

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. U-170970

SUPPLEMENTAL TESTIMONY OF

JAMES D. SCARLETT

REPRESENTING HYDRO ONE

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

I. INTRODUCTION

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

A. My name is James D. (“Jamie”) Scarlett, and my business address is 483 Bay Street, South Tower, 8th Floor, Toronto, Ontario M5G 2P5. I am Executive Vice President and Chief Legal Officer for Hydro One Limited (“Hydro One”).

Q. Did you submit prefiled direct or rebuttal testimony in this proceeding?

A. No, but I testified at the Commission’s May 22, 2018 evidentiary hearing.

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

A. Yes. Attached to my testimony are:

- Exh. JDS-2 - July 2018 Letter Agreement between Hydro One and Her Majesty The Queen in Right of Ontario
- Exh. JDS-3 - Schedule 1 of the *Urgent Priorities Act, 2018*, titled the *Hydro One Accountability Act, 2018*

A table of contents for my testimony is as follows:

I. INTRODUCTION1

II. JUNE 7, 2018 ELECTION2

III. JULY 11, 2018 LETTER AGREEMENT5

IV. HYDRO ONE ACCOUNTABILITY ACT, 2018.....9

V. THE FUTURE OF THE GOVERNANCE AGREEMENT12

VI. SETTLEMENT COMMITMENTS DESIGNED TO PROTECT AVISTA’S INDEPENDENCE AND FINANCIAL HEALTH.....13

VII. PROPOSED NEW OR AMENDED COMMITMENTS25

VIII. ADOPTION OF MAYO SCHMIDT TESTIMONY.....27

1 **Summary of Testimony**

2 **Q. Please summarize your testimony.**

3 A. My testimony addresses the following topics: (i) the June 7, 2018 election
4 of Premier Doug Ford and the Progressive Conservative Party, (ii) the July 11, 2018 Letter
5 Agreement (“July 2018 Letter Agreement”) and the resignation of Hydro One’s Board and
6 retirement of Hydro One’s Chief Executive Officer (“CEO”) Mayo Schmidt, (iii) the *Hydro*
7 *One Accountability Act, 2018*, (iv) the settlement commitments designed to protect
8 Avista’s independence and financial health from Provincial interference, (v) Avista’s and
9 Hydro One’s proposal to add a new commitment and amend its commitment regarding
10 Avista’s post-merger board in response to the events after the June 7, 2018 Ontario election
11 involving Hydro One, and (vi) my adoption of Mayo Schmidt’s previously filed testimony
12 and exhibits in this proceeding.

13

14 **II. JUNE 7, 2018 ELECTION**

15 **Q. Please describe the outcome of the Province of Ontario’s election on**
16 **June 7, 2018.**

17 A. On June 7, 2018, voters in Ontario elected a new government that will be
18 led by the Progressive Conservative Party, replacing the Liberal Party government led by
19 Kathleen Wynne. The Premier is Doug Ford of the Progressive Conservative Party. The
20 Ontario Premier is the equivalent of a state governor in the United States. The Progressive
21 Conservative Party has a substantial majority in the Legislative Assembly of Ontario.

22 **Q. Has the new government taken office?**

23 A. The new government was sworn in on June 29, 2018.

1 **Q. What promises did Premier Ford make during his campaign regarding**
2 **Hydro One?**

3 A. During the campaign, Premier Ford stated that he would remove Hydro
4 One's CEO Mayo Schmidt and some or all of the members of Hydro One's Board of
5 Directors. Premier Ford also promised to reduce electricity rates for Ontario residents.

6 **Q. What mechanisms were available to Premier Ford to fulfill these**
7 **campaign promises regarding Hydro One's CEO and Board of Directors?**

8 A. If Premier Ford and his Progressive Conservative Party wished to seek to
9 remove some or all of Hydro One's Board and its CEO, they could accomplish these
10 objectives either (i) through procedures established by Section 4.7 of the Governance
11 Agreement (the "Governance Agreement") between Hydro One and Her Majesty the
12 Queen in Right of Ontario (the "Province"), or (ii) through legislation. The Governance
13 Agreement is Exh. MMS-5 to former Hydro One CEO Mayo Schmidt's testimony (Exh.
14 MMS-4T) filed in this docket on April 10, 2018.

15 **Q. Please explain the procedures in Section 4.7 of the Governance**
16 **Agreement.**

17 A. The Governance Agreement establishes an independent Hydro One Board
18 with the following features: the CEO is selected by the Board (not the Province), the
19 Province nominates 40% of the Board's directors (or its proportionate share, whichever is
20 less) proposed for election, the Nominating and Governance Committee (now known as
21 the "Governance Committee") nominates the remaining directors proposed for election,
22 and other than the CEO, each director must be independent of Hydro One and the Province.

23 In order to remove the Hydro One Board, the Province must follow the procedures

1 in Section 4.7 of the Governance Agreement:

2 (1) serve a Removal Notice on Hydro One requesting the removal of Hydro One's
3 Board at a shareholder meeting (the Removal Notice does not apply to Hydro One's CEO
4 even though he is a Board member; the Province also can exempt the chair of the Board
5 from its Removal Notice) (Section 4.7.1);

6 (2) the chair of the Board will establish a committee comprising representatives of
7 Hydro One's five largest shareholders, except the Province (the "Ad Hoc Nominating
8 Committee") (Section 4.7.2);

9 (3) the Ad Hoc Nominating Committee and the Province will work together to
10 develop a slate of new Board members to be considered at an upcoming shareholder
11 meeting (the "Removal Meeting") (Section 4.7.3);

12 (4) once the slate of new Board members is established, the shareholder Removal
13 Meeting must be held within 60 days (Section 4.7.4); and

14 (5) at the Removal Meeting, the Province must vote in favor of the slate of new
15 Board members established by the Ad Hoc Nominating Committee and the Province
16 (Section 4.7.6).

