

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Joint Application of)
PUGET SOUND ENERGY,)
ALBERTA INVESTMENT MANAGEMENT)
CORPORATION,)
BRITISH COLUMBIA INVESTMENT)
MANAGEMENT CORPORATION,) DOCKET U-180680
OMERS ADMINISTRATION)
CORPORATION, and OGGM)
VERMOGENSBEHEER B.V.)
)
For an Order Authorizing Proposed Sales of)
Indirect Interests in Puget Sound Energy.)
_____)

DIRECT TESTIMONY OF DR. MARC M. HELLMAN

ON BEHALF OF THE

ALLIANCE OF WESTERN ENERGY CONSUMERS

(REDACTED VERSION)

January 18, 2019

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1 **I. INTRODUCTION AND SUMMARY**

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

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

5 **Q. PLEASE STATE YOUR OCCUPATION AND ON WHOSE BEHALF YOU ARE**
6 **TESTIFYING.**

7 A. I am an economist by training with significant experience in energy utility regulation. I
8 am testifying on behalf of the Alliance of Western Energy Consumers (“AWEC”).

9 **Q. PLEASE SUMMARIZE YOUR EDUCATION AND WORK EXPERIENCE.**

10 A. I have a Master’s and PhD in Economics awarded by Claremont Graduate School and a
11 Bachelor’s degree in both Economics and Mathematics awarded by California State
12 Polytechnic University, Pomona.

13 With regards to my prior work experience, I was employed for 38 years in various
14 capacities by the Public Utility Commission of Oregon, with the last twenty years or so in
15 a management capacity leading economists, accountants and financial analysts in the
16 review of utility general rate filings and rate proposals, financing and affiliated-interest
17 applications, property sales, and merger and acquisitions. I have also provided consulting
18 services with my most recent projects for the Commonwealth Utilities Corporation with
19 headquarters in Saipan, the Smart Energy Alliance in a Nevada Power general rate filing
20 before the Public Utilities Commission of Nevada, and the South Dakota Intrastate
21 Pipeline Company. A copy of work history is provided as Exhibit MMH-2.

1 **Q. PLEASE DESCRIBE YOUR EXPERIENCE REVIEWING AND ANALYZING**
2 **UTILITY MERGERS AND ACQUISITIONS.**

3 A. Most recently, I represented AWEC in the Hydro One proposed purchase of Avista and
4 presented testimony before the Washington Utilities and Transportation Commission
5 (“Commission”). Prior to that work activity and up through most of 2017, I have either
6 participated in the review or led the Oregon Public Utility Commission’s (“Oregon
7 PUC”) staff team responsible for reviewing merger and acquisition filings submitted for
8 approval in Oregon over the course of more than ten years. These include the separate
9 Scottish Power and Mid-American acquisitions of PacifiCorp; the MDU acquisition of
10 Cascade; and the separate applications to purchase Portland General Electric that were
11 filed by TPG (not approved), Northwest Natural (later withdrawn by NW Natural), and
12 Sierra Pacific (approved but not consummated), as well as the PGE stock distribution as
13 an outcome of Enron’s bankruptcy filing. I also led the Oregon PUC staff review of the
14 recent Northwest Natural holding-company formation as well as the Avista proposal filed
15 several years ago to form a holding company, which Avista later withdrew. Some of the
16 mergers and acquisitions, such as those for PacifiCorp and Cascade, for example, also
17 required approvals in more than one state, including Washington.

18 Each of the proposed mergers and acquisitions listed above had their own unique
19 set of risks and potential benefits. To address the risks posed by the transaction, a host of
20 conditions were designed to mitigate those risks as well as other commitments that
21 resulted either in a net benefit or no harm to customers. In this current docket, the
22 standard determined by the Commission is not net benefit, the standard is no harm.

1 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

2 A. The purpose of this testimony is to describe the review AWEC undertook of the proposed
3 transaction, discuss the issues AWEC identified during the course of that review, and
4 provide support for the Multiparty Settlement Agreement and Stipulation (“Multiparty
5 Stipulation”), filed on January 15, 2019, that resolves these issues to AWEC’s
6 satisfaction.

7 **Q. YOU RAISE SOME CONCERNS AWEC HAD WITH THE PROPOSED**
8 **TRANSACTION IN YOUR TESTIMONY BELOW. DOES THIS INDICATE**
9 **THAT AWEC DOES NOT FULLY SUPPORT THE MULTIPARTY**
10 **STIPULATION?**

11 A. Absolutely not. My testimony below is intended to provide the Commission with
12 background on the proposed transaction not currently included in the record, as well as
13 the concerns AWEC identified in reviewing the application. However, AWEC conducted
14 discovery that addressed some of these concerns, while the Multiparty Stipulation
15 incorporates a number of commitments AWEC advocated for in settlement discussions.
16 The new commitments attached to the Multiparty Stipulation now fully address all of
17 AWEC’s remaining issues. AWEC fully supports the Multiparty Stipulation.

18 **II. BACKGROUND ON THE TRANSACTION AND THE SCOPE OF AWEC’S**
19 **REVIEW**

20 **Q. PLEASE PROVIDE A HIGH-LEVEL OVERVIEW OF THE TRANSACTION.**

21 A. Macquarie, the largest single owner of PSE, has agreed to sell its entire 43.99% interest
22 in Puget Holdings LLC, the ultimate parent company of PSE, to the Buyers.^{1/} Two of the

^{1/} In this testimony, “Macquarie” includes Macquarie Infrastructure Partners, Inc. and Padua MG Holdings LLC, both of which are current PSE owners. “Buyers” refers collectively to Alberta Investment

1 Buyers, AIMCo and bcIMC, are existing Puget Holdings members, and following the
 2 transaction will increase their ownership to 13.60% and 20.87% of the company,
 3 respectively.^{2/} The other two Buyers, OMERS and PGGM, would be new owners and
 4 propose to acquire 23.94% and 10.02%, respectively.^{3/} The total purchase price is just
 5 over \$3 billion,^{4/} which, combined with the initial acquisition price Macquarie paid and
 6 the dividends it received during its ownership, will result in an approximate [REDACTED]
 7 annual return to Macquarie for its investment in PSE.^{5/} Tables 1 through 3, below, show
 8 the change in ownership:

9 **Table 1**

	Percent
Current Equity Interests in Puget Holdings	Ownership
MIP Funds	43.89
Padua MG Holdings LLC	0.1
Canada Pension Plan Investment Board	31.57
British Columbia Investment Management Corporation	16.86
Alberta Investment Management Corporation	7.59
Total	100.0

Table 2

Purchasers of the Macquarie Interest in Puget Holdings	
Net Percent of Equity Interest in Puget Holdings Being Purchased	
OMERS Administration Corporation	23.94

Management Corporation (“AIMCo”), British Columbia Investment Management Corporation (“bcIMC”),
 OMERS Administration Corporation (“OMERS”), and PGGM Vermogensbeheer B.V. (“PGGM”).

