

**BEFORE THE WASHINGTON
UTILITIES & TRANSPORTATION COMMISSION**

In the Matter of the Joint Application of HYDRO ONE LIMITED and AVISTA
CORPORATION For an Order Authorizing Proposed Transaction.

DOCKET U-170970

SETTLEMENT TESTIMONY OF J. RANDALL WOOLRIDGE (JRW-1T)

ON BEHALF OF

PUBLIC COUNSEL

April 10, 2018

SETTLEMENT TESTIMONY OF J. RANDALL WOOLRIDGE (JRW-1T)

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EXHIBITS LIST

- | | |
|---------------|---|
| Exhibit JRW-2 | Educational Background, Research and Related Business Experience of J. Randall Woolridge |
| Exhibit JRW-3 | Utility Merger Standards in Other Jurisdictions |
| Exhibit JRW-4 | Side-by-Side Comparison: Initial Commitments filed with Joint Application and Settlement Commitments dated March 27, 2018 |

1 **I. INTRODUCTION / SUMMARY**

2 **Q: Please state your full name, address, and occupation.**

3 A: My name is J. Randall Woolridge, and my business address is 120 Haymaker
4 Circle, State College, PA 16801. I am a Professor of Finance and the Goldman,
5 Sachs & Co. and Frank P. Smeal Endowed University Fellow in Business
6 Administration at the University Park Campus of the Pennsylvania State
7 University. I am also the Director of the Smeal College Trading Room and
8 President of the Nittany Lion Fund, LLC. A summary of my educational
9 background, research, and related business experience is provided in Exhibit
10 JRW-2.

11 **Q: On whose behalf are you testifying?**

12 A: The Public Counsel Unit of the Washington Office of Attorney General (Public
13 Counsel) has asked me to provide an opinion regarding the Settlement Stipulation
14 and Agreement (Settlement) filed in this docket on March 27, 2018. Public Counsel
15 initially asked me to evaluate the Application for Merger filed by Avista Corporation
16 (Avista) and Hydro One Limited (Hydro One) (collectively “Joint Applicants”).

17 **Q: Please describe the parties and the circumstances under which the parties**
18 **entered into the settlement.**

19 A: The parties to the Settlement are Public Counsel; Staff of the Washington Utilities
20 and Transportation Commission (Staff); Northwest Industrial Gas Users
21 (NWIGU); Industrial Customers of Northwest Utilities (ICNU);¹ The Energy

¹ ICNU and NWIGU have become the Alliance of Western Energy Consumers. For purposes of this testimony, I will refer to the parties by their original names because ICNU and NWIGU negotiated terms separately.

1 Project; NW Energy Coalition (NVEC), Renewable Northwest (RNW), and
2 Natural Resources Defense Council (NRDC); Sierra Club; Washington and
3 Northern Idaho District Council of Laborers (WNIDCL); Hydro One; and Avista.
4 The Joint Applicants filed their Application for Merger with the Washington
5 Utilities and Transportation Commission (Commission) on September 14, 2017.
6 The Settlement comes after five months of discovery and negotiations between the
7 Joint Applicants and the Settling Parties.

8 **Q: Please summarize your recommendations.**

9 A: Based on my analysis of the Settlement, I recommend that the Commission accept
10 the Settlement without condition. As a result of extensive negotiations, the
11 Settlement provides significant additions and improvements to the terms and
12 commitments provided in the Merger Agreement filed with the Joint Applicant's
13 initial application. The additions and improvements to the merger terms lead me to
14 now believe that the proposed transaction meets the "net benefit" standard required
15 by statute in the state of Washington. RCW 80.12.020 requires that the Commission
16 will approve a public service company's transaction only if it results in a "net
17 benefit" to ratepayers. This requires that ratepayers not only be shielded or
18 compensated for the transactional risk, but also that ratepayers must realize tangible
19 benefits. In my opinion, the merger terms under the Settlement meet the
20 Washington legal standard by providing "net benefits" to ratepayers relative to, and
21 in consideration to, the risks associated with the proposed merger.

22 **Q: How is your testimony organized?**

23 A: The following is an outline of my testimony:

- 1 • First, I provide an overview of the proposed transaction and summarize the details
2 of the merger;
- 3 • Second, I discuss the “net benefit” standard in the state of Washington;
- 4 • Third, I provide an overview of the customer benefits and the commitments made
5 by the Joint Applicants in the Application;
- 6 • Fourth, I review the market reaction to the proposed merger, the risks associated
7 with the transaction, and provide details on the commitments made by the Joint
8 Applicants to mitigate the risks of the proposed transaction on ratepayers;
- 9 • Fifth, I discuss elements of the proposed Settlement; and
- 10 • Finally, I provide my assessment as to whether or not the proposed settlement
11 meets Washington’s net benefit standard for utility mergers.

12 **II. OVERVIEW OF THE HYDRO ONE - AVISTA PROPOSED MERGER**

13 **Q: Please provide a summary of the proposed Hydro One – Avista merger.**

14 A: On July 19, 2017, Hydro One and Avista announced a definitive merger
15 agreement under which Hydro One will acquire Avista for US\$53 per share in a
16 US\$5.3 billion, all-cash transaction that included the assumption of US\$1.9
17 billion in debt. The US\$53 dollar purchase price represented a 24 percent
18 premium above Avista’s previous stock price of US\$42.74 per share.

19 The proposed merger brings together Hydro One, a major Canadian,
20 investor-owned electric transmission and distribution utility serving more than 1.3
21 million retail customers and Avista, which provides electric and gas service to
22 722,000 customers in Washington, Idaho, Oregon, and Alaska. If approved, the

1 combined companies will be one of North America's largest regulated public
2 utilities, with assets totaling US\$25.4 billion.

3 **Q: Please review the trend in public mergers and acquisitions.**

4 A: The proposed Hydro One – Avista merger is part of the trend toward a more
5 concentrated utility industry. In fact, Hydro One is the latest in a series of
6 Canadian energy companies to acquire a U.S. public utility. Over the past three
7 years, Canadian energy companies have spent over C\$50 billion to buy U.S.
8 utilities.²

9 Mergers and acquisitions have changed the landscape of the utility
10 industry over the past 20 years. During this time, nearly 50 percent of the
11 publicly held public utilities have been acquired. As shown in Figure 1, these
12 transactions have grown over the past decade and, in 2017 alone, there were a
13 total of \$68 billion in announced transactions.³

² Mark Chediak and Kevin Orland, *Hydro One Falls as Investors Sours on Avista's 3.4 Billion Price*, Bloomberg Markets (Jul, 19, 2017, 1:35 PM) (updated Jul. 20, 2017) <https://www.bloomberg.com/news/articles/2017-07-19/hydro-one-reaches-5-3-billion-deal-to-buy-u-s-utility-avista>.

³ Mark Chediak, Ryan Collins, and Jim Polson, *Utility's M&A Is So Hot Not Even Berkshire's Billions Won a Bid*, Bloomberg Markets (Jan. 3, 2018, 3:01 AM) <https://www.bloomberg.com/news/articles/2018-01-03/utility-m-a-is-so-hot-not-even-berkshire-s-billions-won-a-bid>.

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Figure 1
Utility Mergers
2007-17



Source: Data compiled by Bloomberg

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Utilities face a variety of issues that have led to industry restructuring and consolidation. Energy utilities point to stagnant growth, rising operating costs, low natural gas prices, aging infrastructure, distributed generation, investment in renewables, and emissions mandates as challenges to their continued profitability. Mergers and acquisitions have emerged as a very popular strategy to address these issues, to seek out growth opportunities, and to relieve pressure on earnings. The trend is further fueled by the availability of low interest rate debt to finance acquisitions.

13

Q: Please provide an overview of Hydro One as a corporate entity.

14

A: Hydro One is the primary distribution and electricity transmission utility for the largest Canadian province, Ontario. Hydro One is the successor of Ontario Hydro, a state-owned company that managed the generation and transmission of electricity in Ontario. Ontario Hydro was originally established to manage Ontario's hydroelectric generation resources, including Niagara Falls. Ontario Hydro eventually built and managed nuclear and coal powered generation,

19

1 becoming a fully integrated electricity utility and a local institution. Ontario
2 Hydro split into five different companies, and the generation assets were taken
3 over by another state-owned company.

