

1                   BEFORE THE WASHINGTON UTILITIES AND  
                                   TRANSPORTATION COMMISSION  
 2   In the Matter of the Joint        )  
   Application of                    )  
 3                                    )  
   PUGET HOLDINGS LLC and            )DOCKET U-072375  
 4   PUGET SOUND ENERGY, INC.,     )Volume 9  
                                   )Pages 979-1079  
 5   For an order Authorizing         )  
   Proposed Transaction             )  
 6   \_\_\_\_\_)

7                   A hearing in the above matter was held on  
 8   August 27, 2008, at 9:00 a.m., at 1300 South  
 9   Evergreen Park Drive Southwest, Room 206, Olympia,  
 10   Washington, before ADMINISTRATIVE LAW JUDGE DENNIS  
 11   MOSS and CHAIRWOMAN MARK SIDRAN, and COMMISSIONER  
 12   PHILIP JONES, and COMMISSIONER PATRICK OSHIE.

13                   The parties were present as follows:  
 14                   THE COMMISSION, by ROBERT D. CEDARBAUM,  
 15   Assistant Attorney General, 1400 South Evergreen  
 16   Park Drive Southwest, Post Office Box 40128,  
 17   Olympia, Washington 98504-0128, Telephone  
 18   (360) 664-1188, Fax (360) 586-5522, E-mail,  
 19   bcedarba@wutc.wa.gov.

20                   THE PUBLIC, by SIMON J. FFITCH, Assistant  
 21   Attorney General, 900 Fourth Avenue, Suite 2000,  
 22   Seattle, Washington, 98164-1012, Telephone (206)  
 23   389-2055, Facsimile (206) 389-2058, E-mail  
 24   simonf@atg.wa.gov.

25                   PUGET HOLDINGS LLC and PUGET SOUND ENERGY, by  
 26   SHEREE STROM CARSON, Attorney at Law, Perkins Coie,  
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 30   scarson@perkinscoie.com; and by JAMES VAN NOSTRAND,  
 31   Attorney at Law, Perkins Coie, LLP, 1120 NW Couch  
 32   Street, 10th Floor, Portland, Oregon 97209,  
 33   Telephone (503) 727-2162.

22

23

24   Deborah L. Cook, RPR, CSR

25   Court Reporter

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PROCEEDINGS

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Wednesday, August 27, 2008 at 9:04 a.m.

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JUDGE MOSS: Good morning, everybody.

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For those of you who may be listening in for the

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first time, or present in the hearing room for the

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first time, my name is Dennis Moss. I'm the

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Administrative Law Judge for the Utilities and

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Transportation Commission, and they have asked me

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to conduct the proceedings. The Commissioners

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would ordinarily be here with me this morning, but

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we have had some developments off the record.

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Mr. Ffitch visited with me this morning

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to let me know that over the course of the evening

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and this morning, perhaps, he has made the decision

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that he does not need to cross-examine Mr. Horton,

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Mr. Elgin, and Ms. Campbell. There may be some

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remaining questions for Mr. Kupchak. We will take

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that question up in just a minute. And there's

20

also a remaining issue concerning Exhibit 64 HC.

21

As to the bench, I have discussed this

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development with the Commissioners this morning,

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and Commissioner Jones, at least, does have some

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questions he wishes to pose to Ms. Campbell. And

25

he may have some questions for Mr. Hill, he tells

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1 me. So I saw Mr. Hill earlier. Hopefully he's  
2 still around. He's not in the room right now.

3 MR. FFITCH: He's here, Your Honor.  
4 He's just getting a battery for his computer.

5 JUDGE MOSS: Well, that was a change in  
6 information, so I am pleased that he's here this  
7 morning. Now, as to Exhibit 64, have you had any  
8 further discussion/resolution of what you want to  
9 do about that?

10 MR. FFITCH: We have discussed  
11 discussing it, Your Honor. We had -- we were going  
12 to request a recess to have a discovery conference,  
13 and a conference about Exhibit 64.

14 JUDGE MOSS: And the discovery  
15 conference would be concerning the matter of the  
16 dividends that we had discussion about with  
17 Mr. Kupchak yesterday?

18 MR. FFITCH: Correct. And that relates  
19 to Exhibit 23, among other information in the  
20 record.

21 JUDGE MOSS: Okay. Well, since we had  
22 previously scheduled Ms. Campbell to be here at  
23 10:30, what I will do, then, is we will take a  
24 recess until that hour, that moment, and we will  
25 have Ms. Campbell. And then we will see where we

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1 go from there, whether it's to question Mr. Hill or  
2 whether we need to do something further with  
3 respect to Mr. Kupchak.

4 We will see, following your further work  
5 with counsel. Of course, we encourage you, if  
6 possible, to work things out and we will have a  
7 little discussion and be able to wind up our  
8 hearing day.

9 Is there any other business we need to  
10 take up this morning as preliminary matters,  
11 Mr. Cedarbaum.

12 MR. CEDARBAUM: I wanted to confirm that  
13 Mr. Horton is excused.

14 JUDGE MOSS: Yes, Mr. Horton, we  
15 appreciate you calling in this morning and being  
16 present at other times, I know, during the hearing.  
17 Apparently we will not have questions for you  
18 today, so we can excuse you and let you go about  
19 your business.

20 THE WITNESS: Thank you, very much.

21 MR. FFITCH: I guess, Your Honor, if I  
22 may make a statement, we are certainly always  
23 hopeful of being able to work out matters in  
24 conference with other parties. Our preliminary  
25 information indicates that there may be some pretty

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1 serious issues around Exhibit 23. We have to go  
2 through and meet further with the company. And we  
3 will report back in terms of what further  
4 appropriate process there would be. But it may not  
5 be -- it may not be a trivial matter, is what I am  
6 trying to alert you to. We need to work through  
7 that.

8 JUDGE MOSS: Okay. Well, we're prepared  
9 to deal with nontrivial matters, Mr. Ffitch, so  
10 whatever develops. I suppose there is one  
11 housekeeping matter we can go ahead and dispense  
12 with. With respect to the witnesses we were  
13 expecting to have today, am I correct in assuming  
14 that we're simply going to stipulate in all of the  
15 exhibits both, direct, cross, what have you?

16 MS. CARSON: That's correct.

17 JUDGE MOSS: So the only exhibit on the  
18 list that I have previously furnished everyone that  
19 remains in dispute at this time, that we know  
20 about, is 64. There may be some further issues  
21 concerning 23, so with the reservation of those two  
22 possible discussions, we will accept all of the  
23 evidence into the record as previously identified  
24 and marked in the exhibit list.

25 All right. Anything else preliminary,

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1 other housekeeping -- everybody can go have  
2 breakfast, and we will see you at 10:30.

3 (Brief recess taken.)

4 JUDGE MOSS: We're back on the record.

5 Good morning, again, everybody. As we discussed  
6 earlier this morning when we first went on the  
7 record at 9:00 as scheduled, Mr. Ffitch has waived  
8 cross-examination of the witnesses scheduled for  
9 today: Mr. Horton and Mr. Elgin and Ms. Campbell;  
10 however, Ms. Campbell is on the stand. I will  
11 swear her in. Commissioner Jones does have some  
12 questions for her. Commissioner Jones has also  
13 indicated to me that he has some questions for  
14 Mr. Hill, I believe. We have some other matters  
15 pending with respect to a couple of exhibits,  
16 particularly concerning the cross-examination  
17 yesterday of Mr. Kupchak, and we will discuss that  
18 in a few moments. But for the time being at least  
19 let's get the witness sworn and proceed with that  
20 part of our hearing, so if you would please rise  
21 and raise your right hand.

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1                               PHYLLIS CAMPBELL,  
2       produced as a witness in behalf of the APPLICANTS,  
3       having been first duly sworn, was examined and  
4       testified as follows:

5

6                               JUDGE MOSS: Please be seated. And,  
7       Ms. Campbell, I did not reintroduce myself. My  
8       name is Dennis Moss, Administrative Law Judge for  
9       the Commission.

10                              With that, Commissioner Jones.

11

12                              EXAMINATION

13

14       BY COMMISSIONER JONES:

15                              Q    Good morning, Ms. Campbell.

16                              A    Good morning.

17                              Q    I don't know if you have your testimony  
18       in front of you, it might be good to have the proxy  
19       statement in front of you, as well.

20                              A    I will need a copy.

21                              JUDGE MOSS: Counsel can furnish that to  
22       you. Could you help us out, Commissioner Jones,  
23       what exhibit number the proxy statement is.

24                              COMMISSIONER JONES: It's bench request  
25       Exhibit 1.

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1 JUDGE MOSS: That would be 4041.

