

SEP 24 2018

ON BEHALF OF AVISTA CORPORATION

Boise, Idaho

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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
<u>TRANSACTION</u>)	JAMES D. SCARLETT

FOR HYDRO ONE LIMITED

1 I. INTRODUCTION

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

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

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

10 A. No.

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

13 A. Yes. Attached to my testimony are:

- 14 • Exh. No. 10, Schedule 1 - July 2018 Letter Agreement
15 between Hydro One and Her Majesty The Queen in Right
16 of Ontario
- 17 • Exh. No. 10, Schedule 2 - Schedule 1 of the *Urgent*
18 *Priorities Act, 2018*, titled the *Hydro One*
19 *Accountability Act, 2018*
- 20 • Exh. No. 10, Schedule 3 - Governance Agreement
21

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15 **Summary of Testimony**

16 **Q. Please summarize your testimony.**

17 A. My testimony addresses the following topics: (i) the
18 June 7, 2018 election of a new Ontario government, (ii) the July
19 11, 2018 Letter Agreement ("July 2018 Letter Agreement") and
20 the resignation of Hydro One's Board and retirement of Hydro
21 One's Chief Executive Officer ("CEO") Mayo Schmidt, (iii) the
22 *Hydro One Accountability Act, 2018*, (iv) Hydro One's and
23 Avista's efforts to keep the Commission apprised of developments
24 in Ontario, (v) the future of Hydro One's Governance Agreement
25 with the Province, (vi) the impact of NAFTA on the Proposed
26 Transaction, (vii) the settlement commitments designed to
27 protect Avista's independence and financial health from

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1 Provincial interference, (viii) Avista's and Hydro One's
2 proposal to add a new commitment and amend its commitment
3 regarding Avista's post-merger board in response to the events
4 after the June 7, 2018 Ontario election involving Hydro One,
5 and (ix) my adoption of Mayo Schmidt's previously filed
6 testimony and exhibits in this proceeding.

7

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

9 **Q. Please describe the outcome of the Province of**
10 **Ontario's election on June 7, 2018.**

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

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

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

20 **Q. What promises did the Progressive Conservative Party**
21 **make during its campaign regarding Hydro One?**

22 A. During the campaign, promises were made by the
23 Progressive Conservative Party to remove Hydro One's CEO Mayo
24 Schmidt and some or all of the members of Hydro One's Board of

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1 Directors. The Progressive Conservative Party also promised to
2 reduce electricity rates for Ontario residents.

3 **Q. What mechanisms were available to the government to**
4 **fulfill these campaign promises regarding Hydro One's CEO and**
5 **Board of Directors?**

6 A. If the government wished to seek to remove some or
7 all of Hydro One's Board and its CEO, they could accomplish
8 these objectives either (i) through procedures established by
9 Section 4.7 of the Governance Agreement (the "Governance
10 Agreement") between Hydro One and Her Majesty the Queen in Right
11 of Ontario (the "Province"), or (ii) through legislation. The
12 Governance Agreement is Exh. No. 10, Schedule 3 to my
13 supplemental testimony.

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

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

1 In order to remove the Hydro One Board, the Province must
2 follow the procedures in Section 4.7 of the Governance
3 Agreement:

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

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

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

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

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

23 Under the Section 4.7 procedures, Hydro One's shareholders
24 must remove the entire Hydro One Board; they cannot remove just

1 certain Board members. (Section 4.7.1) Further, the Board cannot
2 be replaced with any board members who were part of the previous
3 Board. (Section 4.7.3) All nominees must be vetted by the Ad
4 Hoc Nominating Committee (Sections 4.7.3 and 4.3) and must meet
5 the qualification standards set in Section 4.2.1 of the
6 Governance Agreement -- each director nominee must be an
7 individual of high quality and integrity who has: (i)
8 significant experience and expertise in business or that is
9 applicable to business, (ii) served in a senior executive or
10 leadership position, (iii) broad exposure to and understanding
11 of the Canadian or international business community, (iv) skills
12 for directing the management of a company, and (v) motivation
13 and availability, in each case, to the extent appropriate for a
14 business of the complexity, size and scale of the business of
15 Hydro One and on a basis consistent with the highest standards
16 for directors of leading Canadian publicly listed companies.

17 Section 4.7 does not permit shareholders to hire or fire
18 Hydro One's CEO. Section 4.7 simply provides a process by which
19 Hydro One's shareholders can install a new Board. Section
20 2.3(b) of the Governance Agreement reserves to the Board the
21 authority to appoint, terminate, supervise and compensate the
22 CEO, Chief Financial Officer and other senior officers of Hydro
23 One.

24 **Q. Please explain the legislative path available to the**

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1 **government.**

2 A. As an alternative to following the Section 4.7
3 procedures in the Governance Agreement, the government also had
4 the option of passing legislation during the special legislative
5 session convened in July that would give the Province the
6 authority to remove and replace the Hydro One CEO and its Board.

7

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

9 **Q. What did Hydro One's executive team and Board do after**
10 **the Progressive Conservative Party took a majority of the seats**
11 **in the Ontario Legislature?**

12 A. On July 4, 2018, discussions were held between
13 representatives of the Board and of the government,
14 respectively. On July 5, 2018, discussions were held between
15 legal counsel to the Board and a representative of the
16 government and privileged and confidential discussions were held
17 among the Board Chair, another representative of the Board and
18 the Board's legal counsel. Subsequently, representatives of
19 the Board, the Board's legal counsel and representatives of the
20 government held various discussions and meetings during July 6,
21 2018 through July 8, 2018. These discussions involved
22 representatives from the Cabinet Office, and representatives of
23 the Ministry of Energy, Northern Development and Mines, the
24 Ministry of Finance and the Attorney General, and led to the

1 July 2018 Letter Agreement being approved by Cabinet and entered
2 into between Hydro One and Ontario as represented by the
3 Honorable Greg Rickford, the Minister of Energy, Northern
4 Development and Mines. The July 2018 Letter Agreement between
5 Hydro One and Her Majesty The Queen in Right of Ontario is
6 attached as Exh. No. 10, Schedule 1.

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

9 A. The replacement of the Board and the CEO was one of
10 the campaign promises made by the Progressive Conservative Party
11 during the election campaign for the election that took place
12 on June 7, 2018. In light of this, the Board of Hydro One
13 determined that it would be in the best interests of Hydro One
14 to voluntarily resign to facilitate the orderly replacement of
15 the Board in a sequential manner on an expedited basis. Rather
16 than wait for the government to trigger the procedures in the
17 Governance Agreement or pursue legislation with potentially
18 intrusive provisions, a process for replacing the Board was
19 documented in the July 2018 Letter Agreement. In doing so, the
20 Province and Hydro One complied with the spirit and intent of
21 Section 4.7 of the Governance Agreement. In order to serve the
22 best interests of the company, the parties agreed to forego the
23 requirement to hold a shareholders' meeting, thereby expediting
24 the process and reducing uncertainty.