4 In November 2015, Hydro One was privatized by the Ontario Government
5 in the largest Initial Public Offering (IPO) in Canada's history. The government
6 sold 89 million shares at a price of C\$20.50 per share. Including the IPO
7 proceeds, a deferred tax asset, and a special dividend, the Province brought in
8 about C\$5 billion. By law, the Province is required to retain at least 40 percent
9 ownership in Hydro One, and no other shareholder may own more than 10 percent
10 of the shares outstanding. On May 17, 2017, the Province sold another 120
11 million shares of Hydro One at C\$23.25 per share, bringing in about C\$2.5
12 billion. The Province subsequently also sold another 15 million shares to First
13 Nations of Ontario. After these stock sales, the Province still owned 47.4 percent
14 of Hydro One. Hydro One is listed on the Toronto Stock Exchange (TSX:H).

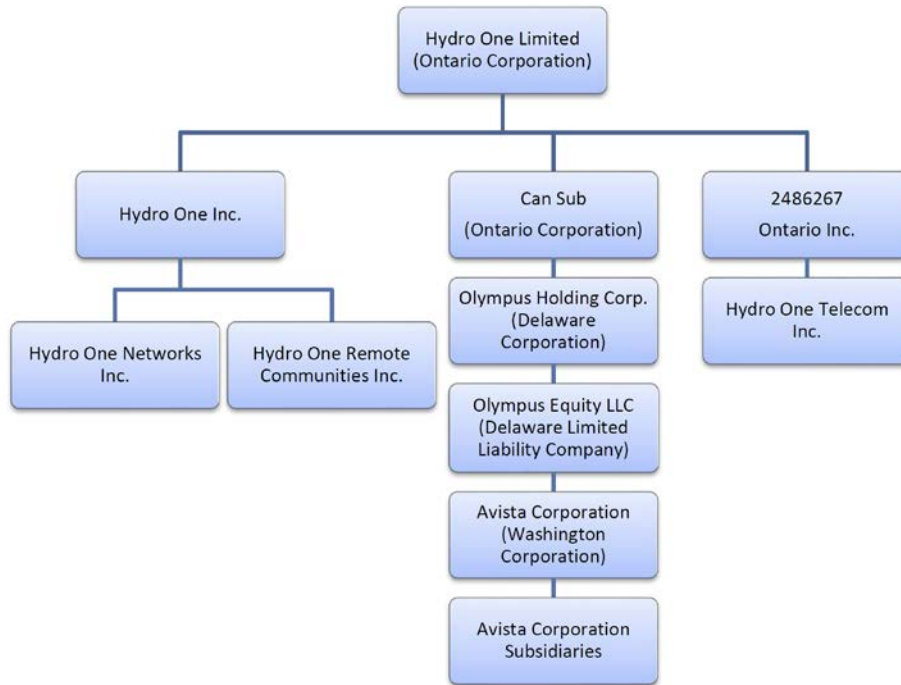
15 **Q: How will Avista be positioned in Hydro One's corporate structure?**

16 A: As shown in Figure 2, Avista will be a wholly-owned subsidiary of Olympus
17 Equity LLC, a bankruptcy-remote entity with no debt. This structure is intended
18 to separate Hydro One's rate-regulated Canadian and U.S. businesses. It is also
19 intended to insulate Avista from any financial problems impacting other Hydro
20 One's businesses.⁴

⁴ Direct Testimony of Christopher Lopez, Exh. CFL-1T at 5.
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Figure 2
Ownership Structure
Hydro One – Avista Merger⁵



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5 **Q: How will the acquisition be structured and financed?**

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6 A: Olympus Holding Corp. will acquire all of Avista's shares through a merger of a
7 wholly-owned indirect subsidiary, Olympus Corp., and Avista. After the merger,
8 Avista will be the surviving corporation and Olympus Corp. will cease to exist.

8

9

The acquisition is an all-cash transaction. Hydro One will finance the
10 transaction with: (1) \$1.2 billion convertible debenture installment receipts, which
11 will be fully converted to equity at the closing; and (2) \$2.6 billion U.S. debt
12 financing using a combination of five-year, 10-year, and 30-year U.S. denominated
13 notes. No Avista assets will be pledged as part of the financing.

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⁵ This is the revised post-closing corporate structure. See Settlement Stipulation and Agreement, Appx. B.

1 **Q: Please discuss Hydro One’s capital structure and credit ratings.**

2 A: As of December 31, 2016, Hydro One’s capital structure consisted of 53 percent
3 debt and 47 percent equity. Hydro One’s S&P long-term issuer credit rating is
4 “A.” On July 19, 2017, following the announcement of the proposed Avista
5 acquisition, Moody’s affirmed the ratings of Hydro One, Inc.’s senior unsecured
6 regular bonds (A3), senior unsecured medium-note program ((P)A3), and senior
7 unsecured commercial paper (P-2). At the same time, Moody’s changed the
8 outlook on Hydro One Inc. from Stable to Negative.⁶ Moody’s indicated that the
9 negative outlook on Hydro One Inc. reflects the possibility that the extraordinary
10 support from the Province of Ontario will be reduced following the transaction.
11 The Canadian rating agency DBRS rates Hydro One Inc.’s long-term debt at A
12 (High). DBRS indicated that should the merger be financed as contemplated in
13 the announcement, it will have no impact on Hydro One Inc.’s credit profile.

14 **Q: How did ratings agencies react to the transaction with respect to Avista’s**
15 **ratings?**

16 A: Avista’s S&P term issuer rating is BBB. On July 19, 2017, S&P affirmed its BBB
17 issuer rating on Avista and revised the outlook from stable to positive. S&P noted
18 that the positive outlook reflects the potential for higher ratings on Avista if the
19 acquisition is completed as proposed.⁷

20 **Q: How do state regulatory agencies typically assess and evaluate public utility**
21 **mergers?**

⁶ The credit ratings are discussed by Hydro One witness Mr. Lopez. See Exh. CFL-1T at 8-9.

⁷ *Id.*

1 A: The most common standard of review used by state regulators in the U.S.
2 evaluating utility mergers is the “public interest” standard.⁸ State regulators differ
3 in their application of the public interest standard and on the factors they consider.
4 The traditional public interest standard was “no net harm,” in which a regulator
5 seeks to insure that the public would be equal or better off after the merger.
6 However, in recent years, regulators are increasingly looking at whether a
7 proposed merger will create specific benefits for customers and whether there
8 were risks involved.⁹

9 Benefits that have been identified by regulators include merger-related
10 savings or synergies that reduce costs. Rate credits or rate freezes are common
11 benefits. Additionally, customer service, operational capability, and reliability
12 standards are often included in benefits analysis. Regulators consider whether the
13 merger will impact the company’s financial capability and the cost of capital, and
14 they look at whether the company has made commitments to its employees or
15 regarding community involvement.¹⁰

16 Risks considered by regulators include whether the utility will be exposed
17 to the financial conditions of the parent or affiliate and whether such exposure
18 poses financial obligations or risks. Regulators also consider the role local

⁸ *Energy Industry Update*, Scott Madden Inc. Vol. 16, Issue 2,
http://www.scottmadden.com/reports/V16_I2/EIU_V16_I2_2016.pdf.

⁹ Concentric Energy Advisors, *Recent Trends in Utility Mergers: Standards of Review* (2016).

¹⁰ William Lamb and Michael Didriksen, *Electric and Gas Utility Mergers and Acquisitions: Trends in Deal Terms, Contract Provisions, and Regulatory Matters*, 38 *Energy Law Journal* 133, 140-141, (2016).

1 management will have after the merger, affiliate interests, codes of conduct, and
2 any impact on competitive markets that might exist.¹¹

3 Buyers and sellers typically make regulatory commitments in their merger
4 applications to provide benefits and minimize the risks to the public. The
5 commitments are usually unique to the proposed transaction, reflecting the unique
6 characteristics of the specific merger.