2 Q BY COMMISSIONER JONES: Ms. Campbell,  
3 you have been on the board, I am going to ask a few  
4 background questions of your background. How long  
5 have you been on the board?

6 A I have been a director of the company  
7 since 2003.

8 Q Have you been on the board since 1993?

9 A I am sorry, since 1993. Did I say 2003?  
10 I have been on the board of the company since 1993.

11 Q So how many CEOs have you been on the  
12 board under or working with?

13 A I have worked initially in 1993 with  
14 Rick Sostolly (phonetic) who was CEO at the time,  
15 then was succeeded by Bill Weaver, and then was  
16 succeeded by Steve Reynolds in 2002.

17 Q You are the chair of the securities  
18 pricing committee, are you not?

19 A Yes, I am.

20 Q How long have you been chair of that  
21 committee?

22 A I don't have the answer to that. I want  
23 to say it's at least a couple, three years. We  
24 rotate assignments between and among committees. For  
25 a couple of years, anyway.

0989

1 Q Turn to page three of your testimony.

2 A (Complies.)

3 Q If you could describe for the bench  
4 basically how the securities pricing committee works  
5 in a little more detail. The purpose here is  
6 described in lines 15 to 19 is to oversee the equity  
7 and debt financing more quickly than the full board.  
8 Obviously it takes more time to assemble the full  
9 board, but can you explain a little more specifically  
10 what this committee oversees?

11 A Sure. Basically the committee was  
12 formed -- the board, the committee does not act in  
13 lieu of the full board. The full board acts as the  
14 board of a whole on securities issuances. So they  
15 are voted on typically at the full board meeting.  
16 But because we don't meet in regular session as  
17 frequently, the securities pricing committee was  
18 formed to basically work with management, the finance  
19 team, to look at the final pricing on securities  
20 which changes daily.

21 So that's really the sole function of  
22 the committee. It doesn't meet that often, because  
23 the company doesn't have that many -- that frequent  
24 an equity issuance and a debt issuance. But it's  
25 basically there to approve the final pricing.

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1 Q Do you rely primarily on the advice of  
2 the CEO and CFO for these issues?

3 A For the issues of debt and equity?

4 Q No, excuse me, for the issues of how to  
5 price securities and are you getting an adequate  
6 price for equity and debt?

7 A We, of course, need to rely on staff's  
8 background and expertise on that for the final  
9 pricing, yes.

10 Q Do you ever interact directly with  
11 underwriters and agents?

12 A No, we do not.

13 Q Now, go back, you have been on the board  
14 since 1993. Do you know how many equity issuances  
15 Puget has undertaken and executed during that period  
16 of time. There have been quite a few --

17 A Quite a few. Probably the only records  
18 I have kept track of are since Steve Reynolds became  
19 CEO in 2002, and there will have been four major  
20 equity issuances since 2002, but before that period I  
21 can't answer a fair number.

22 Q Weren't there some major equity  
23 issuances under Mr. Weaver's reign during the Western  
24 Energy Crisis --

25 A I am sure there were. I don't recall

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1 the number.

2 Q Do you have any idea of how large they  
3 were, what percent of market capitalization they  
4 were?

5 A I don't recall during that period of  
6 time, no.

7 Q Well, since Mr. Reynolds came on board,  
8 do you believe the company was able to raise  
9 sufficient amounts of equity on reasonable terms?

10 A I guess what I would say is we were able  
11 to raise sufficient amounts of equity. I would agree  
12 with the first half of that statement. The  
13 reasonable terms, though, I would simply say it  
14 became increasingly difficult to issue equity at  
15 reasonable terms, given the pyramiding amount which  
16 became up to over \$500 million in that period of six  
17 years.

18 So that was one of the issues that the  
19 board had to face was what was reasonable and how  
20 much dilution did current shareholders need to  
21 incur, and each equity issuance became more  
22 difficult.

23 Q So is it fair to characterize the  
24 primary concern of the board as being dilution of the  
25 current stockholders?

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1 A The primary?

2 Q Yes, the primary?

3 A Well --

4 Q Because I read through your testimony

5 and you talk about other issues --

6 A Sure. As directors of a publicly traded  
7 company, yes, we have at primary duty of loyalty to  
8 current shareholders so that certainly is the primary  
9 function of the board is to look after our fiduciary  
10 duties of shareholders.

11 Q Do you consider the current shareholder  
12 basis, which is Exhibit 415?

13 A I need to find what page, what page are  
14 we on?

15 Q Counsel may want to get this to you.  
16 It's bench request 15, I think you know this table by  
17 heart. It starts with Franklin Advisors at the top.

18 A Sure. Right.

19 Q For those of you in the room, it's a  
20 list of the major mutual fund owners, not the  
21 institutional owners per se, but the mutual fund  
22 owners.

23 So my question is, do you consider this  
24 current ownership base, which is primarily mutual  
25 funds and others, to be well diversified and be

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1       able to offer an adequate source of capital on  
2       reasonable terms, going forward.

3               A    Well, as you might guess, there's a  
4       number of different styles of these funds.  Some  
5       are -- many of them are funds that are looking for a  
6       long-term yield that a utility can provide.  But as I  
7       look at each fund, we can go through that and  
8       different funds hold stock for different reasons.

9               So to be able to depend on current  
10       shareholders as future sources of capital, it's not  
11       necessarily a logical conclusion.  I think the  
12       fund, as you might guess, shareholders are looking  
13       for a reasonable return.  They are looking for the  
14       level of dividend that is able to be sustained,  
15       company earnings.  A number of them are in it for a  
16       number of different reasons.  So it doesn't  
17       necessarily follow that this would be the  
18       shareholder base that would provide future sources  
19       of equity.

20              Q    Is it your opinion that Puget, prior to  
21       when the transaction was announced, that Puget, and  
22       over the years, has Puget provided an above-average  
23       dividend yield?

24              A    Well, yes, an above-average dividend  
25       yield, but we have to -- again, funds and

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1 shareholders are always looking toward the future.  
2 So the future would have to take into account future  
3 earnings of the company, stock price, as well as  
4 dividends. So you have to take all of that into  
5 account. But in answer to your question, yes, at  
6 least in previous years, past years, there has been  
7 an above-average dividend yield. It doesn't predict  
8 the future.

9 Q And isn't it true that many of the  
10 mutual funds on this list are income-oriented mutual  
11 funds?

12 A Yes.

13 Q Do you have any idea how many retail  
14 investors --

15 A Yes --

16 COURT REPORTER: Wait, I need you to  
17 talk one at a time.

18 Q BY COMMISSIONER JONES: Do you know how  
19 many retail investors there are currently, or let's  
20 put it this way, prior to the announcement of the  
21 transaction and the private placement with the  
22 Macquarie consortium?

23 A I wanted to clarify the question.  
24 That's why I was interrupting. I am sorry for  
25 interrupting.

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1                   In terms of numbers or percentage? I  
2       really know the percentage, but not the number.

3           Q    No, I know the percentage -- Numbers.

4           A    I don't know the number, sorry.

5           Q    Do you know how many retail investors  
6       there are in the state of Washington?

7           A    I do not.

8           Q    In July of 2006, the board formed a  
9       strategic review committee, correct?

10          A    Correct.

11          Q    What were the duties of the strategic  
12       review committee and why was it formed?

13          A    Well, the landscape in the utility  
14       industry in Washington began to change at that point.  
15       And if I recall that specific incident -- well, the  
16       announcement of the Cascade Natural Gas transaction  
17       had just occurred. And at that point the board was  
18       beginning to look seriously at the options. There  
19       was a significant premium that was announced on that  
20       transaction. I think we began to, as we did every  
21       year actually, I would say that going back  
22       historically the board had looked every year at the  
23       strategic plan, reviewed our options, taken a look at  
24       the stand-alone business case, and had every  
25       intention of continuing on the stand-alone business

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1 case.

2                   So the main reason for the committee was  
3 to basically look at the Cascade transaction, ask  
4 ourselves how the landscape had changed in not just  
5 the electric business, but obviously the gas  
6 business in the state of Washington, and beyond,  
7 and to basically take a stronger look at the  
8 various options in the marketplace as to what was  
9 occurring with different combinations.

10                  Q    So is it fair to say that the genesis of  
11 the strategic review committee was Macquarie  
12 Securities approaching your company about the  
13 purchase of the gas LDC business?

14                  A    No, actually not. We were not -- the  
15 board really wanted to continue to take a much more  
16 strategic review of the stand-alone business case  
17 vis-a-vis many other options, so I would say at that  
18 point the board and the strategic review committee  
19 became the board as a whole.