17 Under the Section 4.7 procedures, Hydro One's shareholders must remove the
18 entire Hydro One Board; they cannot remove just certain Board members. (Section 4.7.1)
19 Further, the Board cannot be replaced with any board members who were part of the
20 previous Board. (Section 4.7.3) All nominees must be vetted by the Ad Hoc Nominating
21 Committee (Sections 4.7.3 and 4.3) and must meet the qualification standards set in Section
22 4.2.1 of the Governance Agreement -- each director nominee must be an individual of high
23 quality and integrity who has: (i) significant experience and expertise in business or that

1 is applicable to business, (ii) served in a senior executive or leadership position, (iii) broad
2 exposure to and understanding of the Canadian or international business community, (iv)
3 skills for directing the management of a company, and (v) motivation and availability, in
4 each case, to the extent appropriate for a business of the complexity, size and scale of the
5 business of Hydro One and on a basis consistent with the highest standards for directors of
6 leading Canadian publicly listed companies.

7 Section 4.7 does not permit shareholders to hire or fire Hydro One's CEO. Section
8 4.7 simply provides a process by which Hydro One's shareholders can install a new Board.
9 Section 2.3(b) of the Governance Agreement reserves to the Board the authority to appoint,
10 terminate, supervise and compensate the CEO, Chief Financial Officer and other senior
11 officers of Hydro One.

12 **Q. Please explain the legislative path available to Premier Ford.**

13 A. As an alternative to following the Section 4.7 procedures in the Governance
14 Agreement, Premier Ford and his Progressive Conservative Party also had the option of
15 passing legislation during the special legislative session convened in July that would give
16 the Province the authority to remove and replace the Hydro One CEO and its Board.

17

18 **III. JULY 11, 2018 LETTER AGREEMENT**

19 **Q. What did Hydro One's executive team and Board do after Premier**
20 **Ford was elected and his Progressive Conservative Party took a majority of the seats**
21 **in the Ontario Legislature?**

22 A. On July 4, 2018, discussions were held between representatives of the Board
23 and of the Ontario Premier's office, respectively. On July 5, 2018, discussions were held

1 between legal counsel to the Board and a representative of the Ontario Premier's office and
2 privileged and confidential discussions were held among the Board Chair, another
3 representative of the Board and the Board's legal counsel. Subsequently, representatives
4 of the Board, the Board's legal counsel and representatives of the Ontario Premier's office
5 held various discussions and meetings during July 6, 2018 through July 8, 2018. These
6 discussions involved representatives from the Cabinet Office, and representatives of the
7 Ministry of Energy, Northern Development and Mines, the Ministry of Finance and the
8 Attorney General, and led to the July 2018 Letter Agreement being approved by Cabinet
9 and entered into between Hydro One and Ontario as represented by the Honorable Greg
10 Rickford, the Minister of Energy, Northern Development and Mines. The July 2018 Letter
11 Agreement between Hydro One and Her Majesty The Queen in Right of Ontario is attached
12 as Exh. JDS-2.

13 **Q. Why did Hydro One enter into the July 2018 Letter Agreement with**
14 **the Province?**

15 A. The replacement of the Board and the CEO was one of the campaign
16 promises made by Premier Doug Ford during the election campaign for the election that
17 took place on June 7, 2018. In light of this, the Board of Hydro One determined that it
18 would be in the best interests of Hydro One to voluntarily resign to facilitate the orderly
19 replacement of the Board in a sequential manner on an expedited basis. Rather than wait
20 for Premier Ford to trigger the procedures in the Governance Agreement or pursue
21 legislation with potentially intrusive provisions, a process for replacing the Board was
22 documented in the July 2018 Letter Agreement. In doing so, the Province and Hydro One
23 complied with the spirit and intent of Section 4.7 of the Governance Agreement. In order

1 to serve the best interests of the company, the parties agreed to forego the requirement to
2 hold a shareholders' meeting, thereby expediting the process and reducing uncertainty.

3 **Q. What process for selecting the new Board was established in the July**
4 **2018 Letter Agreement?**

5 A. The July 2018 Letter Agreement provides that (i) an Ad Hoc Nominating
6 Committee comprised of representatives of each of Hydro One's five largest shareholders
7 (or a lesser number depending on how many of the five largest shareholders wished to
8 serve on the Ad Hoc Nominating Committee), excluding the Province, would be formed to
9 nominate six directors of the new Board; and (ii) the Province would nominate four
10 directors. The new directors must meet the requirements set out in the Governance
11 Agreement. As noted above, Section 4.2 of the Governance Agreement outlines the
12 qualifications for director nominees. The new Board would then appoint a replacement
13 Chair of the Board from among their number consistent with Section 3.2 of the Governance
14 Agreement.

15 The process prescribed by the July 2018 Letter Agreement to select Hydro One's
16 new 10-member Board, which consists of four Provincial designees and six designees
17 chosen by the Ad Hoc Nominating Committee of Hydro One's largest investors besides
18 the Province, follows the requirements of Sections 4.3 and 4.7 of the Governance
19 Agreement.

20 **Q. Has the process been completed for selecting Hydro One's new Board**
21 **as provided in the July 2018 Letter Agreement,?**

22 A. Yes. As explained in the Supplemental Testimony of Hydro One Interim
23 Chair Thomas Woods (Exh. TDW-1T, "Woods Testimony"), the Ad Hoc Nominating

1 Committee was formed and three of the five largest Hydro One shareholders participated,
2 excluding the Province. The Ad Hoc Nominating Committee selected six members for the
3 Board, and the Province selected four members. Hydro One announced the members of
4 the new Board on August 14, 2018. *See* Woods Testimony, §§ II and III.

