

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. U-170970

SUPPLEMENTAL TESTIMONY OF

JOHN J. REED

CONCENTRIC ENERGY ADVISORS

ON BEHALF OF HYDRO ONE LTD.
AND AVISTA CORPORATION

1 **I. INTRODUCTION**

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

3 A. My name is John J. Reed. I am President and Chief Executive Officer of
4 Concentric Energy Advisors, Inc. (“Concentric”) and CE Capital Advisors, Inc. (“CE Capital”),
5 which has its headquarters at 293 Boston Post Road West, Suite 500, Marlborough,
6 Massachusetts 01752.

7 **Q. On whose behalf are you submitting this testimony?**

8 A. I am testifying on behalf of Hydro One Limited (“Hydro One”) and Avista
9 Corporation (“Avista”). Hydro One filed an Application seeking an order authorizing Hydro
10 One, acting through its indirect subsidiary Olympus Equity LLC, would acquire all of the
11 outstanding common stock of Avista and Avista would become a direct, wholly-owned
12 subsidiary of Olympus Equity LLC and an indirect, wholly-owned subsidiary of Hydro One
13 (the “Proposed Transaction” and “Application for Approval of Transaction”). Hydro One and
14 Avista subsequently executed an all-party stipulation (“Settlement Stipulation”) with the Staff
15 of the Washington Utilities and Transportation Commission (“Staff”), the Public Counsel Unit
16 of the Washington Office of Attorney General (“Public Counsel”), Northwest Industrial Gas
17 Users (“NWIGU”), Industrial Customers of Northwest Utilities (“ICNU”), The Energy Project,
18 Northwest Energy Coalition (“NVEC”), Renewable Northwest (“RNW”), Natural Resources
19 Defense Council (“NRDC”), Sierra Club, and Washington and Northern Idaho District Council
20 of Laborers (“WNIDCL”) (individually a “Party” and collectively the “Parties”). The
21 Settlement Stipulation was filed with the Washington Utilities and Transportation Commission
22 (“Commission”) on March 27, 2018.

1 **Q. Please describe your educational background and professional experience**
2 **in the energy and utility industries.**

3 A. I have more than 40 years of experience in the energy industry and have worked
4 as an executive in, and consultant and economist to, the energy industry. Over the past 29 years,
5 I have directed the energy consulting services of Concentric, Navigant Consulting, and Reed
6 Consulting Group. I have served as Vice Chairman and co-CEO of the nation's largest publicly-
7 traded consulting firm and as Chief Economist for the nation's largest gas utility. I have
8 provided regulatory policy and regulatory economics support to more than 100 energy and
9 utility clients and have provided expert testimony on regulatory, economic, and financial
10 matters on more than 150 occasions before the Federal Energy Regulatory Commission
11 ("FERC"), Canadian regulatory agencies, state utility regulatory agencies, various state and
12 federal courts, and before arbitration panels in the United States and Canada. As an industry
13 expert, I have been involved in numerous utility transactions over the past 20 years, including
14 mergers, divestitures, asset acquisitions, and reorganizations. In addition to this transaction, I
15 have advised clients involved in utility transactions in Arizona, Connecticut, Delaware, the
16 District of Columbia, Hawaii, Kansas, Illinois, Indiana, Iowa, Louisiana, Maryland,
17 Massachusetts, Michigan, Minnesota, New Hampshire, New Jersey, New York, Pennsylvania,
18 Rhode Island, Texas, Utah, and Wisconsin. I have appeared as an expert witness in several
19 jurisdictions on the topics of merger policy standards, acquisition financing plans, merger
20 benefits analyses, affiliate codes of conduct, impacts on competition and energy markets, and
21 merger-related commitments or conditions. I am a graduate of the Wharton School of Business
22 at the University of Pennsylvania, and previously attended the University of Kansas. My
23 background is presented in more detail in Exh. JJR-2.

1 **Q. Please describe Concentric’s activities in energy and utility engagements.**

2 A. Concentric provides financial and economic advisory services to many energy
3 and utility clients across North America. Our regulatory, economic, and market analysis
4 services include utility ratemaking and regulatory advisory services, energy market
5 assessments, market entry and exit analysis, corporate and business unit strategy development,
6 demand forecasting, resource planning, and energy contract negotiations. Our financial
7 advisory activities include both buy- and sell-side merger, acquisition and divestiture
8 assignments, due diligence and valuation assignments, project and corporate finance services,
9 and transaction support services. In addition, we provide litigation support services on a wide
10 range of financial and economic issues on behalf of clients throughout North America. CE
11 Capital is a fully registered broker-dealer securities firm specializing in merger and acquisition
12 activities. As CEO of CE Capital, I hold several securities licenses that cover all forms of
13 securities and investment banking activities

14 **Q. What is the purpose of your testimony?**

15 A. The purpose of my testimony is to provide my assessment of the reasonableness
16 and sufficiency of the governance, financial integrity and ring-fencing provisions of the
17 Commitments attached as Appendix A to the Settlement Stipulation¹ in light of the recent
18 political developments in the Province of Ontario (the “Province”) and changes in Hydro One’s
19 executive management and board of directors.

