was seated. On this same date, following an approach by Hydro One to the province, the entire Hydro One Board of Directors entered into a Letter Agreement with the province waiving certain protections and processes set out in Section 4.7 of the Governance Agreement that required notice to shareholders and a shareholder vote if the province wished to remove and replace the board, and that expressly denied the province the power to remove the CEO.

98 (7) Hydro One publicly announced on July 11, 2018, that the entire Board of Directors had agreed to resign by August 15, 2018, that a new board would be appointed by that date, and that the Hydro One CEO would retire effective immediately.

99 (8) There is no evidence that the Board of Directors considered the potential adverse consequences that might follow from these events, once announced. There is evidence suggesting that no such due diligence review was conducted with respect to several specific risks of harm that could reasonably be anticipated would follow from Hydro One's July 11, 2018, announcement.

100 (9) Hydro One's share price dropped dramatically on July 12, 2018, its credit rating was downgraded, equity analysts lowered their expectations for the stock and ratcheted down their recommendations, and the regulatory review process underway for the proposed transaction was disrupted in three states, including Washington. Avista's share price also dropped significantly on July 12, 2018.

101 (10) The Ontario Minister of Energy introduced on July 16, 2018, Bill 2, the Urgent Priorities Act, 2018, which included in Schedule 1 the Hydro One Accountability Act. The new provincial government passed Bill 2 into law and it became effective on August 15, 2018. This new law gave the province a direct and active role in setting, and continuing oversight of, executive compensation at Hydro

One. The law also amended the Ontario Energy Board Act, 1998, to prohibit the inclusion in rates of compensation paid to the CEO and executives of Hydro One.

102 (11) There is a continuing risk of further provincial government interference in Hydro One's affairs via exertion of influence over the board as Hydro One's largest, and dominant shareholder, or by further legislative action.

103 (12) Provincial government interference in Hydro One's affairs, the risk of which has been shown by events to be significant, could result in direct or indirect harm to Avista if it were acquired by Hydro One, as proposed. This, in turn, could diminish Avista's ability to continue providing safe and reliable electrical and natural gas service to its customers in Washington.

104 (13) The inherent risks of the proposed transaction are not adequately protected against by the Settlement commitments and cannot be adequately protected against because, if the merger were consummated, Avista could not be restored to the status quo ante. Avista's customers would be at greater risk of suffering harm were this proposed transaction to receive all necessary regulatory approvals and be consummated than if it is not approved and does not occur.

105 (14) Hydro One and Avista intend that such affirmative benefits as are offered by the Settlement commitments will be funded out of Avista's revenues approved for recovery by the Commission that yield net income, which can be paid out in dividends or treated as retained earnings available for other purposes at the discretion of the Avista Board of Directors. These revenues would be available to Avista for these purposes with or without the merger and Avista could, if it chose to do so, confer the same benefits to customers and the community using its retained earnings.

106 (15) Avista's customers would be no better off with this transaction than they would be without it.

CONCLUSIONS OF LAW

107 Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings and conclusions upon issues in dispute among the parties and the reasons therefore, the Commission now makes and enters the following summary of those conclusions, incorporating by reference pertinent portions of the preceding detailed conclusions:

108 (1) The Commission has jurisdiction over the subject matter of, and parties to, these proceedings.

109 (2) Chapter 80.12 RCW requires public service companies, including Avista, to secure Commission approval before they can lawfully sell or otherwise dispose of the whole or any part of their franchises, properties or facilities that are necessary or useful in the performance of their duties to the public. Any sale or disposition made without Commission authority is void.

110 (3) Under RCW 80.12.020(1), the Commission "shall not approve any transaction … that would result in a person, directly or indirectly, acquiring a controlling interest in a gas or electrical company without a finding that the transaction would provide a net benefit to the customers of the company."

111 (4) WAC 480-143-170 governs the Commission's standard of review for a change of control transaction and requires a finding that the transaction is consistent with the public interest.

112 (5) Having found that the proposed transaction does not make customers better off than they would be without it we conclude as a matter of law that the proposed transaction does not provide a "net benefit to customers" as required under RCW 80.12.020.

113 (6) RCW 80.01.040(3) requires the Commission to "[r]egulate in the public interest." Having found that the proposed transaction presents an unacceptably high level of risk of direct or indirect harm to Avista arising from the ongoing, and the potential for further, political interference by the Province of Ontario in Hydro One's affairs that could diminish Avista's ability to continue providing safe and reliable electrical and natural gas service to its customers in Washington, the Commission determines under WAC 480-143-170 that "the proposed transaction is not consistent with the public interest" and it accordingly "shall deny the application."

ORDER

THE COMMISSION ORDERS THAT:

114 (1) The Joint Application of Avista Corporation and Hydro One Limited (acting through Olympus Equity LLC, an indirect, wholly owned subsidiary), for an Order Authorizing Proposed Transaction, filed on September 14, 2017, whereby Olympus Equity LLC, a wholly owned Alaska limited liability company and

corporate subsidiary of Hydro One Limited, a Province of Ontario corporation, proposes to acquire all outstanding common stock of Avista Corporation, a Washington corporation and a jurisdictional public service company, making Avista Corporation a direct, wholly owned subsidiary of Olympus Equity LLC and an indirect, wholly owned subsidiary of Hydro One Limited, is denied.

115 (2) The Commission retains jurisdiction to effectuate the terms of this Order.

DATED at Olympia, Washington, and effective December 5, 2018.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DAVID W. DANNER, Chairman

ANN E. RENDAHL, Commissioner

JAY M. BALASBAS, Commissioner

NOTICE TO PARTIES: This is a Commission Final Order. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 and WAC 480-07-870.