Exh. CFL-1T

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. U-17________

DIRECT TESTIMONY OF

CHRISTOPHER F. LOPEZ

REPRESENTING HYDRO ONE

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Christopher F. Lopez, and my business address is 483 Bay Street, South Tower, 8th Floor, Toronto, Ontario M5G 2P5.

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

A. I am Senior Vice President of Finance for Hydro One Limited ("Hydro One"). Hydro One is a major North American electric transmission and distribution utility, serving more than 1.3 million residential and business customers in Ontario, Canada.

Q. Please summarize your education and business experience.

A. I received a Bachelor of Commerce in accounting and finance from Edith Cowan University in 1996. I qualified from the Institute of Chartered Accountants in Australia in 1999. I received a graduate diploma in corporate governance and directorships from the Australian Institute of Company Directors in 2007.

Prior to joining Hydro One, I was the Vice President of Planning and Mergers & Acquisitions at TransAlta from 2011 to 2015. Prior to that, I was Director of Operations Finance at TransAlta in Calgary from 2007 to 2011, and was Country Financial Controller for TransAlta in Australia, from 2002 to 2007.

Q. Have you provided a copy of your résumé?

A. Yes, a copy of my résumé that covers my experience prior to joining Hydro One is included as Exh. CFL-2.

Summary of Testimony

Q. What is the purpose of your direct testimony in this proceeding?

A. The purpose of my testimony is as follows:

- describe the Proposed Transaction;
- discuss Hydro One's corporate structure and where Avista Corporation ("Avista") will reside within that structure;
- discuss Hydro One's capital structure and financial strength;
- describe Hydro One's financing for, and the mechanics of, the Proposed Transaction;
- describe Avista's post-transaction access to capital;
- enumerate certain financial, structural, and ring-fencing commitments that Hydro One and Avista are proposing as part of their request for approval of the Proposed Transaction; and
- describe the Rate Credits included as part of the Proposed Transaction.

A table of contents of my testimony is as follows:

Description **Page**

Q. Are you sponsoring exhibits with your testimony?

A. Yes. Attached to my testimony are:

- Exh. CFL-2: Christopher Lopez Résumé

- Exh. CFL-3: Pre- and Post-Transaction Corporate Structure of Hydro One Limited
- Exh. CFL-4: Hydro One's 2016 Annual Report and 2016 Annual Information Form

II. SUMMARY OF THE PROPOSED TRANSACTION

Q. Please describe Hydro One's proposed acquisition of Avista.

A. The boards of directors for Hydro One and Avista unanimously approved an all-cash transaction pursuant to which Avista shareholders will receive $53 per common share, representing a 24% premium to Avista's closing share price of $42.74 on July 18, 2017. Avista shareholders will receive cash consideration totaling approximately $3.4 billion.

Upon completion of the transaction, based on pro forma financial information at March 31, 2017, following the merger, Hydro One's total assets will increase from approximately C$25.4 billion to approximately C$34.9 billion. Together, Hydro One and Avista will serve more than two million end-use customers[1] and will operate across multiple North American jurisdictions, including Ontario, Washington, Idaho, Oregon, Montana and Alaska.

Once acquired by Hydro One, Avista will be operated much as it is today, with the same management team, and it will continue to be headquartered in Spokane, Washington.

[1] Including 1.3 million Hydro One electric customers, 378,000 Avista electric customers, and 342,000 Avista natural gas customers.