¹ U-170970, All Party Settlement Stipulation (March 27, 2018) (“Settlement Stipulation”).

1 **Q. What is your understanding of the recent political developments in the**
2 **Province and the governance changes at Hydro One?**

3 A. Hydro One agreed on July 11, 2018, that its existing Board of Directors would
4 resign by August 15 and Hydro One’s President and Chief Executive Officer (the “CEO”)
5 would retire, effective immediately. On August 14, 2018, Hydro One announced its new 10-
6 member Board of Directors (the “Board”). Hydro One’s new Board is in the process of
7 selecting a new CEO. It is my understanding that the replacement of Hydro One’s Board was
8 generally consistent with the Governance Agreement (the “Governance Agreement”) between
9 Hydro One and Her Majesty the Queen in Right of Ontario (the “Province”) as described in the
10 Supplemental Testimony of James Scarlett (Exh. JDS-1T, “Scarlett Testimony”) and with the
11 July 11, 2018 Letter Agreement between Hydro One and the Province (“July 2018 Letter
12 Agreement”), provided as Exh. JDS-2 and as an attachment to the Comments of Avista and
13 Hydro One as Joint Applicants in Reference to Management Changes at Hydro One, U-170970
14 (July 18, 2018) (“Avista and Hydro One Comments”).

15 On July 16, 2018, the new Provincial government introduced the *Urgent Priorities Act,*
16 *2018*, which, included as Schedule 1, the *Hydro One Accountability Act, 2018*. The *Urgent*
17 *Priorities Act* received Royal Assent on July 25, 2018, which is the day it came into force as
18 law in Ontario. Schedule 1, the *Hydro One Accountability Act* (the “Act”) came into force on
19 the day named by proclamation of the Lieutenant Governor, which occurred on August 15. The
20 Act requires, among other things, the Board of Hydro One to establish a new compensation
21 framework for the Board, CEO, and other executives in consultation with the Province and the
22 other five largest shareholders. The Act will not apply to Avista if Avista becomes a subsidiary
23 of Hydro One.

1 Please refer to the Scarlett Testimony (Exh. JDS-1T) and the Avista and Hydro One
2 Comments for a more in-depth discussion of these recent developments at Hydro One.

3 **Q. How is the remainder of your testimony organized?**

4 A. Section II summarizes my key conclusions. In Section III, I evaluate the
5 governance commitments made by Hydro One and Avista in the Settlement Stipulation.
6 Section IV provides my evaluation of the ring-fencing commitments made by Hydro One and
7 Avista. In Section V, I evaluate the financial integrity commitments made in the Settlement
8 Stipulation. Finally, Section VI presents my conclusions regarding the Proposed Transaction.

9 **Q. Are you sponsoring any exhibits as part of your testimony?**

10 A. Yes. Attached to my testimony are:

- 11 • Exh. JJR-2 - Resume and testimony listing
- 12 • Exh. JJR-3 - Recent Merger Governance-Related Conditions
- 13 • Exh. JJR-4 - Recent Merger Ring-Fencing Conditions
- 14 • Exh. JJR-5 - Recent Merger Financial Integrity-Related Conditions

15 A table of contents for my testimony is as follows:

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II. SUMMARY OF KEY CONCLUSIONS

Q. Please begin by providing your general observations about the recent political developments in the Province and the governance changes at Hydro One.

A. While changes in Directors and executives are part of the normal course of business, simultaneously changing both the Board of Directors and the CEO is unusual. It is important to consider the potential implications of these changes for the Proposed Transaction, Avista, its ratepayers and the public interest. I have reviewed the Settlement Stipulation, which includes an integrated and comprehensive set of governance, ring-fencing, financial integrity and other regulatory commitments (individually “Stipulated Commitment No.”, collectively, the “Stipulated Commitments”). All the Parties to the Washington proceedings executed the Settlement Stipulation, agreeing that with the Stipulated Commitments attached thereto, the

1 Proposed Transaction “meets the net benefit and public interest standards under RCW
2 80.01.040(3), RCW 80.12.020 and WAC 480-143-170 required for approval in Washington”
3 and “the evidence demonstrates that the Proposed Transaction is in the public interest and
4 should be approved by the Commission.”² Nothing in the recent political changes in the
5 Province and governance changes at Hydro One should change that conclusion. The Stipulated
6 Commitments made in the Settlement Stipulation, in particular the Avista governance, ring-
7 fencing and financial integrity commitments, provide significant protections for customers and
8 support the public interest. There is nothing to suggest that once the Proposed Transaction
9 closes, Avista customers or the public interest in Washington will suffer any ill effects from the
10 recent events discussed above or from potential future actions of the Provincial government.