5 **Q. Are the new Board members announced on August 14 appointed on an**
6 **interim basis?**

7 A. No. As with previous Board members, the new Board members are subject
8 to annual approval of the Hydro One shareholders, consistent with the Governance
9 Agreement and the *Business Corporations Act* (Ontario) (“OBCA”). Section 2 of the July
10 2018 Letter Agreement provides:

11 Each of the Replacement Directors nominated and appointed to the Board pursuant
12 to section 1 of this Agreement shall serve on the Board until the earlier of the 2019
13 annual meeting of shareholders of Hydro One or until his or [sic] resignation or his
14 or her successor is elected or appointed in accordance with the Governance
15 Agreement and the OBCA.

16
17 Exh. JDS-2, § 2.

18 **Q. What led to the retirement of former CEO Mayo Schmidt?**

19 A. The Governance Agreement requires that the CEO be appointed by the
20 Board and annually have his appointment confirmed by a special resolution of the Board
21 (*i.e.*, two-thirds of the votes cast at a directors’ meeting, or consented to in writing by all
22 directors). *See* Section 3.3 of the Governance Agreement. In light of the events outlined
23 above and the anticipated difficulty of him attempting to carry out his duties as CEO
24 without the support of Hydro One’s single largest shareholder, the former CEO Mayo
25 Schmidt retired from his positions, having determined that it would be in the best interests
26 of Hydro One and its stakeholders to do so.

1 **Q. What process for selecting the new CEO was established in the July**
2 **2018 Letter Agreement?**

3 A. The new Board will appoint a replacement CEO, who will become the
4 eleventh Board member. The status of the CEO search is described in Exh. TDW-1T,
5 Woods Testimony, § IV.

6 **Q. Does the July 2018 Letter Agreement contain any other provisions**
7 **besides those described above relating to the replacement of the Hydro One Board**
8 **and CEO?**

9 A. Hydro One has agreed to consult with the Province in respect of future
10 matters of executive compensation. Further, Paul Dobson, Hydro One’s Chief Financial
11 Officer, has been appointed as acting CEO until such time as the replacement board of
12 directors can appoint a new CEO.

13

14 **IV. HYDRO ONE ACCOUNTABILITY ACT, 2018**

15 **Q. Did the new government convene a special legislative session after the**
16 **June 7, 2018 election?**

17 A. Yes. Premier Ford and the Progressive Conservative Party convened a
18 special legislative session on July 11, 2018.

19 **Q. Did the Progressive Conservative Party introduce legislation impacting**
20 **Hydro One?**

21 A. On Monday, July 16, 2018, the new Provincial government introduced the
22 *Urgent Priorities Act, 2018*, which, included as Schedule 1, the *Hydro One Accountability*
23 *Act, 2018*. The *Hydro One Accountability Act, 2018* is attached as Exh. JDS-3.

1 **Q. Please summarize the requirements of the *Hydro One Accountability***
2 ***Act.***

3 A. The *Hydro One Accountability Act* (the “Act”) addresses concerns about
4 compensation for Hydro One executives located in Ontario. It requires the board of Hydro
5 One to establish a new compensation framework for the Board of Directors, CEO, and
6 other executives in consultation with the Province and the other five largest shareholders.
7 The Act gives the Management Board of Cabinet authority to approve this compensation
8 framework and any amendments to it as well as to issue directives governing the
9 compensation of the directors, CEO, and other executives.

10 The Act also amends the *Ontario Energy Board Act, 1998* to require the Ontario
11 Energy Board to exclude any amount in respect of compensation paid to the CEO and
12 executives from consumer rates for Hydro One or its subsidiaries.

13 The Act requires Hydro One to annually publish on its website a record of the total
14 compensation of executives as prescribed by regulation. The Act also requires Hydro One
15 to publish on its website any proposed changes to its compensation frameworks for the
16 board, CEO, or other executives at least 30 days prior to the date on which it seeks
17 Management Board of Cabinet approval for those changes pursuant to the Act.

18 **Q. Does the Act provide the Province and Hydro One immunity from**
19 **certain judicial challenges?**

20 A. The Act also provides the Crown and Hydro One with immunity from civil
21 liability resulting from:

- 22 • the enactment, operation, administration or repeal of any provision of the
23 Act;

- 1 • anything done or not done under the Act;
- 2 • anything related in any way to the involvement of the Government of
- 3 Ontario in compensation matters, or other aspects of the corporate
- 4 governance, of Hydro One or any of its subsidiaries;
- 5 • any alleged misrepresentation within the meaning of applicable securities
- 6 laws in any prospectus, document or other public statement related in any
- 7 way to the involvement of the Government of Ontario in compensation
- 8 matters at Hydro One or any of its subsidiaries; or
- 9 • any adverse market consequences or diminishment in the value of any
- 10 securities in Hydro One, or any of its subsidiaries, or any other investment,
- 11 resulting from the enactment of the Act, anything done or not done in order
- 12 to comply with the Act or the involvement of the Government of Ontario in
- 13 the corporate governance of Hydro One or any of its subsidiaries.

14 **Q. Please describe the legislative status of the Act and when it became law.**

15 A. The *Urgent Priorities Act*, which includes Schedule 1, the Act, went

16 through first, second, and third readings in the Ontario Legislature. The Legislature did

17 not amend the legislation. The *Urgent Priorities Act* then received Royal Assent on July

18 25, 2018, which is the day it came into force as the law of Ontario. Schedule 1 provides

19 that the Act comes into force on a day to be named by proclamation of the Lieutenant

20 Governor. That proclamation was delivered on August 15, and the Act is now effective.

21 **Q. Will the Act apply to the executives of Avista if the merger of Hydro**

22 **One and Avista is consummated?**

23 A. No. As defined in the Act, the term “subsidiary” excludes any subsidiary

1 incorporated in a jurisdiction outside of Canada.