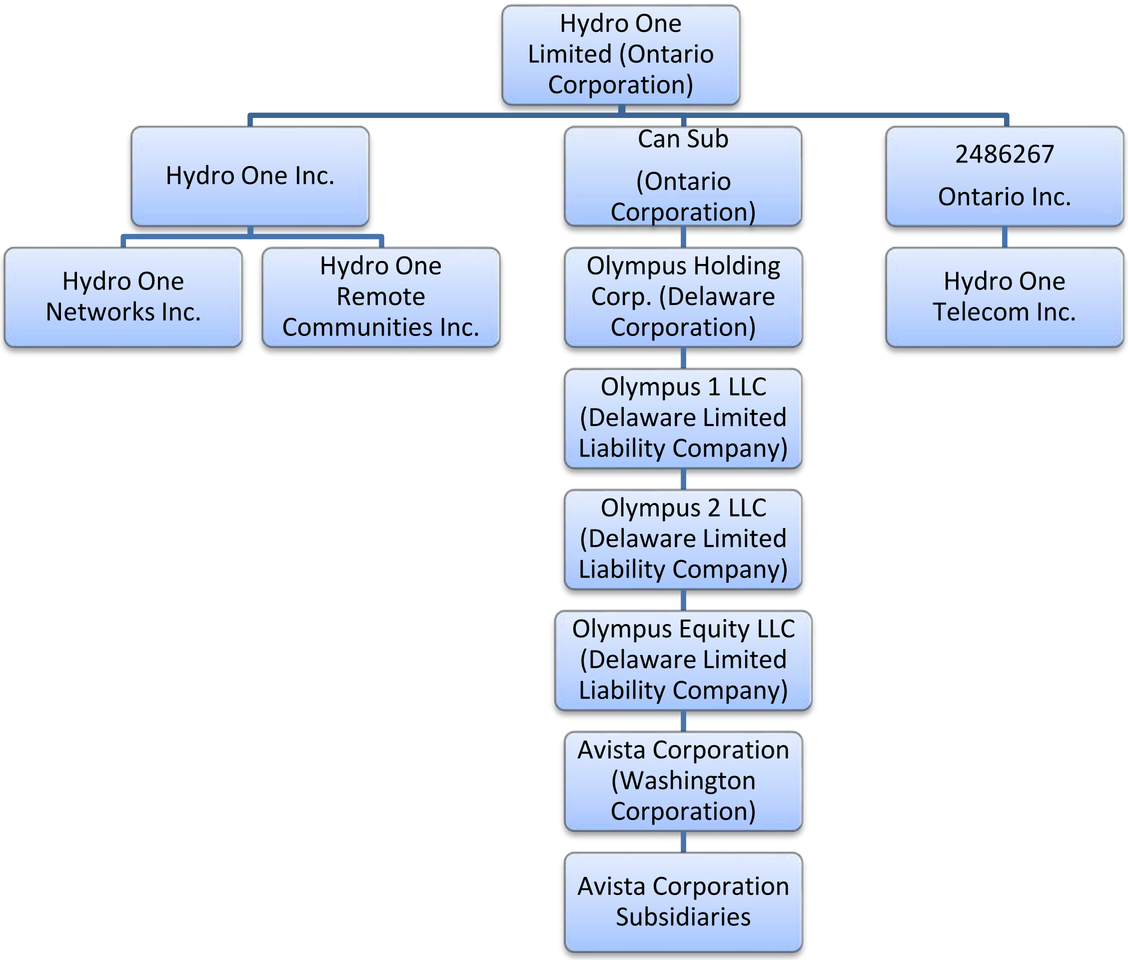
The terms of the transaction are set forth in the Agreement and Plan of Merger (the "Merger Agreement") dated as of July 19, 2017 among Hydro One Limited, Olympus Holding Corp., Olympus Corp. and Avista which has been provided as Exhibit No. 4 to Avista Thies' testimony and in Appendix 2 to the Joint Application. Under the terms of the Merger Agreement, Hydro One would acquire Avista through the merger of Olympus Corp. with and into Avista, with Avista as the surviving corporation and a wholly-owned, indirect subsidiary of Hydro One. No material changes are expected to the operations, management, or corporate structure of Avista and its subsidiaries.

III. POST-TRANSACTION CORPORATE STRUCTURE

Q. Please explain Hydro One's post-transaction corporate structure.

A. Upon completion of the transaction, Avista will be an indirect, wholly-owned subsidiary of Hydro One as illustrated in the following organizational chart, which is included in Appendix 1 to the Joint Application and is Exh. CFL-3 to my testimony:

Illustration No. 1:



Q. Why is Hydro One employing this type of structure?

A. The structure has been set up to provide segregation between the rate-regulated business in the United States and the Ontario rate-regulated business, which is held by Hydro One Inc. Subsequent to the transaction, Avista will be a wholly-owned subsidiary of Olympus Equity LLC, which is a bankruptcy-remote entity with no debt. Together with the ring-fencing provisions described later in my testimony, this structure insulates Avista and its customers from any potential financial weakness at Olympus Equity LLC or other entities up the chain from Olympus Equity LLC.