11 **Q. Please summarize your key conclusions regarding the Avista Board of**
12 **Directors, ring-fencing, financial integrity and other Stipulated Commitments in the**
13 **Settlement Stipulation.**

14 A. The Settlement Stipulation provides a robust, state-of-the-art set of governance,
15 ring-fencing, and other Stipulated Commitments both to provide the appropriate separation of
16 Avista from Hydro One and its other affiliates and subsidiaries, and to protect Avista customers
17 from potential future risks. The Stipulated Commitments are very robust and well in excess of
18 industry norms established by commitments made in other recent utility mergers and
19 acquisitions.

20 The Stipulated Commitments were specifically designed to address Hydro One’s
21 ownership of Avista and the Province’s role as the largest investor in Hydro One. The

² Settlement Stipulation at p. 4.

1 Stipulated Commitments also address the regulation of Hydro One by the Ontario Energy Board
2 (the “OEB”), an agent of the Province which regulates natural gas and electricity utilities in
3 Ontario. Among other things, the OEB sets rates and licenses all participants in the Province’s
4 electricity and natural gas sectors. While the OEB is an independent agency, it is still subject
5 to provincial legislation. In summary, these Stipulated Commitments provide for:

- 6 • The independence of Avista’s Board of Directors, CEO, and executives
7 whereby seven of Avista’s nine Directors will either be independent as
8 defined by the New York Stock Exchange (“NYSE”) rules
9 (“Independent Directors”) or appointed by Avista, making it impossible
10 for Hydro One, the Province, or any shareholder to direct the governance
11 or management of Avista;
- 12 • The Avista Board of Directors to make all decisions regarding the
13 governance, business operations and local presence/community
14 involvement Stipulated Commitments;
- 15 • Continued capital investment in strategic and economic development
16 items;
- 17 • Hydro One’s provision of equity to support Avista’s capital structure;
18 and
- 19 • Ensuring Avista’s financial integrity by maintaining separate credit
20 ratings and debt instruments, prohibiting inter-company debt and
21 lending, restriction on pledging utility assets, and restrictions on Avista’s
22 upwards dividends and distributions, as well as restrictions and
23 protections in the unlikely event of a bankruptcy.

1 The efficacy of the Stipulated Commitments made as part of the Settlement Stipulation
2 is unchanged by recent events. If anything, recent events highlight the validity of these
3 Stipulated Commitments and the unusual level of separation they provide between Hydro One
4 and Avista and restrictions on Hydro One and the Province as it pertains to Avista.

5 Taken as a whole, and in combination with the Commission's on-going regulatory
6 oversight and authority over Avista, these Stipulated Commitments are appropriate and fully
7 address potential risks by ensuring that customers are protected from potential risks of the
8 Proposed Transaction and will continue to enjoy safe and reliable electric service.

9

10 **III. THE SETTLEMENT STIPULATION'S GOVERNANCE COMMITMENTS**

11 **Q. Please briefly highlight the Settlement Stipulation's governance-related**
12 **commitments.**

13 A. The Settlement Stipulation's governance-related commitments start with
14 specific requirements regarding Avista's Board of Directors. As discussed by Hydro One's
15 Executive Vice President and Chief Legal Officer James Scarlett,³ if the Proposed Transaction
16 is approved and closes Avista will continue to be governed by its own, independent Board of
17 Directors, separate from the Hydro One Board. Stipulated Commitment No. 3 requires that
18 Avista's Board of Directors consist of nine members: (1) five Independent Directors, as defined
19 by the NYSE rules, three of whom are also residents of the Pacific Northwest and are designated
20 by Hydro One, and two of whom are designated by Avista and are members of Avista's current
21 Board, (2) two additional Avista designated Directors, including Avista's CEO, and (3) two
22 executives of Hydro One or any of its subsidiaries. The implementation of Stipulated

³ Exh. JDS-1T, § VI.

1 Commitment No. 3 will result in seven of the nine members of Avista’s post-closing Board of
2 Directors being either NYSE-independent or designated by Avista, ensuring continued Avista
3 focus for its Board of Directors.

4 **Q. How do the NYSE rules define “Independent” and what is its import for**
5 **Avista’s post-closing governance?**

6 A. The NYSE rules define “independent” as “no material relationship” with the
7 company “either directly or as a partner, shareholder or officer of an organization that has a
8 relationship with the company”.⁴ In establishing this definition, the NYSE noted that
9 “[e]ffective boards of directors exercise independent judgment in carrying out their
10 responsibilities. Requiring a majority of independent directors will increase the quality of board
11 oversight and lessen the possibility of damaging conflicts of interest.”⁵

12 **Q. Were commitments made to ensure that the composition of Avista’s Board**
13 **of Directors provided in Stipulated Commitment No. 3 will be maintained in the future as**
14 **individual Directors may turn over?**

15 A. Yes. Stipulated Commitment No. 3 specifically provides that if any Avista
16 designee resigns, retires or otherwise ceases to serve as a director of Avista for any reason, the
17 remaining three Avista designees shall nominate a replacement director to fill such vacancy.
18 Nominations are approved by the Avista Board of Directors.