^{2/} Joint Application at 2.

^{3/} Id.

^{4/} Staff Open Meeting Memo, Attachment 1 (Nov. 5, 2018)

^{5/} Confidential Exh. MMH-3C at 5 (Confidential Response to AWEC DR 050).

PGGM	10.02
Alberta Investment Management Corporation	6.01
British Columbia Investment Management Corporation	4.01
Total	43.98

Table 3

Equity Interests in Puget Holdings	
Resulting from the Sale of Macquarie Interest in Puget Holdings	
Canada Pension Plan Investment Board	31.57
OMERS Administration Corporation	23.94
British Columbia Investment Management Corporation	20.87
Alberta Investment Management Corporation	13.6
PGGM	10.02
Total	100

1 **Q. WHAT LEVEL OF REVIEW WERE YOU ABLE TO CONDUCT IN THIS**
2 **PROCEEDING?**

3 A. As directed by the Commission, the level of review was somewhat limited and focused
4 on the “no harm” standard and its application to this transaction. The prehearing
5 conference order, dated November 21, 2018, was guided by the direction of Order 01 in
6 this docket, dated November 9, 2018, and limited the number of data requests that could
7 be issued by any party. For example, parties were limited to 30 data requests, where
8 subparts of a question are treated as a distinct data request, prior to the filing of rebuttal
9 testimony. However, AWEC was granted an exception to this limitation because it had
10 already issued a number of data requests prior to the prehearing conference. To
11 maximize the time AWEC had to substantively review the transaction, AWEC issued its
12 first set of data requests on November 8, 2018, the same day that the Commission

1 determined to open an adjudicative proceeding in this docket. All data requests AWEC
2 issued prior to the prehearing conference were grandfathered in and not counted toward
3 the cap on data requests.

4 The overall time for review also was shortened relative to other merger
5 applications, such as the Hydro One application, where 100 percent of the utility was
6 being purchased. Nevertheless, AWEC was able to issue sufficient data requests and
7 review the responses to better understand: a) the transaction; b) PSE's ongoing
8 governance; c) interests and expectations of the purchasers; and d) new risks associated
9 with this transaction.^{6/}

10 I also note that there were some discovery requests that the Applicants did not
11 respond to based on their understanding of the Commission's direction that a more
12 limited review was appropriate. However, through separate discussions, the Applicants
13 agreed to respond to a number of substantive data requests to which they initially
14 objected, notably those seeking each of the Applicants' due diligence. While some of the
15 due diligence materials were blacked out, most were not and the materials allowed
16 AWEC to generally discern the aims, objectives and general plans of the Buyers.

17 **Q. HAS AN ADJUDICATIVE PROCEEDING IN THIS DOCKET SERVED THE**
18 **PUBLIC INTEREST?**

19 A. Yes. Opening an adjudicative proceeding allowed AWEC to investigate the transaction
20 and develop an understanding of the new ownership that will influence PSE's operations,
21 and therefore its customers, in the future. This, in turn, resulted in the development of

^{6/} In total, AWEC issued 51 data requests, many with a number of subparts. AWEC also reviewed the discovery issued by other parties.

1 additional commitments included in the Multiparty Settlement, some of which I describe
2 below, that provide additional protections for customers in response to the harms raised
3 by this transaction. AWEC also benefitted from the participation of other parties, like
4 Public Counsel, The Energy Project, and the NW Energy Coalition, all of which sought
5 information and raised relevant issues that AWEC did not.

6 AWEC strongly believes that the type of process the Commission ordered in this
7 docket is crucial to ensuring that AWEC can fulfill its mandate to serve the interests of
8 large electric and gas customers. This, in turn, helps the Commission fulfill its statutory
9 mandate to regulate in the public interest and ensure fair, just, reasonable, and sufficient
10 rates by building a broader record on which the Commission can base its decision.

11 Without process, including discovery and hearing rights, parties like AWEC would be
12 effectively foreclosed from meaningfully engaging in Commission proceedings like this
13 one, to the detriment of all customers of regulated utilities. AWEC, therefore, greatly
14 appreciates the Commission's decision to open an adjudication in this proceeding.

15 **Q. PLEASE PROVIDE FURTHER DESCRIPTION OF THE TRANSACTION**
16 **BASED ON AWEC'S REVIEW OF THE TRANSACTION DOCUMENTS AND**
17 **MATERIALS PROVIDED IN DISCOVERY.**

18 A. A review of four categories of documents is critical to obtaining a full understanding of
19 the transaction and the potential harms it could present to PSE customers. First is the
20 various Purchase and Sale Agreements ("PSA") between each of the Buyers and
21 Macquarie, which were attached to the testimony accompanying the Application in this
22 case. While these PSAs contain many of the same terms, they also differ from each other
23 in significant ways. Second is the Puget Holdings LLC Agreement ("LLC Agreement"),

1 which is attached as Exhibit A to the Multiparty Stipulation and governs the rights and
2 obligations of each owner of Puget Holdings LLC, PSE's ultimate corporate parent. This
3 LLC Agreement was produced as a Highly Confidential attachment to Staff informal data
4 request 001(e). Third is the Second Amended and Restated Senior Secured Loan
5 Agreement between Macquarie and Puget Intermediate Holdings, Inc. ("Macquarie
6 Loan"). Puget Intermediate Holdings Inc. resides directly below Puget Holdings LLC in
7 the holding company structure. The Macquarie Loan was produced as a confidential
8 attachment to AWEC Data Request 004 and is attached to this testimony as Confidential
9 Exhibit MMH-8C. Fourth are the due diligence documents undertaken by the acquiring
10 Applicants. Portions of the due diligence conducted by bcIMC, PGGM, and OMERS are
11 attached as Highly Confidential Exhibits MMH-4HC, MMH-5HC, and MMH-6HC. to
12 this testimony. Note that each of the Buyers that provided due diligence material
13 requested that their respective materials not be shared with the other Buyers or with PSE.
14 Consequently, AWEC has prepared separate redacted versions of this testimony to
15 comply with this request.