20                        So I have to say to you that though that  
21 committee was formed to be more specific in looking  
22 at transactions, we began to meet as a board as a  
23 whole, and ask ourselves what were the number of  
24 viable options that were out there, including  
25 stand-alone vis-a-vis partial recapitalization,

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1 including a number of other things already in the  
2 record.

3 And so we wanted to make sure we had a  
4 thoughtful due diligence process that took a look  
5 at how could the stand-alone business case continue  
6 to grow earnings of the company going forward. And  
7 this was basically the continuing discussion. So  
8 it didn't really have anything to do with a  
9 specific party approaching us at that point.

10 Q But isn't it true in late 2005,  
11 according to the proxy statement, Macquarie  
12 Securities approached the Company about possible  
13 transaction --

14 A Yes, that is true, so we were aware of  
15 that.

16 JUDGE MOSS: Let me caution those of you  
17 who are listening on the bridgeline, to put your  
18 telephones on mute/send so we don't hear you in the  
19 hearing room. Thank you.

20 Q BY COMMISSIONER JONES: Who are the  
21 members of that strategic committee?

22 A Sally Naradick (phonetic), myself,  
23 trying to remember who the third person was --

24 Q Was it Steve Frank and Steve Reynolds?

25 A Yes, Steve Reynolds, of course, and

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1 Steve Frank, and I believe that was it.

2 Q Now, I want to get to the role of  
3 Mr. Reynolds as CEO. At that point in late 2005 and  
4 throughout 2006, wasn't Mr. Reynolds president,  
5 chairman, and CEO of PE?

6 A Yes.

7 Q Did the board consider separating those  
8 roles at any time during the strategic review, given  
9 the magnitude of this proposal, and the possible --  
10 or at least the appearance of a conflict of interest  
11 in the change of control?

12 A Sure. Well, as I said, I am the lead  
13 director of the company. So lead director basically  
14 is -- the role of the lead director is to take, in a  
15 sense, the other independent directors into a  
16 conversation without any inside management present.  
17 So I think you will note from the proxy that at every  
18 juncture, including every discussion about strategic  
19 alternatives, we had a session that I led of the  
20 independent directors without Steve Reynolds present.

21 So there's a lot written about  
22 governance. I think if you have a strong lead  
23 director model you don't need to change the  
24 chairman title. The chairman is there certainly to  
25 preside over the main meetings, but in my role, I

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1       presided over the sessions of independent directors  
2       at every juncture and every discussion, without  
3       management present. And that includes Steve.

4               Q     Did the board -- back to my initial  
5       question, did the board consider in terms of good  
6       corporate governance separating those roles during  
7       this transaction? I certainly understand your role  
8       as lead independent director. And the reason I say  
9       that, Mr. Reynolds responded on the stand that he  
10      believes that the announcement by Macquarie after the  
11      transaction to separate the two roles, nonexecutive  
12      and executive, was a good thing, good corporate  
13      governance. But it wasn't announced by the board  
14      with you as a member. It was announced afterward.

15              A     No, I understand. No, the board did not  
16      consider that.

17              Q     And who was advising the board during  
18      this process when Macquarie was approaching you, and  
19      all of these discussions were taking place in '06  
20      and '07 in terms of financial advisory services and  
21      the legal services?

22              A     We immediately engaged two different  
23      parties to help us in an advisory role only, and  
24      those parties were -- at that time it was LaBeouf  
25      Lamb, now Dewey LaBeouf and legal firm, law firm.

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1 Bill Lamb was our lead counsel in that. And also  
2 Morgan Stanley was our advisor on the advisory side.

3 Q Now, was Morgan Stanley, during this  
4 period of time providing any advice to the management  
5 of the company, because the capital expenditure plan  
6 called for an equity issuance in 2007 of between 200  
7 and \$300 billion?

8 A Uh-huh, correct.

9 Q So who was advising management, if  
10 anyone, on the possible issuance of that?

11 A I can't answer that question. I know  
12 there was an advisory firm in place, but I can't  
13 answer that. I know Morgan Stanley has provided  
14 advice to the company over the years, but the board  
15 specifically asked Morgan Stanley to advise the board  
16 in future strategic alternatives.

17 Q If you can turn to page six of your  
18 testimony.

19 A (Complies.)

20 Q On lines 6 through 9, you said the  
21 strategic review committee and the full board  
22 considered basically three options. Weren't there  
23 more options -- I reviewed the confidential material  
24 presented by Morgan Stanley. Weren't there more than  
25 three options that the board considered on strategic

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1 alternatives?

2           A    Well, I think certainly as you already  
3 read in the proxy, there were a number of  
4 alternatives that the board was always considering.  
5 We had been approached over the years by --  
6 especially more recent years by several other parties  
7 other than current investor consortium. We had  
8 considered a number of times buying other entities  
9 ourselves and looking at that as options.

10                So, yes, the fact of the matter was the  
11 board, in its due diligence, was always looking at  
12 a number of options. So what was listed here was  
13 the fact that the Cascade Gas transaction caused us  
14 to take a look at forming the strategic review  
15 committee, as I said, and potentially looking at  
16 the gas distribution business. But in the end we  
17 decided it was a valuable entity, and did not make  
18 sense to sell it.

19           Q    You serve on three other publicly listed  
20 company boards, don't you, or two --

21           A    Two other publicly traded companies.  
22 Alaska Air Group and Nordstrom.

23           Q    Is it your experience that when, quote,  
24 a strategic alternative or strategic direction is  
25 undertaken on the board, that there is some financial

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1 distress or management, some problems or issues with  
2 management where the Company is not meeting  
3 expectations and, therefore, a strategic alternative  
4 needs to be explored?

5 A I don't think there's a hard and fast  
6 rule there. I think at least in today's environment,  
7 given the fast-changing nature of almost any industry  
8 in business, my experience has been that particularly  
9 in the last three or four years, boards in general  
10 have had some sort of strategic alternatives  
11 committee just to take a look at the landscape. So  
12 it's not necessarily in response to a distress  
13 situation.

14 Q If you could turn to page seven, this is  
15 a yellow page.

16 A Uh-huh.

17 Q In lines 10 through 17 -- first of all,  
18 in lines 4 through 9, first you say capital markets  
19 are neither static nor predictable?

20 A Uh-huh.

21 Q Isn't that just common sense? Nothing  
22 is in life, is there?

23 A Right. Uh-huh. It's common sense.

24 Q In lines 10 through 17, I am a little  
25 concerned about where you say --

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1                   JUDGE MOSS: Excuse me, Commissioner  
2       Jones. I want to point out that lines 10 through  
3       17 are marked as confidential.

4                   COMMISSIONER JONES: I am sorry. Yes.

5                   Q    BY COMMISSIONER JONES: It describes in  
6       general the earnings per share outlook. And based on  
7       the both management projections for a full seven-year  
8       period, and the Morgan Stanley analysis of the EPS  
9       prospects, is this a true statement, in your opinion?

10                  A    Yes.

11                  Q    Once the Macquarie Consortium approached  
12       you, you mentioned the stand-alone alternative and  
13       the various alternatives. How much -- specifically,  
14       how much vetting and analysis by the board went into  
15       the business plan, the updates, the execution risks?  
16       I have read the proxy statement, and there was  
17       certainly a lot of attention devoted to the Macquarie  
18       approach, but how much -- how much time and attention  
19       did the board devote to the stand-alone option?

20                  A    Well, as I said earlier in response to  
21       your question, the board always had a strong desire  
22       to pursue the stand-alone option. So we were not  
23       looking for -- we were not looking for any kind of a  
24       buy-out or any -- we were not looking seriously to  
25       any of the alternatives.

1                   We very much wanted to see if we could  
2           make the bit case work on a go-forward basis. So  
3           the board spent a considerable amount of time. As  
4           you can see from the proxy in the records that our  
5           meeting time substantially increased. We had an  
6           increased frequency of meetings. We had not only  
7           an extended board retreat, but we also had meetings  
8           in between where we looked ourselves at the  
9           stand-alone business case. We had advisors that I  
10          just mentioned come in, and give us their opinions  
11          on the stand-alone business case vis-a-vis other  
12          alternatives and options.

13                   So we spent an unusually large amount of  
14          time debating and going over the numbers ourselves,  
15          and with management, as well.

16                  Q    And in summary, what were, in your view,  
17          the board's analysis of the biggest risks to the  
18          stand-alone business case? Was it earnings per  
19          share, regulatory risk, was it other related  
20          activities?

21                  A    We of course looked at all of the above.  
22          But if you were asking me what was the primary risk  
23          in our view, it was the future, the future need for  
24          the company to raise capital, to raise equity, to  
25          raise particularly equity at reasonable rates, as we

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1 said earlier. So it was the need to continue to  
2 repair the infrastructure of the company, to  
3 basically operate the utility on a responsible basis,  
4 to do the things that we needed to do as a  
5 responsible entity in this region.

