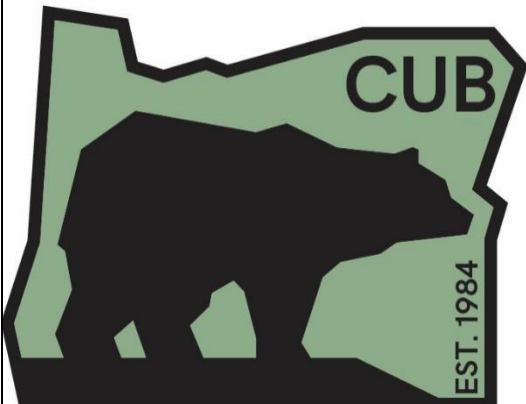


**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UM 1897**

In the Matter of)
)
Hydro One Limited,)
)
Application for Authorization to Exercise)
Substantial Influence over the Polices and)
Actions of Avista Corporation.)
_____)

**REPLY TESTIMONY
OF THE
OREGON CITIZENS' UTILITY BOARD**

September 20, 2018



**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UM 1897**

In the Matter of)
)
Hydro One Limited,) **REPLY TESTIMONY OF THE**
) **OREGON CITIZENS' UTILITY**
Application for Authorization to Exercise) **BOARD**
Substantial Influence over the Polices and)
Actions of Avista Corporation.)
_____)

I. INTRODUCTION

1 **Q. Please state your name, occupation, and business address.**

2 A. My name is Bob Jenks. I am the Executive Director of Oregon Citizens' Utility
3 Board (CUB). My name is William Gehrke. I am an Economist employed by
4 CUB. Our business address is 610 SW Broadway, Ste. 400 Portland, Oregon
5 97205.

6 **Q. Please describe your educational background and work experience.**

7 A. Our witness qualification statements can be found in exhibit CUB/101.

8 **Q. Please provide an outline of your testimony.**

9 A.

10 I. Introduction

11 II. There are no bounds on the Ontario legislature's authority to pass laws that
12 impact Hydro One

13 III. The Governance Agreement is no longer effective

- 1 IV. Hydro One Accountability Act, 2018
- 2 V. Interfering with Hydro One is good for elections
- 3 VI. Conclusion

4
5

Q. What is the purpose of your testimony?

6 **A.** In our testimony, we provide a response to arguments made by Avista Utilities
7 (Avista) and Hydro One Limited (Hydro One) in their August 30, 2018
8 Supplemental Testimony regarding the effects of management changes at Hydro
9 One. Specifically, CUB’s testimony provides analysis on the changes at Hydro
10 One, and details why those changes have altered CUB’s position in this case. CUB
11 no longer supports the acquisition of Avista by Hydro One.

12

13 Before the age of European exploration, it was considered common knowledge that
14 all swans are white. Black swans were considered a creature of fantasy.

15 Historically, black swans were used as an idiom for something that is impossible.

16 However, in the 17th century, Dutch explorer Willem De Vlamingh discovered the
17 impossible. Black colored swans were discovered off the coast of Australia.

18 Black swans went from being a metaphor for the impossible to an actuality. This
19 illustrative tale goes to show that even far-fetched ideas viewed as impossible may
20 actually occur.

21

22 Recent political intervention at Hydro One was unexpected, and its consequences
23 are far-reaching for the company and its management. CUB did not expect Hydro
24 One to experience such a significant operation and management change. Since

1 Canada is a stable democracy with strong property rights, CUB previously assumed
2 that Hydro One was not subject to government interference. Throughout the course
3 of the docket before the election, Hydro One had convinced CUB and stakeholders
4 that Ontario was not involved in the management of Hydro One. Soon after a
5 settlement was reach in this docket, dramatic intervening events changed the scope
6 of how CUB viewed the proposed transaction. An election occurred in Ontario,
7 and Ontario’s freshly elected premier, Doug Ford, followed through on a campaign
8 promise to sack Hydro One’s leadership. The actions of Doug Ford’s government
9 have demonstrated to CUB that Hydro One is subject to interference from the
10 province of Ontario, despite Hydro One and Avista’s claims to the contrary. This
11 is troubling.