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

3 A. The July 2018 Letter Agreement provides that (i) an
4 Ad Hoc Nominating Committee comprised of representatives of each
5 of Hydro One's five largest shareholders (or a lesser number
6 depending on how many of the five largest shareholders wished
7 to serve on the Ad Hoc Nominating Committee), excluding the
8 Province, would be formed to nominate six directors of the new
9 Board; and (ii) the Province would nominate four directors. The
10 new directors must meet the requirements set out in the
11 Governance Agreement. As noted above, Section 4.2 of the
12 Governance Agreement outlines the qualifications for director
13 nominees. The new Board would then appoint a replacement Chair
14 of the Board from among their number consistent with Section
15 3.2 of the Governance Agreement.

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

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

24 A. Yes. As explained in the Supplemental Testimony of
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1 Hydro One's then Chair Thomas Woods ("Woods Testimony"), the Ad
2 Hoc Nominating Committee was formed and three of the five
3 largest Hydro One shareholders participated, excluding the
4 Province. The Ad Hoc Nominating Committee selected six members
5 for the Board, and the Province selected four members. Hydro
6 One announced the members of the new Board on August 14, 2018
7 and Thomas Woods as the Chair on September 7, 2018. See Woods
8 Testimony, §§ II and III.

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

11 A. No. As with previous Board members, the new Board
12 members are subject to annual approval of the Hydro One
13 shareholders, consistent with the Governance Agreement and the
14 *Business Corporations Act* (Ontario) ("OBCA"). Section 2 of the
15 July 2018 Letter Agreement provides:

16 Each of the Replacement Directors nominated and appointed
17 to the Board pursuant to section 1 of this Agreement shall
18 serve on the Board until the earlier of the 2019 annual
19 meeting of shareholders of Hydro One or until his or [sic]
20 resignation or his or her successor is elected or appointed
21 in accordance with the Governance Agreement and the OBCA.
22
23 Exh. No. 10, Schedule 1, § 2.

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

25 A. The Governance Agreement requires that the CEO be
26 appointed by the Board and annually have his appointment
27 confirmed by a special resolution of the Board (i.e., two-thirds

1 of the votes cast at a directors' meeting, or consented to in
2 writing by all directors). See Section 3.3 of the Governance
3 Agreement. In light of the events outlined above and the
4 anticipated difficulty of him attempting to carry out his duties
5 as CEO without the support of Hydro One's single largest
6 shareholder, the former CEO Mayo Schmidt retired from his
7 positions, having determined that it would be in the best
8 interests of Hydro One and its stakeholders to do so.

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

11 A. Pursuant to Section 3.3 of the Governance Agreement
12 and Section 13 of the July 2018 Letter Agreement, the new Board
13 will appoint a replacement CEO, who will become the eleventh
14 Board member.¹ The Board Chair will establish a CEO Selection
15 Committee, which will in turn appoint an Executive Recruiting
16 firm. Internal and external candidates will be interviewed,
17 and a preferred candidate will be selected. Negotiations with
18 the preferred candidate will then take place in an effort to
19 enter into an agreement to be appointed CEO. The Board will
20 proceed with all deliberate speed in the process of finding a

¹ At the time of the Joint Application, Hydro One had 15 directors, one of whom did not stand for re-election at the company's 2018 annual meeting of shareholders. At the time of the July 2018 Letter Agreement, the Hydro One board consisted of 14 directors, 13 members plus President and CEO Mayo Schmidt. Pursuant to the July 2018 Letter Agreement, the new board will initially consist of 10 directors plus the new CEO.

1 CEO. The status of the CEO search is described in Woods
2 Testimony, § IV.

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

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

11 **Q. Does the July 2018 Letter Agreement impact Avista**
12 **employees?**

13 A. The July 2018 Letter Agreement has no impact on Avista
14 employees. All actions taken pursuant to the July 2018 Letter
15 Agreement involve only the replacement of Hydro One's Board and
16 retirement of Hydro One's CEO.

17 **Q. Does the July 2018 Letter Agreement impact the Merger**
18 **Agreement between Avista and Hydro One?**

19 A. The July 2018 Letter Agreement has no impact on the
20 Merger Agreement between Hydro One and Avista. Nothing in the
21 July 2018 Letter Agreement addresses the Merger Agreement in
22 any way, and Hydro One has stated on multiple occasions since
23 the July 2018 Letter Agreement was executed that it remains

1 bound by the Merger Agreement and remains committed to the
2 merger.

3 **Q. Does the July 2018 Letter Agreement include new merger**
4 **terms for Avista executives?**

5 A. No. The July 2018 Letter Agreement does not include
6 "new merger terms for Avista executives" but rather documents
7 the agreement between Hydro One and the Province for the orderly
8 replacement of the board of directors of Hydro One and the
9 retirement of Mayo Schmidt as the chief executive officer
10 effective July 11.

11 **Q. Does the July 2018 Letter Agreement impact the**
12 **Settlement Stipulation signed by the parties?**

13 A. The July 2018 Letter Agreement has no impact on the
14 Settlement Stipulation signed by the parties. Nothing in the
15 July 2018 Letter Agreement addresses the Settlement Stipulation
16 filed in this docket, and Hydro One has stated on multiple
17 occasions since the July 2018 Letter Agreement was executed that
18 it remains committed to the merger.

19

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

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

23 A. Yes. The new government convened a special
24 legislative session on July 11, 2018.

1 **Q. Did the Progressive Conservative Party introduce**
2 **legislation impacting Hydro One?**

3 A. On Monday, July 16, 2018, the new Provincial
4 government introduced the *Urgent Priorities Act, 2018*, which,
5 included as Schedule 1, the *Hydro One Accountability Act, 2018*.
6 The *Hydro One Accountability Act, 2018* is attached as Exh. No.
7 10, Schedule 2.

8 **Q. Please summarize the requirements of the *Hydro One***
9 ***Accountability Act*.**

10 A. The *Hydro One Accountability Act* (the "Act") addresses
11 concerns about compensation for Hydro One executives located in
12 Ontario. It requires the board of Hydro One to establish a new
13 compensation framework for the Board of Directors, CEO, and
14 other executives in consultation with the Province and the other
15 five largest shareholders. The Act gives the Management Board
16 of Cabinet authority to approve this compensation framework and
17 any amendments to it as well as to issue directives governing
18 the compensation of the directors, CEO, and other executives.

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

23 The Act requires Hydro One to annually publish on its
24 website a record of the total compensation of executives as

1 prescribed by regulation. The Act also requires Hydro One to
2 publish on its website any proposed changes to its compensation
3 frameworks for the board, CEO, or other executives at least 30
4 days prior to the date on which it seeks Management Board of
5 Cabinet approval for those changes pursuant to the Act.

6 The new legislation does not change the fact that Hydro
7 One is a publicly traded commercial entity separate from the
8 Province of Ontario.

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

11 A. The *Urgent Priorities Act*, which includes Schedule 1,
12 the Act, went through first, second, and third readings in the
13 Ontario Legislature. The Legislature did not amend the
14 legislation. The *Urgent Priorities Act* then received Royal
15 Assent on July 25, 2018, which is the day it came into force as
16 the law of Ontario. Schedule 1 provides that the Act comes into
17 force on a day to be named by proclamation of the Lieutenant
18 Governor. That proclamation was delivered on August 15, and
19 the Act is now effective.

