BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Application of **PUGET HOLDINGS LLC AND PUGET SOUND ENERGY, INC.,** **For an Order Authorizing Proposed Transaction**	**DOCKET U-072375**

BRIEF OF COMMISSION STAFF

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I. OVERVIEW[1]

1 This docket involves the purchase of Puget Energy, Inc. by an Investor Consortium. The Investor Consortium proposes to purchase all the outstanding shares of Puget Energy and thereby obtain full control of Puget Sound Energy, Inc. ("PSE"), a public service company operating in Washington. The Investor Consortium plans to privately own PSE and fund the utility's substantial, ongoing needs for equity capital.

2 The Commission will approve such a transfer of control if, based on an analysis of the transaction and accompanying conditions, the transaction is "consistent with the public interest." The Commission has said this means "no harm" to ratepayers or the public interest. The well-crafted Multiparty Settlement Stipulation (Settlement Stipulation)[2] meets this standard because it appropriately resolves the legitimate concerns about the transaction that have been expressed in this case.

3 The parties in this case represent many and widely diverse interests. All parties support the Settlement Stipulation as consistent with the Commission's "no harm" standard except one: Public Counsel.[3] However, Public Counsel's case is flawed at its core because it ignores the substantial ring fencing and other substantial protections provided by the Settlement Stipulation to protect PSE from any harm occasioned by the change in control.

4 In fact, the Settlement Stipulation is patterned after other similar transactions that have come before the Commission,[4] and earned Commission approval. Even Public

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[1] Throughout this brief, when we cite a numbered "Commitment," we are referring to the corresponding Commitment contained in Exhibit No. 301: the Multiparty Settlement Stipulation, Appendix A: "Transaction Commitments." We do not separately cite that exhibit each time we cite a Commitment.
[2] Exh. No. 301.
[3] Another party, the Cogeneration Coalition of Washington, has stated it will not oppose the Settlement Stipulation. *Exh. No. 301 at 2, ¶ 2, footnote 2.*
[4] Kupchak, TR. 539:24 - 540:7.

Counsel's witness, Mr. Hill, believes that conditions of this type are "the best I had seen."[5] Indeed, when the bench gave Mr. Hill the opportunity to suggest additional ring fencing measures in this case, he offered none.[6] Furthermore, as one panel witness observed, Macquarie has done a number of these transactions in the United States, "and this is by far the tightest ring fencing that we have ever employed in one of our transactions."[7]

5 Public Counsel simply believes the ring fencing provisions will not work, because Mr. Hill thinks: "You can't protect yourself ultimately from a financial -- serious financial disaster."[8] However, the Commission has never rejected a transaction on the assumption that the well-crafted ring fencing provisions will be violated; the Commission should reject Public Counsel's unprecedented offer to start now.

6 In any event, Public Counsel's argument proves too much, because if ring fencing will not work, then no transaction could likely satisfy the Commission's "no harm" standard, including the many previous transactions Public Counsel successfully has urged the Commission to approve.[9]

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[5] Hill, TR. 1036:20-23. He reached this conclusion after doing research for his recent article on utility mergers and acquisitions. The article is Exh. No. 253.

[6] TR. 1036, beginning on line 17. Mr. Hill's only suggestion was a $500 million additional equity contribution from the Investor Consortium, but that is not a ring fencing measure.

[7] Panel Testimony, TR. 540:8-12 (Kupchak).

[8] Hill, TR. 1037:2-4.

[9] Public Counsel has supported many merger/sale type transactions. To the best of our knowledge, this is the first such transaction presented to the Commission for decision that Public Counsel has opposed. Below is a list of the six merger/sale type dockets before the Commission since 1997. In each one, Public Counsel signed the settlement agreement for Commission approval of the transaction. None of the Commission orders in these dockets reflect a Public Counsel argument that the Commission should ignore the ratepayer protections contained in the settlement, based on the assumption that they will not work:

> **PSE/WNG Merger**: *In re Puget Sound Power & Light Company and Wash. Natural Gas Co.*, Dockets UE-951270 and UE-960195, Fourteenth Supplemental Order (February 5, 1997);
> **ScottishPower Acquisition of PacifiCorp**: *In re Application of PacifiCorp and ScottishPower PLC*, Docket UE-981627, Fifth Supplemental Order (October 14, 1999);
> **GTE Corporation/Bell Atlantic Merger**: *In re GTE Corp. and Bell Atlantic Corp.*, Dockets UT-981367 and UT-990672, Fourth Supplemental Order (December 16, 1999);

7 Indeed, it is conceivable that a "serious financial disaster" can occur to PSE under the *status quo*, potentially resulting in PSE being unable to access capital at all. Public Counsel fails to recognize this fact, let alone address it. In any event, Staff will demonstrate that the ring fencing commitments in the Settlement Stipulation will work to protect PSE and its ratepayers, even in a serious, adverse financial situation. In the end, this transaction meets the Commission's "no harm" standard because the Commitments underlying this transaction mitigate any harm the transaction may impose.

8 Indeed, to focus on the risk issue, Commission Staff (Staff) retained two well-qualified experts: one to identify and analyze the unique risks presented by the Investor Consortium compared to the *status quo* (Dr. Schmidt), and the other to apply that analysis to determine whether transaction conditions mitigate those risks (Mr. Horton). As Mr. Horton concluded, under the conditions contained in the Settlement Stipulation: "PSE is sufficiently protected from the new risks inherent in the new ownership structure, and PSE's risk profile *after* consummation of the Proposed Transaction is no greater than the 'status quo.'"[10] Public Counsel elected not to cross-examine Mr. Horton.[11]

9 For the reasons stated in this brief, the Commission should reject Public Counsel's challenge, find that the Settlement Stipulation satisfies the Commission's "no harm" standard, and approve the transaction.

US WEST/Qwest Merger: *In re Application of US WEST, Inc. and Qwest Communications Int'l, Inc.*, Docket UT-991358, Ninth Supplemental Order (June 19, 2000);
MEHC Acquisition of PacifiCorp: *In re Application of MidAmerican Holdings Co. & PacifiCorp, d/b/a Pacific Power & Light Co.*, Docket UE-051090, Order 07 (February 22, 2006);
Cascade Natural Gas/MDU Merger: *In re Application of MDU Resources Group, Inc. & Cascade Natural Gas Corp.*, Docket UG-061721, Order 06 (June 27, 2007).

When we cite one of these orders in this brief, we use the shortened version of the case name set forth in bold above.

[10] Joint Rebuttal Testimony, Exh. No. 304CT at 23:20 - 24:1 (Horton separate statement) (emphasis added).

[11] TR. 982:13-16.

II. THE COMMISSION'S "NO HARM" STANDARD

10 The Commission has ruled that under RCW 80.12, a sale of stock that transfers control of a regulated utility requires prior Commission approval.[12] However, the Legislature prescribed no explicit standard in RCW 80.12 for Commission review of such a transaction. In its rules, the Commission has adopted a "consistent with the public interest" standard,[13] often called the "no harm" standard.[14] The Commission has decided that its "no harm" standard does not require a showing that the transaction provides net benefits to ratepayers. As the Commission put it, the applicants are not required "to show that customers, or the public generally, will be made better off if the transaction is approved and goes forward;" no harm to the public interest is enough.[15]

11 In applying its "no harm" standard, the Commission looks to how the transaction will affect customers compared to the *status quo*: "The transaction should not harm customers by causing risks or rates to increase … compared to what could reasonably be expected to have occurred in the absence of the transaction."[16]

12 It is important to note that in applying this standard, the Commission has not evaluated whether an alternative arrangement might be better,[17] or whether the utility's

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[12] *ScottishPower Acquisition of PacifiCorp,* Docket UE-981627, Third Supplemental Order at 2, 3 (April 2, 1999).
[13] WAC 480-143-170.
[14] For example, on pages 2 and 3 of the Commission *ScottishPower* order cited in footnote 12 above, the Commission referred to the standard as "no harm to the public interest." In an earlier case involving PSE's predecessors, the Commission referred to the standard and said "the transaction should not harm customers." *PSE/WNG Merger,* Dockets UE-951270 & UE-960195, Fourteenth Supplemental Order (February 5, 1997) at 19.
[15] *ScottishPower Acquisition of PacifiCorp,* Docket UE-981627, Third Supplemental Order at 2 (April 2, 1999).
[16] *PSE/WNG Merger,* Dockets UE-951270 & UE-960195, Fourteenth Supplemental Order (February 5, 1997) at 19.
[17] For example, both Staff and Public Counsel suggested that it might be better if Puget Energy issued the same debt that will be on its books due to the transaction, and invest directly in the utility, rather than the purchase of shares of common stock. *Elgin, Exh. No. 161HCT at 16:15 - 17:6 and Hill, Exh. No. 261HCT at 15:19 - 16:5.* However, that scenario is not before the Commission for approval.

motivation for entering into the transaction is clear and convincing.[18] Rather, the Commission has adhered to its policy and applied the standard to the transaction before it.

13 As we demonstrate below, the transaction now before the Commission satisfies the Commission's "no harm" standard because the Commitments in the Settlement Stipulation assure that neither risk nor rates[19] will increase, compared to the *status quo.*

III. NATURE OF THE TRANSACTION

A. The Applicants and the Basic Transaction

14 The Applicants are Puget Sound Energy, Inc. (PSE) and Puget Holdings, LLC (Puget Holdings). They seek Commission approval of a transfer of ownership and control of Puget Energy (PE) and its wholly-owned subsidiary, PSE, to Puget Holdings.[20] Puget Holdings is owned by the Investor Consortium.

