

**EXHIBIT NO. ___(WRM-1T)
DOCKET NO. U-072375
2007 MERGER PROCEEDING
WITNESS: WILLIAM R. MCKENZIE**

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**In the Matter of the Joint Application of
PUGET HOLDINGS LLC
And
PUGET SOUND ENERGY, INC.
For an Order Authorizing Proposed Transaction**

Docket No. U-072375

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF
WILLIAM R. MCKENZIE
ON BEHALF OF PUGET HOLDINGS LLC**

JULY 2, 2008

PUGET HOLDINGS LLC

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF
WILLIAM R. MCKENZIE**

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1 **PUGET HOLDINGS LLC**

2 **PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF**
3 **WILLIAM R. MCKENZIE**

4 **I. INTRODUCTION**

5 **Q. Will you please state your name and business address?**

6 A. My name is William R. McKenzie. My business address is 340 Terrace Building,
7 9515 - 107 Street, Edmonton, Alberta, Canada T5K 2C3.

8 **Q. By whom are you employed and in what capacity?**

9 A. I am employed by the Alberta Investment Management Corporation (“AIMCo”)
10 as Head, Infrastructure and Timber Investments.

11 **Q. Have you prepared an exhibit describing your education, relevant**
12 **employment experience, and other professional qualifications?**

13 A. Yes, I have. It is Exhibit No. ___(WRM-2).

14 **Q. Please summarize the purpose of your rebuttal testimony.**

15 A. This rebuttal testimony responds to criticisms of the Staff of the Washington
16 Utilities and Transportation Commission (“Commission Staff”) and the Public
17 Counsel Division of the Washington State Attorney General’s Office (“Public
18 Counsel”) regarding the structure of the transaction, the duration of the proposed

1 transaction, and the governance model to be employed by the Investor
2 Consortium for each of Puget Energy, Inc. (“Puget Energy”) and Puget Sound
3 Energy, Inc. (“PSE”).

4 **II. AIMCo IS AN EXPERIENCED INVESTOR WITH AN**
5 **INTEREST IN LONG-TERM INVESTMENTS**
6 **IN QUALITY ASSETS, SUCH AS PSE**

7 **Q. What is AIMCo?**

8 A. AIMCo, based in Edmonton, Alberta, is one of the largest institutional investment
9 managers in Canada.¹ AIMCo provides investment management services to
10 various public sector bodies of the Province of Alberta. The majority of AIMCo
11 assets under management come from Alberta public sector pension plans and
12 provincial endowment funds. These pension plans provide benefits for more than
13 270,000 pension members. These members include public servants, health care
14 workers, academic staff, police officers, and provincial judges. AIMCo
15 endowment clients provide funding for purposes including undergraduate
16 scholarships and medical, science, and engineering research.

17 AIMCo invests client funds across a wide range of asset classes, such as equities,
18 bonds, and alternative investments. Alternative investments include
19 infrastructure, private equity, real estate, and timberland. Approximately 75% of

¹ Alberta Investment Management (“AIM”), the predecessor to AIMCo, was a part of the Department of Finance of the Province of Alberta until December 31, 2007. As of January 1, 2008, AIM was corporatized and the Alberta Investment Management Corporation (“AIMCo”) became an Alberta Crown corporation, which continues to provide investment management services to the same clients. For the purpose of this testimony, all references to AIM or AIMCo will use the term AIMCo.

1 our funds are managed internally.

2 AIMCo is a Crown corporation created by the *Alberta Investment Management*
3 *Corporation Act* and wholly owned by the Province of Alberta. AIMCo has a
4 board of eleven directors appointed by the Province (other than the Deputy
5 Minister of Finance, who is an ex-officio director). Although appointed by the
6 Province of Alberta, the Act requires directors be selected by a Nominating
7 Committee and have relevant professional investment experience.

8 Each director and officer of AIMCo has a legislative duty to act in the best
9 interest of AIMCo, having due regard for the interests of AIMCo's client funds.

10 These legislative requirements create a board that is qualified, professional,
11 independent and at arm's-length of government, while maintaining high standards
12 of governance and oversight on a cost-effective basis.