20 **Q. Will the Act apply to the executives of Avista if the**
21 **merger of Hydro One and Avista is consummated?**

22 A. No. As defined in the Act, the term "subsidiary"
23 excludes any subsidiary incorporated in a jurisdiction outside
24 of Canada.

1 **Q. What, if you know, was the impetus for the Act?**

2 A. It appears that the Act was the result of a campaign
3 promise made by the Progressive Conservative Party to address
4 executive compensation at Hydro One. The Act does not apply to
5 executives of Hydro One's subsidiaries incorporated outside of
6 Canada and hence, would not apply to Avista if the merger is
7 consummated.

8 **Q. Will the Act impact the Merger Agreement between**
9 **Avista and Hydro One?**

10 A. The Act will have no impact on the Merger Agreement
11 between Avista and Hydro One. As noted, the Act does not apply
12 to Hydro One's subsidiaries incorporated outside of Canada.

13 **Q. Will the Act impact the Settlement Stipulation signed**
14 **by the parties?**

15 A. The Act will have no impact on the Settlement
16 Stipulation signed by parties because the Act applies only to
17 Hydro One's subsidiaries incorporated in Canada.

18

19 **V. KEEPING THE COMMISSION APPRISED OF DEVELOPMENTS IN ONTARIO**

20 **Q. Please describe how Hydro One and Avista have kept**
21 **the Commission apprised of developments related to Hydro One in**
22 **the most recent Province of Ontario election?**

23 A. Hydro One, and energy policy in general, have
24 regularly been a focus of the media in Ontario. In this most

1 recent election, statements regarding Hydro One were publicly
2 made by the various political parties and candidates running
3 during the election. It was only after the final settlement
4 conference between the Idaho parties in this proceeding on April
5 4, 2018, that electricity rates in Ontario and Hydro One's
6 executive management and compensation became a more prominent
7 issue. The first mention regarding a change of Hydro One's
8 management happened on April 10, 2018. Election campaigns in
9 Canada are shorter than in the United States and starting in
10 June, 2018, Hydro One and Avista informed the Commission of the
11 recent developments as it became clear they may impact Hydro
12 One, well before the scheduled evidentiary hearing or any
13 potential decision on the merger.

14 Shortly after the June 7, 2018 election, Hydro One and
15 Avista notified the Commission of the outcome of the election
16 and the campaign promises made by the Ontario Progressive
17 Conservative Party regarding Hydro One in their June 20, 2018
18 Avista and Hydro One Joint Comments in Support of Stipulation
19 and Settlement in the Idaho proceedings. On June 20, 2018,
20 Hydro One still did not know how the election could impact Hydro
21 One, but chose to update the Commission regarding campaign
22 promises made by the new government well before the evidentiary
23 hearing scheduled for July 23, 2018.

24 Since the filing of the June 20, 2018 comments in support

1 of the settlement, Hydro One and Avista have regularly updated
2 the Commission on the actions of the Ontario government with
3 respect to the management and Board of Directors of Hydro One,
4 having filed with the Commission a letter, dated July 18, 2018,
5 regarding the July 2018 Letter Agreement; a July 20, 2018 letter
6 regarding a Standard & Poor's Report; a Report, dated August
7 15, 2018, on Hydro One Management Changes; a September 10, 2018
8 Supplemental Report on Hydro One Chair and Management Changes;
9 and a September 14, 2018 Supplemental Report on Hydro One's S&P
10 Rating.

11 **Q. Do you believe that Hydro One's acquisition of Avista**
12 **is still in the public interest?**

13 A. Yes. Hydro One remains a strong and suitable parent
14 company for Avista and the deal continues to be in the public
15 interest. The benefits of the transaction for Avista ratepayers
16 remain unchanged. As was stated in the Joint Application dated
17 September 14, 2017, the companies are culturally aligned. Hydro
18 One's market capitalization is approximately three times the
19 size of Avista and will provide Avista with improved access to
20 capital markets. Hydro One is a strategic investor, rather than
21 a financial investor, and its interests are aligned with
22 Avista's for long-term success. To this end, Hydro One has made
23 a number of commitments to preserve Avista's ability to run its
24 own business on an ongoing basis, for the benefit of Avista's

1 customers. Since the Joint Application, Hydro One and Avista
2 joined other Idaho parties in reaching the Settlement
3 Stipulation filed on April 13, 2018, in this docket, and agreed
4 to significant commitments that will have both immediate and
5 long-term positive impacts on Avista's Idaho customers. Hydro
6 One stands by these commitments. The Ontario election, the July
7 2018 Letter Agreement, and subsequent events have no effect on
8 these commitments and benefits.

9 Further, while the cost of electricity for a typical
10 residential customer in Ontario has more than doubled over the
11 last ten years, those increases have not been driven by Hydro
12 One, which is solely a distribution and transmission utility.
13 Over that same 10-year period, customer costs for Hydro One's
14 transmission and distribution delivery services have increased
15 by an average of less than 3% annually. The costs that have
16 led to the doubling of electricity costs for residential
17 customers over the past 10 years were the result of cost
18 increases at electricity generation companies that were required
19 to comply with Provincial green power initiatives. Hydro One,
20 as the entity that sends the bill to customers, is often
21 incorrectly blamed for the entirety of the bill, regardless of
22 Hydro One's actual impact on the total bill. To the extent that
23 this may subject Hydro One to the politics in Ontario, the
24 governance and ring-fencing commitments in the Settlement

1 Stipulation (including Stipulated Commitment Nos. 2, 3, 9, 10,
2 and 42-51) were designed to ensure that Avista's customers will
3 not be impacted by Ontario politics.
4

5 **VI. THE FUTURE OF THE GOVERNANCE AGREEMENT**

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

9 A. Yes. Pursuant to Section 16 of the July 2018 Letter
10 Agreement between Hydro One and the Province (Exh. No. 10,
11 Schedule 1), except for the provisions of the Act which are
12 principally limited to compensation matters pertaining to Hydro
13 One and its subsidiaries incorporated within Canada, the
14 Province ratified and reaffirmed its commitment to the
15 Governance Agreement, which remains in full force and effect:

16 16. Reaffirmation: By entering into this Agreement, the
17 Province ratifies and reaffirms its obligations under the
18 Governance Agreement and agrees that, except as
19 specifically set out in this Agreement with respect to the
20 subject matter hereof, (i) the execution, delivery and
21 effectiveness of this Agreement or any other documents
22 delivered in connection herewith shall not amend, modify
23 or operate as a waiver or forbearance of any right, power,
24 obligation, remedy or provision under the Governance
25 Agreement, and (ii) such agreement shall continue in full
26 force and effect.
27

28 Exh. No. 10, Schedule 1, § 16.

29 The Governance Agreement requires that the Province act as
30 an investor and not a manager of Hydro One, and the Province's

1 decision-making authority in respect of Hydro One is restricted
2 to that of any other investor with respect to voting its shares
3 in any decisions that are brought forward for shareholder
4 approval. The Province also has the right to nominate 40 percent
5 of the Board of Directors (other than the CEO), but all directors
6 remain subject to an annual vote by all shareholders of Hydro
7 One.

