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 NO. U-072375

REPLY BRIEF

OF PUBLIC COUNSEL

OCTOBER 24, 2008

NON-HIGHLY CONFIDENTIAL

TABLE OF CONTENTS

I. INTRODUCTION 2

II. LEGAL STANDARD 2

A. Consideration of "Access to Capital" Is Appropriate Under the Public Interest Standard. 2

B. The Balancing of Ratepayer and Shareholder Interests is An Element of The "Public Interest" Standard 3

III. INCREASED RISK – EXCESS LEVERAGE 4

A. The $200 Million Equity Infusion Does Not Adequately Reduce Risk. 4

1. What constitutes an adequate equity infusion is not a new issue in the case. 4

2. Puget will not exceed a 40 percent equity ratio on a consolidated basis after the transaction is approved. 5

3. [Begin Highly Confidential] XXXXXXXXXXXXXXXXXXXXXXX [End Highly Confidential] 6

B. Public Counsel is Not Requesting Approval of An Alternative Arrangement. 7

C. Contrary To Staff's Position, The Use Of PSE [Begin Highly Confidential] XX XXXXXXXXXXXXXXXXXXX[End Highly Confidential] Is An Additional Risk Factor. 8

IV. INCREASED RISK - THE FINANCIAL CRISIS 9

A. Joint Applicants and Staff Seek To Minimize The Import Of the Current Economic Situation for This Case. 9

B. The Financial Crisis Has Worsened Since The Initial Briefs Were Filed. 10

C. The Financial Crisis Continues To Have Direct Effects On This Transaction. 12

1. Macquarie is not insulated from the market turmoil. 12

2. It is not certain that the transaction offers a safe haven of committed financing to Puget as Joint Applicants assert. 13

3. Public markets remain a viable option for Puget to raise capital. 15

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

D. Joint Applicants and Staff Disregard the Refinancing Risk Associated with The Transaction. 16

V. RING FENCING 16

A. Public Counsel Does Not Ignore the Ring Fencing Provisions and Other Protections 16

B. Puget Ring Fencing Under Financial Duress – Staff Examples. 17

1. Example 1: Severe Financial Problems at PE or the Investor Consortium. 17

2. Example 2: Severe Financial Problems at PSE. 20

C. Puget Ring Fencing Under Financial Duress – Public Counsel Example. 21

D. Public Counsel Does Not Make A "Newly Conceived Policy Recommendation" Regarding Ring Fencing. 24

VI. ACCESS TO CAPITAL 25

A. Staff's Position on Brief Is Not Supported By The Evidence. 25

B. Staff Blurs The Distinction Between Equity and Debt Capital. 26

C. Joint Applicants and Staff Inaccurately Describe Puget's Capital Needs. 27

D. Staff's Discussion of Patient Capital Is Not Persuasive. 28

VII. CONCLUSION 30

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

TABLE OF AUTHORITIES

Miscellaneous

Http://finance.google.com/finance?q=ASC:MQG 12

http://finance.yahoo.com/finance.com/echarts?s=MIC 12

Michael T. Burr, A Time To Lead, Public Utilities Fortnightly, October 2008, p. 6 15

Moody's Investor Service, Global Credit Research Rating Action, October 16, 2008. Http://www.moodys.com/moodys/cust/research/MDCdocs/16/2007300000541342.asp ?doc_id= Public Counsel requests official notice of the Moody's action. 13

Testimony of Chairman Ben S. Bernanke, Before Committee on the Budget, U.S. House of Representatives, October 20. 2008. Http://www.federalreserve.gov/newsevent/testimony/bernanke20081010a.htm 11

U.S. Securities and Exchange Commission, Schedule 13D, Amendment No. 1, Puget Energy Inc., CUSIP Number 745310102, October 2, 2008 (Item 4. Purpose of Transaction), http://www.sec.gov/Archives/edgar/data/1085392/000095012308012025/y71490sc13d za 14

Rules

WAC 480-07-495(2)(a)(ii) 11

COMMISSION ORDERS

In re Application of US West, Inc., and Qwest Communications International, Inc. For an Order Disclaiming Jurisdiction or in the Alternative Approving the US West, Inc. – Qwest Communications International, Inc, Merger, Docket No. UT-991358, Third Supplemental Order on Scope of Review, pp. 4-5 3

In the Matter of the Application of Puget Sound Power & Light Company and Washington Natural Gas Company for an Order Authorizing Merger, Docket No. UE-960195 et al., Fourteenth Supplemental Order Accepting Stipulation and Approving Merger (*Puget/WNG Merger Order*), p. 20 4

In The Matter of the Application of PacifiCorp and Scottish Power, PLC, Docket No. UE-981627, Third Supplemental Order, p. 2 24

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

In the Matter of the Joint Application of MidAmerican Energy Holdings Company and PacifiCorp dba Pacific Power & Light Company For an Order Authorizing Proposed Transaction,
Docket No. UE-051090, Joint Application, pp. 6-7 25

In the Matter of the Joint Application of Verizon Communications Inc. and MCI, Inc., For Approval of Agreement and Plan of Merger,
Docket No. UT-050814, Order No. 07, ¶ 58 .... 3, 4, 24

In the Matter of the Oregon Electric Utility Company, LLC, et al. Application for Authorization to Acquire Portland General Electric Company, Public Utility Commission of Oregon,
Docket UM 1121, Order No. 05-114, pp. 24-27 30

I. INTRODUCTION

1. While Public Counsel believes that the most important arguments raised by Joint Applicants and Staff were addressed in the opening brief, Public Counsel appreciates the opportunity to respond to certain points raised by the proponents of the settlement. To the extent possible, this brief references the initial brief and evidence of record and tries to avoid undue repetition. This reply brief focuses on the briefs of Joint Applicants and Staff. The other parties' opening briefs did not specifically take issue with Public Counsel's positions and so are not addressed in this filing.