6 We looked at the capital that was  
7 required to do that, and the risk to the company  
8 was considerable, given the amount of equity and  
9 debt that would have had to be raised in the  
10 future. So the risk was basically bottom line to  
11 the earnings per share, and the ability to maintain  
12 the dividends.

13 Q Did the board consider the equity  
14 issuance in 2005 of roughly \$310 million to be on  
15 reasonable terms?

16 A Yes, at that point. And I would also  
17 like to add, the board obviously had looked at the  
18 stock price as well, which is the output of all of  
19 that, which is obviously the future prediction of how  
20 earnings and the dividend would go, and the stock  
21 price has not moved. So that was a consideration as  
22 well.

23 Q Let's go to page eight of your  
24 testimony, Ms. Campbell, line one. This is  
25 nonconfidential. Where you say the financial

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1 analysis supported the forecast of essentially flat  
2 earnings. Looking at the full 2007 to 2013 period,  
3 is that a true statement?

4 A It was essentially flat. I mean, there  
5 were probably small increases. There were a number  
6 of sensitivity analyses that we looked at. But  
7 "essentially" was really the word we used,  
8 essentially flat earnings is a true statement.

9 Q Move down to lines 7 through 9 where  
10 we're talking about the benefits of the investor  
11 consortium. Where the first benefit the board said  
12 was to provide five years of the company's capital  
13 needs, can you provide some backup for that? Why you  
14 think the transaction as proposed, both debt and  
15 equity, provides the guarantee of five years of  
16 capital needs. And I think by capital needs, I think  
17 we're talking about the 5.6 billion, aren't we?

18 A Yes, that's correct. I am sorry, so the  
19 question was, why did the board believe that the  
20 capital would be there?

21 Q No. The question is, what is the basis  
22 for the board's -- or your statement, that the  
23 investor consortium is going to provide this five  
24 years of -- it's a large amount of money?

25 A Sure. I think I would like you to know

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1 that the board took its due diligence on the investor  
2 consortium very seriously. So we had a number of  
3 conversations in executive session about this very  
4 issue. We had certainly a number of conversations  
5 through our own due diligence to corroborate what is  
6 being said here. So it was really part of our  
7 overall due diligence process to determine if we went  
8 through with this transaction, what would be some of  
9 the main benefits.

10 And since I said capital and growth was  
11 one of our major concerns, and the ability to  
12 finance it, that was one of the areas we had a  
13 number of conversations with the consortium on.

14 Q You are familiar with the transaction  
15 commitments, are you not, the so-called ring fencing?

16 A The basics of it, yes. Although I have  
17 to say I was not involved with the negotiations of  
18 those shareholder --

19 Q Commitment number three calls for Puget  
20 Holdings will secure and provide contractually  
21 committed credit facilities for PE and PSE, the term,  
22 not less than three years, in an amount of not less  
23 than 1.4 billion to support PSE's CAPX program, as  
24 set forth in the business plan.

25 So is that -- would that go into your

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1 equation of meeting the capital expenditure needs  
2 of the company going forward?

3 A Well, that would go into my equation.  
4 Again, as I said in my written testimony, we had a  
5 number of conversations with the consortium. We are  
6 well aware of needs of the company going forward, so,  
7 yes, that certainly factors in.

8 Q Would you classify the 3.4 billion now  
9 with the extra 200 million of equity -- let's go back  
10 to the 3.2 billion for the injection of equity to  
11 purchase the company's equity. Would you regard that  
12 as contributing to the capital expenditures program  
13 of the company?

14 A Yes, I would.

15 Q And then you would regard any other  
16 credit facility that the investor consortium was able  
17 to secure and commit to as --

18 A Part of the capital base, yes.

19 Q Okay. I just wanted to clarify that.  
20 Let's go to the proxy statement. Do you have that in  
21 front of you?

22 A I do.

23 Q On page 32, Bench Request No. 1.

24 A (Complies.)

25 Q I think I will proceed. Okay. This

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1 relates to the August 2007 period in which --

2 CHAIRMAN SIDRAN: Excuse me, what page  
3 are you on again?

4 COMMISSIONER JONES: 32, Mr. Chairman.

5 Q BY COMMISSIONER JONES: This describes  
6 the series of events and many meetings with  
7 Macquarie and back and forth, and initially an  
8 indicative offer had been made of \$32 a share from  
9 Macquarie to the company, correct?

10 A Right.

11 Q And then the second paragraph there says  
12 on August 3rd, Mr. Reynolds received a call from a  
13 representative of Macquarie Securities to explain  
14 that in the light of the recent crisis in the debt  
15 and capital markets, including a significant  
16 reduction in the availability of acquisition  
17 financing, coupled with substantial increases in the  
18 cost of such financing, Macquarie was no longer in a  
19 position to discuss an acquisition of the company by  
20 Macquarie led consortium for \$32 per share.

21 So my question is, what did the board  
22 think of this and especially this reason given by  
23 Macquarie that the debt and credit markets are in  
24 turmoil, and private equity firms are now having  
25 problems raising money in wholesale markets?

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1           A    Well, the board was certainly  
2 disappointed, but I think those of us that are on  
3 other boards and certainly very aware of capital  
4 markets during this period of time, knew that the  
5 situation was as Macquarie said it was. We also  
6 concurrently talked to our advisors at that time,  
7 Morgan Stanley, to get an opinion. And, again, went  
8 back to the stand-alone business case, went back to  
9 the business case of the \$32 a share, and \$30 a share  
10 and asked the same basic questions of ourselves as to  
11 whether this would still be a reasonable financial  
12 transaction.

13                 So I certainly would have to say the  
14 board was disappointed, but the board also felt an  
15 obligation to both verify what was being said, but  
16 also go back to the stand-alone business case  
17 versus a \$30 a share price offer. And we did meet  
18 with the consortium at that point.

19           Q    A couple of follow-on questions. So  
20 that did not cause the board to fundamentally  
21 question the basis of the so-called Macquarie model,  
22 did it?

23           A    It did not, no. Well, we certainly  
24 wanted to continue -- part of our due diligence was  
25 to continue to look, to do our due diligence on the

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1 Macquarie model. So throughout the whole period, we  
2 had a number of questions, and we had a number of our  
3 own due diligence efforts that were going on at the  
4 same time. But, no, this particular conversation did  
5 not cause us to have additional questions.

6 Q Would you agree that the Macquarie model  
7 and private equity, in general, depends heavily on  
8 liquid and ample wholesale credit markets?

9 A Well, I would state it a bit  
10 differently. I would say the ability to access  
11 credit markets.

12 Q And wouldn't you agree that there, at  
13 least in the past year or 18 months, there has been a  
14 problem with certain financial institutions accessing  
15 credit markets?

16 A I would agree with that, yes.

17 Q Now, tell me, the next follow-on is  
18 Morgan Stanley. So you asked Morgan Stanley to do  
19 what on the stand-alone option? Anything new at that  
20 point? You said you went back, and what was Morgan  
21 Stanley's advice to you on the stand-alone option in  
22 raising equity in public markets?

23 A On the stand-alone option?

24 Q Yes. The stand-alone option, again,  
25 Ms. Campbell, is remaining an independent company,

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1 not being purchased by an investor consortium and  
2 raising capital on a stand-alone basis?

3 A Well, I think what we really wanted to  
4 do, and that was really the business case that the  
5 board continued to look at was five years out. So we  
6 didn't necessarily look at today or tomorrow or 2007.  
7 We were looking at five years hence, what would the  
8 Company's ability to raise equity be at what price,  
9 and at what dilution to current shareholders.

10 So what we did is ask Morgan Stanley to  
11 take one more look, given the current capital  
12 markets, take a look at the business case, take a  
13 look at the effect on share price five years out on  
14 the stand-alone option. And that is what the board  
15 took very seriously at that point, and asked one  
16 more time, what would be the range of stock price  
17 five years out if we took all the actions and debt  
18 and equity markets five years out, vis-a-vis the  
19 \$30 a share price that was on the table.

20 Q A few more questions, and then I am  
21 done. Obviously the change of control option was one  
22 of several considered by the board, and it is -- it  
23 obviously by its very definition is change of  
24 control, correct?

25 A Correct.

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1           Q    Ownership is changing through this  
2 transaction, correct?

3           A    Correct.

4           Q    How did the board assess and try to  
5 either quantify or qualify the benefits and risks, or  
6 let's say the benefits of having a regulated utility  
7 with a public service obligation located in the state  
8 of Washington, regulated by this Commission, did the  
9 board -- what kind of analysis, what kind of  
10 discussions did you have on the change -- about  
11 control, being able to control?