13 **Q. What is the value of assets under management of AIMCo?**

14 A. As of March 31, 2008, AIMCo has over C\$75 billion of assets under
15 management.

16 **Q. Are the assets under management of AIMCo growing?**

17 A. Yes, the assets under management of AIMCo are growing quickly. The following
18 table shows the dramatic growth of the assets under management of AIMCo over
19 the past four years:

	Mar. 31, 2005	Mar. 31, 2006	Mar. 31, 2007	Mar. 31, 2008
Assets Under Management	C\$47 billion	C\$61 billion	C\$73 billion	C\$75 billion

1 **Q. Please describe the investment objectives of AIMCo.**

2 A. AIMCo provides investment management services to its clients pursuant to the
3 Alberta Investment Management Corporation Act. The objectives of AIMCo's
4 clients are to earn a high risk-adjusted rate of return in order to meet their long-
5 term obligations. AIMCo makes investments solely in accordance with an
6 investment-only mandate and does not make investments based on non-
7 investment criteria. Subject to broad investment guidelines set by the client funds
8 (e.g., asset class allocation), AIMCo has full authority and discretion to make and
9 actively manage investments in the best interests of its client funds.

10 **Q. Is AIMCo an active investor in infrastructure assets?**

11 A. Yes. Alternative investments generally, and infrastructure investments in
12 particular, are an increasing focus at AIMCo. We have been investing in
13 infrastructure for more than five years and have an investment team dedicated to
14 making and actively managing infrastructure investments. AIMCo has made
15 eight direct equity investments and has invested in twelve infrastructure funds.
16 AIMCo takes significant minority ownership stakes and regularly participates as
17 directors or observers on investee company boards. AIMCo understands the
18 importance of making quick investment decisions and has a nimble investment

1 approval process. AIMCo's infrastructure investments are made on a long-term
2 basis, and the portfolio is diversified across sector and geography, including
3 investments in North America, Europe, Asia and Australia.

4 **Q. What is the magnitude of AIMCo's investments in infrastructure assets?**

5 A. As at June 23, 2008, AIMCo manages infrastructure assets of more than
6 C\$1.1 billion. AIMCo clients have thus far allocated an additional C\$1.7 billion
7 to make equity investments in infrastructure, providing AIMCo with significant
8 capital for further investment in this asset class. AIMCo expects client
9 allocations to infrastructure to continue to increase over time.

10 **Q. Why does AIMCo consider infrastructure assets to be good investments?**

11 A. Infrastructure assets are viewed as an effective duration match against the long-
12 term liabilities of AIMCo's pension and endowment fund clients. AIMCo's
13 pension clients need to fund liabilities of the plan for its members for many years
14 following the anticipated date of their retirement. Also, AIMCo's endowment
15 clients need to provide funding for their programs into perpetuity.

16 AIMCo places great importance on its direct equity investment program
17 (including the Proposed Transaction) because direct equity investments allow
18 AIMCo to hold investments indefinitely and effectively match client liabilities.
19 AIMCo expects infrastructure investments to provide a moderate return with a
20 lower degree of risk compared to other asset classes.

1 Furthermore, the dividend yield provided by infrastructure projects also matches
2 the needs of AIMCo's clients to make annual distributions. Infrastructure
3 investments also provide AIMCo's clients with portfolio diversification and an
4 element of inflation-sensitivity in their returns.

5 **III. THE MEMBERS OF THE INVESTOR CONSORTIUM**
6 **WILL SERVE AS EXCELLENT**
7 **CORPORATE STEWARDS FOR PSE**

8 **Q. Is Public Counsel's assertion that Puget Holdings LLC is a partnership in**
9 **which "Macquarie is the general or lead partner and the other members of**
10 **the Investor Consortium are the limited partners" correct? (Exhibit**
11 **No. ___(SGH-1THC) at page 13, lines 1-3.)**

12 A. No. Puget Holdings LLC is a Delaware limited liability corporation and not a
13 limited partnership. The AIMCo investment entities hold a 6.3% aggregate
14 interest in Puget Holdings LLC and will serve as active members of the Investor
15 Consortium, not passive limited partners. Macquarie entities are also members of
16 the Investor Consortium, and they do not serve as general partner of Puget
17 Holdings LLC.

18 AIMCo actively conducted its own due diligence on the Proposed Transaction
19 and came to an investment decision independent of the other members of the
20 Investor Consortium. AIMCo is entitled to vote its interests in Puget Holdings
21 LLC in any manner it sees fit and is not required to exercise its voting rights in
22 accordance with the instructions of any other shareholder, including any

1 Macquarie entity.

2 **Q. What is the intention of AIMCo with regard to the management of its**
3 **investment?**

4 A. The principle format of AIMCo's influence over its investment will be through
5 the boards of directors of PSE and Puget Energy and the board of managers of
6 Puget Holdings LLC. AIMCo will cooperate with other members of the Investor
7 Consortium and will complement the expertise and knowledge of other board
8 members, including representatives of Macquarie entities. AIMCo supports the
9 appointments of William Ayer, Herbert Simon, and Stephen Reynolds to the
10 board of directors of PSE and the appointments of William Ayer and Stephen
11 Reynolds to the board of directors of Puget Energy.