Q. Why is Hydro One creating three intermediate subsidiaries between Avista / Olympus Equity LLC and the Canadian Sub?

A. The entities are created for Canadian tax planning purposes and to manage intercorporate funds flows.

Q. Will this corporate structure result in any additional costs that will be recovered through Avista ratepayers?

A. No. This corporate structure will not result in any additional costs to be recovered from Avista ratepayers.

Q. Have Hydro One and Avista offered ring-fencing commitments to ensure that Avista ratepayers will be protected from any transactions that will occur in relation to these subsidiaries?

A. Yes. These ring-fencing commitments will be explained in more detail later in my testimony. Olympus 2 LLC will not operate or own any business and will limit its activities to investing in and attending to its shareholdings in Olympus Equity LLC, which, in turn, will not operate or own any business and will limit its activities to investing in and attending to its shareholdings in Avista. Furthermore, there will be no cross-subsidization of unregulated activities by Avista customers, and Avista will provide access to books and records required to verify or examine transactions with Avista or that result in costs that may be allocable to Avista.

IV. HYDRO ONE'S CURRENT CAPITAL STRUCTURE AND FINANCIAL STRENGTH

Q. Does Hydro One have financial statements that are similar to a 10K or 10Q in the United States?

A. Yes. Exh. CFL-4 to my testimony contains Hydro One's 2016 Annual Report and 2016 Annual Information Form filed with Canadian Securities regulators. These are also contained in Appendix 6 to the Joint Application.

Q. Please describe Hydro One's current capital structure.

A. Table 1 below shows that, on a consolidated basis, Hydro One's balance sheet as at December 31, 2016, reflects a capital structure that is approximately 53% debt and 47% equity.

Table 1

As at December 31, 2016:	$ CAD	% of total Capital
Long-term debt payable within one year	602	
Short-term notes payable	469	
Long-term debt	10,078	
Less: cash and cash equivalents	(50)	
Total Debt	11,099	53%
Total Shareholders' Equity	10,017	47%
Total Capital	21,116	

Q. To what extent has Hydro One employed long-term debt in its capital structure?

A. As at December 31, 2016, of the 53% debt in Hydro One's capital structure, approximately 51% is long-term debt, which is defined as debt instruments with maturity of 12 months or greater.

Q. Given its balance sheet, how would you characterize the financial strength of Hydro One?

A. As shown in the financial statements contained in my Exhibit, CFL-4, Hydro One maintains a strong balance sheet providing it with access to capital. This is recognized by the rating agencies, as reflected in the strong ratings of Hydro One.

Q. What are the credit ratings that are currently assigned to Hydro One by the major credit rating agencies, and how did the ratings agencies respond to announcement of the transaction?

A. On July 19, 2017, following the announcement of the transaction, Standard and Poors ("S&P") affirmed an 'A' long-term corporate credit rating for Hydro One and revised the outlook to Negative from Stable. It mentioned the negative outlook on Hydro One reflects its view that the Avista acquisition signals a shift in Hydro One's business strategy, which will align the company with its global peers.

On July 19, 2017, following the announcement of the transaction, Moody's affirmed the ratings of Hydro One Inc.'s: (i) senior unsecured regular bonds (A3); (ii) senior unsecured medium-note program ((P)A3); and (iii) senior unsecured commercial paper (P-2). At the same time, Moody's changed the outlook on Hydro One Inc. to Negative from Stable. It mentioned that the negative outlook on Hydro One Inc. reflects its view that the probability of extraordinary support from the Province of Ontario ("Province") will be reduced following the transaction.

The rating agency DBRS (originally known as Dominion Bond Rating) rates Hydro One Inc.'s long-term debt at A (High) and its short-term debt at R1 (low). It expressed its view that, should the merger be financed as contemplated in the announcement, it will have no impact on Hydro One Inc.'s credit profile.

Q. How much equity does the Province own in Hydro One?

A. As of June 30, 2017, the Province owns approximately 49.9% of Hydro One's common shares.

Q. Please explain the laws that govern the level of equity that the Province must maintain in Hydro One.

A. The Province has a preemptive right to subscribe to up to 45% of any new equity. If the Province's ownership in Hydro One drops below 40%, then the Province has an obligation to increase ownership to meet or exceed 40%. No other shareholder may own more than 10% of Hydro One, so Hydro One is essentially take-over proof.

Q. How do the provincial laws requiring the Government of Ontario to maintain a 40% equity interest in Hydro One impact Hydro One's ability to issue additional equity?