II. LEGAL STANDARD

A. Consideration of "Access to Capital" Is Appropriate Under the Public Interest Standard.

2. Public Counsel has challenged the Joint Applicants' claim that this transaction is needed to provide Puget with improved access to capital to meet its substantial needs.[1] Joint Applicants' Brief asserts that Public Counsel's position is based on "incorrect legal standards" and that whether there is a need for the acquisition as an improved source of capital is not a relevant consideration under the public interest test.[2] This is surprising, given the amount of attention Joint Applicants devote to the topic in their testimony and brief. Staff, for its part, takes a similar view in its brief, stating that "the issue does not advance the discussion much" of whether the transaction fails the "no harm" standard. [3]

3. Joint Applicants are wrong about the legal standard. The Commission has expressly stated that "the financial impacts of the proposed merger on cost of capital, capital structure, *and*

---

[1] Public Counsel Brief, Section III, ¶¶ 9-39; Exh. No. 261HCT, p. 2:11-17.
[2] Joint Applicants' Brief, ¶ 16.
[3] Staff's Brief, ¶ 12, n.18.

access to financial markets" is a factor for review and pertinent to applying the public interest and "no harm" standards.[4]

4. Joint Applicants have argued at length that the transaction provides better access to capital at a time of capital need. This amounts to an assertion by Joint Applicants that this sale creates a benefit for Puget and its customers. The effort is also to create a sense of necessity or urgency about the transaction to support a conclusion that it is in the public interest. The Commission has stated that "[i]t is appropriate to inquire into the nature and extent of the claimed benefits" of a merger.[5] It is, therefore, entirely legitimate for Public Counsel to question that Joint Applicants' claims, as Staff also did in its direct testimony.[6]

B. The Balancing of Ratepayer and Shareholder Interests is An Element of The "Public Interest" Standard.

5. Joint Applicants assert that "Public Counsel incorrectly evaluates the Proposed Transaction by comparing the benefits to shareholders against the benefits to customers," calling this an "irrelevant analysis" under the "no harm" standard.[7] Joint Applicants again are mistaken. In the seminal Puget Sound Power & Light/Washington Natural Gas merger decision which established the current standard, the Commission announced as one of its four fundamental standards that:

> The transaction, with conditions required for its approval, should strike a balance between the interests of customers, shareholders,

[4] *In the Matter of the Joint Application of Verizon Communications Inc. and MCI, Inc., For Approval of Agreement and Plan of Merger*, Docket No. UT-050814, Order No. 07, ¶ 58 (*Verizon/MCI Merger Order*)(emphasis added). This is the Commission's most recent merger decision containing a detailed review of the legal standard.
[5] *In re Application of US West, Inc., and Qwest Communications International, Inc. For an Order Disclaiming Jurisdiction or in the Alternative Approving the US West, Inc. – Qwest Communications International, Inc, Merger,* Docket No. UT-991358, Third Supplemental Order on Scope of Review, pp. 4-5.
[6] Exh. No.161, p. 27:20-22 (Elgin).
[7] Joint Applicants' Brief, ¶ 18.

> and the broader public that is fair and preserves affordable, efficient, reliable, and available service.[8]

6. As the Commission stated more recently in the *Verizon/MCI Order*:

> In summary, the Commission determines whether the transaction is consistent with the public interest, *balancing the costs and benefits for the public and for affected customers.* If the costs outweigh the benefits, the result is harm, and the Commission should deny or condition the approval so no net harm results.[9]

7. It is therefore appropriate in this case for Public Counsel, and the Commission, to compare the benefits to shareholders with the benefits and the harm to customers.

III. INCREASED RISK – EXCESS LEVERAGE

A. The $200 Million Equity Infusion Does Not Adequately Reduce Risk.

1. What constitutes an adequate equity infusion is not a new issue in the case.

8. Joint Applicants contend that Public Counsel "asserted a new argument" at the hearing by recommending an infusion of an additional $500 million in equity and thereby establishing a consolidated capital structure with an equity ratio of 40 percent.[10] In fact, Public Counsel witness Stephen Hill was responding to a question from Chairman Sidran asking "[w]hat is it that you would recommend, if anything, with respect to the additional ring fencing for this transaction?"[11] Mr. Hill commented on the limitations of ring fencing in the case of serious financial distress, and went on to observe that the "key element would be more equity, less debt."[12]

---

[8] *In the Matter of the Application of Puget Sound Power & Light Company and Washington Natural Gas Company for an Order Authorizing Merger*, Docket No. UE-960195 et al., Fourteenth Supplemental Order Accepting Stipulation and Approving Merger (*Puget/WNG Merger Order*), p. 20.
[9] *Verizon/MCI Merger Order,* ¶ 59 (emphasis added).
[10] Joint Applicants' Brief, ¶ 75.
[11] TR. 1036:17-19.
[12] TR. 1036:4-5. Mr. Hill's also expressed some reservations about the long-term ability to maintain a 40 percent equity ratio requirement once initially established, if the investors are permitted to continue using debt for future capital expenditures.

9. The question of whether there is an amount of equity infusion that could adequately "de-lever" this transaction is not a new issue in this case. Industrial Customers of Northwest Utilities (ICNU) filed testimony recommending that the amount of equity be increased by $700 million and debt decreased by $700 million in order to de-lever the transaction and restore the capital structure in place before the transaction. [13]

10. The settlement itself incorporates a partial concession by Joint Applicants on this issue resulting in an increase of equity capital of $200 million in an effort to rebalance the debt and equity components of the transaction. [14] If de-levering is offered as a prophylactic measure, however, it must be at effective levels. The de-levering in the settlement does not go far enough, only marginally changing the equity ratio of the post-closing Puget.[15] The appropriate level of equity infusion is not a judgment call susceptible of compromise at any point on a spectrum. There are metrics in the record that indicate what an appropriate equity ratio for a utility should be.[16]

2. Puget will not exceed a 40 percent equity ratio on a consolidated basis after the transaction is approved.

11. Joint Applicants additionally respond to Mr. Hill's recommendation by arguing that, in any event, Puget will exceed the recommended 40 percent equity ratio at or shortly after the closing of the transaction.[17] This is a misleading and inaccurate statement. Joint Applicants calculation of the equity ratio treats the goodwill in the transaction as part of the equity, notwithstanding the fact that Joint Applicants' own witness, Mr. Pettit, states that "[g]oodwill is

---

[13] Exh. No. 221, p. 20:8-22, p. 21 (Gorman Direct).
[14] Exh. No. 302, p. 14:1-7, p. 38:2-10.
[15] Public Counsel Brief, ¶ 59, citing Exh. No. 259HC; Exh. No. 49, p. 56; Exh. No. 52HC, p. 158.
[16] Exh. No. 49, p. 56; Exh. No. 52HC, p. 158.
[17] Joint Applicants' Brief, ¶ 75, n.157.

a distortion because it has no value."[18] If 90 percent of the goodwill is removed, Puget's consolidated equity ratio falls to 35.9 percent of total capital immediately after closing. This is discussed and analyzed in detail in Mr. Hill's testimony.[19]

12. Joint Applicants assert that Public Counsel's recommendation for a consolidated equity ratio violates Commission precedent in the 2005 PacifiCorp general rate case on the "double leverage issue."[20] The PacifiCorp decision, however, does not govern the situation in this case. This is not a rate case and Public Counsel has not made a suggestion in this proceeding that any particular rate treatment of parent company debt be undertaken. Here, the Commission must consider the financial and corporate structure of the surviving entities in order to assess the impact of the transaction under the "public interest" test.