16 **Q. WHAT RIGHTS WILL EACH OF THE OWNERS HAVE IF THE**
17 **TRANSACTION IS APPROVED?**

18 A. The Buyers' rights and obligations are governed primarily by the LLC Agreement. It is
19 important to note that, while the LLC Agreement contains numerous detailed provisions
20 on ownership rights, capital contributions, dividend distributions, and share transfer
21 rights and obligations that are not present in the PSE Bylaws, there is no substantive

1 difference in effect or control between the governance provisions included in the LLC
2 Agreement and those included in the PSE Bylaws.

3 Puget Holdings is governed by a Board of Managers. Under the LLC Agreement,

4 [REDACTED] ^{7/}

5 [REDACTED]

6 [REDACTED]

7 [REDACTED] ^{8/}

8 [REDACTED]

9 [REDACTED]

10 [REDACTED]

11 [REDACTED]

12 [REDACTED] ^{9/}

13 [REDACTED]

14 [REDACTED]

15 [REDACTED]

16 [REDACTED] ^{10/}

17 [REDACTED]

18 [REDACTED] ^{11/}

19 [REDACTED]

^{7/} LLC Agreement § 4.02(b).

^{8/} Id.

^{9/} Id. § 4.02(e).

^{10/} Id. § 4.08.

^{11/} Id. § 4.08(b).

1 [REDACTED]
2 [REDACTED].^{12/} OMERS specifically negotiated a provision in its PSA
3 that ensures it would be the second largest owner of Puget Holdings, [REDACTED]
4 [REDACTED].^{13/}

5 **Q. WILL THE BUYERS WITH SMALLER OWNERSHIP SHARES HAVE**
6 **POWERS AS WELL UNDER THE LLC AGREEMENT?**

7 A Yes, they will have significant power. They will have what the owners of PSE have
8 referred to as “negative control” over Puget Holdings.^{14/}

9 The LLC Agreement defines certain matters for which [REDACTED]
10 [REDACTED].^{15/} These include “all key governance matters,”^{16/} including but
11 not limited to:

- 12 [REDACTED]
13 [REDACTED].^{17/} [REDACTED]
14 [REDACTED]
15 [REDACTED].^{18/}

^{12/} Id. § 4.09. The current LLC Agreement contemplates that [REDACTED], so it is not clear at this time how the owners will amend this provision, although in response to AWEC Data Request 043, attached as Exhibit MMH-3C, the Buyers stated they do not intend to make any substantive changes to the LLC Agreement and will make only “conforming changes” that have yet to be determined.

^{13/} Exh. SZ-3 at 55 § 5.16. In response to AWEC Data Request 13, attached as Exhibit MMH-3C, OMERS stated it negotiated this provision to ensure it would be the second largest shareholder.

^{14/} Confidential Exhibit MMH-9 at 4 (Attach. A to DR 22).

^{15/} PSE’s Bylaws include [REDACTED]. PSE Bylaws Art. III, Sec. 9.

^{16/} Confidential Exh. MMH-9 at 4 (Attach. A to DR 22).

^{17/} “EBITDA”: earnings before interest, taxes, depreciation, and amortization.

^{18/} [REDACTED]. LLC Agreement § 4.06.

1 [REDACTED]
2 [REDACTED]
3 [REDACTED]
4 [REDACTED]
5 [REDACTED]
6 [REDACTED]
7 [REDACTED].^{19/}

8 While AIMCo and PGGM will both own less than [REDACTED] % individually, they have
9 negotiated a voting agreement in which they have committed to vote their shares
10 together.^{20/} In the event of a disagreement between these Buyers over how to vote on an
11 issue that requires a supermajority or unanimous vote, the default will be to vote against
12 the matter that is the subject of the disagreement.^{21/} Thus, even the Buyers with the
13 smallest ownership shares, through this voting agreement, will have significant power to
14 block actions of which at least one of them disapproves. I provide further discussion of
15 these issues in Section IV of my testimony, below.

16 **Q. DOES THE PURCHASE PRICE INCLUDE ANYTHING OTHER THAN**
17 **MACQUARIE’S OWNERSHIP INTEREST IN PUGET HOLDINGS?**
18 A. Yes. The purchase price also entitles each Buyer to a pro rata share of the Macquarie
19 Loan.^{22/} It is my understanding that each of the current Puget Holdings owners has made

^{19/} LLC Agreement § 4.06.
^{20/} Exh. AM-3 at 78; Exh. MJV-3 at 102 (“AIM/PGGM Voting Agreement”).
^{21/} AIM/PGGM Voting Agreement § 2(b).
^{22/} Exh. AM-3 at 18 § 2.1; Exh. LW-3 at 18-19 § 2.1; Exh. SZ-3 at 24 § 2.1; Exh. MJV-3 at 21 § 2.1.

1 similar loans to Puget Intermediate.^{23/} [REDACTED]

2 [REDACTED]^{24/}

3 **Q. WHAT IS THE PURPOSE OF THIS LOAN?**

4 A. My understanding is that it provides tax benefits for the owners. [REDACTED]

5 [REDACTED]

6 [REDACTED]

7 [REDACTED]^{25/} [REDACTED]

8 [REDACTED]

9 [REDACTED]

10 [REDACTED]

11 [REDACTED]

12 [REDACTED]

13 [REDACTED]

14 [REDACTED]^{26/}

15 [REDACTED]

16 [REDACTED]

^{23/} Confidential Exh. MMH-9 (Attach. A to DR 22).
^{24/} Confidential Exh. MMH-8C at 21 and 23 (§ 2.1(a) & § 2.5(a)).
^{25/} Id. at 27-29 (§ 4.4).
^{26/} Confidential Exh. MMH-8C at 23-24 (§ 2.5(c)-(d)).

