

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UM 1897

In the Matter of the Application of Hydro)
One Limited (acting through its indirect) HYDRO ONE LIMITED'S
subsidiary Olympus Equity LLC) for an) RESPONSE TO JUNE 14, 2018
Order Authorizing Hydro One Limited To) BENCH REQUEST
Exercise Substantial Influence Over the)
Policies and Actions of Avista Corporation)

1 Hydro One Limited (“Hydro One”) provides the following response to Administrative
Law Judge Patrick Power’s Bench Request issued on June 14, 2018.

I. BENCH REQUEST

2 The Bench Request requires Hydro One to file a report on the following issues: (1)
implications of the recent Ontario election for (a) the future management and plans of Hydro
One, and (b) Hydro One’s acquisition of Avista; (2) a plan for keeping the Oregon Public Utility
Commission (“OPUC” or “Commission”) informed on a timely basis as to new developments;
and (3) what further measures might be necessary to fully develop the record if material changes
are made in Hydro One’s management or Board of Directors (“Board”).

II. BACKGROUND

3 Hydro One provides the following information as context to the specifics of its response
to the Bench Request.

**A. PROVINCE OF ONTARIO’S ROLE AS HYDRO ONE’S LARGEST
SHAREHOLDER**

4 Until 2015, Hydro One Inc. was owned by the Province of Ontario and referred to as a
Crown Corporation. Hydro One, a new holding corporation, was incorporated by the Province

of Ontario on August 31, 2015, under the *Business Corporations Act* (Ontario). On October 30, 2015, Hydro One's articles of incorporation were amended to authorize the creation of an unlimited number of Series 1 preferred shares and an unlimited number of Series 2 preferred shares, with the Series 1 preferred shares to be issued to the Province. On October 31, 2015, all of the issued and outstanding shares of Hydro One Inc. were acquired by Hydro One from the Province in exchange for the issuance to the Province of common shares and Series 1 preferred shares of Hydro One. On November 4, 2015, the articles of Hydro One were amended to authorize the consolidation of its outstanding common shares such that 595,000,000 common shares of Hydro One were issued and outstanding. The preferred shares continue to be outstanding. On November 5, 2015, Hydro One completed its initial public offering ("IPO") on the Toronto Stock Exchange by way of secondary offering of common shares by the Province of Ontario, with the goal that, over time, approximately 60% of Hydro One would be held by private investors. Today, Hydro One is a public company traded on the Toronto Stock Exchange under the ticker symbol "H."

5 As at June 12, 2018, the Province owned 282,412,648 common shares of Hydro One, representing approximately 47.4% of the common shares. Following conversion of the convertible debentures issued to finance Hydro One's acquisition of Avista, the Province will hold less than 43% of Hydro One's outstanding stock.

6 The 2015 amendments to the Ontario *Electricity Act, 1998* restricts the Province from selling voting securities (including common shares of Hydro One) if it would own less than 40% of the outstanding number of voting securities of that class or series after the sale. If as a result of the issuance of additional voting securities of any class or series by Hydro One, the Province would own less than 40% of the outstanding number of voting securities of that class or series,

then the Province shall, subject to certain requirements, take steps to acquire as many voting securities of that class or series of voting securities as are necessary to increase the Province's ownership to not less than 40% of the outstanding number of voting securities of that class or series.

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

8 Hydro One's Board consists of Hydro One's CEO and, in addition, 13 independent directors who must be, and are, independent of both Hydro One and the Province of Ontario. The Governance Agreement ensures autonomous commercial operations, with the Province of Ontario limited to acting as an investor and not a manager.

B. GOVERNANCE AGREEMENT BETWEEN HYDRO ONE AND PROVINCE OF ONTARIO

9 The Governance Agreement between Hydro One and the Province of Ontario (Attachment A to this Response to Bench Request) is a binding contract that was a pre-requisite for Hydro One's IPO. The Province of Ontario understood that Hydro One would not succeed as an investor-owned utility and would lose the trust of its investors if the Province were to meddle in the running of Hydro One's business. As a result, the Province entered into the Governance Agreement to provide the investment and financial communities the assurance that Hydro One

will operate like any other investor-owned utility, even though the Province will likely continue – strictly as an investor – to own at least 40% of Hydro One’s shares.