7 Regulatory commitments also seek to address areas of interest to the
8 regulator and stakeholders. In approving mergers, regulators must ultimately
9 balance the interests of utilities involved and the interests of the public. This
10 becomes more complicated as merging utilities usually must satisfy regulators in
11 multiple states or jurisdictions. Even so, utilities have generally been successful
12 in this endeavor. While regulators typically impose conditions on merging
13 utilities, the vast majority of utility mergers have been approved.

14 III. WASHINGTON'S NET BENEFIT STANDARD

15 **Q: Please review Washington's standard for public utility transactions.**

16 **A:** In 2009, the Washington State Legislature overwhelmingly passed a bill that
17 changed the standard the Commission must use when determining whether to
18 approve or reject the acquisition of an investor-owned utility operating within the
19 state.¹² Under the new law, there must be a net benefit resulting from the
20 transaction.

¹¹ *Id.*

¹² Washington State Legislature, SB 5055, 2009-10 Legislative Session.

1 The last major merger to take place in Washington was the Macquarie
2 Group’s acquisition of Puget Sound Energy (PSE). The PSE acquisition occurred
3 shortly before the 2009 legislation passed into law. The PSE acquisition was
4 approved by the Commission under the former “no harm” standard. The Avista
5 acquisition will be the first major transaction to which the Commission will apply
6 the net benefit standard.¹³

7 **Q: Please briefly review the most recent PSE acquisition.**

8 A: Certain parties entered into a multi-party settlement to allow Puget Holdings (a
9 subsidiary of the Macquarie Group) to acquire PSE. The Commission approved
10 the settlement, and the acquisition was allowed to go forward. Among other
11 conditions, the settlement included the following terms:

- 12 • \$100 million rate credit to customers over 10 years,
- 13 • Maintaining staffing and service quality levels,
- 14 • Investing in low-income rate assistance programs,
- 15 • Committing to acquire renewable generation resources, and
- 16 • Maintaining a local presence.

17 This transaction was subject to and approved under a “no harm” standard. In
18 other words, the commitments made regarding the PSE acquisition ensured that
19 customers were left at the status quo for safe, reliable service at reasonable and
20 just rates.

21 **Q: How does the net benefit standard differ from the no harm standard?**

¹³ The Commission approved Northwest Natural Gas Company’s corporate reorganization at an Open Meeting considering Docket UG-170094. Northwest Natural is the smallest regulated utility in Washington in terms of customer base. The Commission indicated in its discussion that it believed net benefits would be decided on a case-by-case basis and would take into consideration the facts and circumstances of the proposed transaction. The Commission limited their ruling in that case to the specific circumstances and expressly stated that the decision provided “no specific guidance for future transactions under RCW 80.12.020.”

1 A: In 2009, the Washington Legislature intentionally departed from the “no harm”
2 standard for utility transactions by unanimously passing a bill that raised the
3 standard for acquisitions of investor-owned utilities. As a result of this change, the
4 following conditions must be met:

- 5 • Regulated, investor-owned utilities must demonstrate that the
6 acquisition will provide a net benefit to customers.¹⁴
- 7 • The Commission will issue an order no more than 11 months after the
8 initial application for acquisition. If there is a substantive reason to do
9 so, the Commission can extend the pendency of the case by up to four
10 months.

11 During the bill’s first hearing in the Senate’s Environment, Water, and
12 Energy Committee, Senator Lisa Brown (the prime sponsor) specified that there
13 should be a net public benefit resulting from a merger or acquisition because there
14 is inherent risk in transactions. Market conditions or other proposed benefits
15 might impact a new entity’s financial health, so the public and ratepayers should
16 be compensated for assuming such risk. Commitments that could tip the scale in
17 favor of net benefits include, but are not limited to, renewable energy
18 commitments, environmental considerations, or low-income rate assistance
19 commitments.¹⁵

20 With respect to the Avista-Hydro One merger, the Commission will
21 determine whether the terms of the Settlement are sufficient to mitigate
22 transactional risk and create net benefit to Avista’s customers. In doing so, the

¹⁴ RCW 80.12.020 (1).

¹⁵Washington Senate Environment, Water, and Energy Committee. January 21, 2009 Hearing.
Video at: www.tvw.org/watch/?clientID=9375922947&eventID=2009011178&eventID=2009011178&startStreamAt=485&autoStartStream=true.

1 Commission will likely consider how the net benefits standard differs from
2 acquisitions executed under the no-harm standard.

3 **Q: Is Washington’s net benefit standard consistent with the evolution of utility**
4 **merger standards in the U.S.?**

5 A: Yes. Across the country, dozens of utility acquisitions have occurred since
6 Macquarie sought control of PSE in 2008. The no-harm, public interest standard
7 has evolved from a pure status quo standard to require tangible benefits, even
8 when the statute does not explicitly indicate that transactions must produce a net
9 benefit.

10 For example, numerous state utility commissions have interpreted the need
11 for mergers to be in the public interest as requiring net benefits for customers.

12 Benefits from acquisitions in other jurisdictions include:

- 13 • Rate credits
- 14 • Customer and service guarantees
- 15 • Environmental commitments
- 16 • Financial protections (credit ratings, ring-fencing, financing, etc.)
- 17 • Monetary contributions to the community¹⁶

18 A summary of utility merger standards in other states is provided in Exhibit
19 JRW-3.

20 **Q: Please summarize your assessment of Washington’s net benefit standard.**

21 A: The 2008 PSE acquisition, in a number of ways, moved the needle on the public
22 interest standard for investor-owned utility acquisitions in Washington. Even
23 after the PSE acquisition settlement, the Washington state Legislature proactively

¹⁶ Emmett N. Ellis, Monica W. Sargent, Steven C. Friend, Infrastructure, *The Evolving Public Interest—Recent Decisions in Utility Merger Proceedings*, 55 Infrastructure 1 (Summer 2016), https://www.hunton.com/images/content/3/6/v2/3690/Evolving_Public_Interest_Recent_Decisions_in_Utility_Merger_Proc.pdf.

1 changed the statutory requirement from a “no harm” standard to a “net benefit”
2 standard. As a result, Avista’s proposed transaction presents the Commission
3 with a question of first impression,¹⁷ and the Commission must determine how to
4 apply the new net benefit standard, even in a case where Parties have reached a
5 Settlement.

6 If the Commission follows cues from other states with a net-benefit
7 standard, Avista and Hydro One’s application must (1) demonstrate that the
8 transaction does no harm or mitigates risk to customers and (2) produce tangible
9 benefits to customers. Notably, Washington’s statute lacks specificity in
10 comparison to other jurisdictions. As a result, the Commission wields
11 considerable discretion in developing a test to determine whether or not the
12 application meets the legal standard and what factors can be considered in terms
13 of benefits to utility customers.

14 **IV. THE JOINT APPLICANTS’ COMMITMENTS IN THE PROPOSED**
15 **MERGER**

16 **A. The Commitments**

17 **Q: Please discuss the commitments provided in the Joint Application.**

18 **A:** In the Application, the Joint Applicants provided for 55 commitments related to
19 approval of the Proposed Transaction. These commitments are listed in Appendix
20 8 of the Application and have been grouped by the Joint Applicants into the eight
21 categories listed below:

22 A. Reservation of Certain Authority to the Avista Board of

¹⁷ It may be more accurate to say “case of second impression” in light of the recent Northwest Natural Gas order in Docket UG-170094. But, since that case was not decided in an adjudication, Avista’s case will provide the first major decision under the new statute.