12 **Q. What will be the role of AIMCo in the corporate governance of PSE?**

13 A. AIMCo expects to appoint a director to the boards of Puget Holdings LLC, Puget
14 Energy, and PSE. AIMCo's role in corporate governance will be as an active
15 participant in board discussion and strategy.

16 AIMCo will be a responsive, knowledgeable member of the Investor Consortium
17 ready to act with PSE management and other members of the Investor Consortium
18 to achieve PSE's business plan goals and the commitments made to the
19 Commission and other stakeholders.

1 **Q. Will AIMCo play an active role in the day-to-day management issues of PSE,**
2 **such as customer satisfaction, reliable service, and investment in**
3 **infrastructure?**

4 A. No. Day-to-day management of the utility will remain under the capable
5 guidance of PSE's current management team.

6 **Q. Does AIMCo view its interests in the Proposed Transaction as a short-term**
7 **or long-term investment?**

8 A. AIMCo views this investment as a long-term investment, given its strong duration
9 match to the pension and endowment liabilities of AIMCo's clients. This
10 investment is part of AIMCo's "core" long-term infrastructure holdings, with no
11 defined exit period.

12 **Q. Is Public Counsel correct that "Macquarie...will, at some point have to**
13 **return the capital invested to the current members of the Investor**
14 **Consortium"? (Exhibit No. ___(SGH-1THC) at page 33, lines 22-23.)**

15 A. No. AIMCo is not investing through a Macquarie entity, and there is no
16 requirement for AIMCo's investment to be liquidated to return capital at any
17 point in time. AIMCo's infrastructure clients have a long time horizon, have
18 limited requirements for liquidity, and are generally seeking to increase their
19 allocation to infrastructure. AIMCo's direct equity interest in Puget
20 Holdings LLC does not have a finite life; AIMCo intends to hold this investment

1 over the long-term.

2 **Q. What priority will AIMCo give to PSE’s capital requirements?**

3 A. AIMCo considers PSE’s capital requirements to be a high priority. The
4 successful execution and appropriate funding of PSE’s planned capital
5 expenditure program is a key element to AIMCo’s investment thesis. AIMCo
6 believes that the unified long-term interests of the Investor Consortium and the
7 expeditious decision-making process of private ownership will provide a more
8 effective means to support PSE’s extensive capital requirements when compared
9 to the more volatile funding sources of public equity markets.

10 **Q. Would AIMCo be willing to invest more equity into Puget Holdings LLC if**
11 **the opportunity arises?**

12 A. Subject to further diligence, appropriate returns, an ongoing favorable regulatory
13 environment, and requisite approvals, AIMCo is certainly willing to invest further
14 equity into Puget Holdings LLC.

15 **Q. What is the expectation of AIMCo with respect to returns likely to be earned**
16 **by PSE if the proposed transaction were approved by the Commission?**

17 A. AIMCo expects PSE to earn a return on equity in the low double-digits, similar to
18 the return on equity currently authorized by the Commission. AIMCo expects a
19 portion of its return to come in the form of dividends, although AIMCo has no
20 specific annual requirement for dividend yield.

1 **IV. THE CONCERNS OF PUBLIC COUNSEL WITH RESPECT**
2 **TO THE “MACQUARIE MODEL” ARE MISPLACED AND ILL-**
3 **FOUNDED**

4 **Q. Has AIMCo previously partnered with a Macquarie entity in any**
5 **investment?**

6 A. Yes. AIMCo is currently invested with Macquarie entities in numerous other
7 infrastructure assets. From 2004 to 2006, AIMCo had invested alongside
8 Macquarie entities in South East Water, a UK-based regulated water utility.
9 AIMCo has also invested in Thames Water, a UK-based regulated water and
10 waste-water utility, with a consortium that Macquarie entities and other financial
11 institutions. Furthermore, AIMCo is a limited partner in four Macquarie unlisted
12 funds.

13 In total, AIMCo has invested over C\$400 million in Macquarie funds or
14 Macquarie-advised transactions. AIMCo’s first commitment to a Macquarie fund
15 took place over five years ago.

