Exh. CFL-6T

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. U-170970

SUPPLEMENTAL TESTIMONY OF

CHRISTOPHER F. LOPEZ

REPRESENTING HYDRO ONE

I. INTRODUCTION

Q. Please state your name, business address and present position with Hydro One Limited.

A. My name is Christopher F. Lopez, and my business address is 483 Bay Street, South Tower, 8th Floor, Toronto, Ontario M5G 2P5. I am Senior Vice President of Finance for Hydro One Limited ("Hydro One").

Q. Have you filed testimony in this proceeding?

A. Yes. My prior testimony describes the proposed merger ("Proposed Transaction"), the corporate structure, financing arrangements, ring-fencing, access to capital, rate credits, cost allocations and related benefits to Avista's customers.

Q. Are you sponsoring any exhibits that accompany your testimony?

A. No.

A table of contents for my testimony is as follows:

Summary of Testimony

Q. Please summarize your testimony.

A. My supplemental testimony will describe recent events and demonstrate that the benefits of this transaction for Avista ratepayers remain unchanged since the parties' settlement documents were filed[1] and that recent political developments in Ontario create no risks for Avista or its customers. Specifically, I will:

- Summarize the recent developments in Ontario;
- Summarize and reaffirm my previous testimony explaining how Hydro One is financially healthy and Avista will benefit from having a parent with strong access to capital markets;
- Review the merger commitments relating to Hydro One's financial support for Avista;
- Confirm that Hydro One stands by these commitments and continues to provide the benefits associated with having a financially healthy parent company; and
- Explain why the Ontario election, the July 11, 2018 Letter Agreement between the Province of Ontario (the "Province") and Hydro One (the "July 2018 Letter Agreement") and subsequent events have no effect on these commitments and benefits.

[1] U-170970, Settlement Stipulation and Agreement (March 27, 2018) (including "Stipulated Commitments"); *see also*, Joint Testimony, Joint Parties Exh. JNT-1T (April 10, 2018).

II. SUMMARY OF RECENT DEVELOPMENTS IN ONTARIO

Q. Please summarize recent developments relating to management of Hydro One.

A. There are four developments that I will summarize: the June 7, 2018 election; the July 2018 Letter Agreement; the *Hydro One Accountability Act*, *2018*; and the August 14, 2018 appointment of new board members.

Q. Please describe the June 7, 2018 election as it relates to Hydro One.

A. On June 7, 2018, voters in the Province elected a new majority government led by Premier Doug Ford of the Progressive Conservative Party, which replaced the previous Liberal government led by former premier Kathleen Wynne. The new government was sworn in on June 29, 2018. During the campaign, Mr. Ford stated that he wanted to remove Hydro One's chief executive officer ("CEO") Mayo Schmidt and some or all of the members of Hydro One's Board of Directors ("Board").

During the campaign, members of a different political party, the New Democratic Party or "NDPs," stated that they would try to "bring Hydro One back into public hands" by buying back some or all of Hydro One's shares held by entities other than the Province. The New Democratic Party did not win enough seats to form the provincial government. Mr. Ford and other members of the Progressive Conservative Party, by contrast, made statements throughout the campaign generally supportive of privatization in Ontario's energy sector and did not suggest they would support returning Hydro One to Crown Corporation status.

Q. Please describe the July 2018 Letter Agreement.

A. On July 11, 2018, the 1st Session of the 42nd Parliament of the Legislative Assembly of Ontario commenced. The same day, Hydro One, on behalf of itself and its wholly-owned subsidiary, Hydro One Inc. ("HOI"), announced that following an approach by Hydro One to the Province, they had entered into an agreement for the purpose of the orderly replacement of the Hydro One and HOI boards and the retirement of Mayo Schmidt as the CEO effective July 11, 2018. *See* Exh. JDS-1T (prefiled Supplemental Testimony of James Scarlett ("Scarlett Testimony")) and Exh. JDS-2 thereto (July 2018 Letter Agreement). The Scarlett Testimony describes the July 2018 Letter Agreement in detail.