2

3 **V. THE FUTURE OF THE GOVERNANCE AGREEMENT**

4 **Q. Do you believe that the Governance Agreement continues to govern**
5 **the relationship between the Province and Hydro One?**

6 A. Yes. Pursuant to Section 16 of the July 2018 Letter Agreement between
7 Hydro One and the Province (Exh. JDS-2), except for the provisions of the Act which are
8 principally limited to compensation matters pertaining to Hydro One and its subsidiaries
9 incorporated within Canada, the Province ratified and reaffirmed its commitment to the
10 Governance Agreement, which remains in full force and effect:

11 16. Reaffirmation: By entering into this Agreement, the Province ratifies and
12 reaffirms its obligations under the Governance Agreement and agrees that, except
13 as specifically set out in this Agreement with respect to the subject matter hereof,
14 (i) the execution, delivery and effectiveness of this Agreement or any other
15 documents delivered in connection herewith shall not amend, modify or operate as
16 a waiver or forbearance of any right, power, obligation, remedy or provision under
17 the Governance Agreement, and (ii) such agreement shall continue in full force and
18 effect.

19

20 Exh. JDS-2, § 16.

21 The Governance Agreement requires that the Province act as an investor and not a
22 manager of Hydro One, and the Province's decision-making authority in respect of Hydro
23 One is restricted to that of any other investor with respect to voting its shares in any
24 decisions that are brought forward for shareholder approval. The Province also has the
25 right to nominate 40 percent of the Board of Directors (other than the CEO), but all
26 directors remain subject to an annual vote by all shareholders of Hydro One.

27 As noted above, although the Province's rights as a shareholder are limited by the
28 Governance Agreement, the Province retains legislative authority to pass legislation with

1 respect to subjects within its jurisdiction, such as the Act.

2 **Q. Do you know if the Province intends to take any further actions with**
3 **respect to Hydro One?**

4 A. I am not aware of any further actions that the Province intends to take with
5 respect to Hydro One. As I mentioned above, Premier Ford has stated that he would like
6 to reduce electricity rates for Ontario residents. I do not know what, if any, further actions
7 that the Province may take to address electricity rates, and am not aware of any pending
8 legislation that would impact Hydro One's management or rates. I do not believe that any
9 such action would affect the agreed-upon commitments reflected in the filed Stipulated
10 Settlement, which insulate Avista's customers from provincial affairs, as discussed below.

11

12 **VI. SETTLEMENT COMMITMENTS DESIGNED TO PROTECT**
13 **AVISTA'S INDEPENDENCE AND FINANCIAL HEALTH**

14 **Q. Administrative Law Judge Dennis Moss's July 12, 2018 Notice of Intent**
15 **to Conduct Additional Process and Opportunity for Parties to Submit Comments**
16 **suggests that there may be a question as to whether the Province, through Premier**
17 **Ford and the Ontario Legislature, will directly interfere with Avista's independence**
18 **and financial health if the merger is consummated. Do you think that there is reason**
19 **for concern?**

20 A. No. All of the parties to this proceeding filed a Settlement Stipulation and
21 Agreement with the Washington Utilities and Transportation Commission (the
22 "Commission") on March 27, 2018 ("Stipulated Settlement"). The Stipulated Settlement
23 includes 81 merger commitments (each, a "Stipulated Commitment," collectively, the
24 "Stipulated Commitments") that were designed by all of the parties to ensure the

1 independence and financial health of Avista. Through Hydro One's and Avista's opening
2 testimony filed on September 14, 2017, and two in-person and several telephonic
3 settlement conferences, all of the parties to this proceeding carefully explored the risks to
4 Avista associated with its proposed acquisition by a Canadian utility whose largest
5 shareholder is the Province of Ontario. All of the parties discussed these risks and
6 developed a set of 81 Stipulated Commitments designed to ensure the independence and
7 financial health of Avista in light of the fact that Hydro One's largest shareholder is the
8 Province of Ontario.

9 I firmly believe that the 81 Stipulated Commitments will fully protect Avista's
10 independence and financial health if the merger is consummated, and the events since the
11 June 7, 2018 election do not change my conclusion.

12 The Province will not have jurisdiction to directly affect, interact with, or directly
13 interfere with the management and strategic direction of Avista if the merger is
14 consummated. The Province cannot pass laws that apply to Avista. Rather, if the merger
15 is consummated, Hydro One's ownership of Avista will be constrained by the 81 Stipulated
16 Commitments, any commitments included in the Commission's order approving the
17 merger, and the laws of the United States and the five states in which Avista operates
18 (Oregon, Washington, Idaho, Montana, and Alaska).

19 **Q. How do the Stipulated Commitments protect Avista's independence**
20 **and ensure that the Province cannot directly interfere with Avista's management and**
21 **strategic direction?**

22 A. Stipulated Commitment No. 3 provides that only two of the nine members
23 of Avista's post-merger board can be executives of Hydro One or any of its subsidiaries.

1 The other three Hydro One designees must be independent of Hydro One, Avista, and
2 Hydro One's other affiliates, and be residents of the Pacific Northwest. Further, of the four
3 Avista designees, three initially will be from Avista's pre-merger board, including the
4 Chairman of Avista's pre-merger board, and the fourth will be Avista's CEO. If any Avista
5 designee resigns, retires, or otherwise ceases to serve as a director of Avista, then the
6 remaining Avista designees will have the sole right to replace the departing Avista
7 designee.

8 Presuming that one of the two Hydro One executives on Avista's post-merger board
9 was directed by the Hydro One Board to bring to the Avista post-merger board an initiative
10 that would benefit Hydro One and/or Ontario but diminish Avista's financial resources and
11 service, the seven remaining members of Avista's post-merger board, all of whom will not
12 be executives of Hydro One, would have sufficient votes to reject that initiative.