10 The Hydro One Board, and not the Province, is responsible for supervising the management of Hydro One’s business and affairs. (Governance Agreement (“GA”) 2.1.2 and 2.3) The Province is involved in Hydro One as an investor and not as a manager. (GA 2.1.3) The Province has no role in the processes of appointment, removal, replacement, and compensation relating to executive officers or related succession planning. Hydro One neither takes direction nor seeks consent for its operations from the government of Ontario, outside of the defined regulatory and oversight authority that the government has over the electricity sector. (GA 2.1.3; 2.2)

11 While a 40% or more shareholder of a corporation under most circumstances could control the entire composition of the corporation’s board, the Governance Agreement prevents the Province from exercising similar influence over Hydro One. A Nominating and Governance Committee nominates directors and advises the Board regarding its stewardship role in the management of Hydro One. (GA 3.5). The Board consists of a minimum of 10 and a maximum of 15 members and is comprised as follows: (i) the CEO is proposed for election, (ii) the Province nominates 40% of directors (or its proportionate share, whichever is less) proposed for election,¹ and (iii) the Nominating and Governance Committee nominates the remaining directors proposed for election. (GA 3.3.1; 4.1.1)

12 Other than the CEO, each director must be independent of Hydro One and the Province. (GA 4.2.2; 4.2.3) Directors must be high-quality, reputable, experienced leaders with the

¹ If the Province is diluted below 40%, there will be a minimum 24-month “cure period” before any reduction in its permitted number of nominees occurs. (GA 4.8). In any event, these directors must be independent of the Province and Hydro One.

requisite skills, board experience, time, and motivation for an operation of Hydro One’s size and scope. Directors are also chosen in light of Hydro One’s core operating principles. (GA 4.2.1) Directors must meet the requirements of applicable securities and other laws and any stock exchange on which Hydro One securities are listed. (GA 4.2.4)

13 The Governance Agreement limits the Province’s shareholder rights. The Province cannot initiate fundamental changes to Hydro One described in Part XIV of the *Business Corporations Act* (Ontario) (e.g., amendment to articles, continuance, arrangements, and amalgamations). (GA 2.5) The Province may vote its shares as it sees fit in the event a fundamental change is initiated by another shareholder. (GA 2.5) The Province cannot solicit (either on its own or acting with others) any person to exercise rights as a shareholder in a manner that the Province would be prohibited from doing directly. (GA 2.6). The Governance Agreement may be terminated only with the mutual agreement of both parties. (GA 8.4)

C. **SETTLEMENT STIPULATION COMMITMENTS:
GOVERNANCE AND FINANCIAL RING-FENCING SEPARATE
AVISTA FROM HYDRO ONE**

14 Hydro One, Avista, OPUC Staff, the Citizens’ Utility Board, Alliance of Western Energy Consumers, and the Oregon and Southern Oregon District Council of Laborers (collectively, the “Parties”) filed a Settlement Stipulation on May 25, 2018. The Parties negotiated numerous commitments designed to provide 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 of Ontario and bolster the protections already provided by the Governance Agreement.

15 First, 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. Two of the four directors selected by Avista must be independent under NYSE rules. *See* Stipulation Commitment No. 5. As a result, the Province will not be able to exercise any control over Avista through selection of Avista's board.

16 Second, Avista's CEO must be selected by Avista's board -- not Hydro One or the Province. *See* Stipulation Commitment No. 4.

17 Third, Olympus Equity LLC's three-member board must include one independent director. *See* Stipulation Commitment No. 6.

18 Fourth, Avista's executive management will remain in place and must be selected by Avista's board -- not Hydro One. *See* Stipulation Commitment No. 4.

19 Fifth, Avista's employees will be retained. *See* Stipulation Commitment Nos. 11, 12, 79, 80.

20 Sixth, Hydro One is required to provide Avista with enough equity so that Avista can access debt on reasonable terms. *See* Stipulation Commitment Nos. 44, 47. Therefore, the Province cannot deprive Avista of its capital and assets for the benefit of the Province.

21 Seventh, Avista will continue to have its own credit ratings. Hydro One is required to provide Avista with sufficient equity to ensure that Avista's credit ratings remain investment grade. *See* Stipulation Commitment Nos. 45, 48. Therefore, again, the Province cannot deprive Avista of its capital and assets for the benefit of the Province.

22 Eighth, Avista will be prohibited from issuing dividends if certain financial metrics relating to the equity floor, credit ratings and debt coverage are not met. Basically, this operates to keep retained earnings at the Avista level where they will improve Avista's financial strength.

See Stipulation Commitment No. 50. This too prevents the Province from depriving Avista of its capital and assets for the benefit of the Province.

