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**ON BEHALF OF AVISTA CORPORATION**

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**ON BEHALF OF HYDRO ONE LIMITED**

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**BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION**

IN THE MATTER OF THE JOINT )  
APPLICATION OF HYDRO ONE LIMITED ) CASE NO. AVU-E-17-09  
(ACTING THROUGH ITS INDIRECT ) CASE NO. AVU-G-17-05  
SUBSIDIARY, OLYMPUS EQUITY LLC) )  
AND )  
AVISTA CORPORATION ) SUPPLEMENTAL TESTIMONY  
FOR AN ORDER AUTHORIZING PROPOSED ) OF  
TRANSACTION ) CHRISTOPHER F. LOPEZ

FOR HYDRO ONE LIMITED

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**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. On September 6, 2018 I was appointed as Acting Chief Financial Officer ("CFO") for Hydro One Limited ("Hydro One"). Prior to September 6, 2018 I was Senior Vice President of Finance for Hydro One.<sup>1</sup>

**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:

I. INTRODUCTION.....	1
II. SUMMARY OF RECENT DEVELOPMENTS IN ONTARIO.....	3
III. FINANCIAL STRENGTH OF HYDRO ONE.....	7
IV. AVISTA'S ACCESS TO CAPITAL.....	17

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<sup>1</sup> See AVU-E-17-09, AVU-G-17-05, Supplemental Report on Hydro One Management Changes (Sep. 7, 2018).

1 V. RING-FENCING COMMITMENTS..... 19  
2 VI. PROPOSED TRANSACTION FINANCING..... 24  
3 VII. AVISTA'S FUTURE FINANCIAL HEALTH..... 25  
4

5 **Summary of Testimony**

6 **Q. Please summarize your testimony.**

7 A. My supplemental testimony will describe recent  
8 events and demonstrate that the benefits of this transaction  
9 for Avista ratepayers remain unchanged since the parties'  
10 settlement documents were filed<sup>2</sup> and that recent political  
11 developments in Ontario create no risks for Avista or its  
12 customers. Specifically, I will:

- 13 • Summarize the recent developments in Ontario;
- 14 • Summarize and reaffirm my previous testimony explaining  
15 how Hydro One is financially healthy and Avista will  
16 benefit from having a parent with strong access to  
17 capital markets;
- 18 • Review the merger commitments relating to Hydro One's  
19 financial support for Avista;
- 20 • Confirm that Hydro One stands by these commitments and  
21 continues to provide the benefits associated with having  
22 a financially healthy parent company; and

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<sup>2</sup> AVU-E-17-09, AVU-G-17-05, Stipulation and Settlement (April 13, 2018) (including Appendix A, "Master List of Commitments in Idaho"); see also, AVU-E-17-09, AVU-G-17-05, Avista and Hydro One Joint Comments in Support of Stipulation and Settlement (June 20, 2018).

1 • Explain why the Ontario election, the July 11, 2018  
2 Letter Agreement between the Province of Ontario (the  
3 "Province") and Hydro One (the "July 2018 Letter  
4 Agreement") and subsequent events have no effect on  
5 these commitments and benefits.

6

7 **II. SUMMARY OF RECENT DEVELOPMENTS IN ONTARIO**

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

10 A. There are four developments that I will summarize:  
11 the June 7, 2018 election; the July 2018 Letter Agreement;  
12 the *Hydro One Accountability Act, 2018*; and the August 14,  
13 2018 appointment of new board members.

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

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



1           During the campaign, members of a different political  
2 party, the New Democratic Party or "NDPs," stated that they  
3 would try to "bring Hydro One back into public hands" by  
4 buying back some or all of Hydro One's shares held by entities  
5 other than the Province. The NDPs did not win enough seats  
6 to form the provincial government. Mr. Ford and other members  
7 of the Progressive Conservative Party (the "Conservatives"),  
8 by contrast, made no suggestion that they would support  
9 returning Hydro One to Crown Corporation status. Although the  
10 NDPs and the Conservatives were essentially tied in voting  
11 polls, the Conservatives won a majority of seats in the  
12 legislature.