- 1 Directors (Commitments 1-15)
2 1. Governance
3 2. Business Operations
4 3. Local Presence/Community Involvement
5 B. Rate Commitments (Commitments 16-18)
6 C. Regulatory Commitments (Commitments 19-32)
7 D. Financial Integrity Commitments (Commitments 32-39)
8 E. Ring-fencing Commitments (Commitments 40-46)
9 F. Environmental, Renewable Energy, and Energy Efficiency
10 Commitments (Commitments 47-52)
11 G. Community and Low-Income Assistance Commitments
12 (Commitments 53- 55)¹⁸

13 **Q: Are the commitments initially proposed similar to the commitments that you**
14 **normally see in utility merger proposals?**

15 A: Yes. Utility mergers tend to have unique characteristics that are reflected in the
16 commitments made by the merging companies, but the commitments proposed by
17 the Joint Applicants here are generally consistent with the commitments proposed
18 in other merger applications. One characteristic common in mergers is a
19 commitment to maintain the utility's identity, with strong local management,
20 preservation of brand, maintenance of a local headquarter, support for local
21 economic development, commitments regarding employees, and maintenance of
22 ties to the community.

23 The commitments in this case also include provisions for meeting
24 continued regulatory obligations, adherence to Commission orders, and
25 maintaining sound financial policies and integrity. The commitments provide for
26 Avista's continued adherence to renewable energy and environmental obligations,
27 and support for community and low-income assistance programs. The Joint

¹⁸ Joint Application at 36.

1 Applicants state that the proposed transaction does not include cost-cutting that
2 could potentially lead to a deterioration of customer service, customer
3 satisfaction, safety, or reliability.

4 The ring-fencing provisions provide for Avista's independence and legal
5 separation from Hydro One. The primary purposes of ring-fencing are:

- 6 1. To maintain separation of the utility from the Parent in order to isolate
7 the utility from negative legal and financial impacts of the Parent's
8 investment and financing activities;
- 9 2. To make the utility bankruptcy remote (i.e., protect the utility from
10 being involuntarily brought into bankruptcy for the benefit of the
11 Parent);
- 12 3. To ensure that the utility can operate on a stand-alone basis; and
- 13 4. To protect utility customers from abuse by affiliates, such as cross
14 subsidization.¹⁹

15 Ring-fencing provisions in utility mergers typically include:

- 16 (1) Restrictions of dividends and distributions to the parent in certain
17 situations,
- 18 (2) Provisions in the event of downgrade of the utility credit ratings,
- 19 (3) Restrictions on intercompany loans and on pledging of subsidiary
20 assets in lending agreements,
- 21 (4) Setting standards for cost allocation and the pricing of transactions

¹⁹ Steven Schwarcz, *Ring-Fencing*, 87 Southern California Law Review 69 (2014) (available at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5531&context=faculty_scholarship).

1 with affiliates. These, along with other provisions insure the subsidiary
2 utility is not impacted by financial difficulties and even bankruptcy of
3 the parent utility or its affiliates.

4 **B. The Benefits of the Proposed Acquisition**

5 **Q: What benefits did the Joint Applicants initially propose in the application?**

6 A: Hydro One and Avista fashioned their proposed merger to follow the same pattern
7 as PSE's 2008 application. The most identifiable and tangible benefit to
8 ratepayers was a \$31.5 million rate credit applied across Avista's service territory
9 and paid over 10 years.²⁰

10 The Joint Applicants also indicated that benefits accrue to customers over
11 time. These benefits, according to Avista and Hydro One, include: (1) Short
12 term administrative savings; (2) Economies of scale; (3) Sharing of best practices;
13 (4) Technological platform sharing; (5) Improved purchasing power; (6) Cultural
14 fit; and (7) Continuation of Avista's community involvement.²¹ The Joint
15 Applicants have been unable to quantify many of the identified benefits and claim
16 that unidentified benefits may arise after they merge.²²

17 Additionally, the Joint Applicants identified other benefits that could
18 accrue to Avista's customers:

- 19
- 20 • Investing in innovation that could help both Hydro One and Avista to
21 better meet their customers' growing expectations for choice of energy
supply and tools to manage energy consumption and costs.
 - 22 • Leveraging the innovation, research and development investments of
23 both companies could accelerate their ability to bring the benefits of

²⁰ Joint Application at 29-30.

²¹ Joint Application at 9.

²² Hydro One's Response to Public Counsel Data Request 26.

- 1 new ideas and technologies to their customers;
- 2 • Exercising their purchasing power at greater scale for equipment and
3 materials;
- 4 • Providing mutual assistance during and after storm and emergency
5 events; and
- 6 • Employment of common technology platforms for outage
7 management, distribution management and other operations.²³

8 The Joint Applicants noted that it will take time to identify and capture
9 benefits. In addition, they noted that they are not aware of any net increase in
10 costs to Avista's customers related to the proposed merger.

11 **Q: Please provide more detail on the rate commitments in the application.**

12 A: Commitment Nos. 16-18 address rate commitments associated with the proposed
13 merger. Commitment No. 16 deals with the treatment of net cost savings with the
14 merger. These will be identified and reflected in any subsequent rate proceedings,
15 and may offset the rate credit. The treatment of the merger transactions costs are
16 the subject of Commitment No. 17. As is typical in merger applications, the Joint
17 Applicants will not seek to recover legal and financial advisory fees from
18 ratepayers.

19 As noted, a significant customer benefit in utility mergers is a rate credit
20 that reduces customer bills, and the Joint Applicants initially provide a modest
21 rate credit in Commitment No. 18. As summarized in Table 1 and noted above,
22 the Joint Applicants proposed a retail rate credit of \$31.5 million over a 10-year
23 period.²⁴ This rate credit was to be spread across all of Avista's customers in its

²³ Joint Application at 31-32.

²⁴ Joint Application at 29-30.

1 various service territories. Moreover, of the \$31.5 million, \$22 million was
 2 offsetable if the Joint Applicants demonstrated synergy savings in future rate
 3 cases. Table 1 below illustrates the Joint Applicants' initial proposal regarding
 4 rate credits and offsetable credits.

Table 1
Retail Rate Credit

	Annual Credit Years 1-5	Annual Credit Years 6-10	Total Credit
Total Credit	\$2.65 Million	\$3.65 Million	\$31.50 Million
Offsetable Credit	\$1.70 Million	\$2.70 Million	\$22.00 Million

7
 8 As discussed by witness Lopez, the amount and timing of the rate credit
 9 was set along the terms of the PSE acquisition.²⁵ Specifically, as part of the
 10 settlement agreement approved by the Commission in the PSE acquisition,
 11 Docket U-072375, PSE agreed to provide retail customers with \$100 million in
 12 Rate Credits over a period of 10 years. The total Rate Credits of \$100 million
 13 represented approximately 3.1 percent of PSE's annual revenue requirement in
 14 2008. Applying the same 3.1 percent to Avista's retail revenue requirement for
 15 2016 in its Washington, Idaho, and Oregon jurisdictions results in the retail rate
 16 credit of \$31.5 million.

17 **Q: What is the impact of the rate credit on a typical bill for a Washington**
 18 **customer?**

19 A: The rate credit amounts to an average monthly rate credit of approximately \$0.21
 20 per month for the average Washington residential electric customer and \$0.15 per

²⁵ Lopez, Exh. CFL-1T at 26.

1 month for the average residential natural gas customers.²⁶ This sum could shrink,
2 since the estimate does not account for any potential offsets.

3 **V. ISSUES WITH THE PROPOSED MERGER**

4 **A. The Market Response to the Proposed Acquisition**

5 **Q: Please discuss the short-term reaction to the Hydro One – Avista merger.**

6 A: The market's initial reaction to the proposed Hydro One – Avista merger was
7 negative. According to Bloomberg, Hydro One's stock price initially declined 5.4
8 percent to C\$21.32 in Toronto, before recovering. Avista, on the other hand, rose
9 20 percent to \$51.83 in New York. Bloomberg noted: "The takeover - following
10 multibillion-dollar deals by Enbridge Inc., TransCanada Corp. and Fortis Inc. - is
11 another testament to Canada's hunger for U.S. energy assets offering higher
12 returns."²⁷

13 **Q: What was the subsequent reaction of analysts to the merger announcement?**

14 A: After the initial negative reaction to the Hydro One-Avista announcement, most
15 analysts covering Hydro One published reports indicating the proposed merger
16 was positive for Hydro One. As illustrated in the reports cited below, analysts
17 cited the potential for growth, regulatory and geographic diversification, accretive
18 to earnings,²⁸ higher returns on equity in the U.S., as well as more equity in
19 capital structure ratios. Virtually all of the investment firms following Hydro One

²⁶ Avista Response to Public Counsel Data Request 26, Attachment A (for year one after the proposed merger would close).