8 As noted above, although the Province's rights as a
9 shareholder are limited by the Governance Agreement, the
10 Province retains legislative authority to pass legislation with
11 respect to subjects within its jurisdiction, such as the Act.

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

14 A. I am not aware of any further actions that the
15 Province intends to take with respect to Hydro One. As I
16 mentioned above, the government has stated that it would like
17 to reduce electricity rates for Ontario residents. I do not
18 know what, if any, further actions that the Province may take
19 to address electricity rates, and am not aware of any pending
20 legislation that would impact Hydro One's management or rates.
21 I do not believe that any such action would affect the agreed-
22 upon commitments reflected in the filed Stipulated Settlement,
23 which insulate Avista's customers from provincial affairs, as
24 discussed below.

1 Q. The Joint Application states that "As of July 31,
2 2017, the Province owned 49.9% of Hydro One's shares with the
3 remainder of shares held by private investors. Based on facts
4 known today and assuming the Proposed Transaction is completed,
5 the Province's level of ownership of Hydro One will decline to
6 below 45%." Does this statement continue to be accurate?

7 A. The statement continues to be true except that as at
8 August 31, 2018, the Province owns approximately 47.4% of Hydro
9 One's common shares. As at July 31, 2017, the Province did own
10 49.9% of Hydro One's shares. On January 2, 2018, the Province
11 announced the sale of 14,391,012 common shares of Hydro One
12 Limited, representing approximately 2.4% of the outstanding
13 common shares, to OFN Power Holdings LP, a limited partnership
14 wholly-owned by Ontario First Nations Sovereign Wealth LP, which
15 is in turn owned by 129 First Nations in Ontario at a purchase
16 price of \$18 per share, for a total purchase price of
17 \$259,038,216. That transaction fulfilled the Province's
18 commitment in its agreement-in-principle with the Chiefs-in-
19 Assembly on behalf of the First Nations in Ontario, which was
20 previously announced on July 12, 2016.

21 Immediately prior to the closing of that transaction, the
22 Province owned 296,803,660 common shares of Hydro One Limited,
23 representing approximately 49.9% of the common shares of Hydro
24 One. After completing the transaction, the Province owned

1 282,412,648 common shares of Hydro One, representing
2 approximately 47.4% of the common shares of Hydro One.

3 **Q. As a follow up to the prior question, what is Hydro**
4 **One's understanding regarding the Province of Ontario's future**
5 **stake in Hydro One?**

6 A. Based on facts known today, and assuming the Proposed
7 Transaction is completed, the Province's level of ownership of
8 Hydro One will decline to approximately 42%. The Province has
9 also agreed in the Governance Agreement not to acquire
10 previously issued voting securities if after that acquisition,
11 the Province would own more than 45% of any class or series of
12 voting securities (including common shares of Hydro One).²

13 The Province will likely continue to own at least 40% of
14 Hydro One's shares for the foreseeable future. The Ontario
15 *Electricity Act, 1998* restricts the Province from selling voting
16 securities (including common shares of Hydro One) if it would
17 own less than 40% of the outstanding number of voting securities
18 of that class or series after the sale.

19 If as a result of the issuance of additional voting
20 securities of any class or series by Hydro One, the Province

² This restriction does not apply to the acquisition by the Province of voting securities as a result of the enforcement by the Province of any security interest securing payment of debt obligations owing to the Province or to certain acquisitions of voting securities by entities related to the Province or by third party managed funds or as passive investments. This restriction also does not require the Province to sell any of the common shares of Hydro One that it currently owns, nor does it limit the Province from acquiring voting securities on an issuance by Hydro One, including pursuant to the exercise by the Province of its pre-emptive right.

1 would own less than 40% of the outstanding number of voting
2 securities of that class or series, then the Province shall,
3 subject to certain requirements, take steps to acquire as many
4 voting securities of that class or series of voting securities
5 as are necessary to increase the Province's ownership to not
6 less than 40% of the outstanding number of voting securities of
7 that class or series.

8 In order to assist the Province in meeting its ownership
9 obligations under the *Electricity Act, 1998*, under Section 6 of
10 the Governance Agreement, Hydro One has granted the Province a
11 pre-emptive right to subscribe for and purchase up to 45% of
12 any proposed issuance by Hydro One of voting securities or
13 securities that are convertible or exchangeable into voting
14 securities (other than certain specified excluded issuances).
15 Any offered securities not subscribed for and purchased by the
16 Province pursuant to its pre-emptive right may be issued to any
17 other person pursuant to the proposed offering.

18

19 **VII. THE NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)**

20 **Q. Can Hydro One use NAFTA Chapter 11 to overrule or**
21 **impede the Commission's authority?**

22 A. NAFTA Chapter 11 cannot affect the scope of the
23 Commission's authority over Avista. NAFTA Chapter 11 only
24 provides for monetary awards or restitution of expropriated

1 property and, therefore, cannot be used to alter or nullify a
2 Commission decision or regulation.³ In reviewing the Fortis/CH
3 Energy Group merger, the New York Public Service commission
4 stated the following: "[A] state regulatory agency acting
5 lawfully within its statutory authority is not liable to a claim
6 of damages under NAFTA unless an entity covered by the treaty
7 can demonstrate that it made its investment in the state
8 pursuant to express commitments by the agency which were
9 subsequently broken."⁴

10 To date, the United States has been a defendant 17 times
11 under NAFTA Chapter 11, and none of those claims involved a
12 foreign utility protesting a state utility commission's
13 decision. Not only has the U.S. State Department never lost a
14 NAFTA Chapter 11 claim brought by a foreign investor, but also
15 it has never settled such a claim.

16 **Q. Could Hydro One use NAFTA Chapter 11 to impact**
17 **Avista's Idaho customers?**

18 A. For the reasons stated in my prior answer, Hydro One's
19 understanding is that NAFTA Chapter 11 cannot affect the scope
20 of the Commission's authority over Avista, and Hydro One does
21 not believe NAFTA Chapter 11 would have an impact on Avista's

³ See NAFTA Art. 1135(1)(a), (b).

⁴ *Joint Petition for Approval of the Acquisition of CH Energy Group, Inc. by Fortis, Inc. and Related Transactions*, New York Public Service Commission Case 12-M-092, Order Authorizing Acquisition at 33 (Jun. 26, 2013) and Recommended Decision of Administrative Law Judges at 46 (May 3, 2013).