13 Further, Stipulated Commitment Nos. 2, 9, and 10 also ensure the independence of
14 Avista's post-merger board and the continued service of Avista's executive management
15 and long-term presence in the Pacific Northwest:

16 ***2. Executive Management***

17 Avista will seek to retain all current executive management of
18 Avista, subject to voluntary retirements that may occur. This commitment
19 will not limit Avista's ability to determine its organizational structure and
20 select and retain personnel best able to meet Avista's needs over time. The
21 Avista board retains the ability to dismiss executive management of Avista
22 and other Avista personnel for standard corporate reasons (subject to the
23 approval of Hydro One Limited ("Hydro One") for any hiring, dismissal or
24 replacement of the CEO);

25 ***9. Avista's Headquarters***

26 Avista will maintain (a) its headquarters in Spokane, Washington;
27 (b) Avista's office locations in each of its other service territories, and (c)
28 no less of a significant presence in the immediate location of each of such

1 office locations than what Avista and its subsidiaries maintained
2 immediately prior to completion of the Proposed Transaction;

3 ***10. Local Staffing***

4 Avista will maintain Avista Utilities' staffing and presence in the
5 communities in which Avista operates at levels sufficient to maintain the
6 provision of safe and reliable service and cost-effective operations and
7 consistent with preacquisition levels;

8 The Supplemental Testimony of Hydro One's and Avista's Expert Witness John J.
9 Reed (Exh. JJR-1T, "Reed Testimony") discusses these governance commitments and
10 explains how they represent the state-of-the-art for a utility merger. Reed Testimony, §III.

11 **Q. What tools do the Stipulated Commitments provide the Commission to**
12 **ensure Hydro One's long-term financial support of Avista's safety and reliability**
13 **standards, service quality measures, and customer service metrics?**

14 A. In addition to the protections provided by the independence of Avista's
15 post-merger board, Stipulated Commitment No. 15 limits the Avista post-merger board's
16 and Hydro One's ability to take any actions in the future that would diminish Avista's
17 safety and reliability standards, service quality measures, and customer service metrics:

18 ***15. Safety and Reliability Standards and Service Quality***
19 ***Measures***

20 Avista will maintain Avista's safety and reliability standards and
21 policies and service quality measures in a manner that is substantially
22 comparable to, or better than, those currently maintained.

23 Avista will not seek to remove or reduce existing penalty provisions
24 associated with its safety, reliability, or service quality measures for 10
25 years after the merger.

26 If the 5-year rolling average of SAIFI or SAIDI in Washington
27 exceeds 107.5% of the average of their respective scores from 2013 to 2017
28 (excluding Major Event Days (MEDs), consistent with Avista's service
29 quality program, tariff schedule 85), Hydro One and Avista commit to
30 increase the rate credit for Washington electric customers by \$250,000 per
31 year. This increased rate credit will persist until the 5-year rolling average

1 is less than the threshold stated above.

2 **Q. What tools do the Stipulated Commitments provide the Commission to**
3 **ensure Hydro One will financially support Avista and cannot withdraw dividends**
4 **from Avista if Avista's financial health is in jeopardy?**

5 A. In addition to the protections provided by the independence of Avista's
6 post-merger board, Stipulated Commitment Nos. 26 and 34-39 require Hydro One to
7 financially support Avista and limit the Avista post-merger board's and Hydro One's
8 ability to withdraw dividends from Avista if Avista's financial health is in jeopardy:

9 ***26. Avista Capital Structure***

10 At all times following the closing of the Proposed Transaction,
11 Avista's actual common equity ratio will be maintained at a level no less
12 than 44 percent. This commitment does not restrict the Commission from
13 ordering a hypothetical capital structure.

14 ***34. Capital Structure Support***

15 Hydro One will provide equity to support Avista's capital structure
16 that is designed to allow Avista access to debt financing under reasonable
17 terms and on a sustainable basis.

18 ***35. Utility-Level Debt and Preferred Stock***

19 Avista will maintain separate debt and preferred stock, if any, to
20 support its utility operations.

21 ***36. Continued Credit Ratings***

22 Each of Hydro One and Avista will continue to be rated by at least
23 one nationally recognized statistical "Rating Agency." Hydro One and
24 Avista will use reasonable best efforts to obtain and maintain a separate
25 credit rating for Avista from at least one Rating Agency within the ninety
26 (90) days following the closing of the Proposed Transaction. If Hydro One
27 and Avista are unable to obtain or maintain the separate rating for Avista,
28 they will make a filing with the Commission explaining the basis for their
29 failure to obtain or maintain such separate credit rating for Avista, and
30 parties to this proceeding will have an opportunity to participate and
31 propose additional commitments.

1

37. Credit Ratings Notification

2

3

4

5

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 by S&P, Moody's, or any other such ratings agency that issues such ratings with respect to Avista.

6

38. Restrictions on Upward Dividends and Distributions

7

8

9

10

11

12

13

14

15

16

a. If either (i) Avista's corporate credit/issuer rating as determined by both Moody's and S&P, or their successors, is investment grade, or (ii) the ratio of Avista's EBITDA to Avista's interest expense is greater than or equal to 3.0, then distributions from Avista to Olympus Equity LLC shall not be limited so long as Avista's equity ratio is equal to or greater than 44 percent on the date of such Avista distribution after giving effect to such Avista distribution, except to the extent the Commission establishes a lower equity ratio for ratemaking purposes. Both the EBITDA and equity ratio shall be calculated on the same basis that such calculations would be made for ratemaking purposes for regulated utility operations.

17

18

b. Under any other circumstances, distributions from Avista to Olympus Equity LLC are allowed only with prior Commission approval.

19

20

21

22

23

c. If Avista does not have an investment-grade rating from both Moody's and S&P, or from one of these entities, or its successor, if only one issues ratings with respect to Avista, and the ratio of EBITDA to Avista's interest expense is less than 3.0, no dividend distribution to Olympus Equity LLC or its successors will occur.

24

39. Pension Funding

25

26

27

Avista will maintain its pension funding policy in accordance with sound actuarial practice. Hydro One will not seek to change Avista's pension funding policy.