15 Puget Holdings will pay $30.00 for each share of Puget Energy common stock, and assume $2.6 billion of outstanding debt and preferred securities of PSE, making the enterprise value of the transaction approximately $7.4 billion.[21] If the Commission approves the transaction, the common stock of PE, which is currently listed on the New York Stock Exchange, would be de-listed and privately held by Puget Holdings.[22]

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[18] There was ample discussion on the record whether PSE will be able to finance its ongoing capital needs on reasonable terms. We discuss this evidence *infra* at 7-8, ¶¶ 19-20, but ultimately, this issue does not advance the discussion much, because even if PSE could do so, it does not follow that this transaction fails the "no harm' standard.

[19] As Staff explained, PSE's need for significant amounts of additional capital will likely require regular rate increases; the transaction does not change that. *Elgin, Exh. No. 161HCT at 26:3-6.*

[20] Joint Application for an Order Authorizing Proposed Transaction (Joint Application) (December 17, 2007) at 1, ¶ 1.

[21] Leslie, Exh. No. 31T at 17:7-12; Elgin, Exh. No. 161HCT at 8:10-14.

[22] Leslie, Exh. No. 31T at 17:17-20.

B. The Transaction Funds PSE's Substantial Needs for Equity Over the Next Five Years – Commitments 3, 57, 58 and 59

16 PSE is in a substantial "growth phase," in which it will be making significant capital additions and improvements to fulfill its public service duties. For example, in addition to maintaining and improving its existing facilities, PSE plans to add 1,600 MW in new resources by 2015, compared to its present resource base of 2,116 MW.[23] Obviously, this is a capital-intensive effort. According to PSE's business plan, the company will spend $5.7 billion over the next six years, 2008-2013, and substantial amounts thereafter.[24] These are significant capital needs relative to PSE's size.[25] For example, the credit rating agency Standard & Poor's characterizes PSE's need for capital as "very high,"[26] in an era which finds many utilities in a building cycle, also with high needs for capital.[27]

17 PSE expects to fund this $5.7 billion capital need with $2.3 billion of internally generated funds, leaving a $3.4 billion need for external capital over that period.[28] PSE expects to fund $1.4 billion of this $3.4 billion with equity.[29] To acquire this equity capital, under the *status quo*, PSE plans to access the public equity markets several times over the next several years.[30] By contrast, under the transaction, PSE will have all of its need for equity capital satisfied through 2013,[31] and Puget Holdings expressly commits to make PSE's further equity capital needs "a very high priority."[32]

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[23] Joint Testimony, TR. 463:5-21 (Leslie).
[24] Markell, Exh. No. 71T at 9:1-3.
[25] *E.g.*, Panel Testimony, TR. 556:3-15 (Leslie).
[26] Elgin, Exh. No. 161HCT at 22:20-22 and Exh. No. 170 at 2.
[27] Elgin, Exh. No. 161HCT at 20:21 - 21:23 and Exh. No. 169.
[28] Reynolds, Exh. No. 131T at 4:20-21; Markell, Exh. No. 71T at 9:9-13; Elgin, Exh. No. 161HCT at 8:12-15.
[29] Pettit, Exh. No. 111CT at 7:11-12. Staff understands PSE no longer contends this figure is confidential.
[30] Markel, Exh. No. 76C.
[31] Absent the transaction, PSE would about $900 million of its external capital needs through new issues of common stock to the public. *Panel Testimony, TR. 557:12-15 (Markell).*
[32] Commitment 2. This Commitment contains language similar to that approved by the Commission in the Avista reorganization docket. In that case, the Commission favorably observed that the Commitments and Conditions required that "the capital requirements of Avista will be met by AVA and such capital requirements

18 In particular, Commitments 3 and 59 require Puget Holdings to secure no less than $1.4 billion in capital by establishing committed credit facilities for the benefit of PSE. As shown in Exhibit 167,[33] PE will have a $1 billion credit facility available to meet PSE's future capital needs, and PSE will have nearly $1 billion available via its own credit facilities. Commitment 58 further assures that the capital available under these credit facilities will be used for one purpose: to fund PSE's capital needs.

19 Exhibit No. 167 also shows that as part of this plan, PSE will replace certain of its own, existing credit lines.[34] However, Commitments 9(iii), 24 and 26(a) assure that the cost to ratepayers of these new credit facilities will be no more than it would have been absent the transaction.

20 Obviously, for PSE to obtain these substantial amounts of new equity capital "up front" allows PSE to avoid going to the public markets for equity. However, there was much debate regarding the significance of this fact. For example, while there appears to be no dispute regarding PSE's ability to raise additional common equity through traditional stock issuances as necessary to the public to fund its capital program,[35] opinions differ as to whether PSE could do that on reasonable terms. PSE points out that its need to issue common equity over the next five years is almost twice what it has been the last five years,[36]

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will be given a high priority by the board of directors of AVA and Avista." *In re Application of Avista Corp.*, Docket U-060273, Order 03 (February 28, 2007) at 4, ¶ 12 (quoting Commitment 18).

[33] Note that Exh. No. 167 shows a $1.425 billion term note in the upper left hand box. Commitment 59 reduces the size of this term loan to $1.225 billion, reflecting the additional $200 million in equity funding for the transaction by the Investor Consortium.

[34] The three boxes on the lower left hand side of the page show the new credit lines at PSE; the three boxes on the upper right hand side of the page show the former credit lines at PSE.

[35] *E.g.*, Reynolds, Exh. No. 133T at 12:8-9; Campbell, TR. 1023:4 - 1024:1; Markell, TR. 673:1-6.

[36] Reynolds, TR. 619:8 - 620:1. Mr. Reynolds explained that PSE plans to issue $900 million in equity over the next five years, and it issued about $500 million in equity capital to the public over the last five years. This $500 million figure does not include the $300 million private equity placement in late 2007, involving the Investor Consortium.

and PSE's last public equity financing presented substantial difficulties for the issuer, Lehman Brothers, that will likely impact any future PSE public equity issuances.[37] [38]

21 It is fair to conclude that it will be a challenge for PSE to raise hundreds of millions of dollars in new equity through 2013 (*i.e.,* under the *status quo*), compared to the under the transaction, where that equity immediately will be available in committed credit facilities for PSE to access when it needs that capital to fulfill its public service duties.

22 However, the Commission should remain focused on the fundamental issue in this case: Overall, including all the ring fencing and other Commitments, does the transaction presents risks additional to the *status quo*? As we explain later, the transaction satisfies the Commission's "no harm" standard because the ring fencing provisions protect against any additional risks that may materialize under the transaction.

C. The Investor Consortium is Qualified to Purchase and Manage its Investment in PSE

23 In evaluating transactions such as these, the Commission considers whether the Applicants "are qualified to take over management of a jurisdictional utility in Washington."[39] In this case, the record shows that Puget Holdings is qualified.

24 Puget Holdings is a limited liability corporation owned by private investors: *i.e.,* the Investor Consortium. The Investor Consortium consists of three large Canadian pension

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[37] Reynolds, TR. 605:7 - 606:1.

[38] As Public Counsel's evidence suggests, Lehman Brothers may not be in existence for PSE's next public issuance of common equity. *Exh. Nos. 501-502.* This just adds to the difficulties PSE will face, if the Commission denies the Joint Application in this case, and the *status quo* is maintained

[39] *ScottishPower Acquisition of PacifiCorp,* Docket UE-981627, Third Supplemental Order (April 2, 1999) at 3, first new ¶. The Commission also noted that it looks to the risk of the transaction to the utility, and the efficiency benefits of the transaction. We address risk issues in Part IV below. As to efficiency benefits, though the transaction in the instant case is technically a "merger," *Application at 11-12 ¶ 22, and Elgin, Exh. No. 161HCT at 8:20-22,* it is not a merger in the sense of two utilities merging and realizing substantial synergy benefits. Therefore, Staff expects the costs savings resulting from the transaction to be relatively small; Staff identified about $1.2 million in reduced expenses. *Elgin, Exh. No. 161HCT at 33:1-9.* Whatever the actual cost reductions turn out to be, under Commitment 11, any cost savings will be reflected in subsequent PSE rate proceedings. Moreover, Commitment 34(b) assures that ratepayers will enjoy cost reductions of at least $1.2 million for the next ten years.

funds, and three firms in the Macquarie Group of companies, with ownership shares as follows:[40]

28.1%	Canada Pension Plan Investment Board (CPP)
14.1%	British Columbia Investment Management Corporation (bcIMC)
6.3%	Alberta Investment Management (AIMCo)
31.8%	Macquarie Infrastructure Partners (MIP)
15.9%	Macquarie Capital Group Ltd
3.7%	Macquarie-FSS Infrastructure Trust

The Macquarie Capital Group plans to sell its interest upon consummation of the transaction, most likely to one of the Macquarie Infrastructure Partners family of funds,[41] keeping Macquarie Group companies with a simple majority (51.4 percent) ownership of PSE.