⁴ NYSE, Inc., Listed Company Manual Section 303A.02 (2018),
<http://wallstreet.cch.com/LCMTTools/PlatformViewer.asp?selectednode=chp%5F1%5F4%5F3&manual=%2Fm%2Fsections%2Fm%2Dsections%2F> (last visited Sept. 5, 2018, 4:17 PM).

⁵ NYSE, Inc., Listed Company Manual Section 303A.01 Commentary (2018),
<http://wallstreet.cch.com/LCMTTools/PlatformViewer.asp?selectednode=chp%5F1%5F4%5F3&manual=%2Fm%2Fsections%2Fm%2Dsections%2F> (last visited Sept. 5, 2018, 4:18 PM).

1 The Delegation of Authority (*see* Appendix 5 of the Joint Application)⁶ provides that
2 Hydro One may replace the Hydro One designated Directors, provided that three are
3 Independent. The Delegation of Authority also provides Hydro One with some limited latitude
4 in satisfying this commitment: if it were unable to appoint an Independent Director residing in
5 the Pacific Northwest in a timely manner, Hydro One could appoint an interim Director for no
6 more than a six-month term who is an employee of Hydro One or one of its subsidiaries while
7 it found a suitable Independent Director.

8 **Q. Are you aware of Hydro One and Avista’s proposal to limit Hydro One’s**
9 **latitude with respect to Hydro One’s designated Independent Directors on the Avista post-**
10 **merger board?**

11 A. Yes. Hydro One and Avista propose to amend the Delegation of Authority to
12 eliminate this limited latitude under certain circumstances. As discussed in the Scarlett
13 Testimony, Hydro One and Avista propose that this exception shall not apply if, at any time a
14 circumstance arises, and during the pendency of any such circumstance, whereby the Province
15 exercises its rights as a shareholder of Hydro One, or uses legislative authority, or acts in any
16 other manner whatsoever, that results, or would result, in Ontario appointing nominees to the
17 Board of Directors of Hydro One that constitute, or would constitute a majority of the directors
18 of such board.

19 **Q. What is the importance of this amendment to the Delegation of Authority?**

20 A. This proposed amendment to the Delegation of Authority provides extra
21 protection for the independence of the Avista Board in the event that the Province takes some

⁶ U-170970, Joint Application for an Order Authorizing Proposed Transaction, Appendix 5 Delegation of Authority to Avista Board of Directors (Sep. 14, 2017).

1 action in the future to control a majority of the Hydro One Board. If that event occurs, this
2 amendment is triggered and blocks Hydro One's limited right to replace any of its three
3 Independent Director designees on the Avista board with a Hydro One executive or employee.
4 This limitation makes clear that there are no circumstances under which the Province or Hydro
5 One can control the Avista Board.

6 **Q. Does the Settlement Stipulation include any other specific governance**
7 **commitments?**

8 A. Yes. Stipulated Commitment No. 2 provides that Avista will seek to retain its
9 current executives post-closing of the Proposed Transaction subject to voluntary retirements
10 and Avista's ability to select and retain personnel best able to meet its needs over time. The
11 Avista Board of Directors retains the ability to dismiss executive management of Avista and
12 other Avista personnel for standard corporate reasons. This commitment reinforces Avista's
13 control over its executives.

14 **Q. Has Hydro One made any additional governance-related commitments**
15 **incremental to those made in the Settlement Stipulation?**

16 A. Yes. In response to recent events, Hydro One and Avista have proposed an
17 additional commitment to provide additional clarity regarding the responsibility of the Avista
18 Board of Directors. In the Avista and Hydro One Comments, Hydro One made the following
19 additional commitment:

20 Avista Employee Compensation: Any decisions regarding Avista employee
21 compensation shall be made by the Avista Board consistent with the terms
22 of the Merger Agreement between Hydro One and Avista, and current
23 market standards and prevailing practices of relevant U.S. electric and gas
24 utility benchmarks. The determination of the level of any compensation
25 (including equity awards) approved by the Avista Board with respect to any

1 employee in accordance with the foregoing shall not be subject to change
2 by Hydro One or the Hydro One Board.⁷

3 This new commitment makes clear that the Avista Board, and not the Hydro One Board,
4 the Province, or any other party, will make decisions regarding Avista employee compensation.

5 **Q. Did you evaluate how the Settlement Stipulation's governance**
6 **Commitments compare to other recent utility mergers and acquisitions in the U.S.?**

7 A. Yes. I considered 40 transactions involving the merger or acquisition of a U.S.
8 investor owned utility ("IOU") that have been completed since 2010. My review was based
9 upon publicly-available information about these transactions including state commission orders
10 and information published by SNL Financial, an industry-specific financial market data source
11 for public and private companies worldwide.