Q. Please describe the *Hydro One Accountability Act, 2018*.

A. On July 16, 2018, the new Provincial government introduced Bill 2, the *Urgent Priorities Act, 2018*, which enacts or amends various statutes via Schedules to the Bill. It received Royal Assent on July 25, 2018, and is therefore in full force and effect. The Schedules come into force as provided in each Schedule. Schedule 1 is a new Act entitled the *Hydro One Accountability Act, 2018* (the "Act") and took effect on August 15, 2018. This Schedule deals with the compensation framework (and related disclosure obligations) for the directors, CEO and executives of Hydro One and its subsidiaries (except subsidiaries incorporated in jurisdictions outside Canada). The Scarlett Testimony describes the Act in detail. Exh. JDS-3 to the Scarlett Testimony contains a copy of the Act.

This legislation has no impact on (1) Hydro One's contractual commitment to proceed with its acquisition of Avista, (2) the settlement stipulations Hydro One negotiated with parties in Washington and other states, or (3) the Commission's authority to continue to regulate Avista if the merger with Hydro One is consummated.

Q. Please describe the new Hydro One Board.

A. The new Hydro One Board was announced on August 14, 2018. The members of the Board and the process for their appointment are described in detail in Exh. TDW-1T (prefiled Supplemental Testimony of Hydro One Interim Chair Thomas Woods) and the Scarlett Testimony.

Q. Do any of these developments affect Hydro One's proposed acquisition of Avista?

A. No, they do not affect the Proposed Transaction, and Hydro One remains committed to the Proposed Transaction. The transaction was designed to stand the test of time, through changes in personnel at any level. The *Hydro One Accountability Act* has no application to Avista because it specifically refers to Hydro One and its subsidiaries (except subsidiaries incorporated in jurisdictions outside Canada). The appointment of the new Hydro One Board, consistent with the Governance Agreement,[2] demonstrates that Hydro One is continuing to operate as it has in the past. Hydro One is stable and financially strong. Hydro One remains fully capable of performing all of its obligations under all the merger commitments.

[2] *See* Exh. MMS-5.

III. FINANCIAL STRENGTH OF HYDRO ONE

Q. You previously testified that Hydro One was financially strong and is viewed by credit rating agencies as a prudent, well-managed company. Is that still the case?

A. Yes, the credit rating agencies continue to view Hydro One as a prudent, well-managed company. This is demonstrated by strong investment grade credit ratings from Moody's Investors Service ("Moody's"), Standard & Poor's ("S&P"), and Dominion Bond Rating Service ("DBRS"): (i) HOI has an "A (CreditWatch Negative)" long-term credit rating from S&P, a "Baa1 (Stable Outlook)" rating on senior unsecured debt from Moody's, and an "A (High) (Stable Outlook)" rating from DBRS; and (ii) Hydro One has an "A (CreditWatch Negative)" long-term credit rating from S&P. By comparison, Avista's credit ratings are "BBB (CreditWatch Positive)" from S&P and "Baa1 (Negative Outlook)" from Moody's.

Q. Have rating agencies commented on the recent developments that you describe?

A. Yes, several have commented. For example, on July 16, 2018, Moody's published its "Credit Outlook" report. This is a bi-weekly report outlining Moody's outlook on credit implications of current events. The July 16, 2018 report includes a section on Hydro One entitled "Hydro One's Board and CEO Are Forced Out, a Credit Negative." The report concludes that "Ontario's willingness to force out the current board clearly demonstrates that the utility is not immune to direct political interference, a credit negative." The report also concludes that if the Province follows through on its promise to reduce some customer rates by 12%, and that reduction reduces Hydro One's revenue and cash flow, it would be materially credit negative for Hydro One. Reiterating previous statements by Moody's,[3] the report states that Hydro One's completion of the acquisition of Avista is credit negative for both Hydro One and HOI. Finally, the report notes that Hydro One will be following an established process for establishment of a new board.