3. [Begin Highly Confidential] XXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXX [End Highly Confidential].

13. In response to the concern about excessive debt, Joint Applicants' Brief argues that "Public Counsel ignores the substantial upfront investment by the Investor Consortium in Puget Sound Energy (PSE) and the substantial reinvestment of PSE cash flow."[21] Joint Applicants also assert that **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX"[22] **End Highly Confidential]** Joint Applicants also assert that **[Begin Highly Confidential]** XXXXXXX

[18] Exh. No. 117, p. 1.
[19] Public Counsel Brief, ¶ 43, citing Exh. No. 259HC.
[20] Joint Applicants' Brief, ¶ 76.
[21] Joint Applicants' Brief, ¶ 49.
[22] *Id.*

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX."[23] **[End Highly Confidential]**

14. Several responses are in order. First, "the substantial upfront investment" simply replaces the existing equity capital. It is part of the payment for the company and does not increase the equity ratio. Second, the "reinvestment of cash flow" generated by PSE occurs now and would occur in the future under a stand-alone Puget as a normal operating procedure. The third key point, is that the **[Begin Highly Confidential]** XXXXXXXXXXXXXX **[End Highly Confidential]** is misleading. Including internally generated funds in the calculation drives down the projected amount of debt that is funding total capital expenditures. As Macquarie witness Mr. Kupchak acknowledged under cross-examination, once all the internally generated sources of capital are discounted**, [Begin Highly Confidential]** XXXXXXX **[End Highly Confidential]** of all new capital expenditures that will occur under this transaction are funded by debt.[24] It is not clear to Public Counsel why this critical characteristic of the transaction financing is being kept confidential and not disclosed to the public.

B. Public Counsel is Not Requesting Approval of An Alternative Arrangement.

15. In describing the Commission's "no harm" standard, Staff makes the argument that the Commission does not evaluate in a merger case "whether an alternative arrangement might be better."[25] Staff specifically cites as such an alternative Mr. Elgin's argument that Puget would be better off as a stand alone utility if it were simply to issue the same debt that will be on its books due to this transaction and invest directly in the utility.[26] Staff's Brief misstates the point of the

---

[23] *Id.*
[24] TR. 898:1-900:20 (Kupchak).
[25] Staff's Brief, ¶ 12.
[26] Public Counsel witness Stephen Hill makes the same point. Exh. No. 261HCT, p. 15:19-16:5.

Elgin testimony. Neither Staff nor Public Counsel are recommending this as an actual alternative for Puget, but to highlight the unnecessary and risky nature of the new financial structure. As Staff put it:

> This is precisely why this deal is so troublesome from Staff's perspective. The buyers use significant leverage to complete this transaction, but that leverage creates no incremental value for the public's benefit whatsoever.[27]

This is directly pertinent to the public interest analysis the Commission performs and demonstrates that the transaction increases risk with no offsetting benefit.

C. Contrary To Staff's Position, The Use Of PSE [Begin Highly Confidential] XXXX XXXXXXXXXXXXXXXXX [End Highly Confidential] Is An Additional Risk Factor.

16. Staff argues it is "unfruitful" to attribute "significance to the fact that the debt at the Puget Energy (PE) level will be **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXX XXXXXXXX." **[End Highly Confidential]**[28] As Public Counsel pointed out in its brief, what this means in practical terms is that in the event of default, **[Begin Highly Confidential]** XXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX[29] XXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX **[End Highly Confidential]**[30] Staff's Brief responds to this concern by simply observing that PSE is protected by the ring-fencing provisions. There is no citation to any specific ring fencing provision that would address this. As a general proposition, the ring fencing provisions address

---

[27] Exh. No. 161HCT, p. 17:1-3.
[28] Staff's Brief, ¶ 103. It is Public Counsel's understanding that this information is still designated highly confidential. Exh. No. 51, p. 23.
[29] Public Counsel Brief, ¶ 56.
[30] Joint Applicants' Response to Bench Request No. 24, Attachment A, Credit Agreement, Exhibit C-1.

the activities under the existing corporate ownership structure. Public Counsel has not been able to identify any provisions that address what occurs in the event of a default on the debt obligations.

IV. INCREASED RISK - THE FINANCIAL CRISIS

A. Joint Applicants and Staff Seek To Minimize The Import Of the Current Economic Situation for This Case.

17. Joint Applicants "do not dispute Public Counsel's assertions that these are challenging times[,]"[31] but they argue that PSE, as a publicly traded utility, is far more vulnerable to the turmoil of the financial markets than it would be under the ownership of Puget Holdings.[32] It is asserted that this acquisition "will provide PSE with the real benefit of more options in a time of crisis"[33] because of the "potential perils of relying solely on the public markets." [34] Joint Applicants represent that they "would provide a new source of equity capital for PSE – deep pocketed unlisted funds of infrastructure capital"[35]

18. Commission Staff argues that "[w]ithout reason, Public Counsel sounds the alarm about increasing difficulties in financial markets" and criticizes Public Counsel's submission of evidence on recent historic developments in the markets.[36] Staff now asserts that these major financial developments have no special significance for this transaction because they would impact PSE under the *status quo* in any event. Indeed, Staff argues that "with each day that

[31] Joint Applicants' Brief, ¶ 97.
[32] Joint Applicants' Brief, ¶ 94.
[33] Joint Applicants' Brief, ¶ 99.
[34] Joint Applicants' Brief, ¶ 98.
[35] Joint Applicants' Brief, ¶ 98.
[36] Staff's Brief, ¶ 99.

passes" the ability to borrow money to fund "all of its equity requirements through 2013 appears more and more valuable."[37]

19. Public Counsel disagrees with these unrealistically sanguine reactions to recent economic developments. The scope of the current economic crisis adds an additional layer of risk to this transaction which cannot reasonably be ignored, as both Staff and Public Counsel witnesses testified, and as discussed in Public Counsel's initial brief.

20. The fluidity of the present economic situation presents an unusual problem for the parties in briefing this case in that significant relevant events have continued to occur since the close of the record. The order granting Public Counsel's motion to reopen prior to the initial briefs noted that the Commission can take official notice of matters relating to the financial crisis.[38] This part of the brief references some matters occurring subsequent to the initial briefing date. Public Counsel believes that these matters are important enough that the Commission should be aware of them and requests that Commission take official notice of these items where noted.