25 There was little dispute as to the facts surrounding the competence and financial wherewithal of the Investor Consortium. Collectively, these entities manage $499 billion in assets, "with Macquarie alone raising $71 billion of debt financing since July 2007;"[42] a time of significant uncertainty in capital markets. Staff's experts are very familiar with the "players" in international financial markets, and testified that the Macquarie Group has "done well in infrastructure projects" and "enjoys a strong reputation."[43]

26 Macquarie (and, in some cases, certain other members of the Investor Consortium) has specific experience owning regulated utilities, such as Duquesne Light Company in Pennsylvania (electric), The Gas Company in Hawaii (gas), Aquarion Company in New England (water), and Thames Water in London, England (water), among others.[44] There

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[40] Joint Application at 5. A detailed description of these entities is found in the Joint Application at 6-11, ¶¶ 11-21, and in the separate testimonies of Mr. Leslie, Exh. No. 31T at 5-14; Mr. Webb for bcIMC, Exh. No. 141T at 2:6 - 7:2; Mr. Wiseman for CPP, Exh. No. 151T at 2:8 - 7:14, and Mr. McKenzie for AIMCo, Exh. No. 91T at 2:4 - 6:4.
[41] Leslie, TR. 720-721.
[42] Joint Rebuttal Testimony, Exh. No. 304CT at 20:3-8.
[43] Schmidt, Exh. No. 191T at 20:12-14. This reputation issue has a risk element to it, which we discuss later.
[44] Joint Application at 8:9 - 9:2.

was no evidence adduced in this docket suggesting any problems in the ownership of these regulated utilities that should be of concern to the Commission. In particular, the record contains no example where any member of the Investor Consortium failed to fulfill an obligation to supply capital to a regulated utility it owned.

27 It is true that there has been some criticism of "the Macquarie model" in the press,[45] and Macquarie stock has experienced a substantial decline over the past year,[46] even though Macquarie has no exposure to the risk occasioned by the mortgage loan debacle.[47] Mr. Leslie responded to the other criticisms levied in the various articles.[48] As part of his response, he pointed out that the debt related to MIP's investments is non-recourse, and there is no cross-collateral among the funds.[49] In other words, according to Mr. Leslie, "regardless of the fortunes of the Macquarie Group, MIP stands alone."[50]

28 In the end, the criticisms of Macquarie do not extend to the other half of the Investor Consortium: the three, well-funded Canadian pension funds. These are obviously sophisticated investment management firms or entities that enter into this investment knowingly and consciously. Each of these investors testified they are committed to being "responsible stewards" with regard to their investments in PSE, and they have high regard with how they have been treated by Macquarie in past transactions, including the fees they

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[45] *E.g.,* Exh. Nos. 239, 254, 255 and 417.
[46] Exh. No. 68 and Leslie, TR. 831:12-18. Nonetheless, just last week, Moody's affirmed the Macquarie Group's credit ratings, with a "stable" outlook, and Standard & Poor's affirmed its ratings, but with a "negative" outlook, based on the current financial market turmoil. *Exh. Nos. 514-516.,*
[47] Leslie, TR. 849:14 - 850:9.
[48] Leslie, Exh. No. 41, TR. 836:14 - 843:13.
[49] Leslie, TR. 847:22 - 848:14.
[50] Leslie, TR. 848:1-2.

pay for services rendered by Macquarie-related entities.[51] They are focused on the long term, and have large and growing pools of capital.[52]

29 In sum, the record establishes that Puget Holdings is owned by an Investor Consortium that is a responsible, competent group with a demonstrated ability to own a regulated utility such as PSE. Nonetheless, as we discuss next, the Commitments in the Settlement Stipulation provide ample protections to the Commission and ratepayers to assure this is also PSE's experience.

IV. THE SETTLEMENT STIPULATION SATISFIES THE COMMISSION'S "NO HARM" STANDARD

30 From Staff's perspective, the Settlement Stipulation accomplishes three important goals. First and foremost, it protects PSE, the Commission and the ratepayers from any risks imposed by the transaction. Second, it does not change in any material way the manner in which the Commission currently regulates PSE, while at the same time it fully retains the Commission's discretion to regulate in the public interest in the future. Finally, it retains transparency in the management and governance of PSE.

31 As the Commission will recall, Staff opposed the Joint Applicants' initial proposal because it did not contain sufficient protections for PSE, primarily from the use of significant levels of debt ("leverage") at the PE level, and the creation of a sizeable amount of goodwill on PE's books.[53] This concern was echoed by witnesses for Public Counsel and ICNU.[54] This led to Staff's testimony that under the transaction as filed, there was insufficient protection to PSE from an adverse credit situation at PE, such as a bond rating

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[51] Mr. Webb for bcIMC, Exh. No. 141T at 7:3 - 14:3; Mr. Wiseman for CPP, Exh. No. 151T at 8:1 - 17:15, and Mr. McKenzie for AIMCo, Exh. No. 91T at 6:5 - 14:6.
[52] *Id.* and Leslie, TR. 465:2-13.
[53] Schmidt, Exh. No. 191T at 6:8 - 8:7; Horton, Exh. No. 181HCT at 7:1 - 9:17 and at 14:1 - 16:4.
[54] Hill, Exh. No. 251HCT at 9:3 - 10:6; Gorman, Exh. No. 221T at 10:5 - 17:4.

downgrade of PE and PSE occasioned by a write-down of the "goodwill" PE will record on its books at the close of the transaction, or the leverage at PE, or for some other reason.[55] Staff's experts also believed that although the Macquarie group of companies currently enjoys a strong, positive reputation, this could be reversed, and there were inadequate provisions to protect PSE from potential harm.[56] This reversal could be caused, for example, by the impact of increased gasoline prices and potentially volatile interest rates on the productivity of assets in several of the funds Macquarie manages.[57]

32 However, after negotiations, the settling parties developed additional, stronger ring fencing and other measures, which are now contained in the Settlement Stipulation to protect PSE from these potential adverse impacts. The result: PSE's risk profile will be no greater if the transaction is consummated, compared to the *status quo.*

A. The Ring Fencing Provisions in the Settlement Stipulation Protect PSE, the Commission and the Ratepayers From Incremental Risks Imposed by the Transaction – Commitments 8, 9, 10, 16, 20, 24, 25, 26, 35, 36, 37, 38, 39 and 40

33 The key test in the Commission's evaluation of any transaction of this type is whether there are any new risks associated with the transaction. If so, the issue becomes whether the "ring fencing"[58] provisions of the transaction mitigate those risks such that, overall, the Commission's "no harm" to ratepayers standard is satisfied. The Settlement Stipulation passes this test.

34 The ring fencing provisions in the Settlement Stipulation consist primarily of the following Commitments:

Commitments 8 and 25: Non-consolidation opinion

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[55] Elgin, Exh. No. 161HCT at 29:6 - 30:23; Horton, Exh. No. 181HCT at 14:1 to 16:4.
[56] Schmidt, Exh. No. 191T at 20:1 - 23:17; Horton, Exh. No. 181HCT at 10:19 - 12:21.
[57] Schmidt, Exh. No. 191T at 23:6-17; Horton, Exh. No. 181HCT at 12:16-21.
[58] "Ring fencing" refers to provisions that isolate the risks of the regulated utility from the risks "upstream" in the corporate ownership chain. *Elgin, Exh. No. 161HCT at 33:14-15.*

Commitments 9, 24 & 26:	PSE will maintain separate books and records, and will hold PSE customers harmless from the business and financial risks of PE and Puget Holdings, and other affiliates. PSE's rate of return will not reflect adverse consequences of un-regulated activities; PSE will not advocate for a higher cost of debt or equity than the cost assuming the transaction had not occurred
Commitment 10:	PSE will maintain separate debt and preferred stock, and separate credit ratings
Commitment 16:	The "golden share." One PSE director will be independent and will have authority to veto any decision to include PSE in a bankruptcy
Commitment 20:	No cross-subsidization by PSE customers of unregulated activities
Commitments 35 &36:	PSE will have at least a 44 percent equity ratio (or a lower equity ratio established by the Commission for ratemaking) and PSE will not make a distribution to the extent that would lower the equity ratio below that level
Commitment 37:	PE will not make a distribution unless it has a 2.00 to 1.00 ratio of consolidated EBITDA to consolidated interest expense for the four prior quarters
Commitment 38:	"Equico" is created to provide further protection from business and financing risks of the parent companies above PE[59]
Commitment 39:	PSE will retain separate credit ratings and will make reasonable efforts to retain a ratings separation
Commitment 40:	PSE will retain earnings under the prescribed conditions to assure its financial ratios do not deteriorate

35 In addition, under Commitment 21, PSE will not recover the acquisition premium through rates, nor will PSE recover through rates any of the legal and advisory fees for the transaction, including the advisory fees paid to the Macquarie Group.[60] Shareholders will

[59] Joint Rebuttal Testimony, Exh. No. 304CT at 11:8 - 12:7.
[60] *See* Exh. No. 411, PSE Response to Bench Request 11.

also bear the cost of all officer and director compensation that would not have been paid, but for the transaction.[61]

36 As we explain in detail below, the ring fencing provisions proposed in this case are well-designed to protect PSE, the Commission and the ratepayers from financial distress at any of PSE's parent companies. These Commitments, taken together with the other Commitments in the Settlement Stipulation, allow the transaction to satisfy the Commission's "no harm" standard.

1. Properly constructed, ring fencing provisions isolate the utility from the risks of its parents and affiliates, including the risk of additional leverage at PE

37 The proposed transaction substantially increases the debt on PE's books, and adds a substantial amount of goodwill, each of which increases risk to PE.[62] The issue is whether the ring fencing provisions contained in the Settlement Stipulation adequately protect PSE from this risk.