1 **Q. WHAT IS THE MATURITY DATE FOR THIS LOAN?**

2 A. [REDACTED]^{27/} [REDACTED]

3 [REDACTED]

4 [REDACTED].^{28/}

5 **III. RISKS POSED BY THIS TRANSACTION**

6 **Q. PLEASE DESCRIBE HOW YOU VIEW THE NO-HARM STANDARD FOR THIS**
7 **APPLICATION.**

8 A. I view the no-harm standard as comparing two scenarios. One scenario is the status quo,
9 as in current ownership continuing with applicable commitments remaining in force from
10 the original 2007 transaction. The second scenario is PSE operating under new
11 ownership based on materials provided, including proposed commitments offered at the
12 November 2018 hearing.

13 **Q. THE APPLICANTS SUGGEST IN THEIR APPLICATION THAT, BECAUSE**
14 **THIS IS AN ACQUISITION OF A MINORITY AND INDIRECT INTEREST IN**
15 **PSE, THE COMMITMENTS AGREED TO IN THE 2007 TRANSACTION ARE**
16 **SUFFICIENT TO PROTECT CUSTOMERS. DO YOU AGREE?**

17 A. No. I do not agree that, even with the ring-fencing provisions already in place, PSE's
18 customers should be indifferent to who ultimately owns PSE. Ring-fencing does not, by
19 itself, allow owners to come and go without consequence. The Commission seems to
20 have made this determination in its recent rejection of Hydro One's application to acquire
21 Avista.^{29/} In that case, the Commission determined that no commitments would have

^{27/} Id. at 16 (§ 1.1(a) (definition of "Maturity Date")).

^{28/} Confidential Exh. MMH-3C at 4 (Confidential Resp. to AWEC DR 048).

^{29/} Docket No. U-170970, Order 07 ¶¶ 89-90 (Dec. 5, 2018).

1 been sufficient to protect Avista’s customers from potential harms related to the Province
2 of Ontario’s ability to influence Hydro One’s operations .^{30/}

3 **Q. HAVE YOU IDENTIFIED ANY RISKS POSED BY THIS TRANSACTION?**

4 A. Yes. In reviewing this transaction, there are several risks that are present by reason of
5 this transaction. Some risks are raised by reason of the composition of the existing
6 owners as compared to the new owners.

7 **Q. WHAT DO YOU OBSERVE FROM LOOKING AT THE COMPOSITION OF**
8 **EXISTING OWNERS AND NEW OWNERS?**

9 A. One main observation is that currently there is a diversity of ownership with Macquarie’s
10 significant share of ownership along with Canadian pension funds. Under the proposed
11 sale, PSE will be owned 100 percent by institutions that manage pension fund
12 investments (Pension Funds). Further, Canadian Pension Funds (OMERS, bcIMC,
13 AIMCo, and CPPIB) will own in aggregate nearly 90 percent of PSE, with PGGM
14 owning the remaining roughly ten percent.

15 **Q. DOES THE NEAR 90 PERCENT CANADIAN PENSION FUNDS OWNERSHIP**
16 **RAISE A RISK?**

17 A. I think so. When looking at a “no-harm” standard, as I noted earlier, the comparator from
18 which no harm is measured should be on the status quo versus the new ownership
19 proposal. Under existing ownership, a large portion of the ownership is not Canadian
20 pension related. A negative impact to Canadian Pension Funds would impact a lower
21 percentage of the existing owners relative to the proposed owners.

^{30/} Id. The Province of Ontario holds a minority ownership interest in Hydro One. Id. ¶ 42.

1 **Q. WHAT DO YOU MEAN BY NEGATIVE IMPACT? COULD YOU GIVE A FEW**
2 **EXAMPLES?**

3 A. Yes. Negative impacts to Canada and its pension funds could arise from economic
4 factors such as a significant recession in Canada. While the pension funds themselves
5 seem to be fairly diversified in their investments, including holdings world-wide, a
6 recession would reduce the monies being deposited in the pension funds by reason of
7 reduced employment. Risks also could arise from demographic changes such as low
8 birth rates lowering the percentage of the younger population within Canada and the
9 employment population ratio such that fewer workers are supporting pension funding and
10 retirees. Negative impacts and risks also could arise from political factors such as
11 enacting legislation to increase pension benefits for workers, and thereby increasing the
12 liabilities of the pension fund. This may cause the Canadian Pension Funds to act more
13 aggressively to improve earnings and thereby could affect the operations of PSE so as to
14 provide Canadian funds a better return by aggressively draining cash from PSE. My
15 impression is that public pension benefits in Canada are not as “lucrative” as in the
16 United States.^{31/}

17 **Q. ARE THERE COMMITMENTS IN PLACE, SUCH AS A MINIMUM EQUITY**
18 **REQUIREMENT, OR DIVIDEND RESTRICTION, THAT WILL PROVIDE**
19 **SOME PROTECTION TO PSE CUSTOMERS FROM THESE RISKS?**

20 A. Yes. Commitment 30 prohibits PSE from having a common equity ratio below 44%
21 while Commitment 31 limits PSE’s ability to declare dividends under certain

^{31/} See, e.g., <https://www.bankrate.com/retirement/who-has-a-more-generous-retirement-system-canada-or-the-us/>

1 circumstances.^{32/} I would argue, however, that these existing commitments are not
2 sufficient to meet a no-harm standard with respect to the proposed transaction.

3 **Q. WHY IS THAT?**

4 A. An increased concentration of ownership in Canadian Pension Funds also raises some
5 incremental risk that Canadian legislation will negatively impact these entities, which
6 could flow through to PSE. Similar to Hydro One, each of the Canadian Pension Funds
7 is the subject of federal or provincial laws, which could be amended in a manner harmful
8 to these owners. Indeed, the second largest owner of PSE would be OMERS, which, like
9 Hydro One, is also an Ontario-based corporation. Unlike Hydro One, however, I am not
10 aware of any evidence of a stated intention to amend the relevant Canadian pension laws
11 in a manner that would adversely affect any of the Buyers. Additionally, even if such a
12 change occurred, it may only impact one of the pension funds and, consequently, a
13 minority ownership interest in PSE. This potential minority interest effect contrasts with
14 any impact to Hydro One, which proposed to purchase all of Avista.