Q. Did the publication of this Credit Outlook change Moody's credit rating of HOI or Hydro One?

A. No, it did not.

Q. Have the recent developments you described resulted in any changes to credit ratings of Hydro One by Moody's, S&P or DBRS?

A. No, they have not. Neither Moody's nor DBRS have ratings for Hydro One (that is, Hydro One Limited). HOI, the company that holds our regulated utility in Ontario, has ratings from Moody's and from DBRS. Those ratings likewise have not changed as a result of recent developments.

Q. Are these sorts of comments from rating agencies cause for concern about the financial health of Hydro One and its suitability as a parent company for Avista?

A. No, they are not.

Q. Please explain.

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[3] *See* Moody's Investor Service, *Rating Action: Moody's downgrades HOI to Baa1 from A3; rating outlook stable* (June 20, 2018), https://www.moodys.com/research/Moodys-downgrades-Hydro-One-Inc-to-Baa1-from-A3-rating--PR_385523; *see also*, Moody's Investor Service, *Rating Action: Moody's Affirms Hydro One's senior unsecured A3 ratings; outlook changed to negative* (July 19, 2017), https://www.moodys.com/research/Moodys-Affirms-Hydro-Ones-senior-unsecured-A3-ratings-outlook-changed--PR_370021.

A. First, the ratings themselves demonstrate that the rating agencies believe Hydro One remains financially sound. None of the issues that the agencies commented on resulted in a change to the actual ratings. Strong investment grade credit ratings indicate that the company has access to capital on reasonable terms and conditions.

Hydro One's second quarter results, announced on August 14, 2018, underscore its financial stability. Hydro One reported earnings per share (EPS) of Canadian $0.34 and adjusted EPS of Canadian $0.33, compared to Canadian $0.20 in the prior year, an increase of 70% and 65%, respectively.[4] Our "culture of continuous improvement yielded high performance metrics at the contact centre, billing accuracy in excess of regulatory requirements and a further Canadian $6 million decrease in overdue accounts receivable due to proactive support programs."[5] Paul Dobson, our CFO and Acting President and CEO, stated that, "'Hydro One's strong second quarter financial results coupled with continuously improving operational and customer service metrics highlight the underlying strength of the business as well as the Company's positive momentum since the Initial Public Offering in 2015.'"[6]

In Q2, Hydro One obtained Canadian $4.4 billion in credit lines. HOI obtained Canadian $1.4 billion in long-term debt. The long-term debt included a Canadian $750 million 31-year tranche that was issued at a 3.63%, the lowest interest rate in the history of the company.

[4] News Release, Hydro One, Hydro One Reports Strong Second Quarter Results, (Aug. 14, 2018), http://hydroone.mediaroom.com/2018-08-14-Hydro-One-Reports-Strong-Second-Quarter-Results (last visited Aug. 14, 2018).

[5] *Id.*

[6] *Id.*

Second, Hydro One remains a very suitable parent company for Avista for all the reasons discussed in prior testimony. The companies are culturally aligned. Hydro One's market capitalization is approximately three times the size of Avista and will provide Avista with improved access to capital markets as described in Section IV below. Hydro One is a strategic investor, rather than a financial investor, and its interests are aligned with Avista's for long-term success. Hydro One has made a number of commitments to preserve Avista's ability to run its own business on an ongoing basis, for the benefit of Avista's customers.

Finally, Avista is wholly protected from any potential financial turbulence at Hydro One by the financial and ring-fencing commitments described in Section V below.

Q. Have the recent developments you described resulted in any changes to Hydro One's stock price?

A. Hydro One's stock price has changed, although it is impossible to know all the causes for the changes. Hydro One's stock price decreased Canadian $1.21 (or 6.0%) in the month ended July 31 to close at Canadian $19.0. This decline was greater than the average decline of 3.9% in the Utilities - Regulated sector for the same period.[7] During the month of August, Hydro One's stock price stabilized, and closed at Canadian $19.28 on August 31.