12 **Q. Does CUB still support the stipulation filed by all parties on May 25th,**
13 **2018?**

14 **A.** No. CUB is concerned about Ontario’s Hydro One ownership share. Since it can
15 enact its own laws, there are no limits on the legislative authority of Ontario to pass
16 laws that may affect Hydro One. CUB cannot envision any appropriate ring-
17 fencing provisions on Ontario’s authority over Hydro One to adequately protect
18 Avista’s Oregon customers in a manner that comports with the Commission’s no
19 harm mandate.¹ CUB does not believe it is in the public interest for Avista to be
20 owned by a utility controlled by the whims of foreign politics.

21 **Q. Why has CUB changed its position on the merger?**

22 **A.** Recent events at Hydro One have led CUB to believe that the province has direct
23 influence over the management of Hydro One. Normally, under the rule of law, all

¹ ORS 757.511.

1 parties are equally subject to the terms of a corporate governance agreement.
2 However, Ontario—a legislatively controlled body—is Hydro One’s largest
3 shareholder. Since Ontario is controlled by the legislature, it can pass legislation at
4 will to change the governance of Hydro One. Elected officials such as Doug Ford
5 have also demonstrated their willingness to interfere in the day to day operations of
6 Hydro One. CUB cannot envision any ring-fencing arrangements that will protect
7 Oregon ratepayers from potential actions coming from the provincial government.

8 **Q. How has the Company characterized the relationship between the**
9 **Company and the Ontario government?**

10 **A.** Hydro One has erroneously characterized the relationship between itself and the
11 province of Ontario as that of a typical investor. Jamie Scarlett, Chief Counsel for
12 Hydro One, stated before the Commission “[t]here is zero. Zero involvement from
13 the Government. Zero direction from the Government.”² The recent election and
14 subsequent events in Ontario clearly indicate this is not the case, and call into
15 question the accuracy of Mr. Scarlett’s comments before the Commission. In prior
16 testimony, Hydro One pointed to the governance agreement as a binding contract
17 on the interaction between Hydro One and the province of Ontario.³ Hydro One
18 asserted that the governance agreement prohibits Ontario from interfering in the
19 operations of Hydro One.⁴ The Company also stated that the province would not
20 have a role with regards to the appointment, removal, replacement and

² February 26, 2018 Special Public Meeting UM 1897 Hydro One Acquisition of Avista Corporation,
available at: http://oregonpuc.granicus.com/MediaPlayer.php?view_id=1&clip_id=274

³ UM 1897- Hydro One/800/Schmidt/7/Lines 14-22.

⁴ UM 1897- Hydro One/800/Schmidt/12/Lines 2-4.

1 compensation relating to executive officers.⁵ One again, recent events have clearly
2 demonstrated this is not the case.

3 **Q. What were the results of the 2018 Ontario elections?**

4 **A.** On June 7th, 2018, Ontario elected a new government. The Progressive
5 Conservative Party of Ontario, led by Doug Ford, won a majority in the Legislative
6 Assembly of Canada. The Ontario New Democratic Party became the principal
7 opposition party. The Ontario Liberal Party of Canada lost enough seats in the
8 Ontario legislature to become a minority party. The Liberal Party was the driving
9 force behind the privatization of Hydro One.

10 **Q. Did the Progressive Conservative Party of Ontario make campaign
11 promises with regards to Hydro One?**

12 **A.** Yes. The Progressive Conservatives ran a campaign promise to remove Hydro
13 One's Board of Directors and its Chief Executive Officer.⁶

14 **Q. What is the governance agreement?**

15 **A.** The governance agreement is a contract establishing the relationship between Hydro
16 One and the Province of Ontario.⁷ Hydro One went from being an Ontario-owned
17 organization to a publicly traded corporation. As part of its initial public offering,
18 Ontario entered into a contract with Hydro One to ensure that that Hydro One
19 would maintain the trust of its investors.⁸ This governance agreement is meant to

⁵ UM 1897- Hydro One/800/Schmidt/8/Lines 5-7.

⁶ UM 1897- Hydro One/1600/Scarlett/3/Lines 16-18.