12          A    Relative to the change in control  
13 agreements themselves, and the financial application?  
14 Is that your question?

15          Q    Yeah.

16          A    Well, the board obviously as part of its  
17 fiduciary obligation, particularly through the  
18 compensation committee, continually looks at changing  
19 control agreements and the reasonableness.  And  
20 shareholders, that issue has gotten increasing  
21 shareholder scrutiny as well.  So I would say the  
22 board's review of the change of control agreement was  
23 more the question of about, are these reasonable?  
24 Are they in line with industry peers?  Are they -- do  
25 they certainly stand up to the light of day in terms

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1 of what is acceptable and accepted practice?

2                   And that really has been the board's  
3 continued review of all compensation, but  
4 especially the change of control agreement. So if  
5 your question is, did the board have special  
6 questions in light of the transaction, yes, the  
7 board did ask the compensation committee to refresh  
8 our memory in terms of what would happen in the  
9 event of this transaction taking place, with the  
10 change of control payments.

11                  Q I am also referring, Ms. Campbell to  
12 control -- this is, the service territory is located  
13 entirely within the state of Washington. It's been  
14 located in this state for a long time. I am talking  
15 about the community aspects, charitable  
16 contributions, having directors, such as yourself,  
17 who are from the area, so --

18                  A So what would be the other  
19 considerations in the transaction? I am sorry. I  
20 thought you were talking about the agreements  
21 themselves. Yeah, thank you.

22                  That particular question was paramount  
23 on the board's mind. As you pointed out earlier,  
24 our primary fiduciary obligation is to shareholders  
25 and to the duty of loyalty to the company, which is

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1 primarily the shareholders. But we also strongly  
2 talked about, since most of us are local residents,  
3 talked about the effect of any transaction on the  
4 community, on employees, on labor agreements, on  
5 environmental commitments, all the stakeholders  
6 that were involved. And we wanted to make sure  
7 that if we engaged in the transaction, it would be  
8 net positive to all parties.

9 So that was a very strong driver of the  
10 board's criteria. We set a number of criteria in  
11 place, as a board, early on in any discussions.  
12 And said if we even agree to do any kind of  
13 transaction, all of these criteria would need to be  
14 present. And we felt this particular transaction  
15 met all of our criteria, besides financial.

16 Q Have you had any discussions with the  
17 Macquarie Group about serving on a future board?

18 A I have not.

19 COMMISSIONER JONES: That's all I have,  
20 Judge Moss. Thank you.

21 JUDGE MOSS: Thank you, Commissioner  
22 Jones. Commissioner Oshie.

23 COMMISSIONER OSHIE: No.

24 JUDGE MOSS: Anything from counsel?

25 MR. FFITCH: Yes, Your Honor, I have one

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1 or two questions.

2 JUDGE MOSS: Go ahead, and then we will  
3 see if there's any questions from the joint  
4 applicants.

5

6 CROSS EXAMINATION

7

8 BY MR. FFITCH:

9 Q Good morning, Ms. Campbell. Simon  
10 ffitch with the public counsel office. First  
11 question is, why is it true that the \$3 billion  
12 equity investment by the investor consortium as part  
13 of this transaction supports capital expenditures? I  
14 believe that was your testimony in response to a  
15 question from Commissioner Jones.

16 A Well, I think I mentioned supports the  
17 capital structure of the company. I guess, if we're  
18 trying to get -- I am not sure I understand the  
19 distinction between capital expenditures, and the  
20 basic capital of the company.

21 Q Right. That money that is invested to  
22 purchase the company by the investment consortium is  
23 not an amount of funds that becomes immediately  
24 available to invest in capital expenditures, correct?

25 A Well, I am sorry. I guess I

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1 misunderstood the question. I was just looking at --  
2 I understood the question to be more about support  
3 for the capital basis of the company, not necessarily  
4 immediately available for capital expenditures.

5 Q And you stated that the board was  
6 concerned -- is concerned about raising adequate  
7 capital for capital expenditures?

8 A Correct.

9 Q In the future. Why not just have Puget  
10 borrow all the dollars that are needed for future  
11 capital expenditures?

12 A Versus going to the equity markets? Is  
13 that your question? Borrow?

14 Q That is right. Versus going to the  
15 equity markets.

16 A Well, again, I think the board has to  
17 look at the future cost of capital to the company all  
18 in. So the cost of capital -- one of our jobs is to  
19 take a look at the blended cost of the capital, which  
20 is equity and debt. The Company has traditionally  
21 had a balanced, a balanced portfolio of equity and  
22 debt. And as you know, we have looked to maintain a  
23 certain equity ratio in the company. So if you asked  
24 me the question as to why wouldn't we just go out and  
25 borrow in the capital markets, and we are subject to

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1 the rating agencies' rating of the company. We're  
2 always concerned about debt ratings of the company.  
3 And continuing to denigrate the capital structure  
4 would have affected our overall ratings, which would  
5 have increased our cost of the capital in the debt  
6 market, coupled with the fact the debt markets are  
7 increasingly difficult to access. So it has to be a  
8 balance of equity and debt, and having debt only was  
9 never an option.

10 MR. FFITCH: Thank you. I don't have  
11 any further questions. Thank you, Ms. Campbell.

12 JUDGE MOSS: Ms. Carson.

13 MS. CARSON: Yes, I have a few  
14 questions.

15

16 REDIRECT EXAMINATION

17

18 BY MS. CARSON:

19 Q Ms. Campbell, you have been asked about  
20 the ability to raise the \$5.7 billion necessary over  
21 the five or six years' business plan. And I believe  
22 it's your testimony that you all determined that --  
23 the board determined that the best alternative was to  
24 go forward with this transaction to meet those needs.

25 A Uh-huh.

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1           Q    What was it, or is it about the investor  
2 consortium that makes you comfortable that the  
3 company will be able to meet their capital needs over  
4 that time period?

5           MR. FFITCH:  Objection, Your Honor.

6           It's friendly direct examination of the witness.

7           JUDGE MOSS:  I think it's following up  
8 on some of the questions from the bench, and I  
9 would like to hear the answer, so you are  
10 overruled.

11          THE WITNESS:  I want to make sure I  
12 understand the question and that is, what gave the  
13 directors a comfort that the consortium could  
14 provide or raise the amount of capital that the  
15 company required going forward to finance the  
16 capital expenditures?

17          Q    BY MS. CARSON:  That's correct.

18          A    Again, the board went through an  
19 extensive due diligence on that very issue.  So we  
20 took a look at acquisition from other entities.  We  
21 took a look at a number of different alternatives,  
22 and the reason the board thought this was the best is  
23 that there are a number of parties in this  
24 transaction, as it now turns out, that have access to  
25 patient, long-term capital, including the Canadian

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1 pension funds, which comprise a little under half of  
2 the consortium.

3                   So I think the board wanted to make sure  
4 that not only was the capital available, and we  
5 satisfied ourselves that that was the case with  
6 these various parties, but could it be available on  
7 a longer term, more patient capital rate, if you  
8 will, basis. And the board satisfied itself that  
9 that was, in fact, the case with these groups. So  
10 extensive due diligence was done with all of the  
11 parties in the consortium.

12                   Q There's been testimony, and Commissioner  
13 Jones asked you questions about the change in the  
14 share price from \$32 to \$30 and the turmoil in the  
15 markets, and the effects that had. And to your  
16 knowledge has the investor consortium been unable to  
17 access markets during this time period of turmoil in  
18 the credit markets?

19                   A To my knowledge have they been unable  
20 to?

21                   Q Right.

22                   A To my knowledge, no, the answer is no, I  
23 believe they have been able to access capital. It  
24 just became more difficult. That was the point of  
25 the testimony.

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1 Q And it resulted in a change --

2 A -- resulted in a change in the price of  
3 the transaction, because debt was not only harder to  
4 access, it was more expensive, considerably more  
5 expensive in the capital markets.

6 Q And I wanted to clarify, Commissioner  
7 Jones asked you about whether you looked at the  
8 company on a stand-alone basis in 2006. But I wanted  
9 to clarify, were you looking at that before 2006?

10 A Well, yes, we were. As I said earlier,  
11 I think one of the hallmarks of this board has been  
12 that we have continued to look at the stand-alone  
13 case, ask ourselves the question almost every year  
14 since 2002. But particularly when transactions, such  
15 as Cascade Natural Gas, took place in the region, it  
16 put even more of an emphasis on the board's need to  
17 make sure that we were solid in our belief that the  
18 stand-alone business case could be executed, and  
19 executed at a favorable return to shareholders going  
20 forward.

21 So, yes, we were continuing to examine  
22 the stand-alone business case, including up to the  
23 time we were first approached by Macquarie.