Q. Are changes in Hydro One's stock price cause for concern about Hydro One's ability to finance the Proposed Transaction and to satisfy such merger commitments as providing equity on an as-needed basis and maintaining

[7] News Bites Canadian Markets, *Monthly: Hydro One loses CAD620 million (US$474 million) in MCap in July, biggest drop in Utilities - Regulated sector* (July 31, 2018), LexisNexis Newsdesk (subscription req'd).

investment-grade ratings for Hydro One and Avista?

A. No, the changes in Hydro One's stock price have no meaningful impact on the Proposed Transaction.

Q. Please explain.

A. Since May 2018, Hydro One's access to capital and its ability to finance Avista remains largely unchanged. The decline in Hydro One's stock price does not impact Hydro One's ability to finance the Proposed Transaction. We expect the convertible debentures to be fully converted to equity at the previously agreed equity price around the time of the closing of the Proposed Transaction. The equity from the convertible debentures, and the planned US$2.6 billion debt financing, which is supported by the US$2.6 billion in bridge financing, is sufficient to fund the transaction.

Within our current plans we have sufficient financing flexibility to satisfy the merger commitments. Should Hydro One need to access equity markets to meet the merger commitments, it would issue new equity at the prevailing price at that time.

Q. Several of the Stipulated Commitments in the Washington Stipulated Settlement require Avista's shareholder, Hydro One, and not Avista's ratepayers, to provide funding for certain programs (Stipulated Commitment Nos. 11 - Community Contributions; 19 - Rate Credits; 63 - Professional Home Energy Audit; 64 - Community Contributions; 67 - Funding for Low-Income Participation in New Renewables; 69 - Replacement of Manufactured Homes; 70 - Low Income Weatherization; 77 - Montana Community Transition Fund; 79 - On Bill Repayment). How can the Washington Utilities and Transportation Commission (the "Commission") be certain that funding will be available for these Stipulated

Commitments in light of the developments described above?

A. First, with respect to the $30.7 million rate credit provided in Stipulated Commitment No. 19, that credit will simply flow through to Avista customers in the bills issued by Avista without Hydro One having to take any action. Shortly after the merger, Avista will file a tariff rider requesting approval, which will ensure Avista's Washington customers begin receiving the benefit of the rate credit immediately. Although no funds will flow from Hydro One to Avista, Hydro One will bear the burden of these rate credits, as they will reduce the earnings potentially available to Hydro One as dividends. The rate credit constitutes the bulk of Hydro One's funding commitments.

Second, Stipulated Commitment No. 75 establishes that if Avista has retained earnings that would otherwise be available to Hydro One as dividends, those retained earnings can be used to fund Stipulated Commitment Nos. 63, 64, 67, 69, 70, 77, and 79: "To the extent Avista has retained earnings that are available for payment of dividends to Olympus Equity LLC consistent with the ring fencing provisions of this list of merger commitments, such retained earnings may be used. Funds available from other Hydro One affiliates may be used without limitation."[8] In essence, funds otherwise available for payment of dividends to Olympus Equity and on up the chain will instead be directed to funding these commitments: (i) $600,000 over 10 years for professional home energy audits (Stipulated Commitment No. 63); (ii) $5,000,000 over 10 years for low-income participation in new renewables (Stipulated Commitment No. 67); (iii) $2,000,000 over 10 years for replacement of manufactured homes (Stipulated Commitment No. 69); (iv)

[8] Avista's ability to use retained earnings to meet these commitments also will be governed by Hydro One's commitments in Stipulated Commitment Nos. 26, 34, 36-37.

$4,000,000 over 10 years for low-income weatherization in Washington (Stipulated Commitment No. 70); (v) a one-time investment of $3,000,000 for a Colstrip community transition fund (Stipulated Commitment No. 77); (vi) a one-time investment of $105,000 for the On Bill Repayment Program (OBRP) (Stipulated Commitment No. 79); and (vii) the charitable contributions in Stipulated Commitment Nos. 11 and 64. With this approach, there is no need for cash to flow from Hydro One to Avista.