⁷ UM 1897 – Hydro One/803/Schmidt.

⁸ UM 1897- Hydro One/800/Schmidt/7/Lines 16-18.

1 ensure that Hydro One operates like any other investor-owned utility, rather than a
2 publicly-held organization.⁹

3 **Q. Was the governance agreement adhered to when Hydro One’s leadership**
4 **was removed?**

5 **A.** No.¹⁰ The governance agreement only enables the province to remove Hydro One’s
6 entire board of directors.¹¹ The governance agreement does not enable Ontario to
7 directly remove Hydro One’s CEO.¹² Therefore, Doug Ford’s decision to remove
8 Hydro One’s CEO demonstrates that the province of Ontario and its officers are not
9 bound by the terms of the governance agreement, and are willing to act
10 accordingly.

11 **Q. Was legislation used to enable the province of Ontario to remove the CEO**
12 **and directors of Hydro One?**

13 **A.** Legislation was not used to grant Ontario the authority to remove the CEO and
14 directors of Hydro One.

15 **Q. Why was Hydro One CEO Mayo Schmidt removed from his position?**

16 **A.** Mayo Schmidt “resigned” because he no longer had the support of Hydro One’s
17 single largest shareholder: Ontario. Hydro One, during CEO’s Mayo Schmidt’s
18 term, had out performed earnings estimates in the preceding two quarters prior to
19 Mr. Schmidt’s forced resignation. The replacement of the Board and CEO was one
20 of the campaign promises made by Doug Ford. Mayo Schmidt left his position
21 because the province of Ontario wanted to fire him.

⁹ UM 1897- Hydro One/800/Schmidt/7/Lines 19-22.

¹⁰ UM 1897- Hydro One/1600/Scarlett/7/Lines 3-9.

¹¹ UM 1897- Hydro One/803/Scarlett/25-26.

¹² *Id.*

1 **II. THERE ARE NO BOUNDS ON THE ONTARIO**
2 **LEGISLATURE’S AUTHORITY TO PASS LAWS THAT**
3 **IMPACT HYDRO ONE**

4 **Q. What is legislative authority?**

5 **A.** Black’s Law Dictionary defines legislative authority as the authority of a branch of
6 government that is charged with making and enacting laws.

7 **Q. Has the Ontario used its legislative authority to change its role with regards to**
8 **Hydro One executive compensation?**

9 **A.** Yes. The Legislative Assembly of Ontario has granted the Ontario government
10 (Management Board of Cabinet) the authority to establish a new compensation
11 framework for the Hydro One leaderships.

12 **Q. Why is it concerning that the legislative assembly of Ontario exercised its**
13 **authority over Hydro One?**

14 **A.** It is not uncommon for large controlling shareholders to fire an entire board of
15 directors.¹³ However, the province’s decision to remove the board and CEO was
16 not conducted under the governance agreement, and Ontario is not a typical
17 investor or large controlling shareholder. It is a government body with legislative
18 authority over Hydro One. If Ontario wishes to change the governance agreement
19 with Hydro One, it merely needs to create a law granting it authority. Essentially,
20 Ontario is not bound by the terms of the governance agreement, because its’ broad
21 legislative authority enables it to sidestep this legal document that would otherwise
22 bind a traditional investor. CUB is concerned with Hydro One’s provincial
23 overlord, Ontario, and how it impacts the utility going into the future.

¹³ <https://www.reuters.com/article/us-darden-board/darden-activist-ousts-olive-garden-owners-full-board-idUSKCN0HZ0U320141010>

1 **III. THE GOVERNANCE AGREEMENT IS NO LONGER**
2 **EFFECTIVE**

3 **Q. How did the governance agreement allow Ontario to remove the board of**
4 **directors?**

5 **A.** The governance agreement allowed Ontario to hold a shareholders meeting
6 enabling them to remove all of Hydro One’s Board of Directors from office.¹⁴

7 **Q. Was a shareholders meeting conducted in order to enable the province to**
8 **Hydro One’s board?**

9 **A.** No.¹⁵

10 **Q. How did the governance agreement allow Ontario to remove the Hydro One’s**
11 **CEO?**

12 **A.** It did not. The governance agreement does not enable the province of Ontario to
13 remove the CEO of Hydro One.¹⁶ Only the Board of Directors of Hydro One has
14 the authority to terminate the CEO of Hydro One.¹⁷

15 **Q. Did Hydro One’s Board of Directors terminate the employment of Hydro One**
16 **CEO Mayo Schmidt?**

17 **A.** No.¹⁸ Mayo Schmidt “resigned” from his position under significant political
18 pressure.