²⁷ Mark Chediak and Kevin Orland, *Hydro One Falls as Investors Sour on Avista's 3.4 Billion Price*, Bloomberg Markets (Jul, 19, 2017, 1:35 PM) (updated Jul. 20, 2017) <https://www.bloomberg.com/news/articles/2017-07-19/hydro-one-reaches-5-3-billion-deal-to-buy-u-s-utility-avista>.

²⁸ "Accretive" is a term often used by analysts in regards to mergers, which addresses whether and how soon a merger will result in an increase in earnings.

1 increased their target price on the stock, which indicates a positive change in the
2 long-term outlook for the company and the stock.

3 In an August 10, 2017, report, the National Bank of Canada increased its
4 target price to C\$27.00 and reported: “The acquisition will increase Hydro One’s
5 rate base by ~22% (+\$3.9billion) to close to \$22 billion (based on 2016),
6 diversifying the company’s geographical earnings contribution to ~20% outside
7 of Ontario, while increasing the company’s weighted average allowable ROE
8 (~8.8% in Ontario vs. ~9.5% for Avista).”²⁹

9 Laurentian Bank Securities increased its target price to C\$28.00 and wrote:

10 We view Hydro One’s acquisition of Avista in favourable [sic] light.
11 AVA’s highly regulated rate structure is in keeping with Hydro’s
12 current risk profile while ultimately providing a new geographic
13 footprint (foray into U.S. market) and generation vertical (natural
14 gas). On a combined basis the transaction increases H’s rate base by
15 40%, to \$35B, and earns it a spot on North America’s 20 largest
16 regulated utilities list. Despite it being an all cash transaction, AVA
17 is both an accretive and strategic transaction and provides Hydro a
18 long term option to play the highly fragmented U.S. market and
19 increase its presence.³⁰

20 IA Securities increased its target price for Hydro One to C\$28.00 and reported:

21 The AVA acquisition provides Hydro One with a platform for future
22 growth outside Ontario. We note several positive aspects of the
23 proposed acquisition, which would effectively (1) maintain the
24 Company’s fully-regulated utility profile (AVA is a fully-regulated
25 utility), (2) increase the Company’s size (~20% increase in rate base
26 by 2021), (3) provide greater geographic and regulatory
27 diversification (AVA will represent ~20% of H’s consolidated
28 earnings), (4) generate near-term EPS accretion (we estimate 4-6%
29 in 2019-21) and sustain H’s consolidated longer-term EPS growth
30 (we expect H to continue to grow EPS by 4-6%/year thereafter), and

²⁹ Hydro One Response to Public Counsel Data Request 2, Attachment A, Part 4, National Bank of Canada, Hydro One Ltd., Aug. 10, 2017.

³⁰ Hydro One Response to Public Counsel Data Request 2, Attachment A, Part 4, Laurentian Bank Securities, Hydro One Ltd., Aug. 9, 2017.

1 (5) increase shareholder diversification (the Province of Ontario's
2 ownership would decrease to ~45%). Overall, we believe the
3 transaction will provide Hydro One with a stable source of growth
4 outside its core Ontario market, and a stepping-stone for future
5 acquisitions in the US.³¹

6 In addition, CIBC also increased its target price to C\$28.00 and wrote,
7 "The franchise areas have both higher ROEs (rate-base weighted average of
8 9.66%) and higher equity thickness (49%) than Ontario (8.78% on 40% equity), a
9 common element of U.S. utilities compared to Canadian peers."³²

10 **B. The Risks of the Proposed Acquisition**

11 **1. Operating and Management Risks**

12 **Q: From Public Counsel's point of view, what operating and management risks**
13 **are associated with the proposed acquisition?**

14 **A:** From my review of the proposed transaction, I have identified a number of
15 operating and management risks associated with the transaction.

- 16 (1) Hydro One has only been a public company for little more than two
17 years and before that, did not operate under the pressure of public
18 markets and expectations of investors;
- 19 (2) The proposed transaction is Hydro One's first acquisition of a utility in
20 the United States. Integrating acquisitions is viewed as a difficult
21 managerial task, and the companies merging here have different
22 industry focuses and have their own corporate cultures. Furthermore,

³¹ Hydro One Response to Public Counsel Data Request 2, Attachment A, Part 3, IA Securities, Hydro One Ltd., Aug. 9, 2017.

³² Hydro One Response to Public Counsel Data Request 2, Attachment A, Part 2, CIBC, Hydro One Limited, Aug. 9, 2017.

1 as noted in several equity research reports, there is pressure on
2 management to make the acquisition “accretive” to earnings;
3 (3) Hydro One is a transmission and distribution only electric utility. It
4 does not generate power or distribute gas, which are two of Avista’s
5 businesses;

6 (4) Hydro One management and equity analysts have noted, while this is
7 Hydro One’s first acquisition, others are likely to follow. Mayo
8 Schmidt, Hydro One’s CEO, noted, "There are quite a number of
9 organizations of the same size and complexity of Avista in the arena
10 that, as we think about over the course of the next years, there's some
11 potential."³³

12 The Globe and Mail also indicated, “As it looks ahead to future acquisitions,
13 Hydro One will be making use of its strong balance sheet, about \$700-million of
14 annual net income and ‘A’ credit rating to grab opportunities.”³⁴ Likewise, equity
15 analysts have noted that Avista is just the first of future acquisitions. CIBC noted,
16 “We characterize the planned acquisition of Avista Corporation as a fair start to
17 the company's acquisition strategy.”³⁵ The prospect of future acquisitions,
18 especially those financed with more debt, exposes Avista’s customers to
19 additional risks.

³³ Allison McNeely, *Avista is just the first U.S. deal, Hydro One CEO says*, The Globe and Mail (Nov. 21, 2017).

³⁴ *Id.*

³⁵ Hydro One Response to Public Counsel Data Request 2, Attachment A, Part 2 CIBC, Hydro One Limited, Aug. 9, 2017.

1 **2. Financial Risks**

2 **Q: What are the financial risks associated with utility mergers?**

3 A: There are a number of financial risks that are typically associated with utility
4 mergers. These include the following:

5 (1) Maintenance of books and records that related solely to the acquired
6 utility;

7 (2) Cost and capital allocation methods and approaches that may be
8 detrimental to the utility and its customers;

9 (3) Preservation of investment grade credit ratings; and

10 (4) Insuring adequate liquidity to meet operating and financial obligations
11 as well as access to capital markets to fund investment needs to meet
12 mandated regulatory service requirements.

13 **Q: From Public Counsel’s point of view, what financial risks can be associated**
14 **with the proposed Hydro One – Avista merger?**

15 A: One prominent financial risk is the amount of debt used to finance the acquisition.
16 As noted above, S&P revised its outlook from ‘stable’ to ‘negative’ at the
17 announcement of the proposed transaction. S&P noted, “With the Avista
18 acquisition, we believe [Hydro One Limited’s] business risk has eroded slightly.
19 Furthermore, the additional leverage that the transaction introduces also eroded
20 HOL's credit metrics and financial risk.”³⁶

³⁶ Standard & Poor’s, *Hydro One Ltd. and Hydro One, Inc. Outlooks Revised To Negative From Stable On Proposed Avista Corp. Acquisition* (Jul. 20, 2017).