Third, as discussed above, Hydro One remains financially healthy and I have no reason to think that will change.

Fourth, the Commission will have full enforcement authority over the binding commitments included in the Stipulated Settlement, as described in more detail in Exh. JDS-1T (Scarlett Testimony).

Finally, to the extent that there is concern that the Province will not provide the funding for these commitments, the Province will not be involved in meeting these commitments – the obligations are those of Hydro One, not of its shareholders.

IV. AVISTA'S ACCESS TO CAPITAL

Q. How will having Hydro One as a parent affect Avista's access to capital?

A. By being part of a larger, financially strong holding company, Avista's access to capital will improve. Avista is a relatively small utility company as compared with other utility companies in the U.S. As shown in Avista CEO Scott Morris's testimony,[9] Bank of America Merrill Lynch determined that at the time the Hydro One acquisition was announced in July 2017, Avista's market capitalization of $2.7 billion was smaller than all but four publicly-traded U.S. electric utilities covered by Value Line. Post-merger, the combined Hydro One/Avista company would have a market capitalization of approximately $13 billion, placing the new combined company near the middle of U.S. electric utilities by market capitalization.

Being part of the larger Hydro One organization will provide Avista with increased scale that may enhance its ability to compete for capital with larger utility holding companies in the U.S. Hydro One has deep and broad banking relationships. Banks aggressively pursue Hydro One's business. Once Avista is part of Hydro One, it too may realize the benefits of Hydro One's strong financial relationships. Many small and medium size utility companies, such as Avista, are finding that mergers that allow them to increase their size and financial strength are important in order to allow them continued access to capital markets on reasonable terms to finance the ongoing capital needs associated with serving their customers.

V. RING-FENCING COMMITMENTS

Q. Please describe the merger commitments that "ring-fence" Avista's financial position and insulate Avista's customers from any adverse financial impacts associated with the Proposed Transaction.

A. Hydro One, Avista, and all parties (collectively, the "Parties") filed a Stipulated Settlement on March 27, 2018. The Parties negotiated numerous

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[9] Morris, Avista Exh. SLM-2, p. 1.

commitments designed to provide separate governance and financial ring-fencing between Avista and Hydro One. Certain of these merger commitments were developed to ensure that Avista cannot be subjected to political interference or influence by the Province. Key provisions include:

Avista Board Composition. Avista will have a nine-member board separate from Hydro One that will govern Avista's management and operations. Three of the five Avista directors selected by Hydro One (not by the Province) must be independent under NYSE rules. Further, those three directors must be residents of the Pacific Northwest. *See* Stipulated Commitment No. 3.

Olympus Equity LLC Board Composition. Olympus Equity LLC's three-member board must include one independent director. *See* Stipulated Commitment No. 43.

Avista Executive Management. Avista will seek to retain the executive management currently in place, and replacements must be selected by Avista's board -- not Hydro One. *See* Stipulated Commitment No. 2.

Employee Retention. Avista's employees will be retained. *See* Stipulated Commitment Nos. 9, 10.

Equity Support from Hydro One. Hydro One is required to provide Avista with enough equity so that Avista can access debt on reasonable terms. *See* Stipulated Commitment No. 34. Therefore, neither Hydro One, nor the Province, can deprive Avista of its capital and assets.

Separate Avista Credit Ratings. Avista will continue to have its own credit ratings. Hydro One and Avista agree to notify the Commission within two business days of any downgrade of Avista's credit rating to a non-investment grade status. *See* Stipulated Commitment Nos. 36, 37. Therefore, again, neither Hydro One, nor the Province, can deprive Avista of its capital and assets.