13           **Q. Please describe the July 2018 Letter Agreement.**

14           A. On July 11, 2018, the 1st Session of the 42nd  
15 Parliament of the Legislative Assembly of Ontario commenced.  
16 The same day, Hydro One, on behalf of itself and its wholly-  
17 owned subsidiary, Hydro One Inc. ("HOI"), announced that  
18 following an approach by Hydro One to the Province, they had  
19 entered into an agreement for the purpose of the orderly  
20 replacement of the Hydro One and HOI boards and the retirement  
21 of Mayo Schmidt as the CEO effective July 11, 2018. See  
22 prefiled Supplemental Testimony of James Scarlett ("Scarlett  
23 Testimony") and Exh. No. 10, Schedule 1 thereto (July 2018

1 Letter Agreement). The Scarlett Testimony describes the July  
2 2018 Letter Agreement in detail.

3 **Q. Please describe the *Hydro One Accountability Act,***  
4 ***2018.***

5 A. On July 16, 2018, the new Provincial government  
6 introduced Bill 2, the *Urgent Priorities Act, 2018*, which  
7 enacts or amends various statutes via Schedules to the Bill.  
8 It received Royal Assent on July 25, 2018, and is therefore  
9 in full force and effect. The Schedules come into force as  
10 provided in each Schedule. Schedule 1 is a new Act entitled  
11 the *Hydro One Accountability Act, 2018* (the "Act") and took  
12 effect on August 15, 2018. This Schedule deals with the  
13 compensation framework (and related disclosure obligations)  
14 for the directors, CEO and executives of Hydro One and its  
15 subsidiaries (except subsidiaries incorporated in  
16 jurisdictions outside Canada). The Scarlett Testimony  
17 describes the Act in detail. Exh. No. 10, Schedule 2 to the  
18 Scarlett Testimony contains a copy of the Act.

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

1           **Q.    Please describe the new Hydro One Board.**

2           A.    The new Hydro One Board was announced on August 14,  
3 2018.  The members of the Board and the process for their  
4 appointment are described in detail in the prefiled  
5 Supplemental Testimony of Hydro One Chair Thomas Woods and  
6 the Scarlett Testimony.

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

9           A.    No, they do not affect the Proposed Transaction,  
10 and Hydro One remains committed to the Proposed Transaction.  
11 The transaction was designed to stand the test of time,  
12 through changes in personnel at any level.  The *Hydro One*  
13 *Accountability Act* has no application to Avista because it  
14 specifically refers to Hydro One and its subsidiaries (except  
15 subsidiaries incorporated in jurisdictions outside Canada).  
16 The appointment of the new Hydro One Board, consistent with  
17 the Governance Agreement,<sup>3</sup> demonstrates that Hydro One is  
18 continuing to operate as it has in the past.  Hydro One is  
19 stable and financially strong.  Hydro One remains fully  
20 capable of performing all of its obligations under all the  
21 merger commitments.

22

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<sup>3</sup> See Scarlett Testimony, Exh. No. 10, Schedule 3.

1                   **III.    FINANCIAL STRENGTH OF HYDRO ONE**

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

5           A.    Yes, the credit rating agencies continue to view  
6 Hydro One as a prudent, well-managed company. This is  
7 demonstrated by strong investment grade credit ratings from  
8 Moody's Investors Service ("Moody's"), Standard & Poor's  
9 ("S&P"), and Dominion Bond Rating Service ("DBRS"): (i) HOI  
10 has an "A- (CreditWatch Negative)" long-term credit rating  
11 from S&P, a "Baa1 (Stable Outlook)" rating on senior unsecured  
12 debt from Moody's, and an "A (High) (Stable Outlook)" rating  
13 from DBRS; and (ii) Hydro One has an "A- (CreditWatch  
14 Negative)" issuer credit rating from S&P. By comparison,  
15 Avista's credit ratings are "BBB (CreditWatch Positive)" from  
16 S&P and "Baa1 (Negative Outlook)" from Moody's. Hydro One's  
17 investment grade credit ratings indicate that the company has  
18 access to capital on reasonable terms and conditions.

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

21           A.    Yes, several have commented. For example, on July  
22 16, 2018, Moody's published its "Credit Outlook" report. This  
23 is a bi-weekly report outlining Moody's outlook on credit  
24 implications of current events. The July 16, 2018 report

1 includes a section on Hydro One entitled "Hydro One's Board  
2 and CEO Are Forced Out, a Credit Negative." The report  
3 concludes that "Ontario's willingness to force out the  
4 current board clearly demonstrates that the utility is not  
5 immune to direct political interference, a credit negative."  
6 The report also concludes that if the Province follows through  
7 on its promise to reduce some customer rates by 12%, and that  
8 reduction reduces Hydro One's revenue and cash flow, it would  
9 be materially credit negative for Hydro One. Reiterating  
10 previous statements by Moody's,<sup>4</sup> the report states that Hydro  
11 One's completion of the acquisition of Avista is credit  
12 negative for both Hydro One and HOI. Finally, the report  
13 notes that Hydro One would be following an established process  
14 for establishment of a new board.

