

**Exh. CSH-1T
Docket U-170970
Witness: Christopher S. Hancock**

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

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

DOCKET U-170970

TESTIMONY OF

Christopher S. Hancock

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

Commission Staff's Testimony in Support of Settlement

April 10, 2018

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LIST OF EXHIBITS

- Exh. CSH-2 Attachment A to Hydro One Response to ICNU Data Request No. 30, Moody's
- Exh. CSH-3 Attachment B to Hydro One Response to ICNU Data Request No. 30, S&P
- Exh. CSH-4 Hydro One Q4 2017 Analyst Call Slides
- Exh. CSH-5 Attachment A to Avista Response to UTC Staff Data Request No. 8, Moody's
- Exh. CSH-6 Attachment B to Avista Response to UTC Staff Data Request No. 8, S&P
- Exh. CSH-7 Avista Response to NWECC Data Request No. 18

1 **I. INTRODUCTION**

2

3 **Q. Please state your name and business address.**

4 A. My name is Christopher Scott Hancock. My business address is The Richard
5 Hemstad Building, 1300 S. Evergreen Park Drive S.W., Olympia, WA 98504.

6

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

8 A. I am employed by the Washington Utilities and Transportation Commission
9 (Commission) as a Regulatory Analyst in the Energy Regulation Section of the
10 Regulatory Services Division.

11

12 **Q. Are you the same Christopher Scott Hancock who is sponsoring joint testimony**
13 **in Exh. JNT-1T?**

14 A. Yes. My educational and professional background is included in Exh. JNT-2.

15

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

17 A. Yes. I have prepared four exhibits addressing the ratings outlook for Hydro One
18 Limited (Hydro One) and Avista Corporation (“Avista” or “Company”),
19 respectively. These are Exhibits CSH-2, CSH-3, CSH-5, and CSH-6. In addition, I
20 provide Exhibit CSH-4, which is a series of slides presented during Hydro One’s
21 Fourth Quarter 2017 Earnings Teleconference. Finally, I provide Exhibit CSH-7
22 which contains information on the amount of Avista’s asset retirement obligations
23 (AROs) associated with Colstrip.

1 **Q. Please describe the scope of your testimony in this docket.**

2 A. I articulate Commission Staff's (Staff's) support of the Settlement Stipulation and
3 Agreement ("Settlement") entered into by all parties to this docket. The Settlement
4 expresses the parties' support for the proposed acquisition of Avista by Hydro One
5 (Proposed Transaction), conditioned upon the commitments listed in the Settlement.
6 To explain Staff's support of the Settlement, I include additional detail on certain
7 commitments in the Settlement that address Staff's concerns in this case. In addition
8 I provide Staff's perspective on the new "net benefit" standard as it applies to this
9 case.

10

11 **II. STAFF'S INTERESTS IN THIS PROCEEDING**

12

13 **Q. What standard governs the Commission's decision to approve or deny the**
14 **Proposed Transaction?**

15 A. RCW 80.12.020 requires that mergers and acquisitions of public service companies
16 like Avista in Washington be approved by the Commission. In order to approve the
17 Proposed Transaction, the Commission must find "that the transaction would provide
18 a net benefit to customers of the company."

19 In the Commission's property transfer rules, WAC 480-143-170 provides that
20 if "the commission finds the proposed transaction is not consistent with the public
21 interest, it shall deny the application."

22

1 **Q. What are Staff's interests in this proceeding?**

2 A. Staff is interested in ensuring that the Proposed Transaction meets the Commission's
3 standard for approval, meaning that Avista's ratepayers will receive a net benefit
4 from the Proposed Transaction, and that the Proposed Transaction is in the public
5 interest.

6 In more detail, Staff's principal concerns with the Proposed Transaction are
7 as follows:

- 8 1) Whether there are commitments by the purchaser to important public
9 service obligations such as:
- 10 i) Customer service;
 - 11 ii) Safety;
 - 12 iii) Reliability;
 - 13 iv) Resource adequacy including energy efficiency and conservation;
 - 14 v) Support for low-income customers;
 - 15 vi) Environmental stewardship;
- 16 2) Whether customers are protected from rate increases that might result
17 from the transaction and from financial distress that might occur as a
18 result of the manner in which the purchase was financed or distress at
19 other companies affiliated with the purchaser;
- 20 3) Whether the Commission's ability to regulate the utility in the public
21 interest is fully protected, including preserving access to all necessary
22 information;

- 1 4) Whether the purchaser has the financial and managerial fitness to own
2 and operate the utility in fulfillment of its public service obligations;
3 5) Whether the commitments made in the transaction are enforceable.¹
4

5 **Q. Does Staff believe that the Settlement addresses all of these concerns?**

6 A. Yes. Taken together, the Settlement reasonably assures that the Proposed
7 Transaction provides a net benefit to customers, and is in the public interest.

8 To my knowledge, the result contains the most comprehensive provisions and
9 protective arrangements surrounding a transfer of property that this Commission has
10 ever considered.