1 Idaho customers.

2 **Q. The United States, Canada, and Mexico are currently**
3 **in negotiations to potentially amend and modify NAFTA. Does**
4 **Hydro One have any knowledge regarding the extent to which the**
5 **concepts addressed in Chapter 11 will be included, modified, or**
6 **removed in a renegotiated NAFTA?**

7 A. Hydro One's understanding of the renegotiations of
8 NAFTA between Canada and the U.S. are limited to what
9 information has been released to the public. To the extent that
10 Chapter 11 is being renegotiated it appears that any changes to
11 Chapter 11 will be likely to reduce, not expand, the scope of
12 relief available to investors. Given this understanding, and
13 because existing Chapter 11 provisions do not pose a credible
14 risk of impeding the Commission's authority, Hydro One does not
15 foresee changes to NAFTA's Chapter 11 that would change Hydro
16 One's understanding of NAFTA Chapter 11 or its impact on
17 Avista's Idaho customers.

18 **Q. Notwithstanding the fact that Hydro One believes that**
19 **NAFTA Chapter 11 could not be used to affect the Commission's**
20 **jurisdiction over Avista or impact Avista's customers in Idaho,**
21 **is Hydro One willing to add a commitment in Idaho regarding the**
22 **Commission's jurisdiction and the venue for any potential NAFTA**
23 **dispute?**

24 A. Yes, for example, Oregon Stipulated Commitment No.

1 72, filed as part of the all-party settlement agreement in
2 Oregon Public Utility Commission Docket No. UM 1897 on May 25,
3 2018, specifically ensures that the Oregon Public Utility
4 Commission will retain jurisdiction over any issue that could
5 arise in a NAFTA Chapter 11 arbitration:

6 **72. North American Free Trade Agreement (NAFTA)**

7 Avista and Parent agree that the Commission would have
8 jurisdiction in any future proceedings regarding any
9 unrecovered liabilities to the State of Oregon that may
10 result from NAFTA Chapter Eleven mediations, arbitrations,
11 or any other litigation brought by Hydro One's shareholders
12 under NAFTA. Only the Commission or the Oregon Attorney
13 General may initiate such proceeding.

14 Oregon Stipulated Commitment No. 72 confirms that Hydro
15 One and Avista recognize that NAFTA does not curtail the
16 authority of the Oregon Public Utility Commission to promulgate
17 and enforce relevant rules and regulations, that Hydro One and
18 Avista explicitly recognize that the Commission's authority over
19 Avista's operations will remain unchanged by the Proposed
20 Transaction, that the Parties will comply with all applicable
21 laws and regulations, and that Hydro One and Avista recognize
22 the Oregon Public Utility Commission's jurisdiction. Hydro One
23 and Avista certainly are willing to add a similar commitment in
24 Idaho.

25 Oregon Stipulated Commitment No. 78 also explicitly states
26 that all disputes involving Avista will be resolved in the
27 appropriate state and federal regulatory bodies or courts in

1 the United States:

2 **78. Venue for and Resolution of Disputes**

3 Avista and Parent agree that the venue for disputes
4 regarding the operation of Avista will be in state and
5 federal regulatory bodies or courts of competent
6 jurisdiction, as applicable, in Oregon, Washington, Idaho,
7 Montana or Alaska.

8 Oregon Stipulated Commitment No. 78 ensures that a NAFTA
9 Chapter 11 arbitration will not have jurisdiction over disputes
10 regarding the operation of Avista. Hydro One and Avista
11 certainly are willing to add a similar commitment in Idaho.

12

13 **VIII. SETTLEMENT COMMITMENTS DESIGNED TO PROTECT AVISTA'S**
14 **INDEPENDENCE AND FINANCIAL HEALTH**

15 **Q. Is there a question as to whether the Province will**
16 **directly interfere with Avista's independence and financial**
17 **health if the merger is consummated?**

18 A. No. All of the parties to this proceeding filed a
19 Settlement Stipulation and Agreement with the Idaho Public
20 Utilities Commission (the "Commission") on April 13, 2018
21 ("Stipulated Settlement"). The Stipulated Settlement includes
22 73 merger commitments (each, a "Stipulated Commitment,"
23 collectively, the "Stipulated Commitments") that were designed
24 by all of the parties to ensure the independence and financial
25 health of Avista. Through Hydro One's and Avista's opening
26 testimony filed on September 14, 2017, and an in-person

1 settlement conference, all of the parties to this proceeding
2 carefully explored the risks to Avista associated with its
3 proposed acquisition by a Canadian utility whose largest
4 shareholder is the Province of Ontario. All of the parties
5 discussed these risks and developed a set of 73 Stipulated
6 Commitments designed to ensure the independence and financial
7 health of Avista in light of the fact that Hydro One's largest
8 shareholder is the Province of Ontario.

9 I firmly believe that the 73 Stipulated Commitments will
10 fully protect Avista's independence and financial health if the
11 merger is consummated, and the events since the June 7, 2018
12 election do not change my conclusion.

13 The Province will not have jurisdiction to directly affect,
14 interact with, or directly interfere with the management and
15 strategic direction of Avista if the merger is consummated. The
16 Province cannot pass laws that apply to Avista. Rather, if the
17 merger is consummated, Hydro One's ownership of Avista will be
18 constrained by the 73 Stipulated Commitments, any commitments
19 included in the Commission's order approving the merger, and
20 the laws of the United States and the five states in which
21 Avista operates (Idaho, Washington, Oregon, Montana, and
22 Alaska).

23 **Q. How do the Stipulated Commitments protect Avista's**
24 **independence and ensure that the Province cannot directly**

1 **interfere with Avista's management and strategic direction?**

2 A. Stipulated Commitment No. 3 provides that only two of
3 the nine members of Avista's post-merger board can be executives
4 of Hydro One or any of its subsidiaries. The other three Hydro
5 One designees must be independent of Hydro One, Avista, and
6 Hydro One's other affiliates, and be residents of the Pacific
7 Northwest. Further, of the four Avista designees, three
8 initially will be from Avista's pre-merger board, including the
9 Chairman of Avista's pre-merger board, and the fourth will be
10 Avista's CEO. If any Avista designee resigns, retires, or
11 otherwise ceases to serve as a director of Avista, then the
12 remaining Avista designees will have the sole right to replace
13 the departing Avista designee.

14 Presuming that one of the two Hydro One executives on
15 Avista's post-merger board was directed by the Hydro One Board
16 to bring to the Avista post-merger board an initiative that
17 would benefit Hydro One and/or Ontario but diminish Avista's
18 financial resources and service, the seven remaining members of
19 Avista's post-merger board, all of whom will not be executives
20 of Hydro One, would have sufficient votes to reject that
21 initiative.