15 On September 13, 2018, S&P issued a report titled "Hydro  
16 One Ltd. And Subsidiary Downgraded To 'A-' On Lower Governance  
17 Assessment; Ratings Remain on Credit Watch."<sup>5</sup> S&P lowered  
18 its issuer credit ratings on Hydro One and its subsidiary

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<sup>4</sup> See Moody's Investor Service, *Rating Action: Moody's downgrades HOI to Baal from A3; rating outlook stable* (June 20, 2018), [https://www.moodys.com/research/Moodys-downgrades-Hydro-One-Inc-to-Baal-from-A3-rating--PR\\_385523](https://www.moodys.com/research/Moodys-downgrades-Hydro-One-Inc-to-Baal-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](https://www.moodys.com/research/Moodys-Affirms-Hydro-Ones-senior-unsecured-A3-ratings-outlook-changed--PR_370021).

<sup>5</sup> Avista filed a copy of this report in this docket on September 17, 2018.

1 Hydro One Inc. to 'A-' from 'A'. All ratings remain on  
2 CreditWatch with negative implications.

23 S&P explained the one-notch downgrade as follows:

4 *The Government of Ontario recently implemented*  
5 *legislation, requiring Hydro One's board of*  
6 *directors to establish a new executive compensation*  
7 *framework for the board, CEO, and other executives.*  
8 *The legislation also amends the current Ontario*  
9 *Energy Board Act, requiring the Ontario Energy*  
10 *Board to exclude any compensation paid to the CEO*  
11 *and other executives from consumer rates.*

12  
13 *We consider such action as a governance deficiency*  
14 *related to Hydro One's ownership structure and are*  
15 *lowering our management and governance (M&G)*  
16 *assessment on Hydro One Ltd. (HOL) and Hydro One*  
17 *Inc. (HOI) to fair from satisfactory.*

18 Hydro One's credit rating remains investment grade.

19 Further, the legislation cited by S&P as the reason for the  
20 downgrade, the *Hydro One Accountability Act, 2018*, applies  
21 only to Hydro One's subsidiaries in Canada, and therefore,  
22 would not apply to Avista if the proposed merger is  
23 consummated.

24

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

27 A. No, it did not.

28 **Q. Have the recent developments you described resulted**  
29 **in any changes to credit ratings of Hydro One by Moody's or**  
30 **DBRS?**

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

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

9 A. No, they are not.

10 **Q. Please explain.**

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

17 Hydro One's second quarter results, announced on August  
18 14, 2018, underscore its financial stability. Hydro One  
19 reported earnings per share (EPS) of Canadian \$0.34 and  
20 adjusted EPS of Canadian \$0.33, compared to Canadian \$0.20 in  
21 the prior year, an increase of 70% and 65%, respectively.<sup>6</sup>  
22 Our "culture of continuous improvement yielded high

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<sup>6</sup> 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).

1 performance metrics at the contact centre, billing accuracy  
2 in excess of regulatory requirements and a further Canadian  
3 \$6 million decrease in overdue accounts receivable due to  
4 proactive support programs.”<sup>7</sup> Paul Dobson, our Acting  
5 President and CEO, stated that, “Hydro One’s strong second  
6 quarter financial results coupled with continuously improving  
7 operational and customer service metrics highlight the  
8 underlying strength of the business as well as the Company’s  
9 positive momentum since the Initial Public Offering in  
10 2015.”<sup>8</sup>

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

16 Second, Hydro One remains a very suitable parent company  
17 for Avista for all the reasons discussed in prior testimony.  
18 The companies are culturally aligned. Hydro One’s market  
19 capitalization is approximately three times the size of  
20 Avista and will provide Avista with improved access to capital  
21 markets as described in Section IV below. Hydro One is a  
22 strategic investor, rather than a financial investor, and its

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<sup>7</sup> *Id.*

<sup>8</sup> *Id.*



1 interests are aligned with Avista's for long-term success.  
2 Hydro One has made a number of commitments to preserve  
3 Avista's ability to run its own business on an ongoing basis,  
4 for the benefit of Avista's customers.