11
12 **III. HOW STAFF’S INTERESTS HAVE BEEN ADDRESSED**
13

14 **Q. How will you address how Staff’s interests have been met?**

15 A. This testimony will highlight particular commitments the Parties have agreed to in
16 Appendix A to the Settlement (Exh. JNT-3). Specific considerations around net
17 benefits and the public interest are addressed in section IV of this testimony.

18 The Joint Testimony (Exh. JNT-1T) provides an overview of the Settlement.
19 This testimony will highlight specific commitments that address Staff’s concerns in
20 this proceeding.
21

¹ *In the Matter of the Joint Application of Puget Holdings LLC and Puget Sound Energy, Inc. For an Order Authorizing Proposed Transaction*, Docket U-072375, Order 08, 48-49, ¶ 115 (Dec. 30, 2008) (PSE-Macquarie Order).

1 **A. Commitments to Important Public Service Obligations**

2

3 **1. Customer service, reliability, and safety**

4

5 **Q. Which customer service commitments would you like to highlight?**

6 A. The Settlement provides several commitments from Hydro One and Avista (together
7 “Joint Applicants”) that support consumer protection.

8 Commitment 71, “Security Deposits,” provides for the return of security
9 deposits to residential customers, and a discontinuation of the practice of requiring
10 security deposits from these customers going forward.

11 Commitment 72, “AMI Consumer Protection,” provides for guidelines
12 prohibiting the remote-disconnection of customers under certain temperature
13 extremes as the Company’s AMI program expands. It also provides a path for
14 resolving matters around prepayment billing and remote disconnection.

15 Commitment 79, “On Bill Repayment,” establishes that Hydro One will
16 provide the initial funding for establishing an On-Bill Repayment program, while
17 establishing that the ratepayer population will not be responsible for defaults on
18 obligations paid through the On-Bill Repayment program. The Commitment also
19 establishes that customers will not be disconnected from service due to non-payment
20 of non-utility obligations.

21 Commitment 33, “Commitments Binding,” has been modified to include an
22 obligation by Hydro One and Avista to rectify any failure to comply with the merger
23 commitments.

1 **Q. Which commitments address safety?**

2 A. Commitment 15 (“Safety and Reliability Standards and Service Quality Measures”);
3 and Commitment 80 (“Contract Labor”), which Washington and Northern Idaho
4 District Council of Laborers elaborates upon in its individual testimony.

5
6 **Q. Which commitment addresses reliability?**

7 A. Commitment 15 (“Safety and Reliability Standards and Service Quality Measures”)
8 provides for performance-based ratemaking of a sort. If Avista’s reliability declines
9 significantly during the first ten years of Hydro One’s ownership of Avista,
10 customers will receive an increased rate credit of \$250,000 annually. This represents
11 a substantial incentive for Avista to continue to provide reliable service to its
12 customers in Washington.

13

14 **2. Support for low-income customers**

15

16 **Q. Which commitments address support for low-income customers?**

17 A. One of Staff’s most important considerations in entering into the Settlement with the
18 Joint Applicants and the other parties was securing protections for low-income
19 customers. The broad support among the parties for addressing low-income issues is
20 captured in Commitments 64 through 74.

21 Commitment 67 (“Funding for Low-Income Participation in New
22 Renewables”) dedicates \$5 million in funding for renewable programs that benefit
23 low-income customers, and Commitment 70 (“Low Income Weatherization”)

1 provides for \$4 million of additional funding for weatherization of low-income
2 customers' homes.

3 Commitment 69 ("Replacement of Manufactured Homes") provides for the
4 replacement of inefficient manufactured homes by Hydro One over a ten-year
5 period. Homes built prior to 1976, which tend to be the least energy-efficient homes,
6 are prioritized for replacement. This commitment is important because it will not
7 only assist customers in lowering their bills but it will also increase conservation.
8 Two million dollars is allocated to this program.

9 Commitment 70 (Low Income Weatherization) similarly benefits individual
10 customers by potentially lowering bills and benefits all customers by increasing
11 conservation. The Commitment provides that existing funding for low income
12 weatherization will continue and, in addition, Hydro One will furnish \$4 million over
13 10 years in additional funding.

14
15 **3. Energy efficiency, conservation, and environmental stewardship**

16
17 **Q. Please describe Commitment 55, "Cost of Greenhouse Gas Emissions."**

18 A. The Washington State Legislature recently considered proposed legislation on
19 pricing carbon emissions. The legislative effort failed, but the possibility of such
20 legislation remains.

21 The Joint Applicants agreed to acknowledge this possibility through Avista's
22 resource planning process. Commitment 55 requires Avista to work with its

1 Integrated Resource Plan Advisory Group to determine a range of greenhouse gas
2 costs to model.

3

4 **Q. Have the Joint Applicants and other parties agreed to commitments around**
5 **conservation and energy efficiency?**

6 A. Yes. Several of the commitments directly address conservation; some of these
7 directly target low-income customers, who stand to benefit the most from
8 conservation measures funded by a third-party.

9 Commitment 69 (“Replacement of Manufactured Homes”) and Commitment
10 70 (“Low Income Weatherization”) have been previously addressed in the discussion
11 of low-income issues, but merit acknowledgement here again as energy efficiency
12 and conservation issues.