19 **Q. Do you believe that the governance agreement continues to govern the**
20 **relationship between Hydro One and Ontario?**

¹⁴ UM 1897- Hydro One/803/Schmidt/24-25.

¹⁵ UM 1897- Hydro One/1600/Scarlett/7/Lines 4-5.

¹⁶ UM 1897- Hydro One/1600/Scarlett/5/Line 18.

¹⁷ UM 1897- Hydro One/1600/Scarlett/5/Lines 19-22.

¹⁸ UM 1897- Hydro One/1600/Scarlett/9/Lines 1-8.

1 **A.** No. The governance agreement is not an ironclad agreement between Hydro One
2 and Ontario.¹⁹ In order to fulfill the campaign promises of Doug Ford, Ontario
3 bypassed Hydro One’s governance agreement. Ontario was able to threaten
4 legislation in order force a settlement with Hydro One to remove its CEO and
5 Board of Directors. The legislative assembly of Ontario has no set bounds
6 regarding its authority over Hydro One. There is no indication that this level of
7 control will diminish in the future

8 **Q. Why did CUB believe that Hydro One was independent from Ontario in**
9 **support of the initial stipulation?**

10 **A.** CUB believed that Hydro One, as a Canadian corporation, was under a framework
11 that rendered all of its shareholders subjects to the terms of its corporate
12 governance agreement. Typically, major shareholders have to follow a corporate
13 governance agreement. CUB was incorrectly under the impression that the
14 Province of Ontario would continue to follow the governance agreement.
15 However, CUB did not consider that the legislative assembly of Ontario, as a
16 legislative body, has the authority to change laws in a manner that directly
17 interferes with Hydro One’s operation. If the Province of Ontario wants to make a
18 change within Hydro One, it can merely change the law to suit its needs or simply
19 threaten to change the law.

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

21 **Q. What did Ontario Premier Doug Ford state about the compensation of**
22 **leadership at Hydro One?**

¹⁹ UM 1897- Hydro One/1600/Scarlett/12/Lines 13.

1 **A.** Doug Ford called former Hydro One CEO Schmidt a “six-million-dollar man.”

2 Doug Ford also claimed that the salaries and bonuses for Hydro One executives
3 and board of directors was “outrageous.”²⁰ Doug Ford claimed that executive
4 compensation of Hydro One executives was to blame for increasing electricity
5 bills in the province.

6 **Q. What bill did the Ontario government pass regard Hydro One executive
7 compensation?**

8 **A.** The Progressive Conservative Party passed the Hydro One Accountability Act.²¹

9 This bill asked the board to create a new compensation framework for leadership at
10 Hydro One. The new compensation framework would then be subject to the
11 approval of Ontario’s Management Board of Cabinet. The following position at
12 Hydro One were subject to a new compensation framework: board, CEO, executive
13 vice president, vice-president, chief administrative office, chief operating officer,
14 chief financial officer, chief information officer, chief legal officer, chief human
15 resources officer, chief corporate development officer or any other executive
16 position or office, regardless of the title of the position.²² This would be similar to
17 the Oregon legislature giving the Governor’s cabinet the power to oversee
18 executive salaries of PGE and PacifiCorp. For stakeholders’ familiar to US utility
19 regulation, this is a black swan.

20 **Q. What was the impact of the Hydro One Accountability Act on Hydro One?**

²⁰ Doug Ford vows to fire Hydro One CEO, board as first act as Ontario Premier, The Globe and Mail (April 12, 2018), *available at*: <https://www.theglobeandmail.com/canada/article-doug-ford-vows-to-fire-hydro-one-ceo-board-as-first-act-as-ontario/>.