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

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

10 A. Hydro One's stock price has changed, although it is  
11 impossible to know all the causes for the changes. Hydro  
12 One's stock price decreased Canadian \$1.21 (or 6.0%) in the  
13 month ended July 31 to close at Canadian \$19.0. This decline  
14 was greater than the average decline of 3.9% in the Utilities  
15 - Regulated sector for the same period.<sup>9</sup> During the month of  
16 August, Hydro One's stock price stabilized, and closed at  
17 Canadian \$19.28 on August 31. The stock price has continued  
18 to firm, closing at \$19.85 on September 18.

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

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<sup>9</sup> 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).

1 **investment-grade ratings for Hydro One and Avista?**

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

4 **Q. Please explain.**

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

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

20 **Q. Is the 12% electricity rate reduction proposed by**  
21 **the Provincial government cause for concern about Hydro One's**  
22 **ability to finance the Proposed Transaction and to satisfy**  
23 **its merger commitments?**

1           A.    No, this proposal has no impact on the Proposed  
2 Transaction.

3           **Q.    Please explain.**

4           A.    First, it should be noted that Hydro One has not  
5 proposed any rate reductions.  Moreover, Hydro One does not  
6 anticipate that any electricity rate reductions proposed by  
7 the Province of Ontario will have any impact on Hydro One's  
8 ability to either: a) operate and maintain Avista operations  
9 in Idaho, or b) fund the rate credit and other commitments  
10 stipulated in the Idaho Stipulated Settlement.

11           Hydro One does not intend its acquisition of Avista to  
12 supplement Hydro One's rate revenue in its Ontario service  
13 territory.  To the contrary, the acquisition of Avista is a  
14 strategic investment:  (a) it expands Hydro One's reach into  
15 a new geographical market and into the gas distribution  
16 business, (b) it creates geographic diversification and (c)  
17 it increases scale.  Like Avista, Hydro One earns a regulated  
18 rate of return and the regulatory constraints on rates are a  
19 universal fact of the utility business, not something  
20 specific to Hydro One.  This deal is in no way intended to  
21 subsidize the rates of Hydro One customers, but rather, it is  
22 part of a strategy of diversification and growth with a  
23 partner that is a strong cultural match.

24           With respect to operations in Idaho, Hydro One remains

1 an effective and competent parent company for Avista. The  
2 numerous ring-fencing commitments agreed to in Idaho were  
3 developed to ensure, among other things, that Avista would  
4 not be subjected to influence by the Province of Ontario.  
5 Indeed, Avista's ability to operate and maintain its business  
6 would not have been directly affected by any of the recent  
7 actions by the Province of Ontario.

8       **Q. Several of the commitments (collectively,**  
9 **"Stipulated Commitments" and individually, "Stipulated**  
10 **Commitment") in the Idaho Stipulated Settlement require**  
11 **Avista's shareholder, Hydro One, and not Avista's ratepayers,**  
12 **to provide funding for certain programs (Stipulated**  
13 **Commitment Nos. 11 - Community Contributions; 19 - Rate**  
14 **Credits; 58 - Funding for Energy Efficiency, Weatherization,**  
15 **Conservation, and Low-Income Assistance Programs; 61 -**  
16 **Community Contributions; 70 - Montana Community Transition**  
17 **Fund). How can the Idaho Public Utilities Commission (the**  
18 **"Commission") be certain that funding will be available for**  
19 **these Stipulated Commitments in light of the developments**  
20 **described above?**

21       **A. First, with respect to the \$15.8 million rate**  
22 **credit provided in Stipulated Commitment No. 19, that credit**  
23 **will simply flow through to Avista customers in the bills**  
24 **issued by Avista without Hydro One having to take any action.**

1 Shortly after the merger, Avista will file a tariff rider  
2 requesting approval, which will ensure Avista's Idaho  
3 customers begin receiving the benefit of the rate credit  
4 immediately. Although no funds will flow from Hydro One to  
5 Avista, Hydro One will bear the burden of these rate credits,  
6 as they will reduce the earnings potentially available to  
7 Hydro One as dividends. The rate credit constitutes the bulk  
8 of Hydro One's funding commitments.