13 Commitment 63 establishes a Professional Home Energy Audit program,
14 funded by Hydro One to reach approximately 2,000 homes over a ten year period.
15 This program will provide participating customers an understanding of the lowest-
16 hanging fruit for improving the energy diet of their homes, at no charge.

17 Commitment 61 (“Industrial Customers’ Self Direct Conservation”)
18 establishes the option for industrial customers to engage in large conservation
19 projects, using a mix of funding from Schedule 91 and the Joint Applicants. A
20 project under this program will then be repaid by the customer over a period of time
21 through the Schedule 91 charges to the customer. The program creates no financial
22 burden on other customers, and provides an energy efficiency benefit to all
23 customers.

1 **B. Protection from Costs Associated with the Proposed Transaction**

2

3 **Q. How does the Settlement protect customers from costs associated with the**
4 **Proposed Transaction?**

5 A. Several items in the Settlement address this matter. Commitment 16 (“Treatment of
6 Net Cost Savings”) requires that any cost savings that Avista achieves as a result of
7 the transaction will be captured in future rate proceedings.

8 Commitment 17 (“Pre-Transaction Test Year”) establishes the test year to be
9 used in future general rate case filings, thus preventing controversy surrounding the
10 appropriate test year in those proceedings. Sub-item “c” in this commitment provides
11 for a second test year, presented for informational and comparison purposes only, in
12 order to capture the effect of the acquisition.

13 Commitment 81 (“Most Favored Nation”) ensures that Washington
14 ratepayers can receive the benefits as well as protections that the Joint Applicants
15 agree to in other jurisdictions.

16 Commitment 24 (“Cost Allocations Related to Corporate Structure and
17 Affiliate Interests”) provides important structure around cost allocations as Avista
18 integrates with Hydro One in the coming years.

19

20 **Q. Please describe how Commitment 17, “Treatment of Transaction Costs,”**
21 **addresses Staff’s concerns.**

22 A. Staff and other parties advocated for, and secured, clarifications to the proposed
23 commitment by the Joint Applicants around costs associated with the Proposed

1 Transaction. The revisions to this commitment clarify the types of transaction and
2 transition costs that cannot be recovered from ratepayers.

3 These costs are to be tracked and furnished to the Commission. Specific costs
4 to be excluded from recovery must be identified, without limiting the ability of the
5 parties to dispute unspecified costs in a future general rate case. This Commitment
6 makes clear that the costs of the Proposed Transaction are to be borne by Avista and
7 its new shareholder, and not Avista's customers.

8
9 **Q. Please describe how Commitment 18, "Rate Credits," addresses Staff's**
10 **concerns.**

11 A. The settlement process produced a larger rate credit than originally proposed by the
12 Joint Applicants, and represents a larger rate credit (five percent of base revenues,
13 rather than 3.1 percent) than was provided in the acquisition of Puget Sound Energy,
14 Inc. (PSE) by an investor consortium that included the Macquarie Group.²
15 Furthermore, the rate credit is delivered over a shorter period of time, increasing the
16 time-value of money to Avista's ratepayers. This concentrates the distribution of the
17 rate credit over the crucial first few years of Avista's integration into Hydro One.

18 A rate credit not only protects customers from cost increases due to the
19 Proposed Transaction; it provides a cost *decrease* for the five-year period in the
20 Commitment. This commitment undoubtedly confers a benefit to customers that,
21 absent the Proposed Transaction, would not otherwise exist.

22

² See PSE-Macquarie Order.

1 **C. Protecting the Commission’s Ability to Regulate the Utility in the Public**
2 **Interest**

3
4 **Q. Have the parties agreed to commitments that preserve the Commission’s ability**
5 **to regulate the utility in the public interest?**

6 A. Yes. Commitment 30 (“Commission Enforcement of Commitments”) makes clear
7 that the Commission can compel not only Avista witnesses, but also witnesses from
8 Olympus Holding Corp.³ and Hydro One.

9 Commitment 23 (“Access to and Maintenance of Books and Records”)
10 preserves the Commission’s access to Avista’s books, and makes clear that the
11 Commission may review Avista-related documents at Olympus Holding Corp. and
12 its subsidiaries, as well as at Hydro One.

13 Commitment 22 (“Separate Books and Records”) requires separate books and
14 records for Avista, preventing unnecessary complication of records.

15 Commitment 31 (“Submittal to State Court Jurisdiction for Enforcement of
16 Commission Orders”) further clarifies the enforceability of the Commitments the
17 Joint Applicants have made in this proceeding.

18 Commitment 47 (“Hold Harmless; Notice to Lenders; Restriction on
19 Acquisitions and Dispositions”) requires the Joint Applicants to seek Commission
20 approval of any sale or transfer of any material part of Avista, or any other
21 transaction that would result in an entity other than Hydro One directly or indirectly
22 acquiring a controlling interest in Avista.

³ Olympus Holding Corp. is an intermediate corporate entity between Avista and Hydro One. See Appendix B to Settlement Stipulation, Revised Post-Closing Corporate Structure.

1 Together, these commitments preserve, and in some cases enhance, the
2 Commission’s ability and authority to regulate the Company in the public interest.