B. The Financial Crisis Has Worsened Since The Initial Briefs Were Filed.

21. The record already contains substantial amounts of evidence of the weakness in global markets and the deterioration and increasing fragility of debt-based business models through late September when initial briefs were filed.[39] Since the filing of initial briefs in this proceeding, there has been additional significant deterioration of the international financial markets and investor confidence in those markets, causing a need for government injection of capital on a heretofore unseen scale—trillions of dollars.

---

[37] Staff's Brief, ¶ 100.
[38] Order 05, ¶ 6.
[39] Evidence generally discussed in Public Counsel Brief, ¶¶ 99-112. Exh. Nos.195-200, 235-238, 500-516.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

22. Recent developments and their causes were reviewed by Federal Reserve Chairman Ben Bernanke in testimony before Congress this week regarding the economic outlook and financial markets. Beginning his remarks by looking at the causes of the crisis, he acknowledged the problems in the mortgage industry and then went on to say:

> More fundamentally, the turmoil is the aftermath of a credit boom characterized by underpricing of risk, excessive leverage, and an increasing reliance on complex and opaque financial instruments that have proved to be fragile under stress. A consequence of the unwinding of this boom and the resulting financial strains has been a broad-based tightening in credit conditions that has restrained economic growth.
>
> The financial turmoil intensified in recent weeks, as investors' confidence in banks and other financial institutions eroded and risk aversion heightened. Conditions in the interbank lending market have worsened with term funding essentially unavailable....As confidence in the financial markets has declined and concerns about the U.S. and global economies have increased, equity prices have been volatile, falling sharply on net.[40]

Chairman Bernanke went on to review the various actions being taken by the United States and foreign governments to address the crisis.[41]

23. These on-going world-wide financial troubles serve as a cautionary tale for this Commission in its consideration of the Puget acquisition. There are important parallels. The root cause of the financial crisis is excessive leverage, which is also the primary concern with the proposed acquisition of Puget.

---

[40] Testimony of Chairman Ben S. Bernanke, Before Committee on the Budget, U.S. House of Representatives, October 20, 2008. Http://www.federalreserve.gov/newsevent/testimony/bernanke20081010a.htm. Public Counsel requests that official notice be taken pursuant to WAC 480-07-495(2)(a)(ii).

[41] *Id.*

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

C. The Financial Crisis Continues To Have Direct Effects On This Transaction.

1. Macquarie is not insulated from the market turmoil.

24. Joint Applicant's Brief implies that their "track record of success" means that the Investor Consortium is essentially unaffected by the current crisis.[42] The record indicates otherwise. Prior to the filing of the initial briefs, S&P revised its outlook for the Macquarie Group Ltd. downward from stable to negative. Moody's revised their outlook downward to stable from positive.[43] The stock price for Macquarie Group, Ltd. has fallen significantly during the past year, down 38 percent in August just prior to the hearing.[44] Likewise, prior to the initial briefs, the stock price of Macquarie Infrastructure Corporation (a publicly-traded infrastructure fund similar to the private MIP) had fallen 50 percent over the past year, even before the major declines on Wall Street.[45]

25. Subsequent to the initial briefs, the stock price for Macquarie Group Ltd has fallen further, trading at $32.00 on October 23, down from a 52 week high of $85.50.[46] The stock price for the Macquarie Infrastructure Corporation (MIC) has continued to fall as well. On October 22, 2008, MIC stock was trading at $9.69, down from a 52 week high of $42.00.[47] On October 16, 2008, Moody's revised its outlook for Macquarie Group Ltd. downward from stable to negative. The downgrade addressed "the potential for an extended global economic and capital markets slowdown to negatively affect Macquarie's earnings in calendar year 2009 and possibly beyond." Moody's noted that "in other respects, Macquarie's credit profile remains very robust"

[42] Joint Applicants' Brief, ¶ 98.
[43] Public Counsel Brief, ¶ 108.
[44] Exh. No. 239.
[45] Exh. No. 68.
[46] Http://finance.google.com/finance?q=ASC:MQG Public Counsel request official notice be taken.
[47] http://finance.yahoo.com/finance.com/echarts?s=MIC Public Counsel requests official notice be taken.

and that liquidity, risk management and capital level were healthy. However, Moody's observed that "to the extent that the crisis may lead to a long-lasting reduction in global leverage, this has negative implications for asset prices, potentially reducing returns across the board, including the firm's specialist funds business."[48]

26. That change in investor attitude signals a reduction of confidence in the Macquarie model, one of the risks specifically identified by Staff witness Dr. Schmidt relative to the proposed transaction.[49] Investors have recognized the risks inherent in debt-heavy financial schemes such as the Macquarie model. The markets collectively understand that unnecessarily large debt balances increases the risk of default and, as a result, have dramatically lowered the price they are willing to pay to assume that additional risk. This Commission should likewise be wary of the risks inherent in the Macquarie model.

2. It is not certain that the transaction offers a safe haven of committed financing to Puget as Joint Applicants assert.

27. Joint Applicants and Staff claim that because the financing has already been arranged for this proposed sale, the transaction offers a better opportunity for financing in the future that would be available to a *status quo* Puget.[50] Since the filing of the initial briefs, however, the depth and breadth of the financial crisis has intensified. Credit markets have been essentially frozen, although the situation may be starting to ease as a result of government assistance to the banking system.

28. It is reasonable to ask whether the dislocations throughout the financial system have had

[48] Moody's Investor Service, Global Credit Research Rating Action, October 16, 2008. Http://www.moodys.com/moodys/cust/research/MDCdocs/16/2007300000541342.asp?doc_id= Public Counsel requests official notice of the Moody's action.
[49] Exh. No. 191, p. 21:8-21(Dr. Schmidt).
[50] Joint Applicants' Brief, ¶¶ 94-99; Staff's Brief, ¶ 100.

an impact on the availability, cost and terms of the debt formerly committed to the proposed transaction, on the status of the lenders themselves. Although the Joint Applicants rely upon a "bird-in-the-hand" financing rationale in support of the transaction, the information in the record at this point is not sufficiently current to know whether or not the committed financing will actually be provided and on what terms.