15 **Q. HOW DOES THE MULTIPARTY STIPULATION ADDRESS THESE**
16 **CONCERNS?**

17 A. The Multiparty Stipulation includes a new Commitment 22 that requires PSE to report
18 any changes to the laws that govern each of the Canadian Pension Funds. This will
19 ensure that the Commission and parties are aware of any such changes and whether they
20 have the potential to impact PSE. While AWEC does not anticipate that the Commission
21 would reopen this docket to reconsider any of the commitments should such a change

³² All references to commitment numbers in this testimony refer to Attachment A to the Multiparty Stipulation.

1 occur, knowledge of a change in law could influence the Commission’s decision in other
2 cases, like a rate case, depending on what the change is and how it may ultimately impact
3 PSE. Commitment 22 also requires reporting on any changes to the so-called “30 Percent
4 Rule” that bars a Canadian pension plan administrator from owning 30% or more of the
5 voting stock of a company. This will allow the Commission to track whether any
6 relaxation of this rule could potentially allow any of the Canadian owners to acquire
7 greater influence over PSE’s operations.

8 **Q. WHY IS THERE A 30 PERCENT RULE?**

9 A. According to the Department of Finance of Canada, the 30 Percent Rule exists to limit
10 risk to a pension fund from having a large share of ownership in any company and to
11 discourage the fund from becoming an active investor.^{33/} The LLC Agreement, for

12 instance, [REDACTED]

13 [REDACTED].^{34/} The 30
14 Percent Rule also has resulted in the creation of complex corporate structures to
15 accommodate it, as OMERS has done in this case.^{35/}

16 **Q. WHAT OTHER ISSUES ARE RAISED DUE TO THE SIGNIFICANT INCREASE**
17 **IN CANADIAN OWNERSHIP?**

18 A. Under this transaction, Canadian ownership will increase to 89.98 percent. The LLC
19 Agreement [REDACTED]

^{33/} See <https://www.fin.gc.ca/activty/consult/ppic-prpc-eng.asp> The cited document says that, “pension plans should be passive investors...”

^{34/} LLC Agreement § 3.09(i).

^{35/} Exh. MMH-3C at 2 (Response to AWEC DR 023). The OMERS subsidiary directly purchasing its interest in Puget Holdings in this case is Moby GP Canada Corporation (“Moby GP”). Moby GP is in turn wholly owned by Hamilton Infrastructure Holdings, Inc. (“HIHI”) Exh. SZ-3 at 33 § 4.6(b). OMERS owns 30% of HIHI, while the other 70% is owned by the Hamilton Infrastructure Trust, which is unaffiliated with

1 [REDACTED]
2 [REDACTED]
3 [REDACTED] ^{36/}
4 [REDACTED]
5 [REDACTED]
6 [REDACTED]
7 [REDACTED] ^{37/} [REDACTED]
8 [REDACTED]
9 [REDACTED] ^{38/} [REDACTED]
10 [REDACTED]
11 [REDACTED] PGGM negotiated a provision that prohibited Macquarie (with certain
12 exceptions) from participating in a drag-along sale for three years following closing of
13 the transaction, if Macquarie maintained an interest in Puget Holdings.^{39/} If the
14 transaction is approved, [REDACTED]
15 [REDACTED]
16 [REDACTED]
17 [REDACTED].

OMERS. Id. OMERS has call rights over the shares of HIHI owned by the Hamilton Infrastructure Trust to protect its economic interests. Id.

^{36/} See LLC Agreement §§ 13.05, 7.05(a), 7.05(d).

^{37/} Id. § 7.09.

^{38/} Id. § 7.09(a).

^{39/} PGGM PSA § 5.14. Note that this provision does not appear to prevent PGGM from being the subject of a drag-along sale initiated by any of the Puget Holdings owners following consummation of the proposed transaction (which will not include Macquarie).

1 **Q. DO THE ORIGINAL COMMITMENTS ADDRESS THE ISSUE YOU HAVE**
2 **IDENTIFIED ABOVE?**

3 A. No. The original commitments only require notice of the acquisition of ten percent or
4 more of PSE. I would note, however, that PSE has provided notice on its own initiative
5 for some of the transfers of smaller increments since the 2007 acquisition.

6 **Q. DOES THE MULTIPARTY STIPULATION ADDRESS THE ISSUE YOU HAVE**
7 **IDENTIFIED ABOVE?**

8 A. Yes. New Commitment 9 now requires PSE to provide 30 days' prior notice of the sale
9 or transfer of any interest of any amount in Puget Holdings, and to also identify: (1) the
10 selling or transferring entity; (2) the purchasing entity; and (3) the amount to be sold or
11 transferred. While the commitment identifies that this notice is for informational
12 purposes, the Commission could investigate this transaction under its general regulatory
13 authority if it determines that such a transfer warrants additional scrutiny.

14 **Q. WHAT OTHER RISKS HAVE YOU IDENTIFIED ARE RAISED BY THIS**
15 **PROPOSED TRANSACTION?**

16 A. From reviewing the due diligence materials provided in discovery, I believe there is an
17 increased risk of leverage on a consolidated basis, meaning that the Puget Holdings
18 consolidated capital structure (meaning, collectively, Puget Holdings LLC, Puget
19 Intermediate Holdings Inc., Puget Equiqo LLC, Puget Energy, Inc., and Puget Sound
20 Energy) may be increasingly comprised of debt. Highly Confidential Exhibits MMH-
21 4HC, MMH-5HC, and MMH-6HC contain pages from the due diligence received in
22 response to AWEC Data Request No. 5. PGGM, for instance, [REDACTED]

1 [REDACTED].^{40/} OMERS [REDACTED]

2 [REDACTED]^{41/} bcIMC [REDACTED]

3 [REDACTED]

4 [REDACTED]

5 [REDACTED]^{42/}

6 **Q. WHAT IS YOUR CONCERN WITH THE POTENTIAL FOR INCREASED**
7 **LEVERAGE AT THE HOLDING COMPANY LEVEL?**

8 A. A credit rating agency report on PSE (“Opinion”) produced in discovery notes the level
9 of holding company debt and that dividends from PSE are the sole source for servicing
10 this debt.^{43/} This Opinion is included in Exhibit MMH-7. On page 2 of the Opinion, it
11 lists three credit challenges and I quote them below directly from the Opinion:

- 12 1. PSE's dividends are required to service \$1.7 billion of holding company debt;
- 13 2. Cash flow loss associated with tax reform; and
- 14 3. Significant capital expenditures over the next 12-18 months.