3
4 **D. Financial Integrity**

5
6 **Q. What are some concerns that arise when a regulated utility transitions from
7 being publicly-traded, to being privately-held?**

8 A. A publicly-traded company is regulated both by financial regulators, like the
9 Securities and Exchange Commission (“SEC”), and its diverse body of shareholders.
10 When a company becomes privately-held, especially by a single entity like Hydro
11 One, it no longer is subject to balancing the competing interests of a large body of
12 owners with a diverse set of interests, and will instead begin to reflect the priorities
13 of the single shareholder, which can be myopic.

14 The concern is that Avista may be run in a manner that best suits the singular
15 interests of its singular owner, and not the diverse interests of a broad body of
16 shareholders.

17 The commitments obtained in this Settlement provide an analog for the
18 discipline that would otherwise be imposed on Avista by a large, diverse ownership
19 base.

1 **Q. Have major credit ratings agencies commented on the Proposed Transaction?**

2 A. Yes. Both Avista and Hydro One have maintained sound investment-grade ratings
3 from the major ratings agencies.⁴

4

5 **Q. What do ratings agencies think of Hydro One, given Hydro One’s decision to**
6 **purchase Avista?**

7 A. Both major ratings agencies have negative outlooks for Hydro One;⁵ however, they
8 also explain that these negative outlooks are the result of an expectation of less
9 extraordinary support from the Province of Ontario for Hydro One. Despite the
10 negative outlooks, Hydro One maintains strong investment-grade ratings.

11 In addition, Moody’s noted that “the additional debt that Hydro One Limited
12 plans to issue will not limit the ratings of Hydro One Inc.”⁶

13 Hydro One has significant access to several billions of dollars of credit.⁷

14

15 **Q. What do ratings agencies think of Avista, given the announcement of a purchase**
16 **by Hydro One?**

17 A. On the understanding that Hydro One Limited would issue the debt used to finance
18 the purchase of Avista, Moody’s stated that it believed Hydro One Limited’s
19 “ownership will be credit neutral.” Moody’s went on to say that “the stable rating

⁴ “Major ratings agencies” refers to Moody’s and S&P.

⁵ Hancock, Exh. CSH-2, Attachment A to Hydro One Response to ICNU Data Request No. 30, Moody’s; Exh. CSH-3, Attachment B to Hydro One Response to ICNU Data Request No. 30, S&P.

⁶ Hancock, Exh. CSH-2.

⁷ Hancock, Exh. CSH-4, Q4 2017 investor report slides.

1 outlook reflects our view that the pending acquisition by [Hydro One Limited] will
2 not materially affect the credit quality of Avista.”⁸

3 Moody’s noted that it could provide a downgrade *if* Avista’s “dividend
4 payout increased meaningfully to support the new parent company’s acquisition
5 debt.”⁹ In this statement, Moody’s has raised the possibility that Avista will be relied
6 upon to pay for the debt used to acquire itself.

7 S&P looked more favorably on the proposed transaction’s effects on Avista,
8 revising its outlook from “stable” to “positive.”¹⁰

9
10 **Q. How leveraged is the Proposed Transaction?**

11 A. If one considers the convertible debentures as debt, the Proposed Transaction is
12 leveraged at 53%.¹¹ However, as C\$1.54 billion of the borrowings are unsecured,
13 and will be converted upon closure of the Proposed Transaction, this portion of the
14 financing functions much more like equity. Treating the convertible debentures as
15 equity produces a debt leverage of approximately 24 percent.¹² As a matter of
16 comparison, the PSE-Macquarie deal was 20 percent leveraged, a figure the
17 Commission found to be “substantially less” than the leverage involved in the two
18 preceding transactions that the Commission approved.¹³

⁸ Hancock, Exh. CSH-5, Attachment A to Avista Response to UTC Staff Data Request No. 8, Moody’s.

⁹ *Id.*

¹⁰ Hancock, Exh. CSH-6, Attachment B to Avista Response to UTC Staff Data Request No. 8, S&P.

¹¹ Leverage = total debt divided by total capital. Figures used are after accounting for retired debt + new debt.
\$2.81 billion / \$5.3 billion \approx 0.53.

¹² \$1.27 billion / \$5.3 billion \approx 0.24.

¹³ PSE-Macquarie Order at 7, ¶ 18.

1 The entirety of this debt will sit on Hydro One’s books, not Avista’s.

2 Furthermore, Avista is not the sole entity available to service this debt.

3

4 **Q. How has the Settlement promoted financial integrity of Avista?**

5 A. Staff sought to obtain commitments that promote continued financial integrity of
6 Avista. Absent the disciplining effects of being a publicly-traded company with a
7 broad and diverse base of shareholders, Avista’s balance sheet may
8 disproportionately suit the interests of a single shareholder. Staff and other parties
9 worked together with Avista and Hydro One representatives to arrive at a suite of
10 commitments that promote continued financial health of Avista.