29. Public Counsel also notes that an SEC filing was made on October 2, 2008, regarding this transaction, which reflects that one of the three Macquarie entities listed as part of the acquiring Investor Consortium, Padua MG Holdings Inc. (Padua MGH) is transferring its entire ownership in stock to Macquarie Asset Finance Limited.[51] Padua MGH is referred to on the Post-Acquisition Organizational Chart (Attachment B to the Multiparty Settlement Stipulation) as "Macquarie Capital Group, Ltd." with an ownership share of 15.9 percent, the second largest Macquarie investor, and third largest overall.[52] The impact of this filing is not clear, but it appears to change the profile of the Investor Consortium as described in the application and the Joint Applicants' testimony. While it was disclosed at the hearing that Padua MGH might be transferring its interest at or around the time of closing, perhaps to a new entity, MIP II,[53] it is not clear if this filing reports that event, and if Joint Applicants are planning to provide information to the Commission regarding the matter. This is a further indication of the uncertainties surrounding this acquisition, particularly with respect to the Macquarie role.

[51] U.S. Securities and Exchange Commission, Schedule 13D, Amendment No. 1, Puget Energy Inc., CUSIP Number 745310102, October 2, 2008 (Item 4. Purpose of Transaction), http://www.sec.gov/Archives/edgar/data/1085392/000095012308012025/y71490sc13dza. Public Counsel requests official notice.
[52] Joint Application at 5. Macquarie Capital Group Ltd. was used as a shorthand label for the actual Macquarie entities shown on Exhibit 256. Public Counsel Brief, ¶ 133.
[53] Staff's Brief, ¶ 24.

3. Public markets remain a viable option for Puget to raise capital.

30. As noted, both Staff and the Joint Applicants argue that Puget will be better off under the proposed transaction than trying to meet capital needs in the current market. In fact, investor reaction to the leverage-based Macquarie model shows that the companies that will most easily and most cost-effectively be able to attract capital are those that are not debt-heavy and have better credit ratings.

31. Joint Applicants point to the bankruptcy of Lehman Brothers as an indication that Puget will have increased difficulty raising equity capital in the public markets.[54] This is an unpersuasive point. The New York Stock Exchange continues to function and there are other avenues for stock issuance by utilities. The failure of Lehman Brothers will not by itself prevent Puget from accessing the markets. Indeed, the failure of Lehman Brothers is yet another cautionary example of the risk created by excessive borrowing.[55]

32. With respect to the viability of the public equity markets for regulated utilities, an editorial in the most recent issue of Public Utility Fortnightly observes:

> Investor owned utilities offer an amazingly attractive investment in the current market. Where else can investors place huge amounts of money and get total shareholder returns exceeding 20 percent a year, including rate-regulated equity returns in the 10 percent range. Compared with other investments in today's volatile and bearish market, utility stocks are a no-brainer investment.
>
> Likewise, this market presents a unique opportunity for IOUs to raise equity funds for building a smart and efficient power system. In many respects, the timing is perfect for companies to issue new stock. Of course, doing so might dilute existing share value in the short term, but it's well worth it considering the industry's golden opportunity for growth.[56]

---

[54] Joint Applicants' Brief, ¶ 95.
[55] Exh. Nos. 500-501.
[56] Michael T. Burr, A Time To Lead, Public Utilities Fortnightly, October 2008, p. 6.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

33. There is no reliable evidence in this proceeding to show that Puget will not be able to issue the common equity capital needed to finance its continuing capital needs in a balanced manner.

D. Joint Applicants and Staff Disregard the Refinancing Risk Associated with The Transaction.

34. Even if Joint Applicants are correct that the credit facilities are in place as promised and will provide capital in the initial five year period, neither they nor Staff address the refinancing risk associated with the transaction. All of the debt must be refinanced during the next five years. Puget has very significant exposure to the risk that interest rates could be much higher than at present, costlier than the assumptions in the financial model. If Macquarie falls further from favor or international debt markets continue their turmoil, debt refinancing may not be available to Macquarie or only available at a very high cost. This is new risk that Puget does not currently face and is a key problem with the Joint Applicants' case that the settlement does not resolve. Public Counsel's Brief addresses this issue in more detail.[57]

V. RING FENCING

A. Public Counsel Does Not Ignore the Ring Fencing Provisions and Other Protections.

35. A central point of Staff's Brief is the assertion that "Public Counsel's case is flawed at its core because it ignores the substantial ring fencing and other protections provided [.]"[58] This is not correct. The ring fencing commitments are addressed in detail in Section IV.C. of Public Counsel's Brief and other commitments are addressed throughout the brief and in the cited evidence of record. For example, Public Counsel addressed dividend restrictions,[59] equity

[57] Public Counsel Brief, ¶¶ 52-55.
[58] Staff's Brief, ¶ 3.
[59] Public Counsel Brief, ¶¶ 60-61.

issuance,[60] ratings separation,[61] minimum equity ratio,[62]non-consolidation,[63] and transaction costs.[64] Ring fencing issues are further discussed in the following sections.

B. Puget Ring Fencing Under Financial Duress – Staff Examples.

36. Staff's Brief uses two sample scenarios to illustrate how ring fencing provisions would work in practice. There are several problems with these examples as discussed below.

1. Example 1: Severe Financial Problems at PE or the Investor Consortium.

37. Staff's first example assumes a "severe financial situation under which PE and or the Investor Consortium cannot or will not provide needed equity to PSE," in order to maintain the required 44 percent common equity ratio, and posits that several aspects of the ring fencing provisions will serve to protect PSE and its ratepayers from dire financial consequences.[65]

It is important to understand that the occasion of the Investor Consortium failing to inject equity into PSE would signal, indeed, a dire financial circumstance. PSE's equity ratio is Puget Holding's bread and butter, and is a primary reason why the ring fencing provision to require the Investor Consortium to maintain a 44 percent equity ratio at PSE is of little moment with regard to protecting PSE's ratepayers. The Macquarie business model is built on issuing debt capital at the parent level, injecting those monies into the regulated subsidiary so that ratepayers will provide a return on those monies that is much greater than the cost of that debt capital.[66] Therefore if the Investor Consortium "cannot or will not" provide equity to PSE to meet the 44

---

[60] Public Counsel Brief, ¶¶ 62-63.
[61] Public Counsel Brief, ¶ 64.
[62] Public Counsel Brief, ¶ 65.
[63] Public Counsel Brief, ¶¶ 67-69.
[64] Public Counsel Brief, ¶¶ 143-144.
[65] Staff's Brief, ¶¶ 49-70.
[66] If the cost of short-term debt for Macquarie is, for example, 6 percent, and the monies raised from issuing debt at the PE level are injected as equity to PSE, the return on those monies will be 10.15 percent (according to the most recent Rate Case decision), plus taxes due on that return (which PSE will not pay) that cause the return flowing to PE to equal 15.6% [10.15% ÷ (1-35% tax rate) = 15.62%].

percent equity threshold, there will have been a serious dislocation, and it is unlikely that any provision to prohibit upstreaming distributions from PE to the investors would have any impact whatsoever on financial conditions. After all, debt costs at PE must be met before distributions are allowed and if PE can't pay its debt, the restrictions on distribution are moot, offering no help to financial stability.