15 The Opinion also says on the same page that a factor that could lead to an upgrade is,
16 “Reduced leverage at the parent holding company.” You could surmise from this
17 Opinion that Puget Sound Energy’s credit rating could possibly be higher but for the
18 amount of holding company debt.

19 On page 6 of the Opinion, it states that the \$1.7 billion of holding company debt
20 represents 30 percent of the total consolidated balance sheet debt. The Opinion

^{40/} Highly Confidential Exh. MMH-5HC at 5 (Att. L to Joint Applicants’ First Supp. Resp. to AWEC DR 005).
^{41/} Highly Confidential Exh. MMH-6HC at 4 (Att. G to Joint Applicants’ First Supp. Resp. to AWEC DR 005)
^{42/} Highly Confidential Exh. MMH-4HC at 3 (Att. D. to Joint Applicants’ First Supp. Resp. to AWEC DR 005).
^{43/} Exh. MMH-7 (Att. B to Joint Applicants’ Response to AWEC DR 002).

1 acknowledges that the ring fencing that this Commission has adopted is important in
2 analyzing the creditworthiness of Puget Sound Energy. Nevertheless, with increased
3 debt, all else being equal, more dividends are needed from the regulated utility. When
4 the economy is sound and sales are strong, making these cash flow commitments might
5 not be a problem.

6 However, in rough economic times and slow sales, it may not be so easy to assure
7 that the dividends will be available. In my experience, rating agencies look at all sorts of
8 scenarios to test the strength of the company's cash-flow and the probability of default.
9 The higher the probability of default, the lower the utility's or company's credit rating.

10 **Q. ARE THERE COMMITMENTS ALREADY IN PLACE THAT PROTECT**
11 **CUSTOMERS FROM HIGHER COSTS OF CAPITAL AND CAPITAL**
12 **STRUCTURE AT THE PUGET SOUND ENERGY LEVEL?**

13 A. Yes. Commitment 7, for example, specifies that PSE will not advocate for a higher cost
14 of debt or equity capital as compared to what it would have been absent the change in
15 ownership at Puget Holdings. However, I do not view these commitments as a *guarantee*
16 that ratepayers will be protected from harm. Again, the "no harm" standard should be
17 applied by comparing the status quo to the new set of ownership.

18 **Q. DO YOU HAVE AN ANALOGY TO CONVEY YOUR THINKING?**

19 A. Yes. Suppose you have an older car, and to provide protection against accidents as a
20 passenger in the car, the driver agrees to install seat belts. Take that as the base case.
21 Now assume another driver wants to replace the existing driver except that the
22 replacement driver likes to drive faster and is more adventurous than the current driver.
23 You could argue that the seat belts are in place and so no additional protections are

1 necessary from risks of accidents. I believe the passenger would think otherwise. Maybe
2 now the passenger would like a helmet and airbags with the prospective new driver.

3 What is key to the above example is that the new driver drives differently than the
4 existing driver. Similarly, the new owners of Puget Sound Energy may not have the
5 exact same risk profile and plans as Macquarie. To the extent they are not exactly the
6 same, different risks could arise.

7 **Q. DOES THE BUYERS' DUE DILIGENCE INDICATE A CHANGE IN**
8 **CIRCUMSTANCE FROM THE STATUS QUO?**

9 A. It is not entirely clear. On the one hand, it is reasonable to assume that the owners of
10 PSE, both current and new, would act to maximize their profits within the constraints of
11 the existing commitments and PSE's broader service obligations. This would argue in
12 favor of the position that the proposed transaction will not change the consolidated
13 capital structure relative to what otherwise would have occurred under the status quo. On
14 the other hand, the proposed transaction will result in the exit of the single largest PSE
15 shareholder and the entry of two new shareholders who may hold different intentions
16 over the optimal level of debt in the consolidated holding company. As noted above,

17 PGGM [REDACTED]^{44/} OMERS [REDACTED]

18 [REDACTED]^{45/}

^{44/} Highly Confidential Exh. MMH-5HC at 5 (Att. L to Joint Applicants' First Supp. Resp. to AWEC DR 005).

^{45/} Highly Confidential Exh. MMH-6HC at 4 (Att. G to Joint Applicants' First Supp. Resp. to AWEC DR 005).

1 **Q. DOES THE MULTIPARTY STIPULATION ADDRESS CONCERNS RELATED**
2 **TO INCREASED LEVERAGE AT PSE AND PUGET ENERGY?**

3 A. Yes. New Commitment 38 requires PSE to annually report the level of debt held at PSE
4 and Puget Energy Inc., to the Commission for a period of five years. This includes
5 reporting the material terms of any new debt issuances, including the principal amount,
6 the interest rate, the maturity date, and the reasons for the debt issuances. As noted
7 above, it is not clear at this time whether the proposed transaction will result in higher
8 leverage in the consolidated capital structure and, if it does, whether this higher leverage
9 would harm PSE. This reporting requirement will provide additional transparency on this
10 issue following the transaction, which could assist the Commission in making future rate
11 decisions with respect to PSE.

12 **Q. DOES SOME OF THE DEBT ALSO RESIDE ABOVE PUGET ENERGY INC.?**

13 A. Yes. As noted above, Puget Intermediate holds debt in the form of the Macquarie Loan
14 as well as what I understand to be similar loans to the other Puget Holdings owners.^{46/}

15 Also as noted above, [REDACTED]

16 [REDACTED]

17 AWEC understands that Puget Holdings does not have any debt.

18 **Q. DID AWEC HAVE A CONCERN WITH THE LEVEL OF DEBT HELD ABOVE**
19 **PUGET ENERGY?**

20 A. AWEC had a potential concern here. While the Opinion notes that PSE's credit rating is
21 two notches above Puget Energy's, due to the ring-fencing protections in the existing
22 commitments, it also states that an upgrade could occur if leverage was reduced at the

^{46/} Confidential Exh. MMH-9 at 4 (Att. A to Joint Applicants' Resp. to AWEC DR 022).

1 “holding company.”^{47/} It is not clear from the Opinion whether Moody’s is referring
2 specifically to Puget Energy, Inc. in using the term “holding company” or if it is referring
3 more broadly to all of the entities in the Puget Holdings corporate structure above PSE.
4 Therefore, AWEC did have a concern that debt held above Puget Energy could
5 conceivably impact PSE.