23 Ninth, several of the Stipulation commitments protect Avista from being drawn into bankruptcy proceedings that are not in the best interest of Avista and its customers. Avista will issue a single share of preferred stock referred to as the Golden Share to an independent third party. The vote of this share will be required to place Avista into voluntary bankruptcy. *See* Stipulation Commitment No. 55. Further, Avista's entry into voluntary bankruptcy would require the consent of a two-thirds majority of all of its directors, including the affirmative vote of a majority of the Independent Directors at Avista, which would have to include the affirmative vote of at least two Avista-designated Independent Directors. *See* Stipulation Commitment No. 56. Hydro One and Avista must also provide a non-consolidation opinion to confirm the effectiveness of the ring-fencing measures to prevent the substantive consolidation of the assets and liabilities of Avista with those of the entities above it in the corporate chain of ownership. *See* Stipulation Commitment No. 57. The corporate structure also includes Olympus Equity LLC, a bankruptcy-remote special purpose entity that will have no debt. *See* Stipulation Commitment No. 58. Therefore, the Province cannot obtain Avista's capital and assets through a bankruptcy proceeding unless that would be in the best interests of Avista's customers.

24 Tenth, Avista's utility assets can be pledged only for the benefit of Avista, not Hydro One. *See* Stipulation Commitment No. 59. Therefore, the Province cannot strip Avista of its capital and assets for the benefit of the Province.

III. RESULTS OF ONTARIO ELECTION

25 On June 7, 2018, voters in the Province of Ontario elected a new government that will be led by the Progressive Conservative Party, replacing the Liberal government led by Kathleen

Wynne. The Premier-Designate is Doug Ford. The Ontario Premier is the equivalent of a state governor in the United States. The new government will be sworn in on June 29, 2018.

26 Mr. Ford has suggested that he is going to call the provincial legislature back into session during the month of July to address several priority issues that arose during the campaign. Normally the provincial legislature would not reconvene until fall. On Friday, June 15, 2018, Mr. Ford stated that his top priority is to dismantle Ontario's cap-and-trade system for carbon emissions and repeal the carbon tax. Mr. Ford also wants to pass legislation that will end a strike at Toronto's York University.

27 During the campaign, Mr. Ford stated that he wanted to remove Hydro One's CEO Mayo Schmidt and some or all of the members of Hydro One's Board of Directors. On Friday, June 15, 2018, Mr. Ford made a statement reiterating his intention to remove Mr. Schmidt. We do not know whether or how Mr. Ford will attempt to follow through on these statements.

28 During the campaign, members of the New Democratic Party stated that they would try to "bring Hydro One back into public hands" by buying back some or all of Hydro One's shares held by entities other than the Province; the precise mechanism by which this would be accomplished was never revealed. The New Democratic Party did not win enough seats to control the provincial government, nor offset the majority of seats now held by the Progressive Conservatives in Ontario's Legislative Assembly. Even if a party were to attempt this in the future, the Governance Agreement would make this more complex than simply buying back shares, as it prevents the Province from buying any additional shares if it owns more than 45% of Hydro One. Mr. Ford and other members of the Progressive Conservative Party have not suggested that they will pursue a policy of returning Hydro One to Crown Corporation status and

had made statements throughout the campaign generally supportive of privatization in Ontario's energy sector.

IV. PROCESS FOR REMOVAL OF HYDRO ONE BOARD OR HYDRO ONE CEO

29 If Mr. Ford and his Progressive Conservative Party wished to seek to remove some or all of Hydro One's Board and its CEO, they could accomplish these objectives in one of two ways: (1) procedures established by the Governance Agreement, or (2) legislation.

30 As explained above, the Governance Agreement establishes an independent Hydro One Board with the following features: the CEO is selected by the Board (not the Province), the Province nominates 40% of the Board's directors (or its proportionate share, whichever is less) proposed for election, the Nominating and Governance Committee (now known as the "Governance Committee") nominates the remaining directors proposed for election, and other than the CEO, each director must be independent of Hydro One and the Province. The Province has no role in the processes of appointment, removal, replacement, and compensation relating to executive officers or over related succession planning.

31 In order to remove the Hydro One Board, the Province must follow the procedures in Article 4.7 of the Governance Agreement: (1) serve a Removal Notice on Hydro One requesting the removal of Hydro One's Board at a shareholder meeting (the Removal Notice does not apply to Hydro One's CEO even though he is a Board member; the Province also can exempt the chair of Board from its Removal Notice) (GA 4.7.1); (2) the chair of the Board will establish a committee comprising representatives of Hydro One's five largest shareholders, except the Province (the "Ad Hoc Nominating Committee") (GA 4.7.2); (3) the Ad Hoc Nominating Committee and the Province will work together to develop a slate of new Board members to be considered at an upcoming shareholder meeting (the "Removal Meeting") (GA 4.7.3); (4) once

the slate of new Board members is established, the shareholder Removal Meeting must be held within 60 days (GA 4.7.4); and (5) at the Removal Meeting, the Province must vote in favor of the slate of new Board members established by the Ad Hoc Nominating Committee and the Province (GA 4.7.6).