38. Staff believes that Puget Holding's ability to issue common equity to the public underneath a privately-held Investor Consortium offers a path for necessary equity capital for PSE. Public Counsel witness Stephen Hill testified he was unaware of any such issuance of public equity by a subsidiary of a privately-held investment consortium.[67] The legal ramifications and intricacies of such an equity offering are difficult to even comprehend. Neither Staff nor Joint Applicant have subsequently taken the opportunity to offer any examples of such issuances for the record.

39. Staff sees a safety net in the Commission's ability to go to court to force the Joint Applicants to issue this equity. This is not reassuring. Staff cites no case where this has been achieved or even requested. Going to court to force issuance of equity would significantly delay any benefit obtained from such a sale to the point where it might no longer be helpful and would further depress any perceived value in the securities. Even assuming successful litigation, a minority-ownership of a troubled utility holding company, shared with a private equity consortium to which the public owner has no access, is not a particularly saleable commodity. It is unrealistic to believe that PSE's ratepayers would be helped by such ring fencing provisions.

40. The Staff points to an additional ring fencing protection, PSE's ability to issue "hybrid"

[67] Exh. No. 261, p. 13:16-14:4 .

securities. Here, the Staff succumbs to the illogic that debt is equity. The record clearly establishes that hybrid securities are debt not equity capital.[68] In fact the only reason why they receive so-called "equity credit" from rating agencies is because those debt issues are "deeply discounted." In other words they are constructed to be subordinate to any and all other debt issued by the company and carry a concomitantly lower credit rating—usually one or two notches lower than the lowest-rated debt issue. Therefore, Staff's claim that PSE's ability to issue "hybrid" securities will serve to shore up its equity ratio is simply wrong.

41. Staff states that under the settlement commitments the Commission can refuse to pass on higher capital costs to consumers regardless of troubles at parent company levels. While this is technically correct, it seems unlikely that the Commission would decline to take corrective action in response to financial circumstances that would negatively impact the long-term viability of a Washington utility. Regulation cannot simply stop financial impacts from reaching ratepayers without jeopardizing their long-term access to utility services they require. In other words, if the financial situation is bad enough, the Commission cannot insulate ratepayers from it. The key point is that this transaction increases the risk that this will occur, as a compared to the *status quo*.

42. Finally, Staff believes that the non-consolidation opinion requirements "will be sufficient to prevent PSE's assets from being available to creditors in the event a parent company of PSE goes bankrupt."[69] This significantly overstates the level of protection. Public Counsel's Brief

---

[68] Public Counsel Brief, ¶ 37, n.69; Exh. No. 26.
[69] Staff's Brief, ¶ 68.

addresses the fact that a non-consolidation opinion is not a guarantee against consolidation, as well as identifying other weaknesses in the bankruptcy protections offered.[70]

2. Example 2: Severe Financial Problems at PSE.

43. In its second example, Staff assumes financial difficulties exist at PSE. The initial point raised by the Staff is that as a result of the transaction, PSE's common equity ratio will temporarily be raised to 50 percent at the close of the transaction, which will improve PSE's financial strength compared to the status quo. Again, this ignores the fact that the "equity" added to PSE balance sheet is provided by debt capital issued by its parent, PE, and is encumbered by an obligation that must ultimately be met by PSE. Therefore, the transaction, rather than reducing the financial obligations and risks at PSE, actually increases them.

44. While the dividend restrictions cited in Paragraphs 76 and 77 would serve to retain cash at PSE by eliminating distributions to PE, that could still create significant and dangerous financial problems for PSE. The only means by which PE is able to pay interest on the debt it intends to issue is from distributions by PE. If those are eliminated (due to a below investment-grade PSE and an EBITDA/interest ratio below 3.0), PE will default on its debt, PSE will have new owners (the debt-holders) and the financial status of the Company, and the effectiveness or applicability of the so-called ring fencing measures would be called into question.

45. Staff opines that the equity ratio requirement will make PSE better protected than the *status quo* situation, citing the 2001 Western Energy Crisis as an example.[71] This position is not well-reasoned. Staff again overlooks the fact that the equity capital needed to prop-up the PSE's common equity ratio, as designed in the proposed transaction, comes from debt capital issued by

---

[70] Public Counsel Brief, ¶¶ 67-69.
[71] Staff's Brief, ¶¶ 73 - 75.

the parent. If Puget had adopted this approach in 2001, using large amounts of debt to build PSE's equity to meet the hypothetical ring fencing equity ratio requirement that Staff posits, the consolidated equity ratio would have been driven down even further below the already problematic 35 percent Puget was facing at that time.[72] This would have likely caused additional difficulties related to lower credit ratings and higher capital costs. Instead, what occurred was that PSE issued additional equity over time under the provisions of the equity tracker agreement and gradually built up a healthy and balanced financial structure containing "real" equity.

C. Puget Ring Fencing Under Financial Duress – Public Counsel Example.

46. In response to Staff's examples, Public Counsel offers the following scenario to illustrate the transaction risks and the weaknesses in the ring fencing protections contained in the settlement.

47. <u>The 2013 Western Energy Crisis:</u> The time is spring 2013. The past year has been unusually dry, with very little snowfall during the winter of 2012-2013 and well below-normal rainfall in the Columbia River basin. Those low water conditions have severely reduced the availability of low-cost hydropower, a substantial portion of Puget's power supply. That fact, in combination with a prolonged outage of the California DC Intertie connection has required that Puget buy its replacement power daily on the Northwest power grid. The price of that available power, which is provided mostly by gas-fired generation, has been driven to extremely high levels, due to regional power demand as well as yet another spike in oil prices due to a continued crisis in the Middle East.

48. Although the huge spikes in power cost are rolled into Puget's PCA, the company has

[72] Public Counsel Brief ¶¶ 40-43.

experienced negative earnings for several months. Puget's negative earnings have lowered its common equity ratio below the 44 percent level necessary for the regulated entity PSE to be able to pay dividends to its parent PE. Without cash dividends from PSE, the parent is unable to pay its interest expenses on the debt capital that it has borrowed and is facing default on its loans.