12 **Q. How do the governance Stipulated Commitments compare to governance**
13 **commitments made in these other IOU transactions?**

14 A. The governance Stipulated Commitments compare very favorably with the
15 governance commitments made in these other IOU transactions. Exh. JJR-3 provides a
16 summary of the governance conditions in these transactions. As shown in that exhibit, none of
17 the transactions I reviewed included all of the governance commitments made by the Parties in
18 the Stipulated Commitments. In particular, the new commitment regarding executive
19 compensation was not made or required in any of the other transactions I reviewed or have been
20 involved in. Further, commitments similar to Stipulated Commitment No. 3, Board of
21 Directors, and Stipulated Commitment No. 2, Executive Management, are rarely used or
22 required.

⁷ See Avista and Hydro One Comments at p.8, ¶ 14.

1 **Q. Why is comparing the Stipulated Commitments made by Hydro One and**
2 **Avista to the commitments made by counterparties to IOU transactions informative?**

3 A. While the commitments made in a given transaction should be specific to that
4 transaction's specific circumstances, there are clear industry norms regarding the nature of
5 merger commitments. Some amount of governance-related commitments, ring-fencing-related
6 commitments, and financial integrity commitments are seen in many transactions. The Parties'
7 Stipulated Commitments, however, are well beyond industry norms. I discuss this further in
8 my review of ring-fencing commitments. The import of this observation is simply that more
9 restrictive commitments are being made by Hydro One and Avista through the Settlement
10 Stipulation to ensure that Avista and its Washington customers are protected from risk.

11 **Q. Did your comparison include foreign acquisitions of U.S. IOUs?**

12 A. Yes. Eleven of the transactions I reviewed involved the acquisition of a U.S.
13 IOU by a foreign entity. Of these eleven transactions, ten involved a Canadian acquirer. *See*
14 Exh. JJR-3. None of these transactions included all of the Parties' governance Stipulated
15 Commitments. Only two, Alta Gas' acquisition of WGL and Fortis' acquisition of CH Energy,
16 contained both a majority Independent Board requirement and a commitment to offer
17 employment to executives of the acquired utility.

18 **Q. Are there examples of mergers involving the acquisition of a U.S. IOU by a**
19 **foreign government?**

20 A. Yes. While less common, there are examples of foreign government ownership
21 of U.S. IOUs. EPCOR Utilities Inc., an Edmonton, Alberta-based water and wastewater utility
22 company owned by the City of Edmonton, has acquired four U.S. water utilities collectively
23 serving approximately 175,000 customers for a combined transaction value of approximately

1 \$510 million.⁸ Each of these transactions was approved by the Arizona Public Service
2 Commission (“APSC”). No governance commitments were made, nor were any governance
3 conditions required by the APSC in these transactions.

4 **Q. Does the Settlement Stipulation include other Stipulated Commitments**
5 **supportive of its governance commitments?**

6 A. Yes. Several other Stipulated Commitments pertaining to Avista’s business
7 operations and local presence/community involvement post-merger make clear and binding
8 Hydro One’s commitment to Avista’s management and provision of safe and reliable utility
9 service regardless of changes at Hydro One or the Province. Stipulated Commitment No. 4
10 specifies that Avista will maintain its brand and Avista will establish the plan for its operation.
11 Avista will also maintain both its staffing and presence in the communities in which Avista
12 operates at levels sufficient to maintain the provision of safe and reliable service and cost-
13 effective operations, consistent with pre-merger levels (Stipulated Commitment No. 10) and its
14 headquarters in Spokane, Washington and office locations in each of its other service territories
15 (Stipulated Commitment No. 9). Stipulated Commitment No. 5 specifies Avista will maintain
16 existing levels of capital allocations for capital investment in strategic and economic
17 development items. Avista will maintain its safety and reliability standards and policies and
18 service quality measures in a manner that is substantially comparable to, or better than, those
19 currently maintained (Stipulated Commitment 15). Finally, Stipulated Commitment No. 1
20 reserves all decision-making authority over the governance, business operations and local
21 presence/community involvement Stipulated Commitments to Avista’s Board of Directors.

⁸ 2011 acquisition of Chaparral, 2012 acquisition of Arizona-American Water, 2013 acquisition of North Mohave, and 2016 acquisition of Willow Valley Water Company. Source: SNL.

1 Any changes to policies provided for in these Stipulated Commitments requires a two-thirds
2 vote of the Avista Board and approval from the Commission and all regulatory bodies with
3 jurisdiction over the Stipulated Commitments (Stipulated Commitment No. 1). Collectively,
4 these Stipulated Commitments support the Settlement Stipulation's governance Stipulated
5 Commitments and make clear that Avista's governance will be independent of Hydro One and
6 Avista's focus will be on the provision of safe and reliable service to its customers.