38 This is not the first time the Commission has analyzed whether ring fencing provisions can protect against the risk of leverage, or other risks at the parent level. In the Commission's order in the 2006 PacifiCorp rate case, the Commission determined that the ring fencing provisions the Commission prescribed in the PacifiCorp/MEHC acquisition successfully protect the utility and its customers from such risks:

> Both Staff and Public Counsel acknowledge the point [that increased leverage at the parent level increases risk]. In fact, to protect Washington customers from such risks, both parties advocated for and secured strong ring fencing provisions in our acquisition docket [Docket UE-051090]. The ring fencing provisions required by our final order in Docket UE-051090 insulate PacifiCorp and its customers from risks and financial distress at the MEHC level. … Staff describes the ring fencing

[61] Exh. No. 412, PSE First Supplemental and Revised Response to Bench Request 12 at 2-5, last sentence of the first ¶ of each listed Item 1-5.
[62] Schmidt, Exh. No. 191T at 6:8 - 8:7; Horton, Exh. No. 181HCT at 7:1 - 9:17 and 14:1 - 16:4; Hill, Exh. No. 251HCT at 9:3 - 10:6; Gorman, Exh. No. 221T at 10:5 - 17:4.

provisions as "state of the art." ... **The risks and costs of activities at the parent level are born [sic] exclusively by shareholders – because customers are insulated from them by the ring fence** ...[63]

39 The ring fencing measures in the Settlement Stipulation in the instant case that protect PSE are similar to the ring fencing provisions prescribed by the Commission in the PacifiCorp/MEHC docket, and other similar transactions that have earned Commission approval.[64] Public Counsel supported Commission approval of each and every one of these prior transactions.[65]

40 Indeed, there does not seem to be any disputing that the Commitments contained in the Settlement Stipulation are as good as or better than those typically included in Commission-approved transactions of this type. One panelist testified that the ring fencing provisions "provide not only sufficient but really extraordinary protection that the current stand-alone model does not have."[66] Another panelist noted that "this is by far the tightest ring fencing that we have ever employed in one of [Macquarie's] transactions."[67] [68]

41 Furthermore, as we mentioned earlier, Public Counsel's witness candidly conceded that the ring fencing conditions typically approved by the Commission in a transaction such

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[63] *Wash. Utilities & Transp. Comm'n v. PacifiCorp, d/b/a Pacific Power & Light Co.*, Docket UE-050684, Order 04 (April 17, 2006) at 103-104, ¶¶ 283-285 (emphasis added). This refutes Public Counsel's position, first articulated in the instant case, that ring fencing will not work.

[64] Panel Testimony, TR. 539:24 - 540:7 (Kupchak).

[65] *See* the orders listed in footnote 9 above.

[66] Markell, TR.539:5-9.

[67] Panel Testimony, TR. 540:8-12 (Kupchak).

[68] This is further confirmed by a review of the terms of Macquarie's acquisition of Duquesne Light Company, which was recently approved by the Pennsylvania Public Utility Commission in *In re Application of Duquesne Light Co.*, Docket A-11050F0035, Order (April 24, 2007). For example, that transaction (approved in July 2007) did not require a non-consolidation opinion, and the minimum equity ratio is 40 percent. The Settlement Stipulation in the instant case requires the joint Applicants to obtain a non-consolidation opinion, and that PSE maintain a 44 percent equity ratio, unless the Commission uses a lower figure for ratemaking. *Exh. No. 301, Appendix A, Commitments 8 & 35.* The Pennsylvania PUC's order is found at www.puc.state.pa.us/PcDocs/663378.doc. In that order, the PUC adopted the ALJ's Initial Decision (dated March, 2007). The Initial Decision and the Joint Petition for Settlement is found at www.puc.state.pa.us/PcDocs/659489.doc. The 40 percent equity ratio commitment is found in ¶ III.E.8 of the "Joint Petition for Settlement," which is appended to the Initial Decision.

as this are "the best I had seen."[69] Indeed, it is revealing that when Chairman Sidran gave Mr. Hill the opportunity to suggest any additional ring fencing measures he wished, he could not come up with a single one.[70] Instead, he offered Public Counsel's position that the ring fencing provisions will not work: "You can't protect yourself ultimately from a financial -- serious financial disaster."[71]

42 With all due respect to Public Counsel, this is not particularly helpful to the Commission or the public. First, Public Counsel cannot point to any prior transaction approved by the Commission where the Commission assumed a violation of the ring fencing requirements. Moreover, as we explained earlier, Public Counsel's argument proves too much. For example, if one assumed a severe breakdown in all financial markets, no transaction likely could satisfy the Commission's "no harm" standard, including the many transactions Public Counsel has urged the Commission to approve.[72] Of course, nothing in the *status quo* would protect PSE from the potential harm in that scenario either, but Public Counsel neglects to acknowledge that fact, let alone address it.

43 In any event, as we explain below, Public Counsel's newly-conceived policy recommendation is also ill-conceived, because the carefully crafted ring fencing provisions proposed in this case are effective and enforceable to protect PSE and its ratepayers.

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[69] Hill, TR. 1036:20-23.
[70] TR. 1036, beginning on line 17. Mr. Hill's only suggestion was a $500 million additional equity contribution from the Investor Consortium, but that is not a ring fencing measure.
[71] Hill, TR. 1037:2-4.
[72] *See* footnote 9 above for the list of mergers and acquisitions since 1997, which Public Counsel has urged Commission to approve.

2. The ring fencing provisions in this case are properly constructed because within the ring fence, the transaction maintains or improves PSE's risk profile, compared to the *status quo*

44 The risk analysis under the Commission's "no harm" standard is not as simple as placing the risks and benefits inherent in the *status quo* in one column, and the risks and benefits under the proposed transaction scenario in another column, and comparing the totals. Instead, expert judgment is required, particularly in this case, which involves international financial markets.

45 Staff retained experts to assist the Commission on this crucial issue. Staff expert Mr. Horton was instrumental in the development and evaluation of the Commitments contained in the Settlement Stipulation. Based on his analysis, Mr. Horton provided his expert judgment that under those Commitments, "PSE's risk profile after consummation of the Proposed Transaction is no greater than the 'status quo.'"[73] [74]

46 Mr. Horton is uniquely qualified to make this assessment. For example, over his 33-year career, Mr. Horton has evaluated and advised on numerous merger and acquisition transactions, and a wide range of other transactions, from a pollution control financing for Honda Motor Company in the United States to international financings and foreign currency transactions.[75] Moreover, Mr. Horton's assessment of the risks in this transaction is independently confirmed by confidential Exhibit 305C,[76] which contains a conclusion that the conditions in the Settlement Stipulation reduce the risk to PSE compared to the *status quo*.

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[73] Joint Rebuttal Testimony, Exh. No. 304HCT at 23:20 - 24:1 (Horton separate statement).
[74] ICNU, which raised many of the same issues in its direct case as Staff, also testified that the Settlement Stipulation satisfied its concerns. *Joint Testimony, Exh. No. 302T at 43:2-5 (ICNU separate statement - Early).*
[75] Horton, Exh. No. 182. The Honda matter is listed on page 7; examples of the foreign currency and other foreign transactions can be found on pages 6 & 7.
[76] This confidential Exhibit is discussed in the Joint Rebuttal Testimony, Exh. No. 304CT at 4:5-10 and at 6:1 - 7:8.

47 As Exhibit 305C shows, and as explained in the Joint Rebuttal Testimony and related exhibits, the ring fencing provisions and other Commitments in the Settlement Stipulation are expected to improve PSE's credit quality.[77] Moreover, under Commitment 39, if, in the future, PSE is unable to achieve credit ratings separation from PE, the Joint Applicants commit to explaining the issue to the Commission, and the parties will have an opportunity to propose additional conditions to achieve such a separation.[78]

48 Therefore, while Mr. Hill is technically correct when he told the Commission that PSE's credit rating is "in question," that is only because, as a result of the new commitments and ring fence provisions, PSE's credit quality is expected to improve under the transaction, not deteriorate, as Mr. Hill opines. This confirms that the transaction satisfies the Commission's "no harm" standard because PSE's risk profile is not made worse by the transaction, and in fact, it very likely will improve.

3. The ring fencing provisions are enforceable to protect PSE

49 The record also establishes that the economic and other incentives created by this transaction would most assuredly cause the ring fencing provisions to function according to their terms. But even if these incentives fail to carry the day, the features of the Settlement Stipulation, coupled with applicable statutes, clearly demonstrate that the ring fencing commitments are enforceable, and therefore they will work. By contrast, Public Counsel cannot demonstrate that the ring fencing provisions of the Settlement Stipulation are inadequate. Therefore, it is not surprising that Public Counsel failed to explain why such protections will not work.

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[77] Joint Rebuttal Testimony, Exh. No. 304CT at 5:7-8 and at 5:20 - 7:8, and Exh. No. 305C. *See also* the confidential testimony of Mr. Kupchak at TR. 922:18 - 923:2.
[78] *See also* TR.504:9 - 505:19 (statement of counsel and panel testimony of Mr. Early).

50 Three very strong incentives will surely make the ring fencing provisions operate according to their terms. First, the ring fencing provisions are binding on Puget Holdings,[79] and Puget Holdings is owned by the Investor Consortium.[80] The Commission can reasonably assume the Investor Consortium will assure that Puget Holdings meets its commitments; there is certainly no example in the record which justifies a different assumption.