28

The Reed Testimony (Exh. JJR-1T) discusses these financial ring-fencing commitments and explains how they represent the state-of-the-art for a utility merger.

30

Reed Testimony, § IV.

31

Q. What tools do the Stipulated Commitments provide the Commission to ensure Hydro One will not draw Avista into bankruptcy?

33

A. In addition to the protections provided by the independence of Avista's

1 post-merger board, Stipulated Commitment Nos. 42-51 ensure Hydro One will not draw
2 Avista into bankruptcy except under extremely limited circumstances. Although I will not
3 repeat the substance of these commitments in this testimony, the Reed Testimony (Exh.
4 JJR-1T) discusses these bankruptcy commitments and explains how they represent the
5 state-of-the-art in bankruptcy protections for a utility merger, including requirements for a
6 Golden Share and a non-consolidation opinion. Reed Testimony, § IV.

7 **Q. How can the Commission be certain that Hydro One and Avista will**
8 **abide by these Stipulated Commitments?**

9 A. Stipulated Commitment Nos. 1, 20, 21, 30-33, and 49 ensure that the
10 commitments apply to Hydro One, cannot be amended without Commission approval, and
11 provide the Commission (and U.S. courts, if necessary) authority to enforce the
12 commitments:

13 ***1. Authority Reserved***

14 Consistent with and subject to the terms of Exhibits A and B to the
15 Merger Agreement (referred to as “Delegation of Authority”) contained in
16 Appendix 5 of the Joint Application, decision-making authority over
17 commitments 2-15 below is reserved to the Board of Directors of Avista
18 Corporation (“Avista”) and any change to the policies stated in
19 commitments 2-15 requires a two-thirds (2/3) vote of the Avista Board,
20 provided that Avista must obtain approval for such changes from all
21 regulatory bodies with jurisdiction over the Commitments before such
22 changes can go into effect, and provide written notice to all parties to
23 Docket U-170970 of such request for approval:

24 ***20. State Regulatory Authority and Jurisdiction***

25 Olympus Holding Corp. and its subsidiaries, including Avista, as
26 appropriate, will comply with all applicable laws, including those pertaining
27 to transfers of property (Chapter 80.12), affiliated interests (Chapter 80.16),
28 and securities and the assumption of obligations and liabilities (Chapter
29 80.08).

30 ***21. Compliance with Existing Commission Orders***

1 Olympus Holding Corp. and its subsidiaries, including Avista,
2 acknowledge that all existing orders issued by the Commission with respect
3 to Avista or its predecessor, Washington Water Power Co., will remain in
4 effect, and are not modified or otherwise affected by the Proposed
5 Transaction.

6 Olympus Holding Corp. and its subsidiaries, including Avista, will
7 comply with all applicable future Commission orders that remain in force.

8 ***30. Commission Enforcement of Commitments***

9 Hydro One and its subsidiaries, including Avista, understand that
10 the Commission has authority to enforce these commitments in accordance
11 with their terms. If there is a violation of the terms of these commitments,
12 then the offending party may, at the discretion of the Commission, have a
13 period of thirty (30) calendar days to cure such violation.

14 The scope of this commitment includes the authority of the
15 Commission to compel the attendance of witnesses from Olympus Holding
16 Corp. and its affiliates, including Hydro One, with pertinent information on
17 matters affecting Avista. Olympus Holding Corp. and its subsidiaries waive
18 their rights to interpose any legal objection they might otherwise have to the
19 Commission's jurisdiction to require the appearance of any such witnesses.

20 ***31. Submittal to State Court Jurisdiction for Enforcement of*** 21 ***Commission Orders***

22 Olympus Holding Corp., on its own and its subsidiaries' behalf,
23 including Avista's, will file with the Commission prior to closing the
24 Proposed Transaction an affidavit affirming that it will submit to the
25 jurisdiction of the relevant state courts for enforcement of the Commission's
26 orders adopting these commitments and subsequent orders affecting Avista.

27 ***32. Annual Report on Commitments***

28 By May 1, 2019 and each May 1 thereafter through May 1, 2029,
29 Avista will file a report with the Commission regarding the status of
30 compliance with each of the commitments as of December 31 of the
31 preceding year. The report will, at a minimum, provide a description of the
32 performance of each of the commitments, will be filed in Docket U-170970
33 and served to all parties to the docket. If any commitment is not being met,
34 relative to the specific terms of the commitment, the report must provide
35 proposed corrective measures and target dates for completion of such
36 measures. Avista will make publicly available at the Commission non-
37 confidential portions of the report.

38 ***33. Commitments Binding***

1 Hydro One, Olympus Holding Corp. and its subsidiaries, including
 2 Avista, acknowledge that the commitments being made by them are binding
 3 only upon them and their affiliates where noted, and their successors in
 4 interest. Hydro One and Avista are not requesting in this proceeding a
 5 determination of the prudence, just and reasonable character, rate or
 6 ratemaking treatment, or public interest of the investments, expenditures or
 7 actions referenced in the commitments, and the parties in appropriate
 8 proceedings may take such positions regarding the prudence, just and
 9 reasonable character, rate or ratemaking treatment, or public interest of the
 10 investments, expenditures or actions as they deem appropriate.

11 If Hydro One or any other entity in the chain of Avista's ownership
 12 determines that Avista or any other entity has failed to comply with an
 13 applicable Commitment, the entity making such determinations shall take
 14 all appropriate actions to achieve compliance with the Commitment.

15 ***49. No Amendment of Ring-Fencing Provisions***

16 Hydro One, Olympus Holding Corp. and Avista commit that no
 17 material amendments, revisions or modifications will be made to the ring-
 18 fencing provisions as specified in these regulatory commitments without
 19 prior Commission approval pursuant to a limited re-opener for the sole
 20 purpose of addressing the ring-fencing provisions.