11

12 **Q. Which commitments that address financial integrity are of particular interest to**
13 **Staff?**

14 A. Commitments 34 through 41 address Avista’s financial integrity.

15 Commitment 34 (“Avista Capital Structure”) ensures that the company
16 remains adequately capitalized, and Commitment 37 requires Avista and Hydro One
17 to notify the Commission within two business days of any downgrade of Avista’s
18 credit rating to a non-investment grade status.

19 Additionally, Commitment 22 requires Avista to maintain separate books and
20 records from affiliates

21

22 **Q. As a whole, do the commitments sufficiently address financial integrity at**
23 **Avista?**

1 A. Yes. The total balance of Commitments 34 through 41 promote sound financial
2 practices at Avista, and serve the interests of Avista’s customers in the absence of the
3 moderating force of a diverse set of shareholders.

4 This group of commitments requires Hydro One to provide equity support of
5 Avista under reasonable terms and on a sustainable basis, the maintenance of
6 separate debt and preferred stock, continued evaluation by credit rating agencies,
7 prioritization of debt service over upward distributions; continued reporting to the
8 Securities and Exchange Commission, compliance with the Sarbanes-Oxley Act, and
9 maintenance of Avista’s pension funding obligations.

10

11 **Q. Please address Commitment 38, “Restrictions on Upward Dividends and**
12 **Distributions.”**

13 A. This Commitment has been improved from the Joint Applicants’ original filing.
14 Through negotiation, the parties have agreed that Avista will be required to have an
15 “investment” grade rating from both Standard & Poor’s and Moody’s, rather than
16 only one of these entities, before issuing a dividend to Hydro One or Olympus
17 Equity. This change is consistent with the requirements made of PSE and the
18 Macquarie Group in PSE’s acquisition case.¹⁴

19 By requiring several agencies to make an “investment” grade assessment,
20 Avista’s customers can have stronger assurance that Avista is not paying dividends
21 upstream unless it has a strong balance sheet and wide credibility in the eyes of
22 investors. Requiring that more than one ratings agency must find that Avista is

¹⁴ See PSE-Macquarie Order at 29-30, ¶ 69.

1 investment-grade would also be consistent with the requirements placed on PSE in
2 its merger/acquisition.

3 Absent meeting this condition, Avista can still make an upward distribution if
4 the ratio of Avista's EBITDA to interest expense is greater than or equal to 3.0. This
5 requirement ensures that Avista has pre-tax earnings more than sufficient to meet the
6 company's debt obligations.

7 However, in either of these two scenarios, the Company is required to
8 maintain an equity ratio of at least 44 percent.

9 Altogether, these restrictions ensure that Avista's finances are not
10 jeopardized in order to satisfy parent organizations, and instead prioritize the use of
11 Avista's cash flow to service debt before paying dividends. In its current status as a
12 publicly-traded company, Avista is not bound by such restrictions.

13
14 **E. Ringfencing**

15
16 **Q. What is ringfencing?**

17 A. The Commission has aptly described ringfencing as "a term of art in the world of
18 mergers and acquisitions" that "refers to financial and corporate structuring in a
19 transaction that results in a newly acquired company being isolated from the
20 upstream corporate structure of its new owners and, thus, insulated and protected
21 from any financial distress suffered at the higher levels in the organization."¹⁵

22

¹⁵ PSE-Macquarie Order at 8, n. 11.

1 **Q. Please highlight some of the ringfencing commitments of particular interest to**
2 **Staff.**

3 A. All parties have agreed to important commitments from the Joint Applicants that
4 hold Avista customers harmless from any business and financial risk exposures
5 associated with Hydro One, Olympus, and their affiliates. These commitments
6 provide important protections to Avista ratepayers if Hydro One, Olympus, or their
7 affiliates ever enter bankruptcy.

8 These commitments restrict the Company from acting as a lender to Hydro
9 One without the Commission's formal approval (Commitments 50 and 51). The
10 parties have also agreed to commitments restricting the pledge of utility assets for the
11 benefit of any entity other than Avista (Commitment 46).

12 Importantly, Avista customers are protected from the cost of the debt Hydro
13 One issued to finance its purchase of Avista (Commitments 18, 25, and 35). Hydro
14 One, and not Avista customers, will bear the full risks of their investment in eastern
15 Washington's largest investor-owned utility.

16 Commitments were also secured that require obtaining a non-consolidation
17 opinion to independently verify that the ringfencing commitments obtained in this
18 settlement are suitable to insulate Avista and its ratepayers (Commitment 44). The
19 Company is required to notify lenders of these commitments as well (Commitment
20 47). The suite of ringfencing commitments is fortified by a restriction on modifying
21 these commitments without receiving Commission approval.

22

1 **F. Managerial and Financial Fitness**

2

3 **Q. Is Hydro One financially and managerially fit to purchase Avista?**

4 A. Yes. Hydro One has several decades of experience operating a large electric utility
5 over diverse topology in a highly variate climate with hot summers and bitterly cold
6 winters. As previously explained above, Hydro One is a financially-sound company
7 with investment-grade ratings from major credit ratings agencies.