1 **Q: Please discuss how Avista’s valuation in the acquisition and the valuation**
2 **premium paid by Hydro One presents financial risks for Avista’s customers?**

3 A: As previously noted, Hydro One will pay \$53 per share for Avista, which
4 represented a 24 percent premium above Avista’s previous stock price of \$42.74
5 per share. This is notable for several reasons:

6 (1) The 24 percent is referred to as a control premium, and acquirers must
7 pay a control premium in an acquisition to get investors to agree to the
8 merger. In addition, the premium paid must be large enough to deter
9 other potential acquirers from bidding for the target. Prior to the bid,
10 the market valued Avista at \$42 per share, which reflected the
11 Company’s risk and expected return prospects. In a normal
12 acquisition, acquirers expect to identify and achieve synergies between
13 the merged companies, which can justify the premium being paid.
14 However, as noted above, there are minimal synergies between Hydro
15 One and Avista, and there is pressure on management to make the
16 acquisition “accretive” to earnings;

17 (2) The Joint Applicants are not seeking to recover the price premium paid
18 in the acquisition through an acquisition adjustment in rates. In all
19 likelihood, this is because regulators are very sensitive to allowing
20 recovery of an acquisition adjustment in utility mergers; and

21 (3) From a regulatory perspective, another way to view the premium paid
22 is the price paid relative to the original cost or book value of the assets
23 being purchased. As noted by Hydro One Witness Mr. Lopez, the

1 estimated excess of the purchase price over the book value of Avista's
2 net assets is approximately \$1.7 billion as of June 30, 2017.³⁷ This
3 represents an acquisition adjustment of 40 percent. By foregoing an
4 acquisition adjustment, Hydro One is effectively willing to accept a
5 lower return on investment.

6 **3. Corporate Governance/Ring Fencing Risks**

7 **Q: From Public Counsel's point of view, what corporate governance risks will**
8 **Avista's customers be exposed to if the merger is approved?**

9 A: If the merger is approved, Avista will no longer be owned by its shareholders, but
10 by Hydro One's shareholders. Many of Avista's shareholders live in Avista's
11 service territory, know the Company well, and are interested in the success and
12 well-being of the Company. Hydro One trades on the Toronto stock exchange
13 and 47.7 percent of its shares are owned by the Province of Ontario. The risk and
14 issue for Avista's customers is how concerned Hydro One's stockholders will be
15 about the customers of Avista. This risk is magnified by the political risks
16 associated with the merger.

17 **Q: If Hydro One purchases Avista, how can political risks affect Avista's**
18 **Washington customers?**

19 A: If the merger is approved, Avista's customers will be exposed to the political risks
20 associated with Hydro One. The privatization of Hydro One was not a popular
21 move by the Province of Ontario at the time the decision was made. The purpose
22 of the privatization was to raise a total of C\$9.0 billion – C\$5.0 billion to pay

³⁷ Lopez, Exh. CFL-1T at 12.

1 down the debt of the electric sector and C\$4.0 billion to build new transit lines. In
2 a poll, 60 percent of Ontarians disapproved of selling a majority of the company,
3 and only 24 percent approved.³⁸ More recent polling has indicated 82 percent of
4 Ontarian's oppose the privatization of Hydro One.³⁹ If this trend continues,
5 Avista customers will face the political risks associated with citizens of the
6 Province of Ontario who may be unhappy with the privatization of Hydro One.
7 Furthermore, if the citizens of Ontario are unhappy with the privatization of
8 Hydro One, it seems they could be especially unhappy with Hydro One's move to
9 acquire Avista and the associated risks.

10 In addition, with the Province of Ontario as a significant and concerned
11 investor in Hydro One, Avista customers could face political risks associated with
12 such matters as energy policy in Ontario, as well as fiscal matters related to deficit
13 financing of energy and infrastructure projects in Ontario. Given the investment
14 in Hydro One, Avista customers in Washington may have to deal with energy and
15 financing issues in Ontario. A shift in political winds among Hydro One's
16 customers could lead to sudden and perhaps unexpected changes in the
17 management of the parent company.

18 **C. Commitments to Manage Proposed Transaction Risks**

19 **Q: What commitments have been proposed by the Joint Applicants to address**
20 **the transaction's risks?**

³⁸ Adrian Morrow, *Poll Finds Ontarians Unhappy with Hydro One Privatization Plan*, The Globe and Mail (Mar. 25, 2017).

³⁹ CBC News, "How Privatized Power Haunts Ontario Politics" December 9, 2017.

1 A: The Joint Applicants have proposed a number of commitments to deal with the
2 risks associated with the transaction. Specifically, commitments have been made
3 to insure that Avista, its ratepayers, and other stakeholders are not impacted
4 adversely by these risks. The specific risks and the associated commitments are
5 highlighted in Table 2.

Table 2
Transaction Risks and Commitments

Risk	Commitment No.	Commitment
Operating/ Management	1. Board Vote	Commitment Changes Require 2/3 Vote of Board
	2. Management	Retain Management
	3. Board	2 for H1, 3 NW, 3 Avista, , Avista CEO
	Composition	No Change
	4. Avista Brand	Maintain Investment for Economic Development
	5. Development	Continued Investment
	6. Innovation	Honor Labor Contracts
	7. Union	Maintain Compensation and Benefits
	8. Comp and Benefits	Maintain Headquarters in Spokane
	9. Headquarters	Maintain Local Staffing
	10. Staffing	Maintain Community Contributions
	11. Community	Maintain Community Involvement
	12. Involvement	Maintain Investment for Economic Development
	13. Development II	Maintain Membership in Trade Groups
	14. Membership	Maintain Safety and Reliability Standards
	15. Safety/Reliability	
Financial	21. Books	Maintain Separate Books and Records
	22. Access	Provide Access to Books and Records
	23. Cost Allocations	Provide Methodologies to Commission
	24. Capital Costs	Not Request Higher Debt/Equity Cost Rates
	25. Capital Structure	CE Ratio of at Least 44%
	26. FERC Reporting	Meet FERC Reporting Requirements
	29 Enforcement	Provides for Commission Enforcement of Commitments
	31. Annual Report	Annual Report on Commitments Required
	32. Commitment Bind	Commitments are Binding on Joint Applicants
	33. Capital Structure	H1 will Provide Equity as Needed
	34. Debt/Pref. Stock	AVA Maintain Own Debt/Preferred Stock
	35. Ratings	AVA will be Rated by at least One Rating Agency

	36.Dividend Restrictions	Dividends are OK if Ratings are Investment Grade or EBITA/Interest > 3.0 and CE Ratio 44%
	37. Pensions	AVA Maintain Pension Funding Policy
	38. SEC Reporting	AVA Maintain SEC Reporting
	39. SOX	AVA Maintain Sarbanes-Oxley Requirements
Governance/ Ring Fencing	40. Board	At Least One Independent Director
	41. Opinion	Provide Opinion as to Adequacy of Ring-Fencing
	42. Olympus Equity	All AVA Equity Held by Olympus Equity
	43. Asset Pledge	No AVA Assets Pledged to H1
	44. Hold Harmless	AVA Customers Held Harmless from Unrelated Activities of AVA and H1
	45. Olympus LLC	Limits Activities of Olympus LLC and Equity
	46. Amendments	No Amendments to Ring-Fencing Provisions

1. Operating/Management Risk Commitments

The commitments to mitigate operating and management risks seek to insure the strategy and management of Avista will not meaningfully change after the merger is approved. These commitments address issues such as: (1) the composition of Avista’s Board of Directors, (2) the retention of management and employees, (3) the continuance of the Avista brand and its headquarters in Spokane, (4) the continued support for, and investment in, economic development, (5) the maintenance of local staffing as well as of compensation and benefits for employees, (6) honoring union contracts, (7) continued membership in trade and industry groups as well as support for communities (including contributions), and finally (8) the maintenance of safety and reliability standards.

2. Financial Risk Commitments

The Joint Applicants have included a number of commitments to mitigate any financial risks associated with the proposed transaction. These commitments include: (1) the maintenance of, and access to, separate books for Avista; (2) cost

1 allocation methods approved by the Commission; (3) capital costs that are not
2 impacted by the merger; (4) a capital structure that includes a common equity
3 ratio of at least 44 percent and, if need be, is supported by equity from Hydro
4 One; (5) Avista will issue its own debt and preferred stock and maintain credit
5 ratings by at least one major rating agency; (6) a restriction on dividend payments
6 to Hydro One in the event of a reduction of Avista's credit rating to below
7 investment grade or an interest coverage ratio that falls below 3.0; (7) the
8 continuance of Avista's pension policy; and (8) the maintenance of SEC, FERC,
9 and Sarbanes-Oxley reporting standards.