51 Second, the Investor Consortium has a very strong economic incentive to assure the ring fencing provisions work. The Investor Consortium is putting up $3.4 billion in equity to buy PSE,[81] which is "a far greater commitment to the business than any investor in the public markets today."[82] The Investor Consortium is also issuing $1.2 billion in bank debt,[83] and assuming $2.6 billion of existing debt.[84] This very substantial commitment of capital provides the Investor Consortium a very strong incentive to act in its economic self-interest to preserve its interest in PSE by resolving the financial problem that may be presented: "Put simply, the magnitude of the investment in PSE provides an enormous and undeniable incentive for the Investor Consortium to support PSE in any and all future challenges the utility may face."[85] As Mr. Leslie separately put it: "It is unthinkable that this level of investment would not attract anything but the highest level of attention in the event of unforeseen problems at PSE."[86]

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[79] Commitment 33.
[80] Leslie, Exh. No. 31T at 5:15 – 6:8.
[81] Joint Rebuttal Testimony, Exh. No. 304CT at 3:24-25.
[82] Leslie, TR. 465:21-25.
[83] Joint Rebuttal Testimony, Exh. No. 304CT at 16:18-20.
[84] Leslie, Exh. No. 31T at 19:10.
[85] Joint Rebuttal Testimony, Exh. No. 304CT at 21:15-17.
[86] Leslie, TR. 465:25 - 466:3.

52 Even Public Counsel agrees with this reality-based incentive: "it very well may be that in the case of an extreme event, [PE is] not able to pay [its] debt costs, then money would be coming in from Australia and Canada to pull them out. That could happen."[87]

53 Finally, the Investor Consortium has a strong incentive to make the ring fencing provisions work because it has a reputation to uphold. As Staff witness Dr. Schmidt observed, Macquarie in particular currently enjoys a strong reputation in the world's financial markets, and this reputation is important to Macquarie's continued ability to access those markets to obtain "materially lower debt rates" than otherwise.[88] Obviously, Macquarie has a strong incentive to maintain that reputation by making sure this deal works.

54 But even if these strong, if not compelling, incentives somehow fail to motivate the Investor Consortium to act in its self-interest and assure the Commitments are obeyed, the law will assure such compliance. First, PSE and Puget Holdings are bound by the Commitments and they explicitly understand that includes enforcement. This is confirmed by Commitment 33, in which they explicitly agree the Commitments are binding on them, and by Commitment 31, where they expressly acknowledge they "understand that the Commission has authority to enforce these Commitments in accordance with their terms."

55 Second, to make Commission enforcement easier, under Commitment 32, PSE agrees to file a report each year that addresses compliance with each provision of the Settlement Stipulation.

56 Finally, if Puget Holdings violates a Commission-approved Commitment, it violates a Commission order, and the courts have broad authority to enforce that order. For example, RCW 34.05.578 provides that in enforcing an agency order, the court is given broad

[87] Hill, TR. 1034:10-14.
[88] Schmidt, Exh. No. 191 at 20:9 - 21:6.

authority to provide "declaratory relief, temporary relief or permanent injunctive relief, and other civil remedy provided by law, or any combination of the foregoing."[89]

57 In short, if the Investor Consortium's strong financial incentives do not work to achieve compliance, a legal enforcement action will. Next, we provide examples that explain how the ring fencing works, including enforcement.

4. Two examples show how the ring fencing provisions will protect PSE in adverse financial circumstances

58 Example 1 assumes a financial problem at the PE or the Investor Consortium level. Example 2 assumes a financial problem at PSE. An analysis of these examples demonstrates the care taken by the settling parties to fashion ring fencing provisions to protect PSE, and to make those provisions enforceable in the event of severely adverse financial conditions. At the end of the day, Public Counsel's proclamation that these carefully-crafted ring fencing provisions will not work is nothing more than conjecture that is refuted by the facts and the law.

a. Example 1: Severe financial problems at PE or the Investor Consortium

59 Example 1 assumes a severe financial situation under which PE and/or the Investor Consortium cannot or will not provide needed equity to PSE. For example, the Commission could assume the extreme case where PE has written down the "goodwill" on its balance sheet and faces a short-term problem in acquiring sufficient capital to invest needed equity in PSE. Or, the Commission could assume the extreme case in which problems at the Investor Consortium level result in similar difficulties raising the capital necessary to fund

[89] Moreover, RCW 80.04.387 establishes a monetary penalty against any corporation other than a public service company (*e.g.*, Puget Holdings) that violates a Commission order, and RCW 80.04.390 establishes a criminal penalty (gross misdemeanor) for any person who, "acting individually, or acting as an officer or agent of a corporation other than a public service company" who violates a Commission order.

PSE's capital needs. While both of these situations are unlikely to occur, the analysis demonstrates that the ring fencing contained in the Settlement Stipulation will protect PSE and its ratepayers, if, for some unforeseen reason, these circumstances materialize.[90]

60 First, if the financial problem is at the PE level, Commitment 37 requires PE to have an EBITDA to interest ratio of 2.00 to 1.00 before it may make a distribution "upstream." This assures that PE will be retaining capital to assist it in addressing that financial situation.

61 Second, if, for whatever reason, PE fails to provide PSE the equity capital PSE needs to serve the public, this would likely result in a violation of various Commitments, including the obligation to maintain a 44 percent minimum equity ratio at PSE, which is found in Commitment 35. As we discussed earlier, the parties to this transaction have every incentive to assure that all of the Commitments are satisfied, including Commitment 35. However, we will assume in Example 1 that these incentives are insufficient to result in compliance.

62 Note that Commitment 35 also provides that Puget Holdings can issue common equity to third parties, "including public markets." Puget Holdings could issue that common equity to the public for PSE's benefit. In the extreme case, the Commission can enforce the minimum equity provisions of Commitment 35 by obtaining a court order requiring Puget Holdings to comply. Because RCW 34.05.578 allows the court to employ "any civil remedy provided by law," the court could order Puget Holdings to issue common equity to the public for purposes of compliance, and protect PSE and its customers.

63 Obviously, the mere prospect of such an equity issuance would give the Investor Consortium yet another, even more compelling, incentive to assure compliance with

[90] *See,* Exh. No. 302T at 37:17 – 43:1 (Commission Staff testimony regarding how the Commitments protect PSE and its customers from risk of the proposed ownership structure).

Commitment 35, because such a stock sale would dilute their ownership shares. But even if this powerful, additional economic incentive is insufficient to achieve compliance, judicial enforcement will be sufficient.

64 Moreover, if enforcement of the equity ratio obligation in Commitment 35 is delayed, Commitment 35 also assures that PSE retains the ability to issue "hybrid" securities to help fund its capital needs, if necessary, in the interim. While these securities are considered debt on PSE's books,[91] they are considered 50 percent equity by credit rating agencies,[92] so this would help PSE to maintain its credit rating during a time of severe financial crisis.[93]

65 The ring fencing commitments also protect ratepayers during the course of the assumed, serious financial situation with PE or the Investor Consortium. First, under Commitment 9(iii), PSE agrees to hold ratepayers "harmless from any business and financial risk exposures associated with Puget Energy, Puget Holdings or its affiliates." Thus, even if PSE's credit may suffer temporarily under the circumstances in Example 1, the Commission retains the discretion to assure that the ratepayers are not adversely affected.

66 For example, the Commission can enforce Commitment 9(iii) in a rate case by disallowing any rate increase to the extent it is occasioned by problems caused by business and financial risk exposure of any company above PSE in the ownership chain. The Commission's job is made easier by Commitment 24, under which PSE and Puget Holdings commit not to advocate for a higher cost of capital for PSE than if the transaction had not

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[91] Exh. No. 231 at 3:7.
[92] Pettit, TR. 637:1-23 and Markell, Exh. No. 76C at 6, footnote 1.
[93] Public Counsel sought to discount these clear and effective tools to protect PSE (*i.e.*, the ability of Puget Holdings to issue equity to the public and the ability of PSE to issue hybrid securities). *Hill, Exh. No. 261HCT at 13:3 - 14:15).* In fact, these are significant protections for PSE in the case of adverse financial conditions.

occurred.[94] The burden will be on PSE to demonstrate that ratepayers do not pay higher costs of capital in the event of a severe financial event affecting the new owners. Even further reinforcement comes from Commitment 26(a), which requires the fair return for PSE to be determined "without regard to any adverse consequences that are demonstrated to be attributable to the non-regulated activities" of PSE or Puget Holdings.

67 There appears to be no disputing that these Commitments will be effective to protect ratepayers. For example, even if Mr. Hill is correct in his belief that PE's cost of capital will be higher after the transaction is consummated than under the *status quo*, he properly conceded that the Commitments protect ratepayers because the Commission has "the ability to prevent that capital cost from reaching ratepayers."[95]

68 Finally, in the worst case scenario, should PE go bankrupt, the ring fencing provisions will be sufficient to prevent PSE's assets from being available to creditors in the event a parent company of PSE goes bankrupt.[96] Commitments 8 and 25 require PSE to obtain a non-consolidation opinion, based on the structure of this transaction. PSE will bring additional ring fencing provisions before the Commission for approval if such

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[94] This is a commonly-used provision in a transaction such as this. *E.g., ScottishPower Acquisition of PacifiCorp,* Docket UE-981627, Fifth Supplemental Order, Attachment A, "Stipulation" at 3, ¶ 7: "If, however, the cost of capital of electric operations of PacifiCorp increases as a direct result of the merger, ScottishPower shareholders will bear that cost;" *MEHC Acquisition of PacifiCorp,* Docket UE-051090, Order 07 (February 22, 2006), Appendix A, "Consolidated List of Commitments" at 5, ¶ 21: "MEHC and PacifiCorp will not advocate for a higher cost of capital as compared to what PacifiCorp's cost of capital would have been, using Commission standards, absent MEHC's ownership;" *Cascade Natural Gas/MDU Merger,* Docket UG-061721, Order 06 (June 27, 2007), Appendix A to the Stipulation at 7, ¶ 17: "Cascade will not advocate for a higher cost of debt or equity capital as compared to what Cascade's cost of debt or equity capital would have been, absent MDU Resources' ownership."