8

9 **Q. Will Avista’s experienced leadership team continue in their roles after the**
10 **Proposed Transaction is completed?**

11 A. Yes. Hydro One has committed (Commitment 2) to retain Avista’s leadership as
12 Avista transitions into ownership under Hydro One. Three of Avista’s Board of
13 Directors will be individuals who are currently on Avista’s board (Commitment 3).
14 This also ensures a smooth transition and retains valuable institutional knowledge.

15

16 **G. Other Interests**

17

18 **Q. What other commitments would Staff like to highlight?**

19 A. Commitment 76 addresses the depreciable life of Colstrip Units 3 and 4. An array of
20 circumstances provided for a unique opportunity to more quickly recover
21 depreciation expense of these units in a manner that provides no increase in rates.

22

1 **Q. What confluence of factors provided the opportunity for addressing Colstrip?**

2 A. On December 5, 2017, the Commission issued Order 08 in Dockets UE-170033 and
3 UG-170034, Puget Sound Energy’s most recent general rate case.¹⁶ Many parties to
4 the current proceeding were parties to those dockets. Order 08 approved a settlement
5 which, among other things, uses Production Tax Credit dollars to pay for costs
6 associated with Colstrip Units 1 and 2. Furthermore, that settlement established an
7 end-of-life date of December 31, 2027, for Colstrip Units 3 and 4.

8 On December 22, 2017, the Tax Cuts and Jobs Act (“TCJA”) was passed,
9 and was enacted on January 1, 2018. The reduction in the corporate tax rate from
10 35% to 21% resulted in an excess amount of deferred federal income taxes on
11 Avista’s books, to the tune of several millions of dollars.

12 Subsequently, on February 22, 2018, the Company filed a depreciation study
13 in Dockets UE-180167 and UG-180168. This depreciation study found a useful
14 economic life of Colstrip Units 3 and 4 to be 2034 and 2036, respectively.¹⁷

15 The confluence of these events provided an opportunity to address the
16 recovery of Colstrip 3 and 4 costs from customers, in a docket that included parties
17 interested in this matter. This proceeding has the right parties at the right time.

18

¹⁶ *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy*, Dockets UE-170033 and UG-170034, Order 08 (Dec. 5, 2017) (Order 08).

¹⁷ *In the Matter of the Petition of Avista Corporation, d/b/a Avista Utilities, For an Order Authorizing the Company to Revise its Electric Book Depreciation Rates and Authorizing Deferred Accounting Treatment for the Difference in Depreciation Expense*, Attachment C, p. III-10, Docket UE-180167; *In the Matter of the Petition of Avista Corporation, d/b/a Avista Utilities, For an Order Authorizing the Company to Revise its Natural Gas Book Depreciation Rates and Authorizing Deferred Accounting Treatment for the Difference in Depreciation Expense*, Attachment C, p. III-10, Docket UG-180168.

1 **Q. Of what relevance is Colstrip and excess deferred federal income tax to this**
2 **case?**

3 A. A core consideration in this case is whether or not Hydro One's purchase of Avista
4 provides a net benefit for Avista's ratepayers. One area in which Hydro One's
5 purchase of Avista, and the attending process, can provide a benefit to ratepayers is
6 by rectifying Colstrip-related generational inequities that may burden current and
7 future ratepayers, and mitigating the risks of an earlier-than-expected closure of
8 Units 3 and 4.

9
10 **Q. What do you mean by Colstrip-related generational inequities?**

11 A. Avista has recently filed a depreciation study that continues to indicate an economic
12 end-of-life for Colstrip Unit 3 at 2034, and Colstrip Unit 4 at 2036. However, coal-
13 fired power plants around the country are closing much sooner than anticipated by
14 utilities and their regulators. It is already the case that ratepayers in the near and
15 medium term will incur more than their fair share of costs; if utilities and regulators
16 had a crystal ball, and that ball said that 2035 was the end-of-life for Colstrip 3 and
17 4, past depreciation expenses related to Colstrip 3 and 4 would have been higher, and
18 future depreciation expenses related to these plants would be lower.

19 For example, not a single dollar for Asset Retirement Obligations, or AROs,
20 has ever been collected from ratepayers.¹⁸ In Avista's recently-filed depreciation

¹⁸ Hancock, Exh. CSH-7, Avista Response to NWECA Data Request No. 18. An Asset Retirement Obligation is a liability associated with the future retirement of a long-lived capital asset.

1 study, the Washington-allocated balance for AROs stands at \$37.6 million, or over
2 37% of the depreciable balance.¹⁹

3 The Legislature also recently considered a bill, backed by Governor Inslee,
4 which would have implemented a carbon tax. While that bill narrowly failed to pass
5 the Legislature, Washington voters may approve a ballot initiative adopting a carbon
6 tax. Such a program is likely to make electricity generated from fossil fuel plants
7 more expensive, and thus likely to reduce the economic life of fossil fuel plants like
8 Colstrip 3 & 4. With a non-zero probability that such a policy may become law, it
9 would be wise to consider the impact of a carbon tax on the economic viability of
10 Colstrip 3 & 4 – and the accompanying ratemaking ramifications.

11 Staff believes that it is appropriate to exercise some caution in this area, and
12 to take advantage of a unique set of circumstances that can ameliorate the
13 generational inequities that have already occurred, and that may occur in the future.