22 Further, Stipulated Commitment Nos. 2, 9, and 10 also
23 ensure the independence of Avista's post-merger board and the
24 continued service of Avista's executive management and long-

1 term presence in the Pacific Northwest:

2 **2. Executive Management**

3 Avista will seek to retain all current executive management
4 of Avista, subject to voluntary retirements that may occur.
5 This commitment will not limit Avista's ability to
6 determine its organizational structure and select and
7 retain personnel best able to meet Avista's needs over
8 time. The Avista board retains the ability to dismiss
9 executive management of Avista and other Avista personnel
10 for standard corporate reasons (subject to the approval of
11 Hydro One Limited ("Hydro One") for any hiring, dismissal
12 or replacement of the CEO);

13 **9. Avista's Headquarters**

14 Avista will, and Hydro One agrees Avista will, maintain
15 (a) its headquarters in Spokane, Washington; (b) Avista's
16 office locations in each of its other service territories,
17 and (c) no less of a significant presence in the immediate
18 location of each of such office locations than what Avista
19 and its subsidiaries maintained immediately prior to
20 completion of the Proposed Transaction;

21 **10. Local Staffing**

22 Avista will maintain Avista Utilities' staffing and
23 presence in the communities in which Avista operates at
24 levels sufficient to maintain the provision of safe and
25 reliable service and cost-effective operations and
26 consistent with pre-acquisition levels;

27 The Supplemental Testimony of Hydro One's and Avista's
28 Expert Witness John J. Reed ("Reed Testimony") discusses these
29 governance commitments and explains how they represent the
30 state-of-the-art for a utility merger. Reed Testimony, § III.

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

1 A. In addition to the protections provided by the
2 independence of Avista's post-merger board, Stipulated
3 Commitment No. 15 limits the Avista post-merger board's and
4 Hydro One's ability to remove or reduce any associated penalty
5 provisions for 10 years after the date of the merger:

6 **15. Safety and Reliability Standards and Service Quality**
7 **Measures**

8 Avista has established Service Quality Performance
9 Standards, Customer Guarantees and a Service Quality
10 Measure Report Card for its customers in Washington. Avista
11 is currently working with the Idaho Commission Staff to
12 develop similar performance standards, customer guarantees
13 and a reporting mechanism for its customers in Idaho.
14 Following Idaho Commission approval of such standards,
15 customer guarantees and a reporting mechanism, Avista will
16 not seek, and Hydro One agrees Avista will not seek, to
17 remove or reduce any associated penalty provisions for ten
18 (10) years after the date of the merger.

19

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

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

1 **26. Avista Capital Structure**

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

7 **34. Capital Structure Support**

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

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

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

15 **36. Continued Credit Ratings**

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

29 **37. Credit Ratings Notification**

30 Hydro One and Avista agree to notify the Commission within
31 two business days of any downgrade of Avista's credit
32 rating to a non-investment grade status by S&P, Moody's,
33 or any other such ratings agency that issues such ratings
34 with respect to Avista.

35 **38. Restrictions on Upward Dividends and Distributions**

36 a. If either (i) Avista's corporate credit/issuer rating
37 as determined by both Moody's and S&P, or their successors,

1 is investment grade, or (ii) the ratio of Avista's EBITDA
2 to Avista's interest expense is greater than or equal to
3 3.0, then distributions from Avista to Olympus Equity LLC
4 shall not be limited so long as Avista's equity ratio is
5 equal to or greater than 44 percent on the date of such
6 Avista distribution after giving effect to such Avista
7 distribution, except to the extent the Commission
8 establishes a lower equity ratio for ratemaking purposes.
9 Both the EBITDA and equity ratio shall be calculated on
10 the same basis that such calculations would be made for
11 ratemaking purposes for regulated utility operations.

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

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

21 **39. Pension Funding**

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

25 The Reed Testimony discusses these financial ring-fencing
26 commitments and explains how they represent the state-of-the-
27 art for a utility merger. Reed Testimony, § IV.

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

31 A. In addition to the protections provided by the
32 independence of Avista's post-merger board, Stipulated
33 Commitment Nos. 42-51 ensure Hydro One will not draw Avista into

1 bankruptcy except under extremely limited circumstances.
2 Although I will not repeat the substance of these commitments
3 in this testimony, the Reed Testimony discusses these bankruptcy
4 commitments and explains how they represent the state-of-the-
5 art in bankruptcy protections for a utility merger, including
6 requirements for a Golden Share and a non-consolidation opinion.
7 Reed Testimony, § IV.

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

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

15 **1. Authority Reserved**

16 Consistent with and subject to the terms of Exhibits A and
17 B to the Merger Agreement (referred to as "Delegation of
18 Authority") contained in Appendix 5 of the Joint
19 Application, decision-making authority over commitments 2-
20 15 below is reserved to the Board of Directors of Avista
21 Corporation ("Avista") and not to Hydro One. Any change to
22 the policies stated in commitments 2-15 requires a two-
23 thirds (2/3) vote of the Avista Board, provided that Avista
24 must obtain approval for such changes from all regulatory
25 bodies with jurisdiction over the Commitments before such
26 changes can go into effect, and provide written notice to
27 all parties to Case No. AVU-E-7-09/AVU-G-17-05 of such
28 request for approval:

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

30 Hydro One and its subsidiaries, including Avista, as

1 applicable and as appropriate, will comply with all
2 applicable laws, including those pertaining to transfers
3 of property, affiliated interests, and securities and the
4 assumption of obligations and liabilities. As required by
5 and consistent with applicable laws, venue for resolution
6 of proceedings related to these matters will be at the
7 appropriate state utility commission(s). Hydro One and its
8 subsidiaries, including Avista, will make their employees
9 and officers available to testify before the Commission at
10 the Commission's request to provide information relevant
11 to the matters within its jurisdiction.

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

13 Hydro One and its subsidiaries, including Avista,
14 acknowledge that all existing orders issued by the
15 Commission with respect to Avista or its predecessor,
16 Washington Water Power Co., will remain in effect, and are
17 not modified or otherwise affected by the Proposed
18 Transaction.

19 Hydro One and its subsidiaries, including Avista, as
20 applicable and as appropriate, will comply with all
21 applicable future Commission orders that remain in force.

22 **30. Commission Enforcement of Commitments**

23 Hydro One and its subsidiaries, including Avista,
24 understand that the Commission has authority to enforce
25 these commitments in accordance with their terms. If there
26 is a violation of the terms of these commitments, then the
27 offending party may at the discretion of the Commission, have
28 a period of thirty (30) calendar days to cure such
29 violation.

30 The scope of this commitment includes the authority of the
31 Commission to compel the attendance of witnesses from
32 Olympus Holding Corp. and its affiliates, including Hydro
33 One, with pertinent information on matters affecting
34 Avista. Hydro One and Olympus Holding Corp. and its
35 subsidiaries waive their rights to interpose any legal
36 objection they might otherwise have to the Commission's
37 jurisdiction to require the appearance of any such
38 witnesses.

39 **31. Submittal to State Court Jurisdiction for Enforcement**
40 **of Commission Orders**

1 Hydro One, Olympus Holding Corp., and Avista will jointly
2 file with the Commission prior to closing the Proposed
3 Transaction an affidavit affirming that they will submit
4 to the jurisdiction of the relevant state courts for
5 enforcement of the Commission's orders adopting the
6 commitments made by and binding upon them and their
7 affiliates where noted, and subsequent orders affecting
8 Avista.