A. Under the Electricity Act, 1998, if as a result of the issuance of additional voting securities by Hydro One Limited, the Province of Ontario owns less than 40% of the outstanding number of voting securities of Hydro One Limited, the Province is required to take steps to increase its ownership to not less than 40% of the outstanding voting securities. In order to assist the Province in meeting its ownership obligations under the Electricity Act, 1998, under the governance agreement with the Province, Hydro One has granted the Province a preemptive right to subscribe for and purchase up to 45% of any proposed issuance by Hydro One Limited of voting securities or securities that are convertible or exchangeable into voting securities (other than certain specified excluded issuances). Any offered securities not subscribed for and purchased by the Province pursuant to its preemptive right may be issued to any other person pursuant to the proposed offering.

Hydro One is permitted to issue voting securities or securities that are convertible into or exchangeable for voting securities at any time, provided that it must first give the Province the opportunity to subscribe for the number of securities to which it is entitled to pursuant to its preemptive right before offering them to others.

Q. Does the fact that Hydro One is only traded on the Toronto Stock Exchange impact its access to capital?

A. Hydro One Limited's listing on the Toronto Stock Exchange (TSX) requires it to comply with applicable TSX rules regarding additional listings in the event that the company proposes to issue additional common shares in the future. Any such listing will require prior approval of the TSX and, depending on the size of the issuance or other factors, the TSX could require shareholder approval of the issuance as a condition of its approval. However, listing on the TSX in and of itself does not limit the company's access to equity.

Hydro One Limited may in the future determine that listing its common shares on a second exchange would increase its access to equity. Under the governance agreement with the Province, Hydro One Limited is required to maintain a listing of its common shares on the Toronto Stock Exchange, but it is not prevented from listing on any other stock exchange in the future (so long as it maintains its TSX listing as well).

Q. Is the Ontario Electric Board ("OEB") required to approve Hydro One's proposals to issue more equity?

A. No, the OEB has no jurisdiction to review and approve issuance of new equity by Hydro One.

Q. Does the OEB have jurisdiction to review and approve Hydro One's acquisition of Avista?

A. No, the OEB has no jurisdiction to review and approve Hydro One's acquisition of Avista.

Q. What style of rate regulation does OEB use to regulate Hydro One?

A. The OEB's scheme for regulating Hydro One Networks Inc. is a hybrid of cost-based rates with an allowed equity return and performance-based regulation.

V. PROPOSED TRANSACTION FINANCING

Q. Please describe the steps that will be taken to effectuate the transaction.

A. Olympus Holding Corp., a Delaware Corporation, and an indirect wholly-owned subsidiary of Hydro One, proposes to acquire all of the shares of Avista through a merger of a wholly-owned indirect subsidiary, Olympus Corp., and Avista. After the merger, Avista will be the surviving corporation and Olympus Corp. will cease to exist.

Q. Please describe how the acquisition of Avista by Hydro One will be financed.

A. Hydro One is committed to maintaining an investment-grade balance sheet through and after completion of the acquisition. Hydro One plans to finance this all-cash transaction using a mix of long-, medium- and short-term debt together with a convertible debenture installment receipts offering. Hydro One is planning to issue the debt financing in U.S. dollars totaling US$2.6 billion (and issued convertible debenture installment receipts in Canada of C$1.54 billion or approximately US$1.2 billion). We expect the convertible debenture to be fully converted to equity around the time of the closing of the transaction. The planned US$ debt financing contemplates a combination of 5-year, 10-year and 30-year US$ denominated notes.

Q. Will Avista pledge any assets or guarantee any of these transactions for the purpose of the acquisition of Avista by Hydro One?

A. No. Avista has not and will not pledge any assets or guarantee any of the transactions necessary for this acquisition.

Q. What is Hydro One's current estimate of the excess of the purchase price over the value of Avista as of the expected closing date?

A. The boards of directors for Hydro One and Avista approved an all-cash transaction through which Avista shareholders will receive $53 per common share, representing a 24% premium to the market value of Avista's shares of $42.74 on July 18, 2017. The estimated excess of the purchase price over the book value of Avista's net assets is approximately $1.7 billion as of June 30, 2017.

Q. In and of itself, as a result of the closing of this transaction, will Avista's financial statements change?

A. No. Avista's U.S. financial statements, prepared using generally accepted accounting principles ("GAAP"), will not be impacted by the closing of this transaction.