49. When the lead manager of Puget Holdings, Macquarie, attempted to access the capital markets to raise additional debt on behalf of PE to pay its interest costs and restore PSE's equity ratio to 44 percent, in order to release PSE dividends to PE, it was unable to do so. Liquidity in the international financial markets was not available for already debt-strapped firms like PE and Macquarie. Without the ability to borrow short-term, and with nearly $3 billion of term debt still due to be refinanced by the fall of 2013, Puget faces difficult choices:

50. Default and Bankruptcy. Puget's lenders give notice they will exercise their rights **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXX. **[End Highly Confidential]**[73] In that event it is unclear whether the lenders would be governed by the terms of the ring fencing commitments. To avoid the lenders gaining control of the company, Puget Holding's board votes to file for bankruptcy, persuading the independent director to vote with the majority to include PSE in the Puget Holdings bankruptcy to protect it from forfeiture to the lenders.

51. Rate Increases. PSE is directed by Puget Holdings to file with the Commission for emergency rate relief, a 25 percent residential rate increase, to provide adequate funds to pay the interest expense on the debt of its parent as well as other operating expenses. PSE must ask for a waiver of the provision barring upstream dividend payments and pass-through of higher capital

[73] Joint Applicants' Response to Bench Request No. 24, Attachment A, Credit Agreement, Exhibit C-1.

costs. The Commission is faced with the choice of waiving merger commitments and granting the rate relief or pushing the company into default.

52. Sale of the Company to the Public. Macquarie and its investment partners elect to sell the company to the public. However, the market price, burdened with over $2.2 billion in additional debt is expected to be very low relative to the book value of its assets.

53. Merger. Puget Holdings offers Puget as a potential target for acquisition or merger by another holding company or utility.

54. The new Puget emerging from the above hypothetical would probably be a utility with a below investment-grade bond rating, a market value well below book, a highly-leveraged balance sheet, high capital costs and an unprecedented need for rate relief. Granted, a *status quo* Puget experiencing the same set of conditions would also be in a difficult situation, but it would not be weighed down with additional $2.2 – 2.9 billion in debt planned in the proposed transaction, and, therefore, would be less costly to "rescue."[74]

55. None of the assumptions in this example are far-fetched. As shown in Mr. Hill's Exhibit 258HC, **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. **[End Highly Confidential]** A reasonable risk assessment of this transaction needs to take such a potential scenario into account in assessing the effectiveness of the ring fencing provisions.

/ /

/ / / /

/ / / / /

[74] Initial $1.0 billion credit facility plus $1.225 billion = $2.225 billion. Adding the $750 million accordion facility = $2.975 billion.

D. Public Counsel Does Not Make A "Newly Conceived Policy Recommendation" Regarding Ring Fencing.

56. Staff argues that "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[.]"[75] Staff surely does not mean to suggest that so long as ring fencing is in place, then any transaction must be approved. Staff catalogues the prior cases in which Public Counsel has agreed to ring fencing conditions and accuses Public Counsel of adopting a "newly-conceived policy recommendation"[76] as if to suggest that Public Counsel has forever waived the right to question the adequacy of ring fencing in future transactions.

57. This overlooks the fact that every transaction is different and must be examined on its own merits. The Commission has incorporated this principle in its "public interest" review in merger cases:

> There is no bright line against which to measure whether a particular transaction meets the public interest standard. As we observed in another recent merger case, '*the approach for determining what is in the public interest varies with the form of the transaction and the attending circumstances.*'[77]

There is no presumption that any proposed transaction must be approved. The burden of proof is on the applicants to show that any merger or sale is in the public interest.[78]

58. A set of ring fencing and other conditions that may be adequate to protect against a given set and level of risks may be inadequate in a different case that poses different and more serious

---

[75] Staff's Brief, ¶ 6.
[76] Staff's Brief, ¶ 43.
[77] *Verizon/MCI Order,* ¶ 57 (emphasis added).
[78] *In The Matter of the Application of PacifiCorp and Scottish Power, PLC,* Docket No. UE-981627, Third Supplemental Order, p. 2.

risks.[79] Staff and Joint Applicants have frequently cited the PacifiCorp and Cascade merger settlements as precedent in support of approval here. While there are some similarities, there are also important differences between this acquisition and the PacifiCorp and Cascade mergers. Neither of those transactions involved the "Macquarie model" or its underlying financial model. Neither took place in a context of serious national and international financial crisis. A further and very significant distinction is that in the PacifiCorp transaction no debt was issued by PacifiCorp to help fund the merger. All new debt was issued by MEHC. PacifiCorp itself did not become **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXX. **[End Highly Confidential]**[80]

VI. ACCESS TO CAPITAL

A. Staff's Position on Brief Is Not Supported By The Evidence.

59. Staff has taken inconsistent positions on the "access to capital" issue. Staff's Brief says that "opinions differ" on the issue and that "it is fair to conclude that it will be a challenge for PSE to raise hundreds of millions of dollars through 2013 (i.e. under the *status quo*) compared to the [sic] under the transaction."[81] Staff's position on brief is not supported by its own evidence in the case. After a detailed analysis of the Joint Applicants' claims, Staff witness Mr. Elgin concluded in his Direct Testimony that: "the Joint Applicants' 'access to capital' argument that

[79] Exh. No. 253, p. 41 (Stephen Hill NRRI Report, noting that "absolute isolation of risks is not possible" even with ring fencing and discussing S&P and Fitch concurring views.

[80] *In the Matter of the Joint Application of MidAmerican Energy Holdings Company and PacifiCorp dba Pacific Power & Light Company For an Order Authorizing Proposed Transaction*, Docket No. UE-051090, Joint Application, pp. 6-7.

[81] Staff's Brief, ¶ 20.

underlies the proposed transaction is not compelling; *there are no impediments to PSE's ability to raise sufficient capital on reasonable terms absent the transaction.*"[82]

60. There still has been no persuasive showing that PSE cannot raise capital under the status quo. Staff's Brief acknowledges that "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 programs."[83]

B. Staff Blurs The Distinction Between Equity and Debt Capital.

61. Staff's Brief incorrectly describes the transaction as providing "substantial amounts of new equity capital"[84] for PSE to meet its substantial capital needs. Staff states "under the transaction PSE will have all of its need for equity capital satisfied through 2013."[85] However, according to the brief, this equity is made available by means of "committed credit facilities for PSE to access[.]"[86] Staff does not directly address or acknowledge that **[Begin Highly Confidential]** XXXXXXX **[End Highly Confidential]** of the new capital offered by the investors is derived from debt.[87] This blurring allows Staff to compare the *status quo* option of "traditional stock issuances ...to the public" with the "equity ...available in committed credit facilities" as if they are equivalent forms of financing.[88]

62. By glossing over the distinction between equity and debt capital in this fashion, Staff's brief obscures one of the major issues in this case. No fiscally responsible manager of a

[82] Exh. No. 161HCT, p. 39:15-17 (Elgin Direct); *see generally* Section V. of Mr. Elgin's Direct ("The Joint Applicants' Rationale for the Transaction"), *Id.* pp. 17-28.
[83] Staff's Brief, ¶ 20.
[84] Staff's Brief, ¶ 20.
[85] Staff's Brief, ¶ 17.
[86] Staff's Brief, ¶ 21.
[87] Public Counsel Brief, ¶ 29, citing Exh. No. 51, p. 77; TR. 808:11-14 (Leslie).
[88] Staff's Brief, ¶¶ 20-21.

business would ignore the reality that the new Puget would be relying on **[Begin Highly Confidential]** XXXXXXXXX **[End Highly Confidential]** financing, at the parent company level, with the cash flow generated by the operating company ultimately obligated to pay for that debt.