²¹ UM 1897- Hydro One/1600/Scarlett/10/Lines 5-7.

²² UM 1897- Hydro One/1602/Scarlett.

1 **A.** This act led to credit downgrade. Standard and Poor’s Global Rating downgraded
2 Hydro One to a ‘A-’ due to a governance deficiency related to Hydro One’s
3 ownership structure.²³ Credit ratings are used to signal a company’s risk factor. It
4 is used by investors as a yard stick to compare the risk of the investment. Standard
5 and Poor’s clearly believes the Hydro One Accountability Act increases Hydro
6 One’s risk profile.

7 **Q. What was Hydro One’s long term goal in the Pacific Northwest?**

8 **A.** Former Hydro One CEO Mayo Schmidt stated that the company would look to
9 acquire additional utilities in the United States.²⁴ The Company prior business
10 strategy is to targeting the Pacific Northwest as an area to acquire companies. The
11 Company envisions itself as a leading North American international utility.²⁵

12 **Q. What does the province’s compensation plan signal about management at
13 Hydro One?**

14 **A.** Doug Ford criticized Hydro One leadership for their large compensation packages.
15 However, Hydro One management imagined itself as an international utility. How
16 is Hydro One going to attract a highly qualified international Chief Executive
17 Officer if there are significant restrictions on their compensation? Does Hydro One
18 still have the support of Ontario with regards to the Avista transaction? CUB is
19 unsure if Hydro One has Ontario’s support to expand internationally. In addition,
20 because of the risk of political interference from Ontario, it is less likely that Hydro

²³ UM 1897 – Hydro One's Fifth Supplemental Report to Hydro One Limited's Response to June 14, 2018 Bench Request.

²⁴ Avista is just the first U.S. deal, Hydro One CEO says, The Globe and Mail (Nov. 21, 2017) *available at*: <https://www.theglobeandmail.com/report-on-business/avista-is-just-the-first-us-deal-hydro-one-ceo-says/article37043629/>.

²⁵<https://www.hydroone.com/abouthydroone/CorporateInformation/Documents/Avista/Hydro%20One%20Avista%20Fact%20Sheet.pdf>

1 One will find additional acquisitions in the US because other US regulators will
2 likely be wary of this risk. It is unclear what would happen over the long-term to
3 Avista, if Hydro One's business plan of expanding into the United States is valid.
4 This is an additional risk that merits consideration in CUB's proposal to deny the
5 proposed transaction.

6 **V. INTERFERING WITH HYDRO ONE IS GOOD FOR ELECTIONS**

7 **Q. Has Ontario interfered in the management of Ontario's electricity system?**

8 **A.** Yes. The Ontario government shut down two gas plants in Ontario.²⁶ The liberal
9 party shut down the plants as an election issue.²⁷ CUB previously raised this issue
10 in testimony.²⁸ With the firing of Hydro One's leadership, CUB is even more
11 concerned with the role of politics in energy policy in Ontario. Premier Ford's
12 campaign promised that, if elected, it would interfere in the management of Hydro
13 One. This proved to be a winning argument. In Ontario it is now good politics to
14 politicize the management of Hydro One. It is unclear if there is any way to put
15 this genie back in the bottle.

16 **Q. What has happened to Ontarian electric rates in the past decade?**

17 **A.** From 2006 to 2016, the average household in Ontario experienced a 100% increase
18 in their electricity bill.²⁹ Despite Hydro One merely being an electricity
19 distribution company, the management of Hydro One is now a popular political

²⁶ UM 1897- Hydro One/800/ Schmidt/Page 16/ Lines 14-15.

²⁷ UM 1897- CUB/100/ Jenks-Gehrke/Page 12-13.

²⁸ *Id.*

²⁹ Hydro One is an electricity distribution company. It does not generate electricity for its customers. In 2014, 62.1 percent of Ontarian rates were due to generation. CUB is not implying that Hydro One is solely responsible for this increase in rates. However, CUB does believe that this dramatic increase in rate is partially responsible for political interference in Hydro One. Hydro One does not set its own rates.