6 **Q. DOES THE MULTIPARTY SETTLEMENT ADDRESS DEBT HELD IN THE**
7 **HOLDING COMPANY ABOVE PUGET ENERGY?**

8 A. Yes, because the Applicants have authorized AWEC to state that they agree that,
9 pursuant to other commitments, such as Commitments 10 and 11, AWEC may seek
10 information on debt held by parents above Puget Energy Inc. to the extent that it pertains
11 to or affects PSE. PSE is also free to object to providing such information on the grounds
12 that it does not pertain to or affect PSE. If PSE is downgraded, or prevented from being
13 upgraded, based on the holding company’s consolidated capital structure, however, then,
14 in AWEC’s view, this information should be discoverable in a ratemaking proceeding,
15 and parties should be entitled to request it.

16 **Q. HOW WOULD THIS INFORMATION BE USEFUL TO THE COMMISSION?**

17 A. The existing commitments specify that PSE’s debt and equity costs will be no higher than
18 such costs would have been absent the proposed transaction unless PSE proves that a
19 lower credit rating is due to circumstances independent of the proposed transaction.^{48/}
20 A determination of whether PSE is complying with this requirement is necessarily fact-
21 based and could be the subject of debate in, for instance, a rate case. For example, even

^{47/} Exh. MMH-7 at 3 (Att. B to Joint Applicants’ Response to AWEC DR 002).
^{48/} Commitment 7.

1 if the company agrees that PSE was downgraded because of additional debt held at the
2 holding company level, there is judgment in identifying the basis point reduction in the
3 cost of debt for a one-notch downgrade. The Company might argue it is 5 basis points
4 and other parties may argue it is 20 basis points. If the true answer is closer to 20 basis
5 points, there is still a risk as to whether parties can make a sufficient showing to prevail
6 on the issue.

7 Then again, it is possible that the Company could also argue that PSE would have
8 been downgraded anyway, and that the leverage of the consolidated company was just
9 one of several factors that led to the downgrade. It is doubtful that a rating agency would
10 point to one single factor, and one factor alone, as the cause of a rating downgrade.

11 Ensuring the protection envisioned by Commitment 7 can be even more problematic.

12 **Q. HOW SO?**

13 A. The example above addresses a PSE downgrade and what is the right number of basis
14 points and whether the downgrade would have happened regardless.

15 The issue gets even less clear when, absent the amount of leverage, PSE would be
16 upgraded. We do not observe the upgrade. The rating remains the same. We might
17 observe other similarly situated utilities being upgraded for some industry-trend
18 phenomena, but not PSE. Parties representing customers would need to identify and
19 defend the proposition that an upgrade should have happened and then make a sufficient
20 showing before the Commission that PSE's debt rating should have a one notch
21 improvement and adopt a basis-points adjustment.

1 What this makes clear is that the existing commitments have provided a seat belt,
2 but may not provide adequate protection from unforeseen future events. While the new
3 Commitment 38 does not eliminate the potential for factual disputes over these matters, it
4 does provide additional transparency with regard to the level of debt that potentially
5 impacts PSE's credit rating, including ensuring access to debt that parties may not have
6 otherwise known existed. The lack of an upgrade discussion above is one of the reasons
7 why AWEC thinks it is important to know the level of debt issued above Puget Energy
8 Inc.

9 **Q. WHY NOT INCLUDE A COMMITMENT THAT HOLDING COMPANY DEBT**
10 **BE REDUCED?**

11 A. I have not seen that sort of commitment in my experience in reviewing mergers and
12 acquisitions. The Commission likely lacks the jurisdictional authority to require a
13 reduction of debt held at Puget Intermediate. Further, it is not clear that a reduction in
14 existing debt held at Puget Intermediate would necessarily inure to the benefit of
15 customers; and, even if it did, such a commitment would be more consistent with a net
16 benefits standard, not a no-harm standard. If it becomes clear that the owners are
17 incurring debt for their benefit and also at the harm of customers, this becomes an issue
18 in a rate case.

1 **IV. ABILITY TO CONTROL A UTILITY**

2 **Q. EARLIER YOU TESTIFIED THAT THE COMMISSION STANDARD OF**
3 **REVIEW IS A NO-HARM STANDARD. WHAT IS THE BASIS FOR THE**
4 **WUTC DECIDING THAT A NO-HARM AND NOT A NET-BENEFITS**
5 **STANDARD BE APPLIED?**

6 A. In its November 9, 2018, Order 01, paragraph 35 states that, “Neither the 43.99 percent
7 interest being transferred nor the interest shares being acquired by AIMCo, BCI,
8 OMERS, or PGGM, constitute a ‘controlling interest’ within the plain meaning of the
9 statute.” Because the Commission concluded that a controlling interest is not being
10 transferred, the “no harm” standard applies and not the net benefit standard.

11 **Q. WHAT HAS THE WUTC CONCLUDED IS NEEDED FOR AN OWNER TO**
12 **CONTROL PUGET?**

13 A. As noted in Paragraph 22 of Order 01, all decisions regarding PSE require at least 55
14 percent ownership approval.

15 **Q. WHY 55 PERCENT?**

16 A. As noted in the Commission’s Order 01, that is the minimum percent prescribed by the
17 LLC Agreement for some business decisions to be approved by the owners.

18 **Q. DOES YOUR ANALYSIS OF THIS TRANSACTION SUPPORT THE**
19 **COMMISSION’S CONCLUSION THAT IT IS THE GOVERNANCE**
20 **STRUCTURE THAT IS KEY TO WHAT PERCENT AN OWNER MUST HOLD**
21 **TO YIELD A CONTROLLING INTEREST?**

22 A. Yes. In reviewing the responses to the data requests, it was clear from the Buyers that
23 part of their consideration as to whether to purchase a share of PSE, and in what
24 percentage amount, was the governance structure over PSE’s operations.