24 Q And I believe you testified in response  
25 to Commissioner Jones that you were dedicated up to

1022

1 2006 trying to go forward on stand-alone basis?

2 A Yes. Yes.

3 Q Did you have concerns, or were you  
4 comfortable with your ability to go forward on the  
5 stand-alone basis?

6 A At what period?

7 Q Prior to 2006, as you evaluated the  
8 stand-alone business?

9 A Well, I would say that I can't say  
10 unequivocally, yes, to that question. What I would  
11 say is that the board had an intent to continue to  
12 stay as the current company, which was a stand-alone  
13 business case. I would say that it was a unanimous  
14 opinion of the board that we would do everything we  
15 could to stay the course. But the answer was, as we  
16 got closer to more expensive capital markets, as we  
17 looked at the future earnings power of the company we  
18 became more and more uncomfortable.

19 So at that point I think we really had  
20 to say that we weren't 100 percent comfortable.  
21 That's what caused us to look at a number of  
22 alternatives, not just this particular alternative  
23 was pursued, but a number of alternatives. And  
24 that was something the board took very seriously.  
25 So, again, it was the comfortability of the ability

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1 to sustain good earnings potential going forward,  
2 and therefore a rising stock price that really  
3 caused us to engage in this transaction.

4 Q Commissioner Jones also asked you about  
5 the Company's ability to raise equity over -- since  
6 2002, the 500 million in equity, did you have -- were  
7 you comfortable that you would be able to continue  
8 with raising the equity that you needed going  
9 forward?

10 A No. No. We could have raised the  
11 equity. So I guess I should say that, was I  
12 comfortable that we could raise it at a reasonable  
13 price is probably the question that I would say no  
14 to. I think that was what Commissioner Jones was  
15 asking, was I -- we could have raised equity. But,  
16 again, we have to -- our obligation is to say at what  
17 price, and what cost to the company, and at what cost  
18 to current shareholders, and what cost to the  
19 dividend. So all of those questions had to heavily  
20 factor into our thinking about the ability to raise  
21 capital.

22 Yes, we could have probably raised it,  
23 but the question is what would it have done to the  
24 financial condition of the company. And we were  
25 not comfortable with what we saw as the results of

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1       that.

2               Q     And compared to the 500 million that  
3 Commissioner Jones referenced, were you looking at a  
4 similar amount going forward? Was it more or less?

5               A     It was much more, as we mentioned. We  
6 were looking at what we were talking about earlier  
7 with a need to refresh the infrastructure to keep the  
8 integrity of the system going, to continue to build  
9 more generation. It potentially could have been up  
10 to a billion dollars a year on a go-forward basis.  
11 So it was considerably more going forward.

12              MS. CARSON: Thanks. No further  
13 question.

14              JUDGE MOSS: Nothing further. All  
15 right. Ms. Campbell, we will express our  
16 appreciation for you being here this morning to  
17 testify, and you may step down.

18              THE WITNESS: Thank you.

19              JUDGE MOSS: Let's take a brief recess.  
20 We will take 10 minutes.

21                               (Brief recess taken.)

22              JUDGE MOSS: Let's go back on the  
23 record. While off the record, we determined that  
24 we would proceed with Mr. Hill, and then we're  
25 going to take a recess until sometime in the

1025

1 afternoon when we will resolve the final issues  
2 surrounding Exhibits 23 and 64.

3 So, Mr. Hill, I don't believe you have  
4 been sworn before in this proceeding, have you?

5 THE WITNESS: I was sworn the first day,  
6 but we can do it again.

7 JUDGE MOSS: Well, we won't do it again.  
8 You remain under oath.

9 And anything preliminary, Mr. Ffitch.

10 MR. FFITCH: I can do a brief direct and  
11 introduce Mr. Hill if you would like.

12 JUDGE MOSS: We don't need to do that.  
13 We know Mr. Hill, and I believe we will proceed  
14 with our questions from the bench, which I believe  
15 Commissioner Jones has.

16

17 Steven Hill,  
18 produced as a witness in behalf of the Public,  
19 having been first duly sworn, was examined and  
20 testified as follows:

21

22 EXAMINATION

23

24 BY COMMISSIONER JONES:

25 Q This is Commissioner Jones, Mr. Hill.

1026

1 Did you hear my question to Mr. Leslie yesterday on  
2 why Macquarie investment is not to rely on public  
3 equity markets and private placements in a minority  
4 position, and instead to, quote, gain control of  
5 ownership of assets?

6 A Yes, sir. I believe basically he said  
7 that was their job, that's what they did. They were  
8 a private equity investment firm, and that's what  
9 their investors expected them to do.

10 Q What is your response to more  
11 specifically his answer that the mandate of these  
12 unlisted and listed infrastructure funds, such as MIP  
13 1, gain control and actively manage the companies for  
14 the benefit of Macquarie and its direct investors?

15 A Well, I don't doubt that that is true.  
16 I think he was -- that was a truthful response. I  
17 think one of the advantages of private equity is that  
18 the owners can have much more direct influence in how  
19 their investments are operated, than can a public  
20 investor. For example, unless you own a great deal  
21 of the shares of Puget Energy, you are not going to  
22 have much influence in what the management actually  
23 does. You know, you get 5 percent, 10 percent of the  
24 shares, then they start to listen to you. That's my  
25 general experience.

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1                   But a normal shareholder that has a few  
2                   hundred shares or couple thousand shares, it's not  
3                   going to have much influence. However, if you are  
4                   one of five owners, and you have a beef with the  
5                   management, they are going to listen to you. I  
6                   think that's the essence of it. And for the  
7                   investors, it's a good thing. And if the investors  
8                   are good stewards of the company, it would be a  
9                   good thing for the customers as well; and if not,  
10                  then not.

11                  Q    You submitted, and I don't know the  
12                  exhibit number, Judge, but you submitted a paper to  
13                  us as part of your testimony, the NRRI paper on  
14                  private equity buy-outs, did you not?

15                  A    Yes, sir.

16                  Q    Did you -- as I recall that paper, you  
17                  were examining mainly what are called leverage  
18                  buy-out, private equity buy-out. Is that correct, or  
19                  did you look specifically at infrastructure assets of  
20                  the type Macquarie has?

21                  A    I looked at both. And I did mention  
22                  Macquarie in my article. My charge from NRRI was  
23                  really to write a paper that sort of gave regulators  
24                  a background on the private equity interests in  
25                  utilities. And although -- as I say in my testimony,

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1 although Macquarie doesn't use as much debt to buy  
2 the companies it purchases, as for example KKR or  
3 somebody like that, Pacific Enterprises, they do use  
4 debt to buy it.

5                   And in this case they are investing \$3.4  
6 billion of equity, and they are using the \$1.425,  
7 now \$1.225 billion together to buy the company. So  
8 it is a leverage buy out, although that leverage  
9 part is smaller than if they were being bought by  
10 KKR, as in the TXU (phonetic) deal. KKR, that was  
11 levered up to about 80 percent debt, is my  
12 recollection.

13                   So my charge in that by NRRI was to try  
14 to inform regulators about what this process was,  
15 what the impacts might be, what the good things  
16 about private ownership were, and what the bad  
17 things were.

18                   Q Now, moving on to the cost of capital,  
19 Mr. Hill, do you think the cost of capital will be  
20 higher or lower under this proposed transaction than  
21 under the existing model of relying on public capital  
22 markets?

23                   A I don't think there's any question that  
24 the cost of capital is higher. You have the ability  
25 to prevent that capital cost from reaching rate

1 payers, but I think we saw an interrelated return  
2 figure in our cross-examination of Mr. Leslie the  
3 other day that we know is significantly higher than  
4 the equity return that was decided in the recent rate  
5 case, 10.15 in the settlement.

6           That tells me that the investors, the  
7 private equity investors, are extracting a premium  
8 for the illiquidity of the investment as part of  
9 it. And also another part of it is the increased  
10 usage of debt raises the risk to those investors.  
11 So they are requiring a much higher return on that  
12 investment. So -- and, also, the debt that Puget  
13 Energy will issue has a higher cost rate than the  
14 debt that Puget Sound Energy will issue even under  
15 the Macquarie plan.

16           Q Right. But, Mr. Hill, considering the  
17 ring fencing conditions in commitments 35 through 40,  
18 and 24, which is they will not advocate for a higher  
19 cost of capital, what, in your view, would be the  
20 effect of this higher cost of capital on a  
21 consolidated or HOLDCO basis on Puget Sound rate  
22 payers?