[95] Hill, TR. 1028:24 - 1029:1. Nonetheless, a question arose regarding how this Commitment would be implemented. For example, Staff observed that if a rating agency down-graded PSE's credit rating, and gave three reasons, one of which was the new ownership structure, that may present difficulties in implementing this Commitment. *Elgin, Exh. No. 161HCT at 36:22 - 37:13.* (Note: this Commitment was numbered "Commitment 25" when Staff filed this testimony). However, as the panel (including Staff) explained at hearing, the facts would have to be litigated and the Commission would make a decision. Moreover, although this problem could arise from any of the transactions the Commission has approved, the plan is to use comparable companies in the determination of cost of capital, and this will tend to finesse the problem. *Panel Testimony, TR. 477:7 - 478:7 (Markell) and TR. 479:10 - 481:3 (Elgin).*

[96] Elgin, Exh. No. 161HCT at 33:1 - 34:8.

additional provisions are necessary to obtain that opinion. The legal analysis in the opinion provides a separate business and legal test that will confirm that the ring fencing provisions in the Settlement Stipulation separate the operations of PSE from its parent companies sufficiently to prevent asset consolidation.

69 In sum, the well-crafted ring fencing provisions in the Settlement Stipulation will work to protect PSE, the Commission and the ratepayers. If the inherent, compelling business incentives for compliance do not achieve compliance, legal enforcement will.

b. Example 2: Severe financial problems at PSE

70 Example 2 assumes a financial problem at PSE, such as an event that threatens to deplete PSE's equity base, or some other unanticipated event that causes PSE's financial indicators to erode. Like Example 1, this example also presents a ring fencing issue because, although the assumed financial problem is at the PSE level and would not necessarily be caused by the ownership structure *per se*, the ring fencing provisions still work to prevent the new owners from extracting excessive amounts from PSE while the problem is ongoing. In other words, the Commitments will work to preserve PSE's financial integrity in this situation.

71 First, under Commitment 35, PSE will have an equity ratio of not less than 50 percent at the time the transaction closes. At that time, PSE's equity ratio is expected to increase from 43.7 percent to a robust 50.4 percent, based on the impacts the transaction will have on the capital on PSE's books.[97] This equity level will provide PSE a stronger ability to withstand a financial problem than under the *status quo*.

[97] Exh. No. 306 at 1, last column of the table, Common Equity" line, and Joint Rebuttal Testimony, Exh. No. 304CT at 5:14.

72 Perhaps more importantly, Commitment 35 further assures that "at all times," PSE will have an equity ratio of at least 44 percent (or a lesser percent equity ratio if the Commission uses a lower figure for ratemaking). Commitment 36 works to reinforce this Commitment by requiring PSE to make no distribution to a parent company that will leave PSE's equity ratio below that threshold.

73 These Commitments substantially protect PSE and its ratepayers from a financial problem at PSE, as well as a financial problem "upstream" in the ownership structure, because they assure PSE, the Commission and the ratepayers that at all times, PSE will have sufficient equity capital on its balance sheet, and that PSE's equity ratio will not deteriorate below that sufficient level.[98] This is a substantial improvement over the *status quo*, in which PSE is subject to events that could cause its equity ratio to deteriorate substantially.[99]

74 For confirmation, the Commission needs to look no further than Public Counsel's response testimony. There, Mr. Hill explains in detail how PSE's equity ratio deteriorated so significantly during the Energy Crisis of 2001, the Commission was called upon to approve an extraordinary equity rebuilding program. As part of the program, PSE cut its dividend to shareholders, and according to Mr. Hill, "rates were higher than they would have been based on PSE's actual equity ratio, which had fallen to unbalanced, low levels ..."[100]

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[98] Joint Rebuttal Testimony, Exh. No. 304CT at 9:2-18.

[99] Another benefit of the transaction is Commitment 34, under which the Joint Applicants will provide $100 million in rate credits to PSE ratepayers over a 10-year period, *i.e.*, $10 million per year. A small portion of these credits ($1.2 million per year) can be offset to the extent PSE can demonstrate that it has saved that much by having its stock de-listed from the New York Stock Exchange. The large majority of these credits ($8.8 million) are not off-settable. These rate credits are not available under the *status quo*. Consequently, this is a clear ratepayer benefit from the transaction. However, once again, Public Counsel tries to devalue this Commitment by characterizing it as a "modest" proposal. *Hill, Exh. No. 261HCT at 3:15-16.* In fact, the money associated with this Commitment comes directly from the Investor Consortium via a reduction in its earned return. Moreover, these rate credits "exceed, in both quantity and duration, any non-offsettable rate credits previously offered in any precedent transaction before this Commission involving an electric or natural gas utility." *Joint Rebuttal Testimony, Exh. No. 304CT at 19:6-8.*

[100] Hill, Exh. No. 251HCT at 9:8-18.

75 Had Commitments 35 and 36 been in effect during this period, ratepayers would have benefitted because PSE would have maintained a balanced capital structure containing at least 44 percent equity, rendering this "rebuilding" unnecessary.[101] Therefore, Public Counsel's own example from the Energy Crisis of 2001 refutes its unsupported claim that these equity ratio Commitments provide no benefits and do "not protect the public interest."[102]

76 If PSE maintains at least a 44 percent equity ratio but still finds its credit rating downgraded below investment grade, and its EBITDA to interest expense ratio falls below 3.00 to 1.00 over the prior four quarters, PSE will make no distribution to PE or any other affiliate.[103] In other words, PSE will retain all of its earnings to address the financial problem. This is yet another result more favorable than the *status quo,* because in essence, Commitment 40 calls for an automatic curtailment of the dividend until PSE's financial condition improves. Even in 2001, PSE's did not halt its dividend.[104]

77 If PSE meets the EBITDA to interest ratio in Commitment 40(a), but is rated below investment grade, Commitment 40 allows PSE to make a partial level of distribution to PE, but prevents that distribution to go beyond Equico (*i.e.,* to provide a return to the owners) without Commission approval, unless and until PSE's credit rating returns to investment grade.

78 These ring fencing protections substantially protect PSE and restrict returns to the Investor Consortium should PSE find itself in a financial crisis. Again, these ring fencing

[101] Joint Rebuttal Testimony, Exh. No. 304CT at 13:11 - 15:4.
[102] Hill, Exh. No. 261HCT at 10:18 - 11:5.
[103] Commitment 40,
[104] Hill, Exh. No. 251HCT at 9, footnote 3.

provisions are designed to protect PSE from the risks accepted by the new owners and they are enforceable by the Commission, as we discussed earlier in Example 1.

B. The Settlement Stipulation Maintains the Way the Commission Currently Regulates PSE, While Retaining Commission Discretion

79 To help assure that a transaction passes the "no harm" test, *e.g.*, that the utility's risk profile after the transaction is no worse than before the transaction, it is typical to have transaction conditions that formally reassure the Commission and the public that the utility is not changing in ways that will cause harm. This case is no exception. As one panel witness put it, the Settlement Stipulation reflects "no intent to change the way the Commission regulates the business" of PSE.[105]

80 Indeed, a core principle of the Settlement Stipulation is to ensure the Commission will continue to exercise it discretion to determine what policies will prevail, consistent with the Commission's obligation to regulate in the public interest. This core principle is expressed in Commitment 33, in which the Joint Applicants acknowledge that the Commitments are "binding only upon [Puget Holdings and PSE] (and their affiliates where noted)." Thus, the Commission retains its discretion to implement changes when appropriate.

1. Regulatory statutes that applied before the transaction is consummated will apply afterward – Commitments 3, 4, 20(c), 27(c) and 46

81 Several Commitments reflect the fact that PSE will remain a public service company subject to the same laws and rules after the transaction is consummated as before. Under Commitment 27(c), the Joint Applicants commit that the Proposed Transaction has no effect on the Commission's existing right to access PSE's books and records, or the books and records of Puget Holdings, to the extent those records pertain to affiliated interest

[105] Panel Testimony, TR. 489:17 - 490:25 (Kupchak).

transactions. Other Commitments assure that PSE and Puget Holdings will still comply with all applicable provisions of Title 80;[106] PSE will continue to meet all applicable FERC reporting requirements;[107] and PSE will abide by the state's statutory Renewable Portfolio Standard and acquire all renewable energy resources as required by law.[108]

2. All Commission orders will remain in effect, but the Commission retains discretion to change those orders – Commitments 29, 33, and 51

82 Commitment 29 confirms that all existing Commission orders applicable to PSE "will remain in effect."[109] However, as we discussed above, Commitment 33 assures that the Commission retains the discretion to change any such order using appropriate procedures. Similarly, while under Commitment 51, PSE will maintain its participation in national and regional forums on electricity issues, this Commitment does not bind the Commission or any other party to agree with PSE's position on these issues, or to implement them.