14

15 **Q. Does the Settlement adjust the depreciable life of Colstrip Units 3 and 4?**

16 A. Yes. The Settlement establishes an economic end-of-life of December 31, 2027, for
17 Colstrip Units 3 and 4.

18

19 **Q. Does the Settlement establish a closure date for Colstrip Units 3 and 4?**

20 A. No. The parties agree that there is no agreement to shut down or cease operations at
21 Colstrip Units 3 and 4.

22

¹⁹ The total incremental change to the depreciable balance of Colstrip Units 3 and 4 is \$42.7 million, of which approximately \$37.6 million is AROs.

1 **Q. Other than addressing intergenerational equity concerns, what benefits are**
2 **there to adjusting the depreciable life of Colstrip Units 3 & 4 to the year 2027?**

3 A. Doing so provides the following benefits:

- 4 • Aligns Avista Colstrip 3 & 4 with PSE;
- 5 • Removes barriers to early closure, if such a situation arises;
- 6 • Addresses Colstrip 3 & 4 depreciable life, before Avista potentially enters
7 a three-year stayout period if the stayout is approved in the pending
8 Avista general rate case in Dockets UE-170485 and UG-170486.

9
10 **Q. Why is this a good idea?**

11 A. The Tax Cuts and Jobs Act, or TCJA, was recently enacted. Its most significant
12 change to law for our purposes is a reduction of the corporate tax rate, from 35% to
13 21%. However, under the 35% tax rate, Avista collected funds from ratepayers for
14 the purpose of paying taxes at a future date in the form of Deferred Federal Income
15 Taxes, or DFIT. Because these funds were collected for the purpose of paying
16 federal income taxes that the company now is no longer obligated to pay, it is
17 appropriate to return these funds to customers.

18 However, “ratepayers” is a constantly-changing group. In a perfect world, we
19 would identify the exact amount of excess taxes paid by every single customer prior
20 to the enactment of the TCJA, and return that amount to these individuals and
21 organizations. That is simply impossible. Typically, we would just return these funds
22 to “ratepayers” writ large – creating a generational inequity between previous
23 generations of ratepayers, and the ratepayers of today and tomorrow.

1 We are therefore faced with two intergenerational inequities that run in
2 opposing directions to one another. The intergenerational inequity posed by Colstrip
3 3 and 4 benefits previous ratepayers at the expense of the ratepayers of today and
4 tomorrow. The intergenerational inequity posed by the reduction in corporate tax rate
5 benefits the ratepayers of today and tomorrow at the expense of previous generations
6 of ratepayers.

7 This Settlement presents a unique opportunity to resolve these
8 intergenerational inequities, by assigning funds collected from previous generations
9 of ratepayers to cover costs that were not recovered from previous generations of
10 ratepayers.

11
12 **Q. How does Commitment 76 accomplish this?**

13 A. First, all funds available for immediate return to customers (approximately \$16.7
14 million)²⁰ will be put towards the balance of customer liabilities related to Colstrip 3
15 and 4. This produces an immediate reduction in Net Plant of \$16.7 million.

16 Second, the Settlement establishes that the depreciation expense for these
17 assets will remain at the current level of approximately \$4.53 million per year,
18 through 2027. The cumulative amount of Net Plant recovered through 2027 will be
19 approximately \$45 million.

20 Third, the Settlement proposes that the remaining portion of customer
21 liabilities (approximately \$52 million) related to Colstrip 3 and 4 are accounted for

²⁰ This consists of unprotected excess DFIT as well as protected excess DFIT that meets the Average Rate Assumption Method provision and excess taxes collected since January 1, 2018.

1 as a regulatory asset. In other words, the remaining plant balance of Colstrip 3 and 4
2 is split between a regulatory asset, and what will remain in Net Plant.

3 Under this commitment, Avista will receive a return of (that is, would
4 recover) the balance of the regulatory asset through amortization of the asset. The
5 company will also earn a return on the regulatory asset, as it would be included in
6 rate base. Thus, the Company is made whole.

7 A key element is the length of the amortization period. The Settlement calls
8 for the regulatory asset to be amortized in a manner than best matches the
9 amortization of the regulatory liability that is *protected* Excess DFIT.

10

11 **Q. What is accomplished by amortizing the regulatory asset in this manner?**

12 A. By matching the amortization schedule of the regulatory asset (which can be thought
13 of as the portion of Colstrip 3 & 4 costs under-recovered from previous generations
14 of customers) to the amortization schedule of the regulatory liability (which are
15 excess taxes paid by previous generations of customers), we will have matched a
16 stock and flow of funds from previous generations of customers to cover a stock and
17 flow of costs attributable to previous generations of customers.

18 As a result, we will have mitigated intergenerational inequities²¹ related to
19 Colstrip 3 and 4, particularly in the event that Colstrip 3 and 4 have a shorter
20 economic life than currently anticipated – all while maintaining the status quo for
21 ratepayers in terms of recovering depreciation expense.

22

²¹ Similar reasoning around intergenerational equity was used to justify the use of Production Tax Credits in the PSE general rate case. *See, e.g.*, Order 08 at 40, ¶ 110.