Avista will maintain its own accounting system, separate from Hydro One's accounting system. The acquisition will be accounted for in accordance with GAAP. The premium paid by Hydro One for Avista will be recorded in the accounts of the acquisition company and not in the utility accounts of Avista.

As indicated in the merger commitments described below, Hydro One and Avista will not propose to recover the acquisition premium in Avista's regulated retail rates.

Q. Will the proposed transaction have any impact on the availability of Avista's books and records?

A. No. All Avista financial books and records will continue to be available to the Commission. As indicated by the commitments described below, Olympus Holding Corp. and Avista will provide the Commission access to all books of account, as well as all documents, data, and records of their affiliated interests, which pertain to transactions between Avista and its affiliated interests.

VI. AVISTA'S POST-CLOSING ACCESS TO CAPITAL

Q. How will the acquisition by Hydro One affect Avista's access to capital?

A. We believe Avista's access to capital will be enhanced in light of Hydro One's strong balance sheet. On July 19, 2017, S&P affirmed its BBB' issuer rating on Avista and revised the outlook to positive from stable. S&P noted that the positive outlook reflects the potential for higher ratings on Avista if the acquisition is completed as proposed. Higher ratings would provide Avista with enhanced access to debt capital.

Q. Will Avista maintain its own capital structure and, if so, how will that affect its cost of capital for ratemaking?

A. Yes, Avista will maintain its own balance sheet. We have committed that Avista's cost of capital for ratemaking purposes will be no greater than it would have been absent this transaction.

Q. Will Avista maintain separate credit ratings?

A. Yes, Hydro One and Avista will seek a separate rating for Avista from at least one nationally recognized statistical rating agency ("Rating Agency").

Q. Please describe opportunities for Hydro One and Avista to share certain costs.

A. Initially, Hydro One and Avista do not expect there to be significant opportunities for cost sharing. Over time, however, Hydro One and Avista will look for opportunities to share certain costs such as IT investments. Further, Hydro One and Avista will benefit from increased purchasing power.

Q. Does Hydro One make any commitment with respect to how corporate costs will be allocated?

A. Yes. **Commitment 23** provides that Avista will file cost allocation methodologies used to allocate to Avista any cost related to Olympus Holding Corp. or its other subsidiaries and that Avista will bear the burden of proof in any general rate case that any corporate and affiliate cost allocation methodology it proposes is reasonable for ratemaking purposes. Also, Avista witness, Ehrbar sponsors as Exh. PDE-4, the "Protocol for Direct Assignment of Costs Between Avista and Hydro One".

Avista will notify the Commission of any change in corporate structure that affects Avista's corporate and affiliate cost allocation methodologies and will propose revisions to such cost allocation methodologies to accommodate such changes.

Q. Do the Joint Applicants make any commitment with respect to Commission auditing of such allocations?

A. Yes, Olympus Holding Corp. and Avista commit to provide audit rights with respect to the documents supporting any costs that may be allocable to Avista. Please refer to "Access to and Maintenance of Books and Records" (**Commitment No. 22**) in Appendix 8 (Master List of Commitments) to the Joint Application.

Ring-Fencing Merger Commitments

Q. Please describe the "ring-fencing" protections the Joint Applicants will employ to isolate Avista from Hydro One and Hydro One's other subsidiaries.

A. Hydro One commits to the following ring-fencing protections to isolate Avista from Hydro One and Hydro One's other subsidiaries. The following descriptions are merely summaries of these commitments. The complete text of these ring-fencing commitments is set forth in Appendix 8 to the Joint Application and in Exh. MTT-5 sponsored by Avista witness Thies.

- *Olympus Equity LLC*: **Commitment 42** provides that Hydro One will include an entity, designated as "Olympus Equity LLC," between Avista and Olympus 2 LLC. Following closing of the Proposed Transaction, all of the common stock of Avista will be owned by Olympus Equity LLC, which is a Delaware limited liability company. Olympus Equity LLC is a wholly-owned subsidiary of Olympus 2 LLC. Olympus Equity LLC is a bankruptcy-remote special purpose entity, and will not have debt.