16 **Q. Does AIMCo have a concern with respect to what is described as the**
17 **“Macquarie Model”?**

18 A. No. In AIMCo’s experience, Macquarie entities have effectively generated risk-
19 adjusted returns for its investors while maintaining a prudent degree of leverage
20 and financial risk. Macquarie entities have generated substantial value for
21 AIMCo in portfolio investments through its deep network of operational

1 expertise. AIMCo has found that fees to Macquarie affiliates and management
2 team incentives are managed in a transparent fashion, and Macquarie entities have
3 demonstrated a long-term investment focus and a partnership attitude, contrary to
4 the description presented in the testimony of Public Counsel. Macquarie entities
5 have demonstrated expertise as infrastructure investors, working with local
6 management to deliver operational and service improvements and capital
7 expenditure programs.

8 Furthermore, with respect to the Proposed Transaction, AIMCo is not paying a
9 management fee to any Macquarie entity. Moreover, no Macquarie entity is a
10 preferred provider of financial advisory and investment banking services to Puget
11 Holdings LLC, Puget Energy or PSE. Any contracts that involve a payment of
12 fees to a Macquarie entity for foreign exchange transactions, commodity hedging,
13 interest rate swaps, and related party transactions must be approved by non-
14 conflicted members of the Investor Consortium.

15 **Q. Does AIMCo have concerns with respect to the issues identified in the**
16 ***Fortune* article provided by Public Counsel as Exhibit No. ___(SGH-4)?**

17 A. No. AIMCo's experience is contrary to the concerns expressed in the *Fortune*
18 article provided by Public Counsel as Exhibit No. ___(SGH-4). In AIMCo's
19 experience, Macquarie entities have shown discipline in applying leverage and
20 have clearly disclosed to AIMCo how much debt exists at each portfolio
21 company. Macquarie entities have been transparent regarding earned investment

1 banking fees, and AIMCo has negotiated these fees in advance. As a limited
2 partner in Macquarie funds, AIMCo is often represented on Limited Partner
3 Advisory Boards, which review and approve transactions on which Macquarie
4 entities may be in a conflict of interest, including inter-fund transactions and
5 payment of investment banking fees.

6 **Q. Does AIMCo have concerns with respect to the issues identified in the**
7 **RiskMetrics report provided by Public Counsel as Exhibit No. ___(SGH-5)?**

8 A. No. The RiskMetrics report provided by Public Counsel as Exhibit
9 No. ___(SGH-5) appears to describe publicly-traded infrastructure funds and does
10 not evaluate unlisted funds, which are a substantial portion of Macquarie's
11 business. Indeed, the interests of the Macquarie entities in the Proposed
12 Transaction are funded through Macquarie unlisted funds, not publicly-traded
13 infrastructure funds. In this regard, the RiskMetrics report does not seem to
14 specifically address the investment structure relevant to the Proposed Transaction.

15 Regarding allegations that Macquarie entities charge excessive fees, AIMCo
16 ensures that any fees paid for advisory or management services are competitive
17 with the current market. It is AIMCo's experience that the fees charged by
18 Macquarie entities to AIMCo, including the fees associated with the Proposed
19 Transaction, are market-based. With respect to fund transactions, AIMCo has
20 found that the performance fee incentive to Macquarie entities results in strong
21 alignment between investors and Macquarie staff. This structure is long-term and

1 results-oriented and reduces the likelihood of overpaying for assets.

2 As to the sustainability of the “Macquarie Model,” AIMCo has invested in, and
3 alongside, Macquarie funds for the past five years, and AIMCo is satisfied by
4 Macquarie’s strong performance, effective management, prudent use of leverage,
5 and ability to attract and retain talented staff.

6 Regarding governance, AIMCo and the other members of the Investor
7 Consortium have negotiated a clear set of governance rights with respect to the
8 Proposed Transaction. Sufficient protective minority rights were a key
9 component to AIMCo’s decision to make this investment.

10 **Q. Does AIMCo have concerns with respect to the issues identified in the**
11 **articles provided by Commission Staff as Exhibit No. ___(RHS-4)?**

12 A. No. The first article, dated June 12, 2008, and entitled “Hedge Funds Gang Up on
13 Babcock and Brown,” refers to an entirely different firm, separate and distinct
14 from Macquarie in its management, strategy, risk management, and size. To
15 imply that a firm’s strategy is not sustainable because a smaller competitor
16 appears to be struggling in a period of great capital market uncertainty is overly
17 simplistic. Although the strategies of these two firms may have similarities,
18 AIMCo has confidence in Macquarie’s ability to weather periods of global
19 financial uncertainty due to the strong management, alignment, and culture of
20 success discussed earlier in this testimony.