1 **Q. Is the “net benefit” standard really just a repackaged “no harm” standard?**

2 A. No. The Legislature took action to change the language of the law, which I
3 understand to mean that the intent was to change the practical effect of the law.

4 Furthermore, the Commission has distinguished between the “no harm”
5 standard and the “net benefits” standard itself, relatively recently. For example, in
6 the PSE-Macquarie Order, the Commission said of the “no harm” standard that was
7 applicable at the time: “To be ‘consistent with the public interest,’ a transaction need
8 not confer net benefits on customers or the public by making them better off than
9 they would be absent the transaction. It is sufficient if the transaction causes no
10 harm.”²² Clearly, the Commission has found these to be distinctly different
11 standards.

12
13 **Q. Has the Commission considered the new “net benefits” standard in any other
14 proceeding?**

15 A. Yes, in a recent filing involving the corporate reorganization of Northwest Natural
16 into a holding company structure. In its order approving the reorganization, the
17 Commission stated, “our decision today does not provide specific guidance for future
18 transactions under RCW 80.12.020,” noting that its finding of net benefits “is based
19 on the particular facts and circumstances of NW Natural’s reorganization request and
20 the negotiated commitments.”²³ I glean from the Commission’s decision that it is

²² PSE-Macquarie Order at 48, ¶ 115.

²³ *In the Matter of Northwest Natural Gas Company’s Application for Approval of Corporate Reorganization to Create a Holding Company*, Docket UG-170094, Order 01, 3, ¶ 14 (Dec. 28, 2017).

1 important to identify the benefits of a transaction and to seek protections against
2 harms based on the individual context of each proceeding.

3

4 **Q. Are benefits limited to those than can be dollar-denominated?**

5 A. No. Benefits can be tangible or intangible; they can be financial or non-financial.

6 Although it may be tempting to account for the net benefits of a transaction in
7 currency, this measure only tells part of the story.

8

9 **Q. Are all previously approved transfers of property, which passed a “no harm”
10 standard, necessarily short of the “net benefits” standard?**

11 A. No. It is quite possible that previous mergers and acquisitions, approved under the
12 “no harm” standard, would have passed a “net benefits” standard as well. For
13 example, the Commission noted in the PSE-Macquarie Order that “there is a
14 persuasive argument that PSE and its customers will be better off under the
15 transaction than under the *status quo*, but we need not decide that issue under the ‘no
16 harm’ standard.”²⁴

17

18 **Q. Does the Settlement provide a net benefit to Avista’s customers?**

19 A. Yes. Staff and the other parties have secured important commitments from the Joint
20 Applicants on all of the matters previously identified as concerns for Staff in this
21 matter. These include protections from potential harms as well as identifiable
22 benefits. Collectively, the Settlement produces an improvement from the status quo

²⁴ PSE-Macquarie Order at 49, n. 70.

1 for Avista's customers. The unanimous support of all parties to this proceeding
2 strongly indicates that the Settlement provides net benefits to customers.

3
4 **Q. Has the Commission made any other relevant comments on the 'net benefits'**
5 **standard?**

6 A. Yes. In the PSE-Macquarie Order, the Commission also noted that "a 'net benefit'
7 standard effectively imposes a burden on the shareholders' right to sell by making
8 any potential buyer pay a premium to non-owners. This imposes costs in addition to
9 those necessary to protect the public interest from harm."²⁵

10
11 **Q. Does the Settlement impose costs on Hydro One that are both reasonable and**
12 **necessary to meet the standard?**

13 A. In Staff's view, yes.

14
15 **B. The Public Interest**

16
17 **Q. Is approving the Proposed Transaction in the public interest?**

18 A. Yes, but only with the protections and benefits of the Settlement. The Settlement
19 renders the Proposed Transaction in the public interest not only because it provides
20 net benefits to Avista's customers, but also because it benefits a community that
21 extends beyond ratepayers. Prime examples are the commitments that support energy
22 efficiency, conservation, and renewable energy (Commitments 52-63). These

²⁵ PSE-Macquarie Order at 50, ¶ 118.

1 commitments are in the public interest because they provide for a greener, cleaner
2 means of meeting customer energy demand, which ultimately benefits everyone in
3 the region. Further examples are found in the “community contributions”
4 commitments in Commitment 11 and Commitment 64; and in Commitment 77
5 (“Montana Community Transition Fund”).

6 Together, these commitments provide for millions of dollars of one-time
7 contributions and ongoing community support.

9 V. CONCLUSION

10
11 **Q. Do you recommend that the Commission approve the Settlement?**

12 A. Yes. I recommend that the Commission approve the Settlement, thereby authorizing
13 the Proposed Transaction between Avista and Hydro One. The Settlement is
14 supported by all parties to this proceeding, representing the interests of industrial
15 customers, environmentalists, laborers, residential and small business customers,
16 Commission Staff, and low income customers. The commitments in the Settlement
17 provide substantial benefits for Washington ratepayers. These benefits, as well as
18 protections secured by the commitments, render the Proposed Transaction in the
19 public interest.

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

22 A. Yes.