- *Independent Directors and Managers*: **Commitment 40** provides that at least one of the nine members of the board of directors of Avista will be an Independent Director who is not a member, stockholder, director (except as an independent director of Avista or Olympus Equity LLC), officer, or employee of Hydro One or its affiliates. At least one of the members of the board of directors of Olympus Equity LLC will be an independent director who is not a member, stockholder, director (except as an independent director of Olympus Equity LLC or Avista), officer, or employee of Hydro One or its affiliates. The same individual may serve as an independent director of both Avista and Olympus Equity LLC.
- *Bankruptcy Protections*: **Commitment 40** provides that the organizational documents for Avista will not permit Avista, without the consent of a two-thirds majority of all its directors, including the affirmative vote of the independent director (or if at that time Avista has more than one independent director, the affirmative vote of at least one of Avista's independent directors), to consent to the institution of bankruptcy proceedings or the inclusion of Avista in bankruptcy proceedings.
- *Non-Consolidation Opinion*: **Commitment 41** provides that within ninety (90) days of the Proposed Transaction closing, Avista and Olympus Holding Corp. will file a non-consolidation opinion with the Commission which concludes, subject to

customary assumptions and exceptions, that the ring-fencing provisions are sufficient that a bankruptcy court would not order the substantive consolidation of the assets and liabilities of Avista with those of Olympus Holding Corp. or its affiliates or subsidiaries (other than Avista and its subsidiaries).

- *Separate Books and Records*: **Commitment 21** provides that Avista will maintain separate books and records.
- *Restriction on Pledge of Utility Assets*: **Commitment 43** provides that Avista will agree to prohibitions against loans or pledges of utility assets to Hydro One, Olympus Holding Corp., or any of their subsidiaries or affiliates, without Commission approval.
- *Hold Harmless; Notice to Lenders; Restriction on Acquisitions and Dispositions*: **Commitment 44** includes a number of provisions designed to ensure Avista's customers are held harmless from certain events and that such events are subject to regulatory supervision:
  - Avista customers must be held harmless from any business and financial risk exposures associated with Olympus Holding Corp., Hydro One, and Hydro One's other affiliates.
  - Prospective lenders must receive a notice explaining the ring-fencing provisions.
  - Avista commits that Avista's regulated utility customers will be held harmless from the liabilities of any unregulated activity of Avista or Hydro One and its affiliates. In any proceeding before the

Commission involving rates of Avista, the fair rate of return for Avista will be determined without regard to any adverse consequences that are demonstrated to be attributable to unregulated activities. Measures providing for separate financial and accounting treatment will be established for each unregulated activity.

- Olympus Holding Corp. and Avista will notify the Commission subsequent to Olympus Holding Corp.'s board approval and as soon as practicable following any public announcement of: (1) any acquisition by Olympus Holding Corp. of a regulated or unregulated business that is equivalent to five (5) percent or more of the capitalization of Avista; or (2) the change in effective control or acquisition of any material part of Avista by any other firm, whether by merger, combination, transfer of stock or assets.
- Neither Avista nor Olympus Holding Corp. will assert in any future proceedings that, by virtue of the Proposed Transaction and the resulting corporate structure, the Commission is without jurisdiction over any transaction that results in a change of control of Avista.
- Within sixty (60) days following the notice required by this subsection (c)(ii)(2), Avista and Olympus Holding Corp. or its subsidiaries, as appropriate, will seek Commission approval of any sale or transfer of any material part of Avista. The term "material

part of Avista" means any sale or transfer of stock representing ten percent (10%) or more of the equity ownership of Avista.

- If and when any subsidiary of Avista becomes a subsidiary of Hydro One or one of its subsidiaries other than Avista, Avista will so advise the Commission within thirty (30) days and will submit to the Commission a written document setting forth Avista's proposed corporate and affiliate cost allocation methodologies.

- *Corporate Structure - Cost Allocation*: **Commitment 23** establishes that Avista will provide cost allocation methodologies used to allocate to Avista any costs related to Olympus Holding Corp. or its other subsidiaries, and commits that there will be no cross-subsidization by Avista customers of unregulated activities. Avista will notify the Commission of any change in corporate structure that affects Avista's corporate and affiliate cost allocation methodologies. Avista will propose revisions to such cost allocation methodologies to accommodate such changes.

- *Olympus 2 LLC and Olympus Equity LLC Sub-entities*: **Commitment 45** provides that Olympus 2 LLC will not operate or own any business and will limit its activities to investing in and attending to its shareholdings in Olympus Equity LLC, which, in turn, will not operate or own any business and will limit its activities to investing in and attending to its shareholdings in Avista.