Restrictions on Dividends. Avista will be prohibited from issuing dividends if certain financial metrics relating to the equity floor, credit ratings and debt coverage are not met. Basically, this operates to keep retained earnings at the Avista level where they will improve Avista's financial strength. *See* Stipulated Commitment No. 38. This too prevents Hydro One from depriving Avista of its capital and assets.

Golden Share and Other Protections against Bankruptcy Proceedings. Several of the Stipulated Commitments protect Avista from being drawn into bankruptcy proceedings that are not in the best interest of Avista and its customers. Avista will issue a single share of preferred stock referred to as the Golden Share to an independent third party (see Exh. MTT-7). The vote of this share will be required to place Avista into voluntary bankruptcy. *See* Stipulated Commitment No. 42. Further, Avista's entry into voluntary bankruptcy would require the consent of a two-thirds majority of all of its directors, including the affirmative vote of at least one of the Independent Directors at Avista. *See* Stipulated Commitment No. 43. Hydro One and Avista must also provide a non-consolidation opinion to confirm the effectiveness of the ring-fencing measures to prevent the substantive consolidation of the assets and liabilities of Avista with those of the entities above it in the corporate chain of ownership. *See* Stipulated Commitment No. 44. The corporate structure also includes Olympus Equity LLC, a bankruptcy-remote special purpose entity that will have no debt. *See* Stipulated Commitment No. 45. Therefore, neither Hydro One, nor the Province, can obtain Avista's capital and assets through a bankruptcy proceeding unless that would be in the best interests of Avista's customers.

<u>Restriction on Pledge of Assets</u>. Avista's utility assets can be pledged only for the benefit of Avista, not Hydro One. *See* Stipulated Commitment No. 46. Therefore, neither Hydro One nor the Province can strip Avista of its capital and assets.

Q. In light of recent events, have Hydro One and Avista proposed any additional commitments?

A. Yes, Avista and Hydro One have agreed upon an additional commitment to provide further protection to Avista's employees, such that Avista will be able to continue to recruit and retain the most highly qualified employee talent base for our customers:

> Avista Employee Compensation: Any decisions regarding Avista employee compensation shall be made by the Avista Board consistent with the terms of the Merger Agreement between Hydro One and Avista, and current market standards and prevailing practices of relevant U.S. electric and gas utility benchmarks. The determination of the level of any compensation (including equity awards) approved by the Avista Board with respect to any employee in accordance with the foregoing shall not be subject to change by Hydro One or the Hydro One Board.[10]

VI. <u>PROPOSED TRANSACTION FINANCING</u>

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

A. As I previously testified, Hydro One is committed to maintaining an investment-grade balance sheet through and after completion of the acquisition. Hydro

[10] Comments of Avista and Hydro One as Joint Applicants in Reference to Management Changes at Hydro One, U-170970 (July 18, 2018), pp. 8-9.

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

Q. Have recent developments led to any changes in this plan?

A. No, the financing plan described above is still in place.

VII. AVISTA'S FUTURE FINANCIAL HEALTH

Q. Do the commitments in the Application ensure that Hydro One will preserve Avista's financial health?

A. As previously discussed, there is evidence that Avista's credit rating may be improved as a result of the Proposed Transaction -- in fact, Avista's credit rating outlook was revised from Stable to Positive by S&P upon announcement of the deal. Further, Hydro One has specifically committed to maintain Avista's actual common equity ratio at a level no less than 44 percent. *See* Stipulated Commitment No. 26. Hydro One is committed to provide equity to support Avista's capital structure designed to allow Avista access to debt financing under reasonable terms and on a sustainable basis. *See* Stipulated Commitment No. 34. An interlocking provision, Stipulated Commitment No. 25, provides that, "Avista will not advocate for a higher cost of debt or equity capital as compared to what Avista's cost of debt or equity capital would have been absent Hydro One's ownership." Thus, Hydro One has fully protected Avista's financial health against any negative effects from the Proposed Transaction.

Q. Does this conclude your supplemental testimony?

A. Yes it does.