10 As in the case of the commitments for operating and management risks,
11 the financial risk commitments are structured to insure that Avista's financial
12 integrity is not negatively impacted due to the proposed transaction.

13 **2. Corporate Governance/Ring Fencing Risk Commitments**

14 Corporate governance and risk fencing commitments are critical in
15 mergers to insure that an acquired utility continues to meet its public service
16 obligation and is not negatively impacted by the investment and financial
17 decisions, or other business activities of the acquiring utility company. Certain
18 commitments addressing operating and management risks have been addressed
19 above. Additional commitments relating specifically to ring-fencing proposed by
20 the Joint Applicants include the following:

- 21 (1) Avista's equity must be held by Olympus Holdings, LLC,
22 (2) no Avista assets may be pledged to Hydro One;
23 (3) Avista's customers are held harmless from unrelated activities of

1 Avista and Hydro One;
2 (4) a limitation on the activities of Olympus Holdings, LLC; and
3 (5) the provision that no amendments be made to the ring-fencing
4 provisions.

5 Finally, Commitment No. 41 requires that Avista and Olympus Holdings file a
6 non-consolidation opinion with the Commission, which concludes that the
7 ring-fencing provisions are sufficient to exclude Avista's assets and liabilities
8 from a consolidation with those of Olympus Holdings in a bankruptcy.

9 **VI. THE PROPOSED SETTLEMENT**

10 **Q: Please discuss Exhibit JRW-4.**

11 A: Exhibit JRW-4 provides a side-by-side summary of (1) the Initial Commitments
12 as provided in Appendix 8 of the Joint Application and (2) the Settlement
13 Commitments agreed to in the Settlement dated March 27, 2018. As noted above,
14 there were 55 Initial Commitments included in the Joint Application. There are
15 81 Settlement Commitments. The discussion below highlights the changes in the
16 commitments as well as the additional commitments.

17 **A. Rate Commitments**

18 **Q: What rate commitments are in the Settlement?**

19 A: From a net benefit standpoint, the most significant change is Settlement
20 Commitment No. 19 (Initial Commitment No. 18), the Rate Credit. In the
21 Application, the Joint Applicants proposed a retail rate credit of \$31.5 million in
22 total over a ten-year year period. This included a total of \$2.65 million per year
23 for the first five years, and \$3.65 million in years six through 10. This total rate

1 credit of \$31.5 million represented 3.1 percent to Avista's retail revenue
2 requirement for 2016 in its Washington, Idaho, and Oregon jurisdictions. The
3 rate credit was subject to an annual offset of \$1.7 million per year in years one
4 through five and \$2.7 million per year in years six through 10, for a total potential
5 offset of \$22.0 million.

6 Settlement Commitment No. 19 provides a significant benefit to
7 Washington ratepayers and a large improvement over the initial rate credit
8 proposed. Settlement Commitment No. 19 calls for a total rate credit of \$30.7
9 million paid to Washington ratepayers, spread over five years, not 10 years.⁴⁰
10 This figure represents five percent of Washington base revenues as of
11 February 1, 2018. The annual rate credit is \$6.1 million for five years.⁴¹ As
12 indicated in Settlement Commitment No. 19, the offsetable portion of the rate
13 credit for Washington ratepayers to \$1.02 million per year.⁴² Before any offset to
14 the rate credit, the average Washington electric customer would receive
15 approximately \$9.60 per year (or \$0.80 per month) for five years. The average
16 Washington natural gas customer would receive approximately \$5.64 per year
17 (\$0.47 per month) for five years.

⁴⁰ The exact agreed-upon figure is \$30,715,050, which is equal to five percent of the Washington base revenue as of 02/01/18. Washington electric base revenue is \$492,134,000, and Washington natural gas base revenue (including natural gas costs – Schedules 150/155) is \$122,167,000. Five percent of those revenues are \$24,606,700 (electric) and \$6,108,350 (natural gas).

⁴¹ The exact amount agreed upon is \$6,143,010 per year. The annual Washington electric Rate Credit for each of the five years is \$4,921,340. The annual Washington natural gas Rate Credit for each of the five years is \$1,221,670.

⁴² The offsetable portion of the Rate Credit is calculated using a pro rata share of the jurisdictional total of the rate credit (i.e. Washington's share of the offsetable Rate Credit is 60.29 percent, therefore Washington's share of the \$1.7 million offsetable portion is \$1.02 million).

1 **Q: Do you believe that the increase in the rate credit represents a significant**
2 **benefit for Washington Ratepayers?**

3 A: Yes. The rate credit has increased from 3.1 percent of revenues to 5.0 percent of
4 revenues for Washington ratepayers. In addition, the rate credit is spread over
5 five years and not 10 years. The larger amount of the rate credit, and the fact that
6 it is spread over five years, results in a significant increase to the present value of
7 the net benefit associated with the rate credit for Washington customers.

8 **Q: Are there any other issues associated with Settlement Commitment No. 19?**

9 A: Yes. As highlighted in the last sentence of Settlement Commitment No. 19, the
10 Joint Applicants have also agreed to the following condition on the offset, “Any
11 application of offsetable savings will be reviewed by the Commission before the
12 offset is applied, and Avista bears the burden of proof to prove that savings have
13 materialized and the offset to rate credits should apply.” Therefore, Settlement
14 Commitment No. 19 provides for regulatory oversight and review of the offset
15 amounts. This also represents a benefit to ratepayers.

16 Additionally, the offsetable amount under the Settlement is reduced. The
17 Joint Applicants have identified \$1.7 million in administrative savings from the
18 merger.⁴³ The Settlement limits the rate credit offset to Washington’s share of the
19 administrative savings, which reduces the total amount of rate credit that may be
20 offset.

⁴³ These costs include cost savings in six categories: Proxy Costs, Board of Director Activities, Annual Report Costs, Investor Relations, Insurance and Accounting. Hydro One and Avista have also noted that there are potential cost savings in other areas such as the benefits of scale as well as collaboration in supply chain activity, IT development and implementation, innovation and potentially other areas.

1 **Q: Are there any other new rate commitments that are beneficial to ratepayers?**

2 A: Yes. There are two other provisions in the settlement rate commitments that are
3 beneficial to ratepayers.

4 First, Settlement Commitment No. 17, a new rate commitment, provides
5 for a pre-transaction test year. According to Settlement Commitment No. 17:

6 **17. Pre-Transaction Test Year:** The parties agree to the following
7 provisions for ratemaking purposes.

- 8 a. If Avista files for a rate case between the conclusion of
9 Dockets UE-170485 and UG-170486 and December 31,
10 2018, Avista will present a normalized test year using the
11 most recent 12-month period available.
12
13 b. If Avista files for a rate case between January 1, 2019, and
14 April 30, 2019, Avista must use a normalized test year of
15 October 1, 2017 – September 30, 2018.
16
17 c. If Avista files for a rate case between May 1, 2019, and April
18 30, 2021, Avista must present two normalized test years, (1)
19 October 1, 2017 – September 30, 2018 for informational
20 purposes, and (2) the most recent 12-month period available.

21 The new commitment requires Avista to use normalized test years in any rate
22 cases filed over the next three years. This will allow for a better evaluation of the
23 revenues and expenses of a “new” Avista.

24 Second, Settlement Commitment No. 18 (which was originally presented
25 as Initial Commitment No. 17), provides for a more complete and detailed
26 accounting for costs and expenses associated with the proposed transaction. It
27 specifically requires the Joint Applicants to account for any in-house expenses,
28 consulting fees, and other costs associated with the proposed transaction.