- *Access to and Maintenance of Books and Records*: **Commitment 22** provides that Olympus Holding Corp. and its subsidiaries, including Avista, will provide reasonable access to Avista's books and records; access to financial information and filings; audit rights with respect to the documents supporting any costs that may be allocable to Avista; and access to Avista's board minutes, audit reports, and information provided to credit rating agencies pertaining to Avista.

- *Utility-Level Debt, Preferred Stock and Ratings*: **Commitment 34** provides that Avista will maintain separate debt and preferred stock, if any, to support its utility operations.
- *Ratemaking Cost of Debt and Equity*: **Commitment 24** provides that Avista will not advocate for a higher cost of debt or equity capital as compared to what Avista's cost of debt or equity capital would have been absent Hydro One's ownership. For future ratemaking purposes: (a) Determination of Avista's debt costs will be no higher than such costs would have been assuming Avista's credit ratings by at least one industry recognized rating agency, including, but not limited to, S&P, Moody's, Fitch or Morningstar, in effect on the day before the Proposed Transaction closes and applying those credit ratings to then-current debt, unless Avista proves that a lower credit rating is caused by circumstances or developments not the result of financial risks or other characteristics of the Proposed Transaction; (b) Avista bears the burden to prove prudent in a future general rate case any pre-payment premium or increased cost of debt associated with existing Avista debt retired, repaid, or replaced as a part of the Proposed Transaction; and (c) Determination of the allowed return on equity in future general rate cases will include selection and use of one or more proxy group(s) of companies engaged in

businesses substantially similar to Avista, without any limitation related to Avista's ownership structure.

- *<u>Avista Capital Structure</u>*: **Commitment 25** provides that at all times following the closing of the Proposed Transaction, Avista will have a common equity ratio of not less than 44 percent (as calculated for ratemaking purposes) except to the extent the Commission establishes a lower equity ratio for Avista for ratemaking purposes.
- *<u>Restrictions on Upward Dividends and Distributions</u>*: **Commitment 36** imposes the following restrictions on Avista's upward dividends and distributions:
    - If either (i) Avista's corporate **credit**/issuer rating as determined by at least one industry recognized rating agency, including, but not limited to, S&P, Moody's, Fitch, or Morningstar is investment grade or (ii) the ratio of Avista's EBITDA to Avista's interest expense is greater than or equal to 3.0, then distributions from Avista to Olympus Equity LLC shall not be limited so long as Avista's equity ratio is equal to or greater than 44 percent on the date of such Avista distribution after giving effect to such Avista distribution, except to the extent the Commission establishes a lower equity ratio for ratemaking purposes. Both the EBITDA and equity ratio shall be calculated on the same basis that such calculations would be made for ratemaking purposes for regulated utility operations.

- Under any other circumstances, distributions from Avista to Olympus Equity LLC are allowed only with prior Commission approval.

- *Continued Credit Ratings*: **Commitment 35** provides that each of Hydro One and Avista will continue to be rated by at least one nationally recognized statistical "Rating Agency." Hydro One and Avista will use reasonable best efforts to obtain and maintain a separate **credit** rating for Avista from at least one Rating Agency within the ninety (90) days following the closing of the Proposed Transaction. If Hydro One and Avista are unable to obtain or maintain the separate rating for Avista, they will make a filing with the Commission explaining the basis for their failure to obtain or maintain such separate **credit** rating for Avista, and parties to this proceeding will have an opportunity to participate and propose additional commitments.
- *No Amendment of Ring Fencing Provisions*: **Commitment 46** provides that Olympus Holding Corp. and Avista commit that no material amendments, revisions or modifications will be made to the ring-fencing provisions as specified in these regulatory commitments without prior Commission approval pursuant to a limited re-opener for the sole purpose of addressing the ring-fencing provisions.

VII. RATE CREDITS

Q. Will Avista provide Rate Credits to customers as part of the Proposed Transaction?

A. Yes. Customers will see immediate financial benefits in the form of proposed retail Rate Credits ("Rate Credits") beginning at the close of the Proposed Transaction. Through **Commitment 18,** Avista and Hydro One are proposing to flow through to Avista's retail customers in Washington, Idaho, and Oregon a Rate Credit of $31.5 million over a 10-year period, beginning at the time the merger closes. The Rate Credit consists of two components, and reflects an increased level of savings in years 6-10 as illustrated in the table below.