1 **Q. IN YOUR VIEW, DID THE APPLICANTS FOCUS ON A 55 PERCENT**
2 **OWNERSHIP INTEREST?**

3 A. No. Rather, the ability to control at least [REDACTED] of Puget Holdings, and the associated
4 “negative control,”^{49/} (i.e., veto power) appeared to be the most important consideration
5 for the buyers with respect to the level of interest held in Puget Holdings. This is evident
6 from the voting agreement AIMCo and PGGM – the only two owners who would hold
7 less than [REDACTED] – have entered into, discussed in Section II, above. According to due
8 diligence materials, PGGM [REDACTED].^{50/}
9 Due diligence materials from the other buyers also reflects the importance of [REDACTED]
10 ownership to the Puget Holdings governance structure. As discussed above, all of the
11 most significant governance decisions at Puget Holdings (and, consequently, PSE)
12 require a supermajority [REDACTED] vote.

13 **Q. CAN YOU THINK OF REASONS AS TO WHY AN ABILITY TO VETO A**
14 **BUSINESS DECISION MAY BE ATTRACTIVE TO A PROSPECTIVE OWNER?**

15 A. Yes. Having a veto right upon [REDACTED] ownership is an attractive feature because it allows
16 an owner to effectively exercise significant control over the utility while at the same time
17 not requiring the owner to buy a majority percentage of the utility. This feature is
18 certainly more attractive when we are dealing with a multi-billion-dollar investment such
19 as Puget Sound Energy. The drawback is there could be several owners who all can
20 exercise significant control over the utility, so it will be important to “get along” with the

^{49/} Confidential Exh. MMH-9 (Attach. A to Joint Applicants’ Resp to AWEC DR 022).

^{50/} Highly Confidential Exh. MMH-5HC at 8 (Att. L to Joint Applicants’ First Supp. Resp. to AWEC DR 005).

1 other owners and have somewhat common visions so that the utility can efficiently and
2 timely carry out its business.

3 **Q. DO THE BUYERS APPEAR TO HAVE COMMON VISIONS FOR PSE?**

4 A. Yes and no. OMERS and PGGM, the two new owners, appear to have accepted the
5 current 5-year business plan for PSE, so at least in the short-term, there appears to be
6 general agreement on PSE's direction.^{51/} Additionally, all of the proposed owners under
7 the transaction have pension fund investments as their general business activity, and
8 almost 90 percent of the owners are Canadian Pension Fund Investment companies, so
9 the owners likely have many common goals as shareholders and a common framework to
10 work from.

11 Conversely, though, some of the due diligence material produced in discovery
12 indicates that certain owners have very different visions for where PSE will be in the
13 long-term from an income statement and balance sheet perspective. PGGM, for instance,

14 [REDACTED]

15 [REDACTED]^{52/} OMERS, [REDACTED]

16 [REDACTED]^{53/} This suggests that at least these two
17 owners may have different long-term investment objectives for PSE. If the new set of
18 owners disagrees on these and other objectives, then non-optimal results can occur,
19 similar to a car being high-centered so it cannot move in any direction.

^{51/} See Exh. SZ-3 at 37 § 5.1(b)(vi); Exh. MJV-3 at 31 § 5.1(b)(vi)-(vii). As existing owners, AIMCo and bcIMC have also necessarily agreed to the current PSE business plan.

^{52/} Highly Confidential Exh. MMH-5HC.

^{53/} Highly Confidential Exh. MMH-6HC.

1 **Q. DOES THE LEVEL OF CONTROL OF THE COMPANY CHANGE WITH**
2 **INCREASES IN PERCENTAGE OWNERSHIP?**

3 A. Yes. At ownership level of 55 percent, the owner can independently make most
4 decisions regarding the business that are not designated as supermajority, or require a
5 unanimous vote [REDACTED]

6 These next “step-up” in authority is at [REDACTED]
7 [REDACTED]
8 [REDACTED].^{54/}

9 The next stepping point is where an owner has an [REDACTED] percent stake in PSE. This
10 percentage ownership gives the owner the right to independently decide all matters
11 requiring a super-majority decision. With this level of ownership no other owner can
12 veto a substantive decision [REDACTED]. A prospective buyer might
13 consider this level of ownership where the existing set of owners do not have similar
14 visions and objectives. This answer assumes that control means you can do almost
15 anything you want as the “major” shareholder.

16 **Q. WHAT DOES THIS ANALYSIS SUGGEST WITH RESPECT TO WHAT**
17 **CONSISTUTES A CONTROLLING INTEREST IN A COMPANY?**

18 A. Whether or not a prospective buyer has a controlling interest in a utility is a matter that is
19 best understood after analyzing the governance of the utility—the owners’ operating
20 agreement. Therefore, I conclude that, in general for mergers and acquisitions, there is
21 no magic percentage which, if exceeded, provides an owner with a controlling interest.

⁵⁴ LLC Agreement § 7.09.

1 Analysis of governance agreements should be tackled first to understand what is
2 necessary for control.

3 And, as is clear in the Hydro One transaction, it may be necessary to see if the
4 “nominal owners” in fact are independent from influence. There could be major owners
5 of the “nominal owners,” and these “indirect” owners have some control and have
6 substantial influence over the downstream regulated utility.

7 The importance of this issue becomes magnified when, as in this case, there are so
8 many owners, each with at least nominally “minority” ownership shares. This
9 circumstance potentially allows two or more owners to achieve effective control over
10 PSE by agreeing to vote their shares together, similar to the voting agreement between
11 AIMCo and PGGM but with larger ownership percentages at stake. Such an action could
12 allow these owners to circumvent Commission review of this arrangement and
13 application of the “net benefits” standard in RCW 80.12.020(1).

14 **Q. DOES THE MULTIPARTY STIPULATION ADDRESS THIS RISK?**

15 A. Yes. New Commitment 23 requires PSE to file notice of: (1) any change to the voting
16 requirements in either the PSE Bylaws or LLC Agreement; and (2) the creation of any
17 enforceable voting agreement among two or more Puget Holdings members. This will
18 ensure that the Commission has notice of any change to the voting rights that may impact
19 PSE’s operations and that may trigger a “net benefits” review.

1 **Q. BASED ON YOUR TESTIMONY AND THE COMMITMENTS THE JOINT**
2 **APPLICANTS HAVE AGREED TO IN THE MULTIPARTY STIPULATION, DO**
3 **YOU RECOMMEND THAT THE COMMISSION APPROVE THE PROPOSED**
4 **TRANSACTION?**

5 A. Yes.

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

7 A. Yes.