9 **32. Annual Report on Commitments**

10 By May 1, 2019 and each May 1 thereafter through May 1,
11 2029, Avista will file, and Hydro One agrees Avista will
12 file, a report with the Commission regarding the status of
13 compliance with each of the commitments as of December 31
14 of the preceding year. The report will, at a minimum,
15 provide a description of the performance of each of the
16 commitments, will be filed in Case No. AVU-E-I7-09/AVU-G-
17 17-05 and served to all parties to the docket. If any
18 commitment is not being met, relative to the specific terms
19 of the commitment, the report must provide proposed
20 corrective measures and target dates for completion of such
21 measures. Avista will make publicly available at the
22 Commission non-confidential portions of the report.

23 **33. Commitments Binding**

24 Hydro One, Olympus Holding Corp. and its subsidiaries,
25 including Avista, acknowledge that the commitments being
26 made by them are binding only upon them and their
27 affiliates where noted, and their successors in interest.
28 Hydro One and Avista are not requesting in this proceeding
29 a determination of the prudence, just and reasonable
30 character, rate or ratemaking treatment, or public interest
31 of the investments, expenditures or actions referenced in
32 the commitments, and the parties in appropriate proceedings
33 may take such positions regarding the prudence, just and
34 reasonable character, rate or ratemaking treatment, or
35 public interest of the investments, expenditures or actions
36 as they deem appropriate.

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

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

Scarlett, Supp 37
Hydro One Limited

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

7 Q. Several of the Stipulated Commitments in the Idaho
8 Stipulated Settlement require Avista's shareholder, Hydro One,
9 and not Avista's ratepayers, to provide funding for certain
10 programs (Stipulated Commitment Nos. 11 - Community
11 Contributions; 19 - Rate Credits; 58 - Funding for Energy
12 Efficiency, Weatherization, Conservation, and Low-Income
13 Assistance Programs; 61 - Community Contributions; 70 - Montana
14 Community Transition Fund). How can the Commission be certain
15 that Hydro One, as Avista's sole shareholder, will ensure there
16 is funding for these Stipulated Commitments?

17 A. First, as detailed in the Supplemental Testimony of
18 Chris Lopez, § III, the \$15.8 million rate credit will simply
19 flow through to Avista customers in the bills issued by Avista.
20 No cash from Hydro One is needed.

21 Second, Stipulated Commitment Nos. 58 and 70 clearly state
22 that the funds for these programs will be arranged by Hydro One
23 and Stipulated Commitment No. 66 provides that "any commitment
24 that states Hydro One will arrange funding is not contingent on
25 Hydro One's ability to arrange funding, particularly from
26 outside sources, but is a firm commitment to provide the dollar

1 amount specified over the time period specified and for the
2 purposes specified. ... Avista will not seek cost recovery for
3 any of the commitments funded or arranged by Hydro One in this
4 list of merger commitments. Hydro One will not seek cost
5 recovery for such funds from ratepayers in Canada or the United
6 States." Therefore, Hydro One, as Avista's sole shareholder,
7 ultimately bears the cost of these commitments.

8 Third, Stipulated Commitment No. 66 also establishes that
9 if Avista has retained earnings that would otherwise be
10 available to Hydro One as dividends, those retained earnings
11 can be used to fund Stipulated Commitment Nos. 11, 58, 61, and
12 70: "To the extent Avista has retained earnings that are
13 available for payment of dividends to Olympus Equity LLC
14 consistent with the ring fencing provisions of this list of
15 merger commitments, such retained earnings may be used. Funds
16 available from other Hydro One affiliates may be used without
17 limitation."⁵ In essence, funds otherwise available for payment
18 of dividends to Olympus Equity and on up the chain will instead
19 be directed to funding these commitments, as explained in
20 Supplemental Testimony of Chris Lopez, § III.

21 Fourth, as noted in response to the previous question,

⁵ 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 Stipulated Commitment No. 33 establishes that Hydro One and/or
2 its subsidiaries are bound by the Stipulated Commitments,
3 Stipulated Commitment No. 30 subjects Hydro One and/or its
4 subsidiaries to the jurisdiction of the Commission for
5 enforcement of the Stipulated Commitments, and Stipulated
6 Commitment No. 31 provides that "Hydro One, Olympus Holding
7 Corp., and Avista will jointly file with the Commission prior
8 to closing the Proposed Transaction an affidavit affirming that
9 they will submit to the jurisdiction of the relevant state
10 courts for enforcement of the Commission's orders adopting the
11 commitments made by and binding upon them and their affiliates
12 where noted, and subsequent orders affecting Avista."
13 Therefore, Hydro One, as Avista's sole shareholder, and/or its
14 subsidiaries, have submitted to the jurisdiction of the
15 Commission and Idaho courts for the enforcement of all of the
16 Stipulated Commitments, including those that require Hydro One
17 funding.

18 Fifth, if the merger is consummated, the Province will not
19 have jurisdiction to modify or nullify the 73 Stipulated
20 Commitments and any conditions included in the Commission's
21 order approving the merger. Hydro One is bound by these
22 contractual obligations. Even though the Province is a
23 shareholder of Hydro One, Hydro One is the entity that bears
24 the full legal responsibility for the 73 Stipulated Commitments

1 and any commitments included in the Commission's order approving
2 the merger if the merger is consummated. The Province is not a
3 party to Hydro One's contracts and commitments in this
4 proceeding and no action on the part of the Province is required
5 for Hydro One to fulfill its obligations.

6 **Q. Does Section 8.1 of the Governance Agreement make any**
7 **of Hydro One's financial and funding commitments in the**
8 **Stipulated Settlement subject to Provincial appropriations?**

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

12 ***8.1 Financial Obligations of the Province***

13 Pursuant to the [Financial Administration Act (Ontario)],
14 any payment required to be made by the Province pursuant
15 to this Agreement is subject to there being sufficient
16 appropriation by the Legislative Assembly of Ontario for
17 the fiscal year in which the payment is to be made or the
18 payment having been charged to appropriation for a previous
19 year.

20 This provision in the Governance Agreement applies only to "any
21 payment required to be made by the Province pursuant to this
22 [Governance] Agreement" The Province has no payment
23 obligations, whatsoever, pursuant to Hydro One's contracts and
24 commitments related the Proposed Transaction. Therefore, to
25 the extent Section 8.1 limits the Province's payment obligations
26 to the availability of appropriated funds, such limitations have
27 no bearing or legal relationship to Hydro One's contractual

1 obligations with respect to the Proposed Transaction.