7 **Q. Do the recent political developments in Ontario and changes in governance**
8 **at Hydro One have any impact on the Settlement Stipulation's governance commitments?**

9 A. No. The governance Stipulated Commitments clearly separate and insulate
10 Avista from the governance of Hydro One and its largest shareholder, the Province. The
11 efficacy of this separation and insulation was demonstrated through the recent developments in
12 the Province, in particular in the acknowledgement and commitment that the *Hydro One*
13 *Accountability Act, 2018* will not apply to Avista if Avista becomes a subsidiary of Hydro One,
14 as discussed in the Scarlett Testimony (Exh. JDS-1T). The governance Stipulated
15 Commitments provide Avista and its Washington customers with appropriate independence and
16 protections; recent events have not created any need for modifications to these commitments.
17 Further, these governance Stipulated Commitments are binding (Stipulated Commitment No.
18 33), the Commission has the authority to enforce them (Stipulated Commitment No. 30) and
19 Avista and Hydro One and/or its subsidiaries submit to state court jurisdiction for enforcement
20 of the Commission's orders (Stipulated Commitment No. 31). Taken as a whole, and in
21 combination with the Commission's on-going regulatory oversight and authority, as well as the
22 ring-fencing and financial integrity Stipulated Commitments that I discuss later in my
23 testimony, the Settlement Stipulation's governance Stipulated Commitments provide customers

1 with appropriate protections and assurances that they will continue to enjoy safe and reliable
2 electric service at rates that reflect their Commission-approved cost of service.

3
4 **IV. THE SETTLEMENT STIPULATION'S RING-FENCING COMMITMENTS**

5 **Q. In addition to its governance Stipulated Commitments, have you also**
6 **reviewed the ring-fencing Stipulated Commitments?**

7 A. Yes, I have. While the governance Stipulated Commitments address the
8 independence of the going-forward governance of Avista under Hydro One ownership, the ring-
9 fencing Stipulated Commitments provide clear objectives, practices and policies, and
10 restrictions to protect Avista and its Washington customers from the unlikely event of a
11 bankruptcy and other potential risks, including potential risks perceived with the recent
12 governance changes at Hydro One and political changes in the Province.

13 **Q. Please briefly highlight the Settlement Stipulation's bankruptcy-related**
14 **ring-fencing Stipulated Commitments.**

15 A. Stipulated Commitment Nos. 42 through 45 are intended to protect Avista in the
16 unlikely event of a bankruptcy. Stipulated Commitment No. 42 provides for a "Golden Share"
17 in the event Avista were to declare voluntary bankruptcy. The "Golden Share" is the sole share
18 of Preferred Stock authorized by the Commission and held by an independent third-party with
19 no financial stake, affiliation, relationship, interest, or tie to Avista or any of its affiliates. The
20 holder of the Golden Share must be authorized by the Commission. Any declaration of
21 voluntary bankruptcy would require the vote of the holder of the Golden Share and in any
22 matters of bankruptcy the Golden Share will override all other outstanding shares of all types
23 or classes of stock. In addition to the holder of the Golden Share, a two-thirds majority vote of

1 Avista's Board of Directors, including the affirmative vote of the Independent Director at
2 Avista, is required for Avista to enter into voluntary bankruptcy (Stipulated Commitment No.
3 43).

4 Stipulated Commitment No. 44 requires Hydro One and Avista to file with the
5 Commission within 90-days of the closing of the Proposed Transaction a non-consolidation
6 opinion, which is a legal opinion addressing the likelihood of the utility becoming an
7 involuntary party to the bankruptcy of an affiliate, concluding that the ring-fencing Stipulated
8 Commitments are sufficient that a bankruptcy court would not order the substantive
9 consolidation of the assets and liabilities of Avista with Hydro One or any of its other affiliates
10 or subsidiaries in the unlikely event of bankruptcy. If the Settlement Stipulation's ring-fencing
11 commitments are not sufficient to secure such a non-consolidation opinion, then Hydro One
12 must propose and implement upon the Commission's approval additional ring-fencing
13 protections sufficient to obtain a non-consolidation opinion. Further, Hydro One and Olympus
14 Holding Corp. must file an affidavit with the Commission stating that neither Hydro One,
15 Olympus Holding Corp., nor any of their subsidiaries, will seek to include Avista in a
16 bankruptcy without the consent of a two-thirds majority of Avista's board of directors including
17 the affirmative vote of Avista's independent director.

18 Finally, Stipulated Commitment No. 45 provides that all of the common stock of Avista
19 will be owned by Olympus Equity LLC, a bankruptcy-remote special purpose entity, with no
20 debt.

1 **Q. Please briefly highlight the Settlement Stipulation’s other ring-fencing**
2 **Stipulated Commitments.**