29 Specifically, Settlement Commitment No. 18 reads as:

30 **18. Treatment of Transaction Costs:**

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- a. Costs associated with the Proposed Transaction will be separately tracked as non-utility costs with no charges, either allocated or direct, to be recovered from Avista customers. After the consummation of the Proposed Transaction, any remaining transaction costs or other costs of Olympus Holding Corp. or Hydro One will not appear on Avista's utility books, i.e. such costs will be recorded as non-utility. Avista shall furnish the Commission with journal entries and supporting detail showing the nature and amount of all costs of the Proposed Transaction (including but not limited to management time, BOD time, in-house and outside counsel time, any consultants engaged, etc.) since the Proposed Transaction was first contemplated, as well as the accounts charged, within 120 days of a Commission order in this docket.

 - b. Avista will exclude from Avista general rate cases, or any other method of cost recovery, all costs related to the Proposed Transaction including but not limited to: (i) all legal work from in-house counsel and outside counsel; (ii) any financial advisory fees associated with the Proposed Transaction; (iii) the acquisition premium; (iv) costs related to M&A consulting and advice (v) preparation of and materials for presentations relating to the Proposed Transaction (vi) any senior executive compensation or any Avista board of director time tied to a change of control of Avista; (vii) any other costs directly related to the Proposed Transaction.

30 In sum, Settlement Commitment No. 18 provides for a very detailed accounting of
31 the costs and expenses associated with the proposed transaction.

32 **B. Financial Integrity Commitments**

33 **Q: What modifications have the settlement terms made to the financial integrity**
34 **commitments?**

35 **A:** There have been several additions and modifications.

1 First, Settlement Commitment No. 37 is a new commitment that requires
2 Hydro One and Avista to notify the Commission of any changes in credit ratings.
3 Settlement Commitment No. 37 reads:

4 37. Credit Ratings Notification: Hydro One and Avista agree to
5 notify the Commission within two business days of any downgrade
6 of Avista's credit rating to a non-investment grade status by S&P,
7 Moody's, or any other such ratings agency that issues such ratings
8 with respect to Avista.

9 Second, Settlement Commitment No. 38, which addresses restrictions on
10 upward dividends and distributions, has been modified to address dividends
11 restrictions based on the credit ratings of both S&P and Moody's rating agencies.
12 In addition, Settlement Commitment No. 38 includes an additional restriction
13 related to upward dividends and distributions:

14 If Avista does not have an investment-grade rating from both
15 Moody's and S&P, or from one of these entities, or its successor, if
16 only one issues ratings with respect to Avista, and the ratio of
17 EBITDA to Avista's interest expense is less than 3.0, no dividend
18 distribution to Olympus Equity LLC or its successors will occur.

19 This additional restriction strengthens the limitations on upward dividends and
20 therefore further protects ratepayers.

21 Third, Settlement Commitment No. 46, a Financial Integrity Commitment
22 that restricts the pledging of Avista assets for loans, has been strengthened with
23 the following addition:

24 In addition, the Applicants agree that Avista's assets will not be
25 pledged by Avista or any of its affiliates, including Hydro One and
26 Olympus Holding Corp. and any of their subsidiaries or affiliates,
27 for the benefit of any entity other than Avista.

28 This additional restriction strengthens the limitations on upward dividends and
29 therefore further protects ratepayers.

1 Fourth, Settlement Commitment Nos. 50 and 51 are new commitments
2 that require Avista to request and receive Commission approval for any
3 inter-company debt transactions and for any loans made by Avista to Hydro One
4 or any affiliates. Settlement Commitments Nos. 50 and 51 read as:

5 50. No Inter Company Debt: Avista will notify the Commission
6 before entering into any inter-company debt transactions with
7 Olympus Holding Corp., Hydro One, or any of their subsidiaries or
8 affiliates.

9
10 51. No Inter Company Lending: Without prior Commission
11 approval, Avista will not lend money to Olympus Holding Corp.,
12 Hydro One, or any of their subsidiaries or affiliates.

13 These commitments provide for additional protection for ratepayers against the
14 financial risks associated with inter-company loans and debt.

15 Finally, and most significantly, the Financial Integrity Commitments now
16 include a Golden Share requirement. Specifically, Settlement Commitment No.
17 42 reads as:

18 42. Golden Share: Entering into voluntary bankruptcy shall require
19 the affirmative vote of a “Golden Share” of Avista stock. The Golden
20 Share shall mean the sole share of Preferred Stock of Avista as
21 authorized by the Commission. This share of Preferred Stock must
22 be in the custody of an independent third-party, where the third-party
23 has no financial stake, affiliation, relationship, interest, or tie to
24 Avista or any of its affiliates, or any lender to Avista, or any of its
25 affiliates. This requirement does not preclude the third-party from
26 holding an index fund or mutual fund with negligible interests in
27 Avista or any of its affiliates. In matters of voluntary bankruptcy, this
28 Golden Share will override all other outstanding shares of all types
29 or classes of stock.

30 The Golden Share is also included in Settlement Commitment No. 43, regarding
31 the role of independent directors. Specifically, Settlement Commitment No. 43
32 now includes the following provision: “In addition to an affirmative vote of this

1 independent director, the vote of the Golden Share shall also be required for
2 Avista to enter into a voluntary bankruptcy.”

3 Overall, the addition of the Golden Share commitment overrides other
4 commitments related to bankruptcy and provides much leverage to the
5 Commission in the event of any such proceedings.

6 **VII. THE SETTLEMENT STIPULATION AND AGREEMENT SATISFIES**
7 **WASHINGTON’S ‘NET BENEFIT’ STANDARD**

8 **Q: Please again review the primary elements of Washington’s net benefit**
9 **standard.**

10 A: As discussed above, Washington’s net benefit standard requires that Avista and
11 Hydro One’s merger must: (1) demonstrate that the transaction does no harm or
12 mitigates risk to customers; and (2) produce tangible benefits to customers. As
13 noted, since Washington statute lacks statutory specificity, the Commission has
14 considerable discretion in developing a test to determine whether or not the
15 application meets the legal standard and what factors can be considered in terms
16 of benefits to utility customers.

17 **Q: What is your conclusion as to whether the Hydro One – Avista proposed**
18 **acquisition meets Washington’s net benefit standard.**

19 A: As initially filed, I did not believe that the Hydro One – Avista Application met
20 the Washington ‘net benefit’ standard. I did not believe that the rate credit of
21 \$31.5 million spread over 10 years, which represented 3.0 percent of regulated
22 revenue, was a sufficient benefit to customers. In addition, I did not believe that
23 the commitments, especially the Regulatory and Financial Integrity

1 Commitments, protected ratepayers from the operating/management, financial,
2 and corporate governance/ring-fencing risks associated with the transaction.

3 However, the Settlement as negotiated and joined by the parties does meet
4 the net benefits standard. The Settlement includes significantly improved and
5 higher Rate Commitments as well as strengthened and additional Regulatory and
6 Financial Integrity Commitments.

7 The Rate Commitments include: (1) approximately a 50 percent increase
8 of the rate credit for Washington ratepayers, spread over five as opposed to 10
9 years; (2) improved regulatory oversight and review of the offset amounts; and
10 (3) the provision for a pre-transaction test year and a more detailed accounting for
11 transaction costs.

12 The improvements in the Regulatory and Financial Integrity Commitments
13 include:

14 (1) upward dividend restrictions based on both S&P and Moody's credit
15 ratings;

16 (2) strengthened of restrictions on the pledging of Avista assets for loans;

17 (3) new commitments requiring Avista to request and receive Commission
18 approval for any inter-company debt transactions and for any loans
19 made by Avista to Hydro One or any affiliates; and

20 (4) most significantly, the Financial Integrity Commitments now include a
21 Golden Share requirement that overrides other commitments related to
22 bankruptcy and provides much leverage to the Commission in the event
23 of any such proceedings.

1 The Settlement provides terms and conditions under which the proposed
2 transaction will provide net benefits to Avista's customers. Because the
3 Settlement meets the statutory standard, and the benefits provided to Avista's
4 customers are in the public interest, I recommend that the Commission approve
5 the Settlement without condition.

6 **Q: Does this conclude your testimony?**

7 A: Yes.