2 **Q. Testimony previously filed in this proceeding by**
3 **Avista's CEO Scott Morris and Hydro One's former CEO Mayo**
4 **Schmidt emphasized the strong relationship between the two CEOs**
5 **and the cultural compatibility of Hydro One and Avista. Does**
6 **the retirement of Mr. Schmidt and the Province's actions change**
7 **this justification for the Proposed Transaction?**

8 **A. No.** While the strong relationship between Mr. Morris
9 and Mr. Schmidt certainly contributed to a meeting of the minds
10 on the terms of the merger agreement between Hydro One and
11 Avista, any corporate transaction of this size is not dependent
12 on the relationship of two executives. Eventually, executives
13 retire or leave a company to pursue other opportunities. Both
14 sides understood this and negotiated a merger agreement, the
15 delegation of authority described in Mr. Morris's and Mr.
16 Schmidt's direct testimony, and merger commitments that provide
17 a very clear framework for the interaction of the two companies.
18 Hydro One's commitments to (i) an Avista board with Avista
19 directors and independent directors (as defined by the NYSE
20 rules) ("Independent Directors") from the Pacific Northwest,
21 (ii) continued headquarters in Spokane, WA, (iii) the continued
22 service of Avista's executives, management, and employees, (iv)
23 Avista board control over the hiring and replacement of Avista's
24 CEO, (v) Avista's day-to-day management of its business, and

1 (vi) substantial charitable and community contributions, are
2 all preserved in contractual documents that continue long past
3 the tenure of any single executive involved in the negotiation
4 of the Proposed Transaction. Moreover, the commitments are
5 sufficiently clear and detailed that responsibility for
6 implementation will fall not on the CEOs but on other staff.

7

8 **IX. PROPOSED NEW OR AMENDED COMMITMENTS**

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

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

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

27 See Letter from Joint Applicants Regarding Update on Recent
28 Changes in Hydro One Management, AVU-E-17-09, AVU-G-17-05, (July
29 18, 2018), pp. 5-6.

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

7 **Q. In addition to the above commitment which Hydro One**
8 **and Avista have already proposed, would you adopt any additional**
9 **commitments relating to Avista governance and enforcement of**
10 **the commitments?**

11 A. Although Hydro One and Avista believe the current
12 Idaho commitments are sufficiently robust to insulate Avista's
13 customers in Idaho from any potential effects of political,
14 management, or rate changes at Hydro One, Hydro One and Avista
15 would be willing to adopt any of the following Oregon
16 commitments in Idaho:

17 **Oregon Stipulated Commitment No. 4 (compare Idaho**
18 **Stipulated Commitment No. 2)**

19 ***Executive Management***

20 Subject to the remaining provisions of this commitment and
21 subject to voluntary retirements and resignations that may
22 occur, Avista and Parent agree that Avista will retain all
23 current executive management of Avista for a period of
24 three years. This commitment will not limit Avista's
25 ability to determine its organizational structure and
26 select and retain personnel best able to meet Avista's
27 needs over time. The post-Proposed Transaction Avista board
28 retains its current ability to dismiss executive management

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1 of Avista and other Avista personnel for standard corporate
2 reasons. Any decision to hire, dismiss or replace the Chief
3 Executive Officer of Avista shall be within the discretion
4 of the Avista Board of Directors, and shall not require
5 any approval of Hydro One or any of its affiliates (other
6 than Avista), notwithstanding anything to the contrary in
7 the merger agreement, and its exhibits and attachments,
8 between Hydro One and Avista.

9 **Oregon Stipulated Commitment No. 5 (compare Idaho**

10 **Stipulated Commitment No. 3)**

11 **Avista Board of Directors (BOD)**

12 Avista and Hydro One agree that after closing of the
13 Proposed Transaction, Avista will have a separate board of
14 directors from Hydro One that consists of nine (9) members,
15 determined as follows:

16 **Five Hydro One Designated Directors:**

17 Two executives of Hydro One or any of its subsidiaries,
18 and

19 Three Independent Directors who are residents of the
20 Pacific Northwest Region.

21 **Four Avista Designated Directors:**

22 Three directors who as of immediately prior to the closing
23 of the Proposed Transaction are members of the Board of
24 Directors of Avista, including the Chairman of Avista's
25 Pre-Merger Board of Directors (if such person is different
26 from the Chief Executive Officer of Avista), and

27 Avista's Chief Executive Officer.

28 At least two of the Avista directors must be Independent
29 Directors.

30 The initial Chairman of Avista's post-closing Board of
31 Directors shall be the Chief Executive Officer of Avista
32 as of the time immediately prior to closing for a one year
33 term. If any Avista designee resigns, retires or otherwise
34 ceases to serve as a director of Avista for any reason,
35 the remaining Avista designees shall have the sole right
36 to nominate a replacement director to fill such vacancy,

1 and such person shall thereafter become an Avista designee.
2 Hydro One shall have the unfettered right to designate,
3 remove and replace the Hydro One designees as directors of
4 the Avista Board with or without cause or notice at its
5 sole discretion, subject to the requirement that:

6 (i) two of such directors are executives of Parent or any
7 of its subsidiaries; and

8 (ii) three of such directors are Independent Directors who
9 are residents of the Pacific Northwest region, while such
10 requirement is in effect (subject in the case of clause
11 (ii) hereof to Hydro One determining, in good faith, that
12 it is not able to appoint an Independent Director who is a
13 resident of the Pacific Northwest region in a timely
14 manner, in which case Hydro One may replace any such
15 director with an employee of Hydro One or any of its
16 subsidiaries on an interim basis, not exceeding six months,
17 after which time Hydro One shall replace such interim
18 director with an Independent Director who is a resident of
19 the Pacific Northwest region); provided, however, that this
20 exception to clause (ii) hereof shall not apply if, at any
21 time a circumstance arises, and during the pendency of any
22 such circumstance, whereby the Province of Ontario
23 ("Ontario") exercises its rights as a shareholder of
24 Parent, uses legislative authority or acts in any other
25 manner whatsoever, that results, or would result, in
26 Ontario appointing nominees to the board of directors of
27 Parent that constitute, or would constitute a majority of
28 the directors of such board).

29 Note that the additional language underlined and in italics
30 was not included in Oregon Stipulated Commitment No. 5 filed on
31 May 25, 2018. However, Hydro One and Avista proposed this
32 addition in their Oregon supplemental testimony filed on August
33 30, 2018, and in their Washington supplemental testimony filed
34 on September 6, 2018.

35 Oregon Stipulated Commitment No. 38 (no comparable
36 commitment in Idaho)

1 **Environmental Liabilities of Parent**

2 Hydro One will hold Avista and Avista ratepayers harmless
3 from any environmental obligations or liabilities of Hydro
4 One or its affiliates other than Avista, including those
5 associated with harmful substances such as asbestos or
6 polychlorinated biphenyls (PCBs) and environmental cleanup
7 and restoration.

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

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

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

1 result, in Ontario appointing nominees to the board
2 of directors of Parent that constitute, or would
3 constitute a majority of the directors of such board);

4 Q. What is the purpose of the new text in the Delegation
5 of Authority?

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

13
14 X. ADOPTION OF MAYO SCHMIDT TESTIMONY

15 Q. Are you aware of testimony previously submitted by
16 Mayo Schmidt?

17 A. Yes.

18 Q. What testimony was previously submitted by Mayo
19 Schmidt?

20 A. The testimony previously submitted by Mayo Schmidt
21 includes:

- 22 • Direct Testimony of Mayo M. Schmidt, submitted
23 September 14, 2017, including Exh. No. 2, Schedules
24 1 and 2
- 25 • Avista and Hydro One Joint Comments in Support of
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1 Stipulation and Settlement, submitted June 20, 2018

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

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

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

9 A. Yes it does.

10