3 A. Stipulated Commitment Nos. 46 through 51 work together to provide for the
4 separation and independence of Avista from Hydro One and Hydro One’s other affiliates.
5 Stipulated Commitment No. 48 provides that Olympus Equity LLC will not operate or own any
6 business and will limit its activities to investing in and attending to its shareholdings in Avista.
7 Stipulated Commitment No. 49 commits Hydro One and Avista to making no material
8 amendments to the ring-fencing provisions without the approval of the Commission. Stipulated
9 Commitment No. 47 requires that Avista customers be held harmless from any business and
10 financial risk exposure associated with Hydro One and its other affiliates and any liabilities of
11 any unregulated activity of Avista or Hydro One and its affiliates. Notice will be provided to
12 all current and prospective lenders describing the ring-fencing Stipulated Commitments and
13 stating that there is no recourse to Avista assets as collateral or security for debt issued by Hydro
14 One or any of its subsidiaries. Finally, Olympus Holding Corp. and Avista will notify the
15 Commission of any acquisition by Olympus Holding Corp. of a regulated or unregulated
16 business that is equivalent to 5% or more of the capitalization of Avista or any change in control
17 or ownership of Avista. In addition, Commission approval will be sought of any sale or transfer
18 of any material part (i.e. 10% or more) of Avista, or of any transaction or series of transactions,
19 regardless of size, that would result in a person or entity, other than a wholly owned subsidiary
20 of Hydro One, directly or indirectly, acquiring a controlling interest in Avista or Olympus
21 Holding Corp.

1 Stipulated Commitment Nos. 46 and 51 prohibit the pledging of Avista utility assets and
2 inter-company lending without prior Commission approval. Stipulated Commitment No. 50
3 prohibits inter-company debt without prior notification to the Commission.

4 **Q. How do the Settlement Stipulation's ring-fencing Stipulated Commitments**
5 **compare to other recent utility mergers and acquisitions?**

6 A. The Settlement Stipulation's ring-fencing Stipulated Commitments compare
7 very favorably with the ring-fencing commitments made in other IOU transactions effectuated
8 since 2010. Exh. JJR-4 provides a summary of the ring-fencing conditions in these 40 recent
9 transactions. As shown in that exhibit, the ring-fencing Stipulated Commitments made by the
10 Parties are rarely offered or required. As shown in that exhibit, only one of the transactions I
11 reviewed included all of the ring-fencing commitments in the Settlement Stipulation. In fact,
12 most transactions included none or very few of the ring-fencing Stipulated Commitments.
13 These ring-fencing Stipulated Commitments, in combination with the governance Stipulated
14 Commitments made by the Parties, provide a very strong degree of separation of Avista from
15 Hydro One post-merger. The efficacy of this separation and insulation is unaffected by the
16 recent developments in the Province.

17
18 **V. THE SETTLEMENT STIPULATION'S FINANCIAL INTEGRITY**
19 **COMMITMENTS**

20 **Q. Please briefly highlight the Settlement Stipulation's financial integrity**
21 **Stipulated Commitments.**

22 A. Financial integrity Stipulated Commitment Nos. 34 through 41 work together to
23 ensure that Avista's financial integrity, including its access to capital and ability to make the
24 investments necessary to continue to provide its customers with safe and reliable service, will

1 be maintained post-merger. Stipulated Commitment No. 34 addresses Avista's post-closing
2 access to capital, committing Hydro One to providing Avista with equity to support Avista's
3 capital structure and allow it to access debt financing on reasonable terms. Avista will also
4 maintain separate debt and preferred stock (Stipulated Commitment No. 35). Hydro One and
5 Avista will use reasonable best efforts to ensure that Avista's debt will continue to be separately
6 rated by at least one nationally recognized ratings agency (Stipulated Commitment No. 36) and
7 will notify the Commission of any downgrade of Avista's credit rating to non-investment grade
8 status (Stipulated Commitment No. 37).

9 Stipulated Commitment No. 38 ensures that dividends paid by Avista to Hydro One
10 cannot be financially detrimental to Avista. If Avista does not have an investment-grade credit
11 rating and the ratio of earnings before interest, taxes, depreciation and amortization
12 ("EBITDA") to Avista's interest expense is less than 3.0, then no dividend distribution to
13 Olympus Equity LLC will occur.

14 Finally, Hydro One will not seek to change Avista's pension funding policy and Avista
15 will maintain this policy in accordance with sound actuarial practice (Stipulated Commitment
16 39), and Avista will continue to file reports with the Securities Exchange Commission
17 (Stipulated Commitment No. 40), and comply with the Sarbanes-Oxley Act (Stipulated
18 Commitment No. 41).

19 **Q. Are there any other Stipulated Commitments which support the financial**
20 **integrity commitments that you would like to highlight?**

21 A. Yes. In addition to the ring-fencing Stipulated Commitments which insulate
22 Avista and its customers from Hydro One, a number of other regulatory Stipulated
23 Commitments were made in the Settlement Stipulation that provide additional protections from

1 potential financial risks. Avista will not advocate for a higher cost of debt or equity capital as
2 compared to what Avista's cost of debt or equity capital would have been absent Hydro One's
3 ownership (Stipulated Commitment No. 25). In addition, Avista's actual common equity ratio
4 will be maintained at a level no less than 44% (Stipulated Commitment No. 26). Finally, as I
5 noted earlier in my testimony, Avista will hold Avista customers harmless from any business
6 and financial risk exposures associated with Olympus Holding Corp., Hydro One, and Hydro
7 One's other affiliates (Stipulated Commitment No. 47).