9       Second, Stipulated Commitment No. 66 establishes that if  
10 Avista has retained earnings that would otherwise be  
11 available to Hydro One as dividends, those retained earnings  
12 can be used to fund Stipulated Commitment Nos. 11, 58, 61,  
13 and 70: "To the extent Avista has retained earnings that are  
14 available for payment of dividends to Olympus Equity LLC  
15 consistent with the ring fencing provisions of this list of  
16 merger commitments, such retained earnings may be used. Funds  
17 available from other Hydro One affiliates may be used without  
18 limitation."<sup>10</sup> In essence, funds otherwise available for  
19 payment of dividends to Olympus Equity and on up the chain  
20 will instead be directed to funding these commitments: (i)  
21 \$5,308,847 over 10 years to fund energy efficiency,  
22 weatherization, conservation, and low-income assistance

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<sup>10</sup> 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 programs (Stipulated Commitment No. 58); (ii) \$4,500,000 for  
2 a Colstrip community transition fund (Stipulated Commitment  
3 No. 70); and (iii) the charitable contributions in Stipulated  
4 Commitment Nos. 11 and 61. With this approach, there is no  
5 need for cash to flow from Hydro One to Avista.

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

8 Fourth, the Commission will have full enforcement  
9 authority over the binding commitments included in the  
10 Stipulated Settlement, as described in more detail in the  
11 Scarlett Testimony.

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

17

18 **IV. AVISTA'S ACCESS TO CAPITAL**

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

21 A. By being part of a larger, financially strong  
22 holding company, Avista's access to capital will improve.  
23 Avista is a relatively small utility company as compared with  
24 other utility companies in the U.S. As shown in Avista CEO

1 Scott Morris's testimony,<sup>11</sup> Bank of America Merrill Lynch  
2 determined that at the time the Hydro One acquisition was  
3 announced in July 2017, Avista's market capitalization of  
4 \$2.7 billion was smaller than all but four publicly-traded  
5 U.S. electric utilities covered by Value Line. Post-merger,  
6 the combined Hydro One/Avista company would have a market  
7 capitalization of approximately \$13 billion, placing the new  
8 combined company near the middle of U.S. electric utilities  
9 by market capitalization.

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

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<sup>11</sup> Morris Exh. No. 1, Schedule 1.

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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 April 13, 2018. The Parties negotiated numerous 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.



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

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

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

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

19        **Restrictions on Dividends.** Avista will be prohibited  
20 from issuing dividends if certain financial metrics relating  
21 to the equity floor, credit ratings and debt coverage are not  
22 met. Basically, this operates to keep retained earnings at  
23 the Avista level where they will improve Avista's financial  
24 strength. See Stipulated Commitment No. 38. This too

1 prevents Hydro One from depriving Avista of its capital and  
2 assets.

3 **Golden Share and Other Protections against Bankruptcy**

4 **Proceedings.** Several of the Stipulated Commitments protect

5 Avista from being drawn into bankruptcy proceedings that are

6 not in the best interest of Avista and its customers. Avista

7 will issue a single share of preferred stock referred to as

8 the Golden Share to an independent third party (see Thies

9 Exh. No. 12, Schedule 1). The vote of this share will be

10 required to place Avista into voluntary bankruptcy. See

11 Stipulated Commitment No. 42. Further, Avista's entry into

12 voluntary bankruptcy would require the consent of a two-

13 thirds majority of all of its directors, including the

14 affirmative vote of at least one of the Independent Directors

15 at Avista. See Stipulated Commitment No. 43. Hydro One and

16 Avista must also provide a non-consolidation opinion to

17 confirm the effectiveness of the ring-fencing measures to

18 prevent the substantive consolidation of the assets and

19 liabilities of Avista with those of the entities above it in

20 the corporate chain of ownership. See Stipulated Commitment

21 No. 44. The corporate structure also includes Olympus Equity

22 LLC, a bankruptcy-remote special purpose entity that will

23 have no debt. See Stipulated Commitment No. 45. Therefore,

24 neither Hydro One, nor the Province, can obtain Avista's

1 capital and assets through a bankruptcy proceeding unless  
2 that would be in the best interests of Avista's customers.

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

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

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

15 Avista Employee Compensation: Any decisions regarding  
16 Avista employee compensation shall be made by the Avista  
17 Board consistent with the terms of the Merger Agreement  
18 between Hydro One and Avista, and current market  
19 standards and prevailing practices of relevant U.S.  
20 electric and gas utility benchmarks. The determination  
21 of the level of any compensation (including equity  
22 awards) approved by the Avista Board with respect to any  
23 employee in accordance with the foregoing shall not be  
24 subject to change by Hydro One or the Hydro One Board.<sup>12</sup>

25 **Q. In addition to the above commitment which Hydro One**  
26 **and Avista have already proposed, would you adopt any**

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<sup>12</sup> AVU-E-17-09, AVU-G-17-05, Letter from Joint Applicants Regarding Update on Recent Changes in Hydro One Management (July 18, 2018), pp. 5-6.