32 Under the Article 4.7 procedures, Hydro One's shareholders must remove the entire Hydro One Board; they cannot remove just certain Board members. (GA 4.7.1) Further, the Board cannot be replaced with any board members who were part of the previous Board. (GA 4.7.3) All nominees must be vetted by the Ad Hoc Nominating Committee and must meet the stringent qualification standards set in the Governance Agreement. (GA 4.7.3 and 4.3) Article 4.7 does not permit shareholders to hire or fire Hydro One's CEO or other members of its management team. (GA 4.7.1) Article 4.7 simply provides a process by which Hydro One's shareholders can install a new Board.

33 Although the Province cannot remove the CEO, presumably the new Board installed pursuant to Article 4.7 procedures could take steps to consider removing the CEO if the Province triggers this process.

34 As an alternative to following the Article 4.7 procedures in the Governance Agreement, Mr. Ford and his Progressive Conservative Party could attempt to pass legislation during the upcoming legislative session that would give the Province the authority to remove and replace the Hydro One CEO and/or its Board. We do not know whether Mr. Ford and his party will pursue such legislation, and we do not know what provisions and procedures would be included in that legislation to effect the removal of the Hydro One CEO and/or the Board.

V. REPORTS ON FUTURE POLITICAL DEVELOPMENTS IN ONTARIO

35 Hydro One's plan for keeping the Commission informed on a timely basis as to new developments in Ontario and the management of Hydro One is as follows. Hydro One respectfully requests that each report filed pursuant to the plan described below be included as part of the record in this docket.

36 Hydro One will file reports in this docket (until the docket is closed) whenever a significant event occurs or statement is made by the Province's new leadership that provides further new insight regarding the future of Hydro One's executive leadership and/or Board. The next scheduled significant event would be the convening of the provincial legislature in July if Mr. Ford follows through on his proposal to reconvene the legislature before the regular session this fall or any media statements in the interim period containing new and significant insight into the government's plans with regard to Hydro One. Hydro One will file reports regarding any legislation that is proposed or statements made prior to or during that session regarding Hydro One's executive leadership and Board. Further, Hydro One also will file reports on any significant public statements made by the Province's new leadership that provide new insight regarding the future of Hydro One's executive leadership and Board. Finally, Hydro One will file reports on any efforts made by the Province to trigger the procedures in Article 4.7 of the Governance Agreement to replace Hydro One's Board.

VI. CONCLUSION

37 The Province could trigger the provisions in Article 4.7 of the Governance Agreement to replace Hydro One's Board or the Province's new leadership could introduce legislation for the purpose of dismissing Hydro One's CEO or members of the Board. These are just possibilities,

but even if they were to come to pass, Hydro One, Avista, and the other Parties in this docket have included governance and financial ring-fencing in the Settlement Stipulation that will protect Avista and its customers. Even if Hydro One's CEO and Board are replaced, that would not change anything with respect to Avista as established by the Parties in their Settlement Stipulation.

38 Even if Mr. Ford succeeded in removing Hydro One's CEO or Board, such actions would not diminish Hydro One's deep and highly experienced management and its ability to successfully operate Hydro One's business and be an owner of Avista. Furthermore, as described above, Avista will be governed by its own board and operated by its own management after the merger.

39 Hydro One and Avista, along with the rest of the Oregon Parties, developed the Settlement Stipulation to ensure that Avista could not be negatively impacted in any way by any of the hypothetical events described in the previous sections. If any of the above-described hypothetical events were to occur, Hydro One would still be legally obligated to comply with the Stipulation in this docket, the settlements it has reached in Washington, Montana, and Idaho, the Regulatory Commission of Alaska's June 4, 2018 order approving this merger, the Montana Public Service Commission's forthcoming order approving this merger, and any orders approving this merger issued by this Commission, the Washington Utilities and Transportation Commission, and the Idaho Public Utility Commission. As a result, all of the protections described above that have been built into the Stipulation to ensure that Avista will continue as a financially sound, stand-alone utility will bind Hydro One regardless of political developments (e.g., Avista's independent board, financial ring-fencing, capital support). Furthermore, through the Stipulation in this proceeding and the settlements in Washington and Idaho, Hydro One and

Avista have committed that none of the commitments in the settlements can be amended without approval from Avista's state regulators. *See* Stipulation Commitment No. 2.

40 Finally, the Stipulation in this docket confirms that the Commission will continue to regulate Avista as it always has to ensure that Avista's customers are protected and continue to pay fair, just, and reasonable rates. *See* Stipulation Commitment Nos. 64-71, 110-114.

DATED: June 19, 2018.

K&L GATES LLP on Behalf of Hydro One Limited and Olympus Equity LLC

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