C. Joint Applicants and Staff Inaccurately Describe Puget's Capital Needs.

63. Staff's presentation of PSE's capital needs is inaccurate. Staff's Brief states "PSE expects to fund $1.4 billion of this $3.4 billion [external capital need] with equity," citing testimony of Puget witness Justin Pettit.[89] In the next sentence, Staff cites Chief Financial Officer Eric Markell's testimony that the amount of external capital to be financed in the public markets is $900 million in equity. This discrepancy was noted at the hearing -- $900 million is the correct figure.[90]

64. Joint Applicants' Brief makes no mention of the discrepancy, using the $1.4 billion figure as the capital need that "will need to be financed with primarily equity and equity-like securities."[91] As Public Counsel's Brief explains, Mr. Pettit's overstated estimate is based on inclusion of hybrid securities which are debt not debt on the company balance sheet.[92]

65. Joint Applicants' Brief describes Puget's estimated equity issuances in the next five years as "well above the industry average equity issuance," stating for example that "PSE needs represent 90th percentile equity needs,"[93] relying primarily on the testimony of Mr. Pettit. As Public Counsel's Brief demonstrates in detail, Mr. Pettit's conclusions overstate the size of

---

[89] Staff's Brief, ¶ 17 and n.29.
[90] Public Counsel Brief, ¶37, citing TR. 674:3-10 (Markell); Staff's Brief, ¶ 20, n. 36, quoting Mr. Reynolds use of the $900 million figure. Staff appears to accept the Joint Applicants' approach of removing the recent $300 million equity issuance from the calculation of past issuances.
[91] Joint Applicants' Brief, ¶ 23.
[92] Public Counsel Brief, ¶ 37.
[93] Joint Applicants' Brief, ¶ 24.

Puget's capital need, as mentioned above, and then use a faulty analysis to understate industry averages.[94]

D. Staff's Discussion of Patient Capital Is Not Persuasive.

66. Staff mischaracterizes Public Counsel's concern about the length of commitment of these investors as a concern that they will "soon opt out" or will flip their investment in PSE.[95] Staff appears to endorse the Joint Applicants "patient capital" argument, describing the Investor Consortium as "committed long term investors" who have not entered the investment to "flip it."[96] Staff also seeks to minimize the importance of a future sale of the company as if to say it is almost a routine matter.[97] This disregards the potential impact that any sale transaction inevitably has on the company, with the potential disruptions in management, financial structure, transaction costs, and regulatory review.

67. Staff's critique is off target. Public Counsel has never argued that the investors intend to "flip" their Puget investment. It is worth remembering, however, that the advocacy in favor of this transaction has portrayed it as essentially an open-ended long term investment that would free Puget from the uncertainties of the financial markets. In his Direct Testimony in this case, for example, Macquarie witness Mr. Leslie, when asked to describe the investment goals of the Investor Consortium, stated that the investors "*do not require a sale or defined exit strategy to achieve their investment goals.*"[98] When asked to explain, he elaborated:

> Many institutional investors are willing to commit to an investment for a set number of years only if they receive a commitment that the fund will exit the investment at the end of that term. Private equity typically works in this fashion....The Macquarie Group and the Investor Consortium members approach

[94] Public Counsel Brief ¶¶ 35-39.
[95] Staff's Brief, ¶ 104.
[96] *Id.*
[97] Staff's Brief, ¶ 105.
[98] Exh. No. 31T, p.6:22-7:1 (Leslie Direct)(emphasis added).

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

infrastructure investments very differently than the way private equity funds approach investments. Because they have long-term investment horizons and are constantly receiving new funds to invest, the Investor Consortium investors do not necessarily want the assets to be sold in the near or medium term. The Macquarie Group's investment in the Chicago Skyway, for example, is based on a 99 year concession.[99]

As a result of the discovery in this case conducted by Public Counsel it is now known that the transaction is structured for Macquarie's equity partners as a closed-end **[Begin Highly Confidential]** XXXXXXX **[End Highly Confidential]**[100] investment with extension options. All of the financial modeling is consistent with this. This fact was not voluntarily disclosed and was designated highly confidential. Joint Applicants now seek to downplay its significance.

68. The Oregon Public Utility Commission examined this same issue in its decision on the proposed Texas Pacific Group (TPG) acquisition of Portland General Electric (PGE). The evidence was that TPG would hold PGE for up to 12 years. The Oregon Commission reviewed the range of factors and incentives resulting from this "short term ownership" plan and concluded: "we find that PGE's customers may be harmed by the proposed acquisition, in that short-term ownership makes it somewhat more likely that they will be exposed to the effects of poor spending and investment decisions."[101]

69. It is not an inconsequential consideration that the financial viability of this investment for the equity investors is premised on the finite term and the various "exit strategies" that are available. This means that in **[Begin Highly Confidential]** XXXXX **[End Highly Confidential]** time, PSE may again be faced with the costs and disruptions of a sale or merger

[99] *Id.*, p. 7:6-20 (Leslie Direct).
[100] Exh. No.50, p. 11. Public Counsel Data Request No. 3005.
[101] *In the Matter of the Oregon Electric Utility Company, LLC, et al. Application for Authorization to Acquire Portland General Electric Company*, Public Utility Commission of Oregon, Docket UM 1121, Order No. 05-114, pp. 24-27.

transaction, solely to serve the financial interests of the investors.

VII. CONCLUSION

70. For the foregoing reasons, as well as those set out in its opening brief, Public Counsel respectfully requests that the Commission find that the proposed transaction as described in the Settlement Stipulation is not in the public interest.

DATED this 24th day of October, 2008.

ROBERT M. McKENNA
Attorney General

Simon J. ffitch
Senior Assistant Attorney General
Public Counsel