1 issue. With each election, the leadership at Ontario’s legislature could change.

2 This uncertainty makes CUB extremely wary of the proposed transaction.

3 **Q. Have the Progressive Conservatives made any promises with regards to**
4 **electricity rates?**

5 **A.** One of the Progressive Conservatives’ campaign promises is that they would reduce
6 electricity rates by 12 percent.

7 **Q. Has the Liberal Party of Ontario made any previous changes to electricity**
8 **rates in Ontario?**

9 **A.** Yes. The Liberal controlled legislative assembly passed the Fair Hydro Act. The
10 Fair Hydro Act reduced rates for residential customers by 31 percent.³⁰ A
11 regulatory asset was created to finance this reduction in rates. Future ratepayers in
12 Ontario are going have increased electricity bills to pay for this short term
13 reduction in rates.

14 **Q. Has the New Democratic Party made any promises with regards to**
15 **electricity rates?**

16 **A.** The New Democratic Party has promised to return Hydro One to public ownership.
17 The New Democratic Party believes that public ownership would reduce electricity
18 rates for the Ontario government. CUB questions whether a publically owned
19 Hydro One would continue to own and operate Avista. In this instance, at the very
20 least, Avista would be a forgotten US subsidiary. Various Ontario political parties
21 are continuing to politicize the operation of Hydro One in a manner that makes its

³⁰ https://www.hydroone.com/RatesAndBilling_/Documents/Hydro%20One%20-%20Fair%20Hydro%20Plan%20Fact%20Sheet.pdf

1 future operation uncertain, and raises questions about Hydro One’s ability to
2 operate as a competent owner of Avista.

3 **Q. What is the opposition in a parliamentary system?**

4 **A.** Parliamentary opposition is the largest party sitting in opposition to the
5 government. The New Democratic Party of Ontario is currently the opposition
6 party in the legislative assembly. The New Democratic Party of Ontario is not a
7 minor member of the legislative assembly. It is possible for the New Democratic
8 Party to win the election and change the Hydro One’s ownership structure.

9 **Q. How often are elections called in the legislative assembly of Ontario?**

10 **A.** The Ontario legislative assembly holds elections every four years. The only
11 exception to this election schedule vote of no confidence can lead to an election.

12 **Q. What are minority governments?**

13 **A.** Minority governments result from elections in which no political party has a
14 majority in the legislature. Minority governments have less stability than majority
15 government. If the minority government is unable to sponsor legislation, a vote of
16 no confidence can be cast against it. If the government loses a vote of confidence,
17 either a new provincial election is called or a new government is formed. This is
18 not a hypothetical; a vote of no confidence has led to a change in the controlling
19 party in Canada. In short, elections in Ontario can occur outside of a four-year
20 election cycle.

21 **Q. What concern does CUB have about the legislative assembly?**

22 **A.** CUB is concerned about the volatility of the Ontario’s management with regards to
23 Hydro One. In the past election, direct interference with Hydro One was a winning

1 campaign move. The Progressive Conservatives have made interfering with Hydro
2 One a suitable campaign issue. Each political party envisions a different track for
3 Hydro One. The strategy for management of Hydro One can change with each
4 election.

5 IV. CONCLUSION

6 **Q. What was Avista's history prior to the proposed Avista Hydro One**
7 **merger?**

8 **A.** Avista was a long operating electricity company based out of Spokane,
9 Washington. Avista's corporate management was not subject to the results of a
10 political election. The management at Avista has provided safe and reliable service
11 to Avista customers across the Pacific Northwest. If this merger were to continue,
12 Avista would be subject to the management of a company controlled by the whims
13 of Ontario elections. With each election, Hydro One can change its corporate
14 vision. Importantly the comparator in a merger docket under the regulatory guise
15 of the Oregon Public Utility Commission is that of the prudent, well-run utility of
16 today. Avista has been well-run throughout its history. It is unclear whether this
17 would continue to be the case if the proposed merger were approved. At this point
18 in time, CUB asks the Commission to not approve the merger between Avista and
19 Hydro One.

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

21 **A.** Yes.