23           A It would increase the probability of a  
24 negative financial event, because in order to extract  
25 the promised return to the investor consortium, the

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1 only source for that return is cash flows from PSE.  
2 That's the only place they can get it. And in order  
3 to deliver on their promise to investors, they have  
4 to provide that IRR that we talked about the other  
5 day. And the only place it can come from is from the  
6 cash flows up from Puget Sound Energy. And those  
7 have to cover the debt also, and provide the monies  
8 to those investors.

9                   Therefore, it seems to me that that  
10 situation runs the risks of creating the potential  
11 for negative financial events for Puget Sound  
12 Energy rate payers. And in the extreme, the event  
13 could be serious enough that the ring fencing  
14 measures wouldn't help.

15                   Q Mr. Leslie yesterday talked about the --  
16 not the irrelevance, but the less importance of one  
17 of the financial metrics used by credit rating  
18 agencies, the average debt to total capital ratio.  
19 Could you respond to him when he asserted that  
20 ratings agencies in general give more weight and  
21 credence to the cash flow metrics and not this  
22 metric?

23                   A I think they publish all the metrics --  
24 first of all, let me caveat my comment to say it's  
25 difficult to know exactly what they do behind closed

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1 doors. But they publish those metrics for a reason.  
2 The debt obviously is something that is important to  
3 investors or they wouldn't publish it. I agree they  
4 focus their metrics on cash flow recently. If you  
5 remember some years ago, it was pre-tax interest  
6 coverage of debt costs. They don't even publish that  
7 anymore.

8                   Although they do talk, be it in their  
9 ratings evaluations, it's not a benchmark metric  
10 they publish. They publish cash flow coverage of  
11 interest, and cash flow coverage of total amount of  
12 debt, and then debt to capital. Those are the  
13 three methods, and I don't think you can really  
14 point to one of those as being more or less  
15 important.

16               Q This is my last question, Mr. Hill, and  
17 it's back to this access to public markets and public  
18 capital markets. All parties appear to agree that  
19 the external capital number for Puget is a large  
20 number to be raised through debt and equity after  
21 considering retained earnings and funds from  
22 operation.

23                   Why do you think PSE, slash, PE, can  
24 raise the external capital on reasonable terms on a  
25 stand-alone basis?

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1           A     Well, they have done it in the past  
2 under adverse conditions. That's the primary reason.  
3 Even Mr. Reynolds said absent the sale, they would be  
4 able to operate as they always have, fund the capital  
5 expenditures. Most of the capital expenditures under  
6 any ownership circumstance will be provided by  
7 internally generated funds.

8                     The question is, where do you go to get  
9 the external generated funds. We just heard  
10 Ms. Campbell say for Puget on a stand-alone basis,  
11 going to the debt market alone is not a good idea.  
12 And I think that is a primary reason why under the  
13 Macquarie model, financing only with debt is  
14 similarly not a good idea.

15                    Finally, I would say that the Company  
16 has not made the case that they cannot finance on a  
17 stand-alone basis. I am not going to talk about  
18 Mr. Petis (phonetic) analysis, take advantage of  
19 your question that way. But I think it's not a  
20 reliable analysis.

21                    COMMISSIONER JONES: Judge Moss, that's  
22 all I have.

23                    JUDGE MOSS: Thank you. Commissioner  
24 Oshie.

25                    COMMISSIONER OSHIE: Thank you, Judge

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1 Moss.

2 EXAMINATION

3

4 BY COMMISSIONER OSHIE:

5 Q I have a couple of follow-up questions,  
6 and these are follow-ups to your responses as given  
7 to Commissioner Jones. And in one of your  
8 statements, I will paraphrase. It was that under  
9 some extreme financial condition, that the ring  
10 fencing measures that are in the settlement  
11 agreement may not help to protect the utility.

12 A Yes.

13 Q So one is -- the first question is, that  
14 question, you had a context in mind as you phrased  
15 the question. So what kind of extreme circumstances  
16 were you considering as you framed your answer that  
17 the ring fencing measures may not serve to protect  
18 the utility?

19 A Clearly if Puget Energy defaults on its  
20 \$1.425 billion loan, the ring fencing measures are in  
21 trouble, because the security for that loan is Puget  
22 Sound Energy, the ownership, the equity.

23 So when -- if PE defaults on that loan,  
24 then the question of who owns PSE comes into play.  
25 Do the debt holders then own the company? If

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1       that's the case, then I would say that the ring  
2       fencing measures are not going to help.

3               Q    And just curious, are you assuming that  
4       the investor group would just cut it loose at that  
5       point, and be stand-alone, but there would be no  
6       support from above?

7               A    I don't know what they would do. That's  
8       not my assumption. My assumption is, if they default  
9       and they are not able to pay the debt costs, then the  
10      debt holders then are running the show. And it very  
11      well may be that in the case of an extreme event,  
12      they are not able to pay their debt costs, then money  
13      would be coming in from Australia and Canada to pull  
14      them out. That could happen.

15              Q    I just wanted to search out what you  
16      really meant by an extreme condition. Also, another  
17      comment that you made, I believe you were talking  
18      about the kind of -- put it in context, as I recall,  
19      that the investors in this situation here are  
20      extracting the premium because of the illiquidity of  
21      the investment. Can you explain what you mean by the  
22      illiquidity of this investment? And put that in  
23      context so we understand it better.

24              A    A liquid investment, simply put, is  
25      something that is easily sold --

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1           Q    I understand that part.  But why do you  
2 believe this investment -- maybe I should have framed  
3 it better.  Why is this investment, in your mind,  
4 illiquid?

5           A    Well, it's not easily sold.  If one of  
6 the Canadian investors or even a Macquarie  
7 Infrastructure Partner -- you heard Mr. Leslie say  
8 the MIP partners make a commitment for ten years, and  
9 he said very clearly it's hard for them to get out.  
10 That's one of their complaints.

11                And I think it would be difficult, under  
12 the ownership agreement that the investor  
13 consortium has, for one of those pension funds to  
14 get out of the investment, as well.

15                And, also, I will be able to pinpoint  
16 it -- I can't do it from memory right now, but one  
17 of the investors offered an exhibit with his  
18 testimony, or referenced an exhibit with his  
19 testimony that was their annual report.  And I will  
20 provide that aside for you, after I am off the  
21 stand.

22                But it talks about in their  
23 infrastructure investment portfolio, one of the  
24 things they considered is a risk premium for  
25 illiquidity.  So they understand they will be in it

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1 for a long time, and they require a higher return  
2 for that.

3 COMMISSIONER OSHIE: Thank you. I have  
4 no further questions, Judge Moss.

5

6 EXAMINATION

7

8 BY CHAIRMAN SIDRAN:

9 Q Mr. Hill, following up on Commissioner  
10 Jones' reference to Exhibit 253, this is the  
11 monograph that you wrote for NRRI, wherein you  
12 subscribe issues surrounding private equity  
13 acquisition of regulated utilities, and in that  
14 monograph, among other things, you describe  
15 conditions that you recommend to regulators that are,  
16 in effect, ring fencing type provisions intended to  
17 reduce the risk, among others. What is it that you  
18 would recommend, if anything, with respect to the  
19 additional ring fencing for this transaction?

20 A I will note first of all that the ring  
21 fencing measures that I cite in that NRRI article are  
22 from this Commission. Not to pat anybody on the  
23 back, but I thought those were the best I had seen.

24 Q You may pat away.

25 A But I do say, I do make the caveat that

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1 the paper, that even the best laid plans of mice and  
2 men often go astray. You can't protect yourself  
3 ultimately from a financial -- serious financial  
4 disaster. That said, I think the key element would  
5 be more equity, less debt. And in discussing this  
6 with my counsel, trying to figure out a place where  
7 we could land in all of this, I would prefer that the  
8 investor consortium start off the consolidated  
9 capital structure of PE with a 40 percent equity  
10 ratio. And that would mean a contribution of about  
11 \$500 million of equity and a reduction of that much  
12 debt.

13                   The problem with the Macquarie model is  
14 that that is a starting point, but you go downhill  
15 from there. There's more debt added as you go on,  
16 because you are financing with debt as you go  
17 along. If you look at the financial model, the  
18 debt ratio increases year after year for ten years.  
19 That would happen even if they started at 40  
20 percent equity and 60 percent debt. It would grow  
21 from there. And I think ultimately that would be  
22 problematic with the bond rating agencies.

23                   So the short answer is, more equity,  
24 less debt. A number for me would be 500 million.

25                   Q Now, I think one of the principal

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1 contentions of the joint applicants in the testimony  
2 is that because the overwhelming bulk of their  
3 capital, including the Macquarie Infrastructure  
4 Partners, is coming from pension funds, and, in fact,  
5 primarily government pension funds, their argument  
6 would be that it is a superior source of capital,  
7 both because it is, by its nature, stable long-term  
8 capital, and because it has as its source of capital,  
9 the pension contributions which are a long-term,  
10 stable source of revenue to those pension funds?