Two-Step Rate Credit Proposal

	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

Commitment 18 further provides that the Total Rate Credit to customers for the first five years following the closing would be $2.65 million per year, and the credit would increase to $3.65 million per year for the last five years of the 10-year period. A portion of the annual total Rate Credit would be offsetable, as indicated in the table above. During the 10-year period the financial benefits will be flowed through to customers either through the separate Rate Credit described above or through a reduction to the underlying cost of

service as these benefits are reflected in the test period numbers used for ratemaking. At the time of the close, the $2.65 million benefit will be provided to customers through a separate Rate Credit, as long as the reduction in costs has not already been reflected in base retail rates for Avista's customers.

Commitment 18 also provides that to the extent Avista demonstrates in a future rate proceeding that cost savings, or benefits, directly related to the Proposed Transaction are already being flowed through to customers through base retail rates, the separate Rate Credit to customers would be reduced by an amount up to the offsetable Rate Credit amount. The portion of the total Rate Credit that is not offsetable effectively represents acceptance by Hydro One of a lower rate of return during the 10-year period.

Commitment 18 finally provides that the $31.5 million represents the "floor" of benefits that will be flowed through to Avista's customers, either through the Rate Credit or through benefits otherwise included in base retail rates. To the extent the identifiable benefits exceed the annual offsetable Rate Credit amounts, these additional benefits will be flowed through to customers in base retail rates in general rate cases as they occur. The increase in total Rate Credits for years 6-10 will provide time for Avista and Hydro One to identify and capture over time an increased level of benefits, directly related to the Proposed Transaction, that can be flowed through to customers. Avista and Hydro One believe additional efficiencies (benefits) will be realized over time from the sharing of best practices, technology and innovation between the two companies. It will take time, however, to identify and capture these benefits. The level of annual net cost savings (and/or net benefits) will be tracked and reported on an annual basis, and compared against the offsetable level of savings.

Q. Why did Hydro One and Avista choose a total Rate Credit of $31.50 million over 10 years?

A. As explained in the testimony of Avista witness Mark Thies, there will be cost savings immediately following the close, such as reduced expenses associated with the fact that Avista will no longer have publicly traded common stock. Some savings will materialize with respect to filings with the SEC, including legal and accounting costs. In addition, the post-close Avista Board of Directors will have fewer non-employee members, which will result in lower costs. Mr. Thies estimates the total estimated annual cost savings to customers, on a system basis, for Avista is approximately $1.7 million.

Hydro One and Avista also considered one of the most recent electric utility mergers in the Pacific Northwest, which involved Puget Sound Energy ("PSE"). Although it was subject to a "no harm" standard in Washington at that time, PSE through its settlement agreement provided a substantial benefit to its customers through the adoption of a $100 million Rate Credit over 10 years. Hydro One and Avista concluded that it was important to demonstrate their commitment to providing net benefits to Avista's customers at the outset of this proceeding. Using the PSE Rate Credit as a baseline, we are providing an equivalent Rate Credit for Avista's customers.

Q. Have you evaluated how the Rate Credits you are proposing compare to the Rate Credits provided in connection with the acquisition of PSE in 2008?

A. Yes. Our proposal is equivalent to the credits provided to PSE customers considering the relative size of each company.

Q. Please explain.

A. As part of the settlement agreement approved by the Washington Utilities and Transportation Commission (in Docket No. U-072375), PSE agreed to provide retail customers $100 million in Rate Credits over a period of 10 years. The total Rate Credits of $100 million represented approximately 3.1 percent of PSE's annual revenue requirement in 2008. Applying the same 3.1 percent to Avista's combined retail revenue requirement for 2016 in its Washington, Idaho, and Oregon jurisdictions yields a total Rate Credit of approximately $31.5 million. Like PSE, Hydro One and Avista are proposing to return the Rate Credits to customers over a period of 10 years. In addition, the PSE Rate Credits included a portion that was offsetable to the extent PSE demonstrated in a subsequent rate case that the underlying cost savings were reflected in customers' rates. We have structured our proposal in a similar manner with a portion of the Rate Credits offsetable to the extent identifiable cost savings are included in customers' rates.

Q. Does this conclude your direct testimony?

A. Yes, it does.