21 **Q. Several of the Stipulated Commitments in the Washington Stipulated**
 22 **Settlement require Avista's shareholder, Hydro One, and not Avista's ratepayers, to**
 23 **provide funding for certain programs (Stipulated Commitment Nos. 11 - Community**
 24 **Contributions; 19 - Rate Credits; 63 - Professional Home Energy Audit; 64 -**
 25 **Community Contributions; 67 - Funding for Low-Income Participation in New**
 26 **Renewables; 69 - Replacement of Manufactured Homes; 70 - Low Income**
 27 **Weatherization; 77 - Montana Community Transition Fund; 79 - On Bill**
 28 **Repayment). How can the Commission be certain that Hydro One, as Avista's sole**
 29 **shareholder, will ensure there is funding for these Stipulated Commitments?**

30 A. First, as detailed in the Exh. CFL-6T (Supplemental Testimony of Chris
 31 Lopez), § III, the \$30.7 million rate credit will simply flow through to Avista customers in
 32 the bills issued by Avista. No cash from Hydro One is needed.
 Supplemental Testimony of James D. Scarlett
 Hydro One

1 Second, Stipulated Commitment Nos. 63, 64, 67, 69, 70, 77, and 79 all clearly state
2 that the funds for these programs will be arranged by Hydro One and Stipulated
3 Commitment No. 75 provides that “any commitment that states Hydro One will arrange
4 funding is not contingent on Hydro One’s ability to arrange funding, particularly from
5 outside sources, but is a firm commitment to provide the dollar amount specified over the
6 time period specified and for the purposes specified. . . . Avista will not seek cost recovery
7 for any of the commitments funded or arranged by Hydro One in this list of merger
8 commitments. Hydro One will not seek cost recovery for such funds from ratepayers in
9 Ontario.” Therefore, Hydro One, as Avista’s sole shareholder, ultimately bears the cost of
10 these commitments.

11 Third, Stipulated Commitment No. 75 also establishes that if Avista has retained
12 earnings that would otherwise be available to Hydro One as dividends, those retained
13 earnings can be used to fund Stipulated Commitment Nos. 63, 64, 67, 69, 70, 77, and 79:
14 “To the extent Avista has retained earnings that are available for payment of dividends to
15 Olympus Equity LLC consistent with the ring fencing provisions of this list of merger
16 commitments, such retained earnings may be used. Funds available from other Hydro One
17 affiliates may be used without limitation.”¹ In essence, funds otherwise available for
18 payment of dividends to Olympus Equity and on up the chain will instead be directed to
19 funding these commitments, as explained in Exh. CFL-6T (Supplemental Testimony of
20 Chris Lopez), § III.

21 Fourth, as noted in response to the previous question, Stipulated Commitment No.

¹ 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.

1 33 establishes that Hydro One and/or its subsidiaries are bound by the Stipulated
2 Commitments, Stipulated Commitment No. 30 subjects Hydro One and/or its subsidiaries
3 to the jurisdiction of the Commission for enforcement of the Stipulated Commitments, and
4 Stipulated Commitment No. 31 provides that “Olympus Holding Corp., on its own and its
5 subsidiaries’ behalf, including Avista’s, will file with the Commission prior to closing the
6 Proposed Transaction an affidavit affirming that it will submit to the jurisdiction of the
7 relevant state courts for enforcement of the Commission’s orders adopting these
8 commitments and subsequent orders affecting Avista.” Therefore, Hydro One, as Avista’s
9 sole shareholder, and/or its subsidiaries, have submitted to the jurisdiction of the
10 Commission and Washington courts for the enforcement of all of the Stipulated
11 Commitments, including those that require Hydro One funding.

12 Fifth, if the merger is consummated, the Province will not have jurisdiction to
13 modify or nullify the 81 Stipulated Commitments and any conditions included in the
14 Commission’s order approving the merger. Hydro One is bound by these contractual
15 obligations. Even though the Province is a shareholder of Hydro One, Hydro One is the
16 entity that bears the full legal responsibility for the 81 Stipulated Commitments and any
17 commitments included in the Commission’s order approving the merger if the merger is
18 consummated. The Province is not a party to Hydro One’s contracts and commitments in
19 this proceeding and no action on the part of the Province is required for Hydro One to fulfill
20 its obligations.

21 **Q. Does Section 8.1 of the Governance Agreement make any of Hydro**
22 **One’s financial and funding commitments in the Stipulated Settlement subject to**
23 **Provincial appropriations?**

1 A. No, none of the commitments are contingent on Provincial funding because
2 none calls for any payment by the Province. Section 8.1 of the Governance Agreement
3 states:

4 ***8.1 Financial Obligations of the Province***

5 Pursuant to the [Financial Administration Act (Ontario)], any
6 payment required to be made by the Province pursuant to this Agreement is
7 subject to there being sufficient appropriation by the Legislative Assembly
8 of Ontario for the fiscal year in which the payment is to be made or the
9 payment having been charged to appropriation for a previous year.

10 This provision in the Governance Agreement applies only to “any payment required to be
11 made by the Province pursuant to this [Governance] Agreement” The Province has no
12 payment obligations, whatsoever, pursuant to Hydro One’s contracts and commitments
13 related the Proposed Transaction. Therefore, to the extent Section 8.1 limits the Province’s
14 payment obligations to the availability of appropriated funds, such limitations have no
15 bearing or legal relationship to Hydro One’s contractual obligations with respect to the
16 Proposed Transaction.