8 **Q. How do the Settlement Stipulation's financial integrity Stipulated**
9 **Commitments compare to other recent utility mergers and acquisitions?**

10 A. The Settlement Stipulation's financial integrity Stipulated Commitments
11 compare favorably with financial integrity commitments made in other IOU transactions
12 effectuated since 2010. Exh. JJR-5 provides a summary of the financial integrity conditions in
13 these 40 recent transactions. As shown in that exhibit, none of the transactions I reviewed
14 included all of the financial integrity commitments in the Settlement Stipulation. In fact, most
15 transactions included only a few of the financial integrity Stipulated Commitments. These
16 financial integrity Stipulated Commitments, in combination with the governance and ring-
17 fencing Stipulated Commitments made by the Parties, provide for the continued prudent
18 financial management of Avista and ensure that Avista's financial management cannot be
19 harmed by Hydro One ownership.

1 **Q. Do the recent political developments in the Province and changes in**
2 **governance at Hydro One have any impact on the Settlement Stipulation's financial**
3 **integrity Stipulated Commitments?**

4 A. No. The financial integrity Stipulated Commitments agreed to by the Parties
5 provide Avista and its Washington customers with appropriate assurances, independence and
6 protections. These Stipulated Commitments insulate Avista and its Washington customers
7 from Hydro One and anything the Province may do in its role as an investor in Hydro One. As
8 I discussed earlier, the dividend restrictions and commitment that Hydro One will provide
9 equity to Avista to support Avista's capital structure agreed to by the Parties to the Settlement
10 Stipulation ensure that Avista cannot be stripped of its capital (Stipulated Commitment 38).

11 Recent events have not created any need for modifications to these Stipulated
12 Commitments. Any recent or future changes at Hydro One or in the Province have no impact
13 on the facts that the Stipulated Commitments are binding (Stipulated Commitment No. 33) and
14 the Commission has the authority to enforce them (Stipulated Commitment No. 30).

15 **Q. Are the financial integrity Stipulated Commitments included in the**
16 **Settlement Stipulation appropriate for the Proposed Transaction?**

17 A. Yes. Taken as a whole, and in combination with the other Stipulated
18 Commitments and the Commission's on-going regulatory oversight and authority, the financial
19 integrity Stipulated Commitments provide customers with appropriate assurances that they will
20 continue to enjoy safe and reliable electric service at rates that reflect their Commission-
21 approved cost of service.

22

1 **VI. CONCLUSIONS**

2 **Q. Do the recent developments at the Province and Hydro One have any**
3 **impact on the public interest in Washington?**

4 A. No, these developments do not affect the public interest. For all the reasons
5 described above, the Stipulated Commitments are fully protective of the public interest in
6 Washington, as well as the interests of Avista's Washington customers.

7 **Q. If the Province took action in the future to exercise influence over or control**
8 **of the Board of Hydro One, would that negatively impact Avista and its customers or the**
9 **public interest in Washington?**

10 A. No. The governance, bankruptcy and financial ring-fencing and other Stipulated
11 Commitments, coupled with the Commission's on-going regulatory oversight of Avista and the
12 laws of the United States in the five states in which Avista operates (Washington, Oregon,
13 Idaho, Montana, and Alaska) put parameters around how Avista will be owned and operated
14 post-merger. As I discussed earlier, the Stipulated Commitments are binding regardless of any
15 actions the Province might take in the future. The Province has no ability to directly influence
16 Avista. The Province cannot pass laws that apply to Avista. Further, even in the speculative
17 scenario where the Province took control of Hydro One and directed the two Hydro One
18 executives on Avista's post-merger board to pursue initiatives that would benefit Hydro One
19 and/or Ontario to the detriment of Avista's financial resources or service, the remaining seven
20 independent or Avista-designated directors on Avista's post-merger board could override that
21 direction.

1 **Q. Are the Stipulated Commitments included in the Settlement Stipulation**
2 **appropriate for the Proposed Transaction?**

3 A. Yes. The Stipulated Commitments are robust and ensure, as intended, that
4 recent developments at Hydro One and the Province, as well as potential future changes, can
5 have no adverse effect on Washington customers or on the interest of the public in Washington.
6 Nothing in the recent developments even suggests that Avista's financial management, access
7 to capital, cost of capital, quality of service, rates, or Hydro One's attention to Avista's needs
8 will be adversely affected. The Settlement Stipulation provides a comprehensive set of
9 Stipulated Commitments that collectively ensure the appropriate level of separation between
10 Avista and Hydro One and Hydro One's other affiliates. The package of Stipulated
11 Commitments exceeds industry norms established by the 40 utility transactions completed since
12 2010 that I reviewed. These Stipulated Commitments insulate Avista, protect its customers
13 from potential risks, and support the public interest. In combination with the Commission's
14 on-going regulatory oversight and authority, the Stipulated Commitments ensure that
15 stakeholders will experience the benefits from the Proposed Transaction, will be insulated from
16 potential risks, and will continue to ensure safe and reliable service at rates that reflect their
17 Commission-approved cost of service.

18 **Q. Does this conclude your testimony?**

19 A. Yes, it does.