11                   So I would like you to indulge a  
12 hypothetical. Let's assume that is their argument.  
13 I have characterized it as best I can. And let's  
14 assume all of this ring fencing currently in the  
15 transaction is in place. And let's even assume  
16 that your suggestion that there should be  
17 40 percent equity is in place. And bearing in mind  
18 that our legal standard is, for reviewing this  
19 transaction, is no harm to the public interest, can  
20 you describe for me, what is the harm from that  
21 model, relying on that capital source in relation  
22 to the alternative of relying on the public  
23 markets?

24                   A    In a word, debt, because the Macquarie  
25 model is -- that is the engine that drives it. They

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1 acquire their investments with a balance of debt and  
2 equity. But they finance capital additions with the  
3 cheapest capital they can find. That's not equity,  
4 that's debt. And so over time, the debt will  
5 increase. The way for them to get their returns is  
6 to leverage the cash flows.

7           And what I mean when I say leverage,  
8 they use debt to finance the capital additions to  
9 leverage the cash flow, to get to the risk return  
10 matrix that is comfortable for those pension funds.  
11 Notice the pension funds don't invest all of their  
12 money in infrastructure. It's only about 2, 3,  
13 maybe 5 percent of their investments. The rest is  
14 in stocks and bonds and the traditional. This is  
15 an alternative investment. They don't put all of  
16 their eggs in one basket.

17           So the discussion about the relatively  
18 low risk, and that sort of thing, that risk is  
19 increased during the Macquarie model's use of debt  
20 and leverage. So that's my fundamental concern.  
21 Even under the conditions, the benign conditions  
22 that you discuss, I would say that still over time  
23 the financing of the capital additions will be done  
24 with debt capital.

25           CHAIRMAN SIDRAN: Thank you, that's all.



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1 right now. All right. It's now 2:35 in the  
2 afternoon. We have had some brief  
3 off-the-record-discussion. We have been handed a  
4 supplement to Exhibit No. 23, previously entered  
5 into the record. I assume the supplement is coming  
6 in without objection.

7           Hearing none, it will be made part of  
8 the exhibit. We have had some discussion  
9 concerning Exhibit 64, which we will get to  
10 momentarily, I guess. Mr. Ffitch has informed the  
11 bench that he wishes to inquire further of Mr.  
12 Kupchak, who I believe is here.

13           Why don't you come on back up here,  
14 Mr. Kupchak. And he indicates he has approximately  
15 one hour of examination for the witness, and he  
16 also tells me that this will need to be in closed  
17 session because it concerns a highly confidential  
18 exhibit, specifically Exhibit 23. I am not sure  
19 about 64, but in any event, that is -- is it not  
20 what you have asked for, Mr. Ffitch? Have I said  
21 it right?

22           MR. FFITCH: We're examining on both  
23 Exhibits 23 and 64, both were designated by the  
24 company as highly confidential, and we are not able  
25 to examine this witness in a public hearing room,

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1 Your Honor.

2 JUDGE MOSS: So with that, I will ask  
3 those of you who are in the hearing room who are  
4 not signatories of the appropriate affidavit under  
5 the protective order entered in this proceeding,  
6 you will have to leave. You can check in with  
7 Mr. Meeks at the back of the room if you wish to be  
8 contacted when we go back into public session.

9 I expect that all we will be doing in  
10 the public session this afternoon is closing the  
11 hearing with the various housekeeping that usually  
12 accompanies that face of the proceedings. In their  
13 words, once we finish with Mr. Kupchak, we will  
14 have finished with the evidentiary portions, I  
15 believe, except for, perhaps, the introduction of a  
16 stray exhibit or two.

17 So those of you who are now having to  
18 leave the room may choose not to come back just for  
19 those ministerial matters. The bridgeline will be  
20 on for those if you wish to listen in, but that's  
21 my thought on the subject.

22 And with that, any of you who are on the  
23 conference bridgeline, I am going to mute the send  
24 function on the conference bridgeline. We will  
25 resume that in approximately one hour. But, again,

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1       there largely will be ministerial matters to be  
2       dealt with at that time. I believe our -- is there  
3       any preliminary?

4                   MR. FFITCH: No, Your Honor, not for  
5       public counsel.

6                   JUDGE MOSS: Does Mr. Kupchak have  
7       everything he needs?

8                   THE WITNESS: I don't think I have  
9       Exhibit 23, actually.

10                  JUDGE MOSS: He should be given a copy  
11       of that. Very good. So then I believe we're ready  
12       to go.

13                  Mr. Ffitch, you may undertake your  
14       examination.

15                  MR. FFITCH: Thank you, Your Honor.

16                  (Begin CONFIDENTIAL TESTIMONY --

17                               ATTORNEYS'S EYES ONLY.)

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1 (End CONFIDENTIAL ATTORNEYS' EYES  
2 ONLY TESTIMONY.)

3 JUDGE MOSS: Mr. Kupchak, it would  
4 appear that we have finished with the examination  
5 for today, and you may step down. And I believe  
6 that brings us to the conclusion of all the witness  
7 presentations, the panel presentation, and so  
8 forth.

9 The only other matter that I have in  
10 mind as far as our record is concerned, Mr. Ffitch,  
11 is the exhibit of public comments. I assume that  
12 you intend to provide that in the usual fashion the  
13 public counsel does in these types of cases?

14 MR. FFITCH: Yes, Your Honor, thank you.  
15 That was on my list.

16 JUDGE MOSS: We will need only one copy  
17 of that. And I have identified it as Exhibit 400,  
18 and I will simply go ahead and mark it as admitted  
19 subject to the understanding that you will submit  
20 that exhibit within what time frame;

21 (EXHIBIT ADMITTED.)

22 MR. FFITCH: Your Honor, at the public  
23 comment hearing last night, Judge Torem recommend a  
24 final written comment date of September 5th. And  
25 if I could please have a moment to speak with our

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1 analyst, Stephanie Johnson, who is working on this  
2 exhibit -- and we can go off the record for this  
3 discussion.

4 JUDGE MOSS: Off the record.

5 (Discussion off the record.)

6 JUDGE MOSS: Judge let's be back on the  
7 record. We have had off-the-record discussion  
8 about housekeeping matters, including the  
9 furnishing of answers to bench requests. We have  
10 agreed that it makes sense to give the parties a  
11 few days to coordinate amongst themselves with  
12 respect to this responses since some of them call  
13 for interpretations of provisions of settlement  
14 stipulation, and they should all be in agreement  
15 about that.

16 Mr. Ffitch has rightly pointed out, of  
17 course, he would have an opportunity to weigh into  
18 the bench response cycle himself. And while not  
19 likely, a possibility, of course.

20 So we expect to have those responses  
21 with us by next Friday, the 5th. And the sooner  
22 the better, so if you can get to it earlier, that's  
23 fine.

24 We have also discussed a briefing  
25 schedule a little bit, and Mr. Ffitch has requested

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1 a brief extension of that schedule from the  
2 previous date of the 19th. He said it would help  
3 to go to the 24th, although you would probably  
4 prefer some additional time. But to the 24th is a  
5 reasonable accommodation, so we will extend the  
6 briefing date until the 24th.

7 And as before, that will be the date for  
8 electronic submission. So the hardcopies need to  
9 arrive here the next day. So, of course, as  
10 always, I ask all of you who like to file your  
11 materials in .pdf format to send me a courtesy copy  
12 in .doc format so you can see your eloquent words  
13 appearing quoted in the order without me having to  
14 retype them.

15 So with that, I think that concludes --  
16 Mr. Ffitch is going to furnish us with some copy,  
17 appropriately formatted versions of the public  
18 comments. And that was to be done also --  
19 actually, the close is on the 5th, Mr. Ffitch, so  
20 you will want a day or two after that, won't you?

21 MR. FFITCH: I think so, Your Honor,  
22 yes.

23 We realize Consumer Affairs is part of  
24 this processing, so maybe the following Wednesday,  
25 Your Honor.

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1                   JUDGE MOSS:  Let's shoot for the 10th,  
2                   and if something comes up, you let me know.  Am I  
3                   leaving anything out?  I am tired.

4                   MR. CEDARBAUM:  The only other date I  
5                   recall, September 8th is the date for responding to  
6                   the public counsel motion; is that correct?

7                   JUDGE MOSS:  That's correct.  With that,  
8                   I thank you all for being here for the past several  
9                   days, and for the excellent presentations you have  
10                  given us in terms of developing our record in this  
11                  matter.

12                  And with that, our hearing is closed.

13                  ENDING TIME:  3:45 P.M.

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