3. PSE will maintain its current business practices, but the Commission retains full discretion to address them – Commitments 1, 5, 6, 12-15, 17, 18, 22, 23, 49, 51, 52 and 53

83 PSE also commits to maintain its current business practices. However, per Commitment 33, the Commission's discretion to address these practices is not affected:

Commitment 1: PSE will maintain service quality measures

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[106] Commitment 20(c). As noted in Exh. No. 420, PSE Response to Bench Request 20, virtually all of the provisions of RCW Title 80 apply to PSE, and not PE. However, PE is subject to provisions of RCW Title 80 relating to enforcement (RCW 80.04.387 and .390), affiliated interests (when PE qualifies as an affiliate of PSE; RCW 80.16), and securities (RCW 80.08.120).

[107] Commitment 46.

[108] Commitments 3 & 4.

[109] The sole exception is the Commission's final order in *In re Application of Puget Sound Energy, Inc.*, Docket UE-991779 (August 15, 2000), in which the Commission authorized the current holding company structure. Obviously, if the Commission approves the Joint Application, a different corporate structure will result. The order in Docket UE-991779 needs to be superseded to be consistent with such approval.

Commitments 5& 6:	PSE will maintain energy efficiency policies and its Greenhouse Gas and Carbon policy set forth in its current Integrated Resource Plan (IRP)
Commitment 12:	PSE will maintain existing labor contracts
Commitment 13:	PSE will maintain existing pension policies (so long as consistent with sound actuarial practices)
Commitment 14:	PSE will maintain sufficient staffing and community presence to maintain safe, reliable and cost-effective service
Commitment 15:	PSE will maintain current management, subject to PSE's ability to retain personnel best able to meet PSE's needs over time
Commitment 17:	PSE will maintain its headquarters within its service territory
Commitment 18:	PSE will maintain PSE's existing level of contributions and community support
Commitments 22&23:	PSE will maintain existing low income programs and continue to work with low income agencies
Commitment 49:	PSE will continue to acquire renewable resources consistent with PSE's IRP and its current internal objectives
Commitment 51:	PSE will continue to offer the investment cost recovery incenting in RCW 82.16.020 and promote net metering
Commitment 52:	PSE will continue to actively participate in national and regional forums on issues of importance
Commitment 53:	PSE will continue to publish an annual greenhouse gas emissions inventory report

84 Though redundant to the impact of Commitment 33, some of the above Commitments expressly acknowledge the fact that the Commission may change the *status quo* identified in those particular Commitments. For example, Commitment 1 assures that the Joint Applicants will continue to use the Commission's service quality measures, as currently mandated, but also any other measures or changes in measures as the Commission may order. Likewise, Commitment 22 commits PSE to maintain its existing low income programs, "or as such programs may be modified in any future proceeding."

85 In sum, the foregoing Commitments appropriately reassure the Commission and the public that the *status quo* will be maintained in these important areas, while explicitly preserving the Commission's role as the ultimate decision-maker on the appropriateness of those PSE policies and practices, including the extent to which the ratepayers will be called upon to support those policies and practices through rates.

4. Some commitments make modest changes to what PSE does currently, but again, the Commission retains discretion to address those changes – Commitments 22, 42, 47, 48, 50, 54, 55, 60, 61 and 62

86 Finally, some Commitments either add to what PSE does currently, or preserve the *status quo* for a specified, limited period of time, but again, the Commission's full discretion is preserved. In these categories are:

Commitment 42:	PSE will propose and support increasing low income customer bill assistance in the pending general rate case
Commitment 47:	PSE will do a study of energy efficiency improvement prospects for its distribution, transmission and generation assets
Commitment 48:	In the next budget cycle, PSE will support increased funding for the Northwest Energy Efficiency Alliance, and continue to pay PSE's *pro rata* share of such funding
Commitment 50:	PSE will try to increase market penetration of its Green Power Program
Commitment 54:	PSE will file a voluntary carbon offset program for natural gas customers
Commitment 55:	PSE will consider and report on recommendations of the Oregon Public Utility Commission in a pending IRP-related docket in Oregon
Commitment 60:	For five years, PSE will not materially change the structure and method for setting rates in Schedule 449
Commitment 61:	PSE will use a certain methodology for setting Schedule 40 rates in its next general rate case

Commitments 62&63: PSE will not propose electric or gas decoupling for two years

87 Part of Commitment 22 falls within these categories as well; *i.e.,* the part in which the Joint Applicants commit to increase the budgeted funding for low income energy efficiency programs commensurate with increases to such programs for residential customers. This is intended to address the problem that the level of funding of low income energy efficiency programs has remained static compared to the overall residential program.[110]

88 However, if the Commission later decides that this is not a problem that needs to be resolved, the Commission retains discretion to address that in a future proceeding when these budgets are before the Commission, and determines a different amount for recovery through rates.[111] In all events, cost effectiveness remains a key consideration for application of this funding.[112]

89 In other words, while the foregoing Commitments identify the course PSE will take, none of them bind the Commission to that course. Instead, the Commission retains its current regulatory authority to accept these initiatives in whole or in part, or reject them. For example, there was some suggestion on the record that Commitment 42 would mandate an increase in low income customer bill assistance.[113] However, apart from the merits of this idea,[114] Commitment 42 by its terms only commits PSE to pursue the matter. In other words, the Commission retains full discretion to approve, reject or modify this proposal in an appropriate proceeding, including determining where the funding should comes from, if Commission approves the proposal.

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[110] Panel Testimony, TR. 507:5-12 (Eberdt).
[111] Panel Testimony, TR. 509:5-10 (Markell) and TR. 512:24 - 513:2 (Elgin).
[112] Panel Testimony, TR. 514:9-12 (Eberdt).
[113] TR. 517:14-20.
[114] Panel Testimony, TR. 518:2-18 (Markell).

90 In sum, the Commitments described in this section simply preserve PSE practices and policies reflected in the *status quo*, or make modest changes to the *status quo*. Nonetheless, the Commission retains full discretion to decide in a proper proceeding which, if any of these practices and policies will be continued, changed or eliminated, and whether any related costs are recoverable through rates.[115]

C. The Settlement Stipulation Provides Appropriate Transparency and Governance – Commitments 9(ii), 19, 20, 26(b)&(c), 27, 28, 41, 43, 44, 45, 46

91 Several provisions of the Settlement Stipulation provide for appropriate transparency and governance for PSE:[116]

Commitment 9(ii): PSE will not loan or pledge assets to PE or Puget Holdings without Commission approval

Commitments 19&27: PSE will provide the same access to records, board minutes, audit reports, and information provided to credit rating agencies, as required by the Commission in other merger orders. PSE and Puget Holdings will keep records sufficient to provide an audit trail for transactions involving PSE.

Commitments 20&28: For transactions with Puget Holdings, PSE will file a cost allocation manual, propose standards for treatment of affiliated interest transactions, and assure no cross-subsidy by PSE ratepayers of unregulated activities.

Commitment 26(b)&(c): PSE will notify the Commission when it acquires a substantial non-regulated business, or if 10 percent or more of PSE is acquired by any other firm.[117] PSE and Puget Holdings will not use the transaction as a basis to challenge the

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[115] There are two exceptions: First, the Commission does not have discretion to change a statutory requirement. The second exception deals with Commitment 18, which includes the company's practices regarding charitable contributions. The Commission regulates "in the public interest as provided by the public service laws," *RCW 80.01.040(3)*, and the public service laws generally do not include consideration of charitable contributions and similar expenditures. *Jewell v. Wash. Utilities & Transp. Comm'n*, 90 Wn.2d 775, 777, 585 P.2d 1167 (1978) (holding as beyond the Commission's authority the inclusion of charitable contributions in setting rates for a regulated utility: "there is nothing in the statutory scheme which directs that the telephone company must be a good corporate neighbor"). Consequently, to the extent Commitment 18 preserves or enhances PSE's charitable giving, that is not a factor the Commission can consider in determining whether the transaction satisfies the public interest. In any event, Staff did not consider Commitment 18 in its analysis of the transaction under the Commission's "no harm" standard.

[116] *See* Exh. No. 422 for clarification of certain of these requirements.

[117] The 10 percent element is found in Exh. No. 419: PSE Response to Bench Request 19.

Commission's jurisdiction over a future change in control transaction.

Commitment 41: PSE's board will contain at least three directors who reside in the region, one of which will be PSE's CEO; PE's board will contain at least two directors who reside in the region, one of which will be PSE's CEO.

Commitment 43: Though PSE stock will be de-listed from the New York Stock Exchange (NYSE), PSE will abide by the many NYSE's reporting rules listed in the Commitment, to the extent practical. The Commission will decide what is "practical' in a given situation.[118]

Commitment 44: PSE will continue to make the disclosures under Section 13(a) and 13(d) of the SEC rules, plus comply with indenture covenant disclosure requirements.

Commitment 45: PSE and PE will comply with a long list of Sarbanes-Oxley Act provisions.

Commitment 46: PSE will meet FERC requirements for annual and quarterly reports.

92 It bears repeating that if the transaction is consummated, PSE will remain a public service company subject to Commission jurisdiction and regulation. The transaction does not change the statutes and rules with which all public service companies must comply, including PSE. In other words, nothing in the transaction changes the Commission's current authority to regulate PSE.