1 **additional commitments relating to financial matters?**

2 A. Yes, although Hydro One and Avista believe the  
3 current Idaho commitments are sufficiently robust to insulate  
4 Avista's customers in Idaho from any potential effects of  
5 political, management, or rate changes at Hydro One, Hydro  
6 One and Avista would be willing to adopt any of the following  
7 Oregon commitments in Idaho.

8 **Oregon Stipulated Commitment No. 39 (no comparable commitment**  
9 **in Idaho)**

10  
11 ***Foreign Exchange and Hedging on Dividends Payments and***  
12 ***Allocations***

13 Avista and Parent agree that Avista ratepayers will be  
14 held harmless from any currency exchange or related cash  
15 flow smoothing or hedging costs pertaining to activities  
16 beyond Avista's Oregon utility operations and not usual  
17 and customary prior to close of the Proposed  
18 Transaction.  
19

20 **Oregon Stipulated Commitment No. 43 (compare Idaho Stipulated**  
21 **Commitment No. 25)**

22  
23 ***Cost of Capital***

24 Avista and Parent agree that Avista's Cost of Capital,  
25 including Avista's Rate of Return (ROR), common equity,  
26 and Long-Term Debt, shall not be more costly after the  
27 close of Proposed Transaction than they would have been  
28 absent the Proposed Transaction. Consistent with  
29 Commitment 35(a), Avista bears the burden of proving  
30 that increases in Avista's Cost of Capital, including  
31 Avista's ROR, common equity, and Long-Term Debt, is  
32 caused by circumstances or developments that are  
33 unrelated to the financial risks or other  
34 characteristics of the Proposed Transaction.  
35

36 **Oregon Stipulated Commitment No. 54 (no comparable commitment**  
37 **in Idaho)**

38

1           **Avista Cash Flows**

2           Avista commits, and Parent agrees, that prior to upward  
3           dividends from Avista to Olympus Equity LLC, Avista cash  
4           flows will not be comingled in common accounts with cash  
5           flows for other purposes at either of Olympus Equity,  
6           LLC or Hydro One, including all Hydro One subdivisions  
7           and affiliates. Hydro One will ensure that all of the  
8           Parent's corporate entities maintain accounts and  
9           subaccounts that are separate from Avista accounts and  
10          subaccounts, sufficient to cause handling of cash flows  
11          to be entirely consistent with Avista's corporate  
12          purposes.  
13

14                           **VI.    PROPOSED TRANSACTION FINANCING**

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

17           A.    As I previously testified, Hydro One is committed  
18           to maintaining an investment-grade balance sheet through and  
19           after completion of the acquisition. Hydro One plans to  
20           finance this all-cash transaction using a mix of long-,  
21           medium- and short-term debt together with a convertible  
22           debenture installment receipts offering. Hydro One is  
23           planning to issue the debt financing in U.S. dollars totaling  
24           US\$2.6 billion (and issued convertible debenture installment  
25           receipts in Canada of Canadian \$1.54 billion or approximately  
26           US\$1.2 billion). We expect the convertible debenture to be  
27           fully converted to equity around the time of the closing of  
28           the Proposed Transaction. The planned US\$ debt financing  
29           contemplates a combination of 5-year, 10-year and 30-year US\$  
30           denominated notes.

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

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

5

6                   **VII.    AVISTA'S FUTURE FINANCIAL HEALTH**

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

9           A.    As previously discussed, there is evidence that  
10 Avista's credit rating may be improved as a result of the  
11 Proposed Transaction -- in fact, Avista's credit rating  
12 outlook was revised from Stable to Positive by S&P upon  
13 announcement of the deal. Further, Hydro One has specifically  
14 committed to maintain Avista's actual common equity ratio at  
15 a level no less than 44 percent. See Stipulated Commitment  
16 No. 26. Hydro One is committed to provide equity to support  
17 Avista's capital structure designed to allow Avista access to  
18 debt financing under reasonable terms and on a sustainable  
19 basis. See Stipulated Commitment No. 34. An interlocking  
20 provision, Stipulated Commitment No. 25, provides that,  
21 "Avista will not advocate for, and Hydro One agrees Avista  
22 will not advocate for, a higher cost of debt or equity capital  
23 as compared to what Avista's cost of debt or equity capital  
24 would have been absent Hydro One's ownership." Thus, Hydro

1 One has fully protected Avista's financial health against any  
2 negative effects from the Proposed Transaction.

3 **Q. Does this conclude your supplemental testimony?**

4 A. Yes it does.