17 **Q. Testimony previously filed in this proceeding by Avista’s CEO Scott**
18 **Morris and Hydro One’s former CEO Mayo Schmidt emphasized the strong**
19 **relationship between the two CEOs and the cultural compatibility of Hydro One and**
20 **Avista. Does the retirement of Mr. Schmidt and the Province’s actions change this**
21 **justification for the Proposed Transaction?**

22 A. No. While the strong relationship between Mr. Morris and Mr. Schmidt
23 certainly contributed to a meeting of the minds on the terms of the merger agreement
24 between Hydro One and Avista, any corporate transaction of this size is not dependent on
25 the relationship of two executives. Eventually, executives retire or leave a company to

1 pursue other opportunities. Both sides understood this and negotiated a merger agreement,
2 the delegation of authority described in Mr. Morris's and Mr. Schmidt's opening testimony
3 (Exhs. MMS-1T and SLM-1T, respectively), and merger commitments that provide a very
4 clear framework for the interaction of the two companies. Hydro One's commitments to
5 (i) an Avista board with Avista directors and independent directors (as defined by the
6 NYSE rules) ("Independent Directors") from the Pacific Northwest, (ii) continued
7 headquarters in Spokane, WA, (iii) the continued service of Avista's executives,
8 management, and employees, (iv) Avista board control over the hiring and replacement of
9 Avista's CEO, (v) Avista's day-to-day management of its business, and (vi) substantial
10 charitable and community contributions, are all preserved in contractual documents that
11 continue long past the tenure of any single executive involved in the negotiation of the
12 Proposed Transaction. Moreover, the commitments are sufficiently clear and detailed that
13 responsibility for implementation will fall not on the CEOs but on other staff.

14

15 **VII. PROPOSED NEW OR AMENDED COMMITMENTS**

16 **Q. Despite your conclusion that the merger commitments in the Stipulated**
17 **Settlement will fully protect Avista from Provincial interference if the merger is**
18 **consummated, have Hydro One and Avista proposed any additional commitments to**
19 **respond to the events in the Province since July 11, 2018?**

20 **A. Yes. Hydro One and Avista have proposed one additional merger**
21 **commitment since July 11, 2018:**

22 **Avista Employee Compensation: Any decisions regarding Avista**
23 **employee compensation shall be made by the Avista Board consistent with**
24 **the terms of the Merger Agreement between Hydro One and Avista, and**
25 **current market standards and prevailing practices of relevant U.S. electric**

1 and gas utility benchmarks. The determination of the level of any
2 compensation (including equity awards) approved by the Avista Board with
3 respect to any employee in accordance with the foregoing shall not be
4 subject to change by Hydro One or the Hydro One Board.

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

7 Although the *Hydro One Accountability Act* does not apply to Avista if the merger
8 is consummated, Avista and Hydro One have agreed upon this additional commitment to
9 provide further protection to Avista's employees, such that Avista will be able to continue
10 to recruit and retain the most highly qualified employee talent base for Avista's customers.

11 **Q. Have Avista and Hydro One discussed making any revisions to the**
12 **Delegation of Authority (Appendix 5 of the Joint Application) to respond to the events**
13 **after the June 7, 2018 Ontario election involving Hydro One?**

14 A. Yes. Avista and Hydro One propose to amend this section of the Delegation
15 of Authority as follows:

16 Shareholder shall have the unfettered right to designate, remove and
17 replace the Shareholder Designees as directors of the Surviving Corporation
18 with or without cause or notice at its sole discretion, subject to the
19 requirement that (i) two (2) of such directors are executives of Parent or any
20 of its Subsidiaries and (ii) three (3) of such directors are Independent
21 Directors who are residents of the Pacific Northwest Region, while such
22 requirement is in effect (subject in the case of clause (ii) hereof to
23 Shareholder determining, in good faith, that it is not able to appoint an
24 Independent Director who is a resident of the Pacific Northwest Region in
25 a timely manner, in which case Shareholder may replace any such director
26 with an employee of Parent or any of its Subsidiaries on an interim basis,
27 not exceeding six months, after which time Shareholder shall replace such
28 interim director with Independent Director who is a resident of the Pacific
29 Northwest Region); provided, however, that this exception to clause (ii)
30 hereof shall not apply if, at any time a circumstance arises, and during the
31 pendency of any such circumstance, whereby the Province of Ontario
32 ("Ontario") exercises its rights as a shareholder of Parent, uses legislative
33 authority or acts in any other manner whatsoever, that results, or would
34 result, in Ontario appointing nominees to the board of directors of Parent

1 that constitute, or would constitute a majority of the directors of such
2 board);

3 **Q. What is the purpose of the new text in the Delegation of Authority?**

4 A. This proposed amendment to the Delegation of Authority is designed to
5 protect the independence of the Avista board in the event that the Province takes some
6 action in the future to control a majority of the Hydro One Board. If that event occurs, this
7 amendment is triggered and blocks Hydro One's limited right to replace any of its three
8 Independent Director designees on the Avista board with a Hydro One executive or
9 employee.

10
11 **VIII. ADOPTION OF MAYO SCHMIDT TESTIMONY**

12 **Q. Are you aware of testimony previously submitted by Mayo Schmidt?**

13 A. Yes.

14 **Q. What testimony was previously submitted by Mayo Schmidt?**

15 A. The testimony previously submitted by Mayo Schmidt includes:

- 16 • Hydro One Exh. MMS-1T – Direct Testimony of Mayo M. Schmidt,
17 submitted September 14, 2017, including Exhs. MMS-2 and MMS-3
- 18 • Joint Testimony Exh. JNT-1T – Joint Testimony in Support of Settlement
19 Stipulation, submitted April 10, 2018, including Exhs. JNT-2, JNT-3, JNT-
20 4, and JNT-5
- 21 • Hydro One Exh. MMS-4T – Testimony of Mayo M. Schmidt submitted
22 April 10, 2018, including Exh. MMS-5

23 **Q. Do you adopt Mayo Schmidt's testimony as your own?**

1 A. Yes, subject to (i) the Province's ability to introduce, or threaten, legislation,
2 as evidenced by the events that have transpired, (ii) the passage of the *Hydro One*
3 *Accountability Act, 2018*, and (iii) the government's promise to reduce rates in Ontario.

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

5 A. Yes it does.