93 This principle echoes throughout the Settlement Stipulation, including those Commitments under which PSE will continue to file all of the reports it currently files with the Commission. As Mr. Markell assured, the Settlement Stipulation "neither eliminates nor reduces the current reporting and compliance obligations of PSE under Washington law..."[119] Moreover, the Settlement Stipulation prescribes additional solid, meaningful

[118] Panel Testimony, TR. 481:8-18 (Markell).
[119] Markell, Exh. No. 75CT at 27:17 – 28:1.

reporting requirements applicable to PSE's parent, PE, which the Commission does not regulate as a public service company.[120]

94 On balance, then, the foregoing reporting requirements mark a "step forward" compared to existing requirements, not the opposite, as Public Counsel suggests.[121]

95 In the end, however, like many of the Commitments in the Settlement Stipulation, the Commission retains the full authority and discretion under its statutes to acquire relevant information. For example, RCW 80.04.080 empowers the Commission to public service companies such as PSE to file "periodic" or "special" reports "concerning any matter about which the Commission is authorized or required by this [*i.e.,* RCW Title 80] or any other law, to inquire into or keep itself informed about …"

96 The court has recognized that the Commission has "broad authority" under this section.[122] If, in the future, the substantial reporting requirements in the Settlement Stipulation are insufficient, Commission statutes are sufficient to protect PSE and ratepayers.

D. Public Counsel's Opposition to the Transaction is Not Credible Because Public Counsel Either Ignores or Devalues the Clear Protections for PSE Contained in the Settlement Stipulation

97 As we noted at the outset, all parties support the Settlement Stipulation as consistent with the Commission's "no harm" standard (or do not oppose the Settlement Stipulation)[123] except one: Public Counsel. However, Public Counsel's opposition is not credible because it focuses on the operations and risks of the new ownership structure, and essentially ignores the protections for PSE that will be in place to protect against those risks.

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[120] *Id.* at 28:2 – 33:10. Commitment 27(d) also commits Puget Holdings (a company not regulated by the Commission) to provide access to written information provided by and to credit rating agencies.
[121] Joint Rebuttal Testimony, Exh. No. 304CT at 22:1-6.
[122] *Qwest Corp. v. Wash. Utilities & Transp. Comm'n,* 140 Wn. App. 255, 262, 166 P.3d 732 (2007).
[123] Exh. No. 301 at 6, ¶ 11. The Cogeneration Coalition of Washington has stated it will not oppose the Settlement Stipulation. *Id.* at 2, ¶ 2, footnote 2.

98 The foundation for Public Counsel's opposition to this transaction is the policy position that "ultimately," ring fencing will not work.[124] This is a truly surprising argument for Public Counsel to make. Indeed, Public Counsel's argument is misplaced because in any ownership structure, there is no assurance that the firm can protect itself from any and all financial emergencies; PSE's existing ownership structure is no exception. The real issue before the Commission, and the Public Counsel would prefer to avoid, is whether the transaction increases risk to PSE compared to the *status quo.* As we explained earlier, the terms and conditions of the transaction do not result in increased risk to PSE, and those terms and conditions will work to protect PSE from potential risks caused by the new ownership structure, either by the strong economic incentives inherent in this transaction, or by the legal process, if necessary.[125]

99 Without reason, Public Counsel sounds the alarm about increasing difficulties in financial markets. For example, Mr. Hill refers to the current environment of bank closings, inflation and volatile financial markets.[126] Public Counsel offered numerous, often redundant articles into the record on this subject,[127] even after the record was closed.[128] Yet, Public Counsel ignores the fact that, under the *status quo,* PSE is not immune to these impacts. In fact, these very same risks will have an effect on PSE's ability to access capital under the *status quo.*

100 Indeed, as each day passes, the fact that the transaction provides PSE committed lines of credit to fund all of its equity requirements through 2013 appears more and more

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[124] Hill, TR. 1037:2-4.
[125] *Supra* at 18-21, ¶¶ 49-57.
[126] *E.g.,* Hill, Exhibit 261HCT at 17:15-18.
[127] *E.g.,* the cross-examination exhibits of Staff witness Dr. Schmidt, Exh. Nos. 195-200.
[128] Exh. Nos. 500-512. Under Order 05 in this docket, the Commission allowed Public Counsel to do this, though the Commission noted that the record was sufficient on the point. *Order 05 (September 22, 2008) at 3, footnote 8.*

valuable, compared to the *status quo*. In any event, the point here is that when a balanced discussion of these impacts on PSE under the *status quo* compared to the impacts under the transaction is needed, Public Counsel chooses to focus, myopically, on the potential impact of these events on the new ownership structure. Moreover, in doing so, Public Counsel then fails to recognize the protections from such impacts that are secured by the Settlement Stipulation.

101 Earlier we discussed some of Public Counsel's ill-conceived attempts to devalue the protections contained in the Settlement Stipulation. For example, while Public Counsel asserts that the 44 percent equity ratio commitment in Commitment 35 provides no benefits and does "not protect the public interest,"[129] the facts show that Commitment 35 provides a substantial protection for ratepayers, as confirmed by an example taken from Public Counsel's own testimony in this docket.[130]

102 Public Counsel is also wrong in its belief that the equity issuance provisions and hybrid security provisions of Commitment 35 are not helpful,[131] because the facts show that these provisions will protect PSE in a time of significant financial distress.[132] Similarly, while Public Counsel chooses to see no merit to the use of Equico in the proposed ownership structure,[133] the facts show that Equico protects PSE by further insulating PSE "from any business or financing risks of the parent companies above Puget Energy."[134]

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[129] Hill, Exh. No. 261HCT at 10:18 - 11:5.
[130] *Supra* at 26-27, ¶¶ 74-75.
[131] Hill, Exh. No. 261HCT at 13:3-10. Mr. Hill erroneously refers to Commitment 40 for these protections; in fact, they are contained in Commitment 35.
[132] *Supra* at 22-23, ¶¶ 62-64.
[133] Hill, Exh. No. 261HCT at 11:6-16.
[134] Joint Rebuttal Testimony, Exh. No. 304CT at 12:5-7.

Indeed, Equico was created in response to a recommendation previously explained on the record by ICNU,[135] a fact that Public Counsel appears to have ignored.

103 Other Public Counsel initiatives in this docket have proven equally unfruitful. For example, Public Counsel apparently plans to attribute some significance to the fact that the debt at the PE level will be secured in part by PE's interest in PSE's equity.[136] However, again, PSE is protected because PE's interest in PSE's equity is supervised by the same ring fencing protections we discussed earlier.

104 Public Counsel also expended considerable time and effort creating an issue based on the terms "discretionary" and "non-discretionary" contained in certain financing documents,[137] when in fact, these terms have no operational significance to PSE.[138] Public Counsel also opines that the new owners have an "exit strategy" and will soon opt out of their investment in PSE.[139] Once again, the facts prove otherwise. The record shows that the Investor Consortium members have not entered this investment to "flip" it; they are committed long-term investors, and a closed-end fund can be extended or the investment can be placed in a new fund.[140]

105 But even if it turns out that a re-sale of PSE should occur in the future, that simply means that a new ownership structure will be proposed, and the Commission will evaluate the merits of the proposed sale at that time. It does not follow that ratepayers will be harmed. For Public Counsel to assert otherwise is yet another overly-ambitious leap from the facts. For example, ScottishPower LLC recently re-sold the regulated utility PacifiCorp

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[135] Gorman, Exh. No. 221T at 25:20-23.
[136] Leslie, TR. 798:21 – 799:2 and Exh. No. 52 at 23.
[137] Hill, Exh. No. 251HCT at 41:18 – 51:6 and exhibits cited therein; TR. 817:18-22.
[138] Kupchak, Exh. No. 3HCT at 8:14 – 10:18.
[139] *E.g.,* Public Counsel's cross-examination of Mr. Leslie, TR. 748-749.
[140] Leslie, Exh. No. 38HCT at 6:7-7:32; Mr. Webb for bcIMC, Exhibit 141 at 10:1 – 11:15; Mr. Wiseman for CPP, Exhibit 151 at 11:17 – 12;16, and Mr. McKenzie for AIMCo, Exhibit 91 at 8:6 – 9:1. *See also* Leslie, TR. 748-18-21.

after less than seven years of ownership, with no apparent harm to the public interest.[141] More to the point, if PSE is ever re-sold, the Investor Consortium has every incentive to assure that in the interim, PSE remains a valuable, productive company. Public Counsel's contrary opinion has no room for these facts.

106 In sum, the Commission should reject Public Counsel's opposition to the proposed transaction. Public Counsel's opposition is not fact-based, and it is unbalanced because Public Counsel unfairly ignores or undervalues the substantial protections contained in the Settlement Stipulation.

V. CONCLUSION

107 For all of the reasons stated in this brief, the record proves what Mr. Horton concludes: "PSE is sufficiently protected from the new risks inherent in the new ownership structure, and PSE's risk profile after consummation of the Proposed Transaction is no greater than the 'status quo.'"[142] Therefore, the transaction meets the Commission's "no harm" standard and the Commission should grant the Application according to the terms and conditions contained in the Settlement Stipulation.

DATED this 24th day of September, 2008.

Respectfully submitted,

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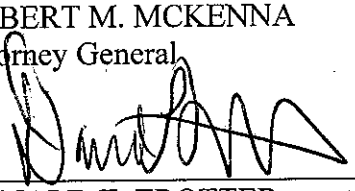

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[141] *See generally, MEHC Acquisition of PacifiCorp,* Docket UE-051090, Order 07 (February 22, 2006).
[142] Joint Rebuttal Testimony, Exh. No. 304CT at 23:20 to 24:1 (Horton separate statement).