

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAI'I

In the Matter of the Application of)
)
HAWAIIAN ELECTRIC COMPANY, INC.) Docket No. 2015-0022
HAWAII ELECTRIC LIGHT COMPANY,)
INC., MAUI ELECTRIC COMPANY,)
LIMITED, and NEXTERA ENERGY, INC.,)
)
For Approval of the Proposed Change of)
Control and Related Matters.)
_____)

OFFICE OF PLANNING, STATE OF HAWAI'I'S EXHIBIT LIST

DIRECT TESTIMONIES

SUPPORTING EXHIBITS

CERTIFICATE OF SERVICE

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OFFICE OF PLANNING, STATE OF HAWAI‘I’S EXHIBIT LIST

Planning Office Exhibit No.	Description
1	Direct Testimony of Leo R. Asuncion, Jr., Acting Director, Office of Planning, State of Hawai‘i (“Planning Office”)
2	Table of Issues Addressed by the Planning Office
3	Resume of Leo R. Asuncion, Jr.
4	Direct Testimony of Scott Hempling, Expert for the Planning Office
5	Excerpts from Amendment No. 3 to NextEra’s S-4 effective March 24, 2015
6	Resume of Scott Hempling

PLANNING OFFICE EXHIBIT-1
DOCKET NO. 2015-0022

DIRECT TESTIMONY OF
LEO R. ASUNCION, JR.

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Q. Please state your name and business address.

A. My name is Leo R. Asuncion, and my business address is P.O. Box 2359, Honolulu, Hawai'i 96804.

Q. By whom are you employed and in what capacity?

A. I am employed by the State of Hawai'i, and am currently the Acting Director of the Office of Planning. I am also the Planning Program Manager for the State's Coastal Zone Management Program within the Office of Planning.

Q. Please describe your educational background and work experience.

A. I hold a Bachelor of Arts degree in Political Science, and a Masters of Urban and Regional Planning degree from the University of Hawai'i-Manoa, as well as a Master of Business Administration degree from Hawai'i Pacific University. I have been in the planning profession for over 20 years, in various capacities at governmental agencies including the Land Use Commission, the Hawai'i State Judiciary, and the Office of Planning, as well as private organizations including SSFM International, Inc., and Hawaiian Electric Company. My resume is attached as Planning Office Exhibit-3.

Q. Who is the Office of Planning, and what is its purpose and responsibilities?

A. The Office of Planning assists "the governor and the director of business, economic development, and tourism in maintaining an overall framework to guide the development

1 of the State through a continuous process of comprehensive, long-range, and strategic
2 planning to meet the physical, economic, and social needs of Hawai‘i’s people, and
3 provide for the wise use of Hawai‘i’s resources in a coordinated, efficient, and
4 economical manner, including the conservation of those natural, environmental,
5 recreational, scenic, historic, and other limited and irreplaceable resources which are
6 required for future generations.” Hawai‘i Revised Statutes (“HRS”) § 225M-1.

7 The Office of Planning’s responsibilities cover various areas from comprehensive
8 planning, land use planning, coastal zone management, national and international
9 planning, geographic information systems, and strategic planning. The mandated
10 responsibility of the Office of Planning is to gather, analyze, and provide information to
11 the Governor to assist in the overall analysis and formulation of state policies and
12 strategies to provide central direction and cohesion in the allocation of resources and
13 effectuation of state activities and programs and effectively address current or emerging
14 issues and opportunities. See HRS § 225M-2.

15 The Office of Planning also assists “the governor in assuring that state programs are in
16 conformance with” chapter 226, HRS. See HRS § 226-59(b).

17 Q. What is the purpose of your testimony?

18 A. As stated above, the Office of Planning is concerned with “the physical, economic, and
19 social needs of Hawai‘i’s people.” We anticipate that the Energy Office of the
20 Department of Business, Economic Development, and Tourism will discuss issues
21 relating to renewable energy which is important to Hawai‘i’s and the world’s physical
22 environment. Our expert, Scott Hempling, has discussed some of the potential economic

1 impacts of the Proposed Transaction. I won't be repeating that testimony here. My
2 testimony focuses on some of the social impacts of the Proposed Transaction on
3 Hawai'i's people.

4 Q. What issues identified by the PUC will you be discussing.

5 A. My testimony addresses the following issues identified by the Commission.

6 1. Whether the Proposed Transaction is in the public interest.

7 a. Whether approval of the Proposed Transaction would be in the best
8 interests of the State's economy and the communities served by the
9 HECO Companies.

10 6. Whether any conditions are necessary to ensure that the Proposed
11 Transaction is not detrimental to the interests of the HECO Companies'
12 ratepayers or the State and to avoid any adverse consequences and, if so,
13 what conditions are necessary?

14 Planning Office Exhibit 2 is a table indicating which portion of the prefiled testimony of
15 myself and Mr. Hempling specifically addresses each of the issues identified by the Commission
16 and which issues are not being addressed.

17 Q. What is the basis of Office of Planning's testimony?

18 A. In reviewing the subject application and Proposed Transaction, the Office of Planning
19 looked to the Hawai'i State Plan (Hawai'i Revised Statutes (hereinafter "HRS") chapter
20 226) which statutorily sets forth the state's goals, objectives, policies, and priority

1 guidelines in a number of areas ranging from population, the economy, physical
2 environment, facility systems, and socio-cultural advancement. Further, the Hawai'i
3 State Plan requires that agencies of the state, in their decision-making processes, shall be
4 in conformance with the overall theme, goals, objectives, and policies. See HRS § 226-
5 59(A). So, the Commission must make appropriate findings regarding whether the
6 Proposed Transaction is in conformance with the Hawai'i State Plan.

7 In this case, the Office of Planning is focused on the objectives and policies in the
8 Hawai'i State Plan relating to the economy and socio-cultural advancement. Although
9 not specifically addressed by the Office of Planning, we note that the Hawai'i State Plan
10 also discusses renewable energy specifically (HRS § 226-10(b)(8) and (16)) and energy
11 systems generally, including liquefied natural gas (HRS § 226-18), and sustainability
12 (HRS § 226-108). But these issues are being addressed by other parties, and are not
13 discussed here.

14 Q. Please provide further context to the Office of Planning's review of the Proposed
15 Transaction.

16 A. The Office of Planning understands that Applicant Hawaiian Electric Companies are very
17 important to the State of Hawai'i, not only in the area of energy, but also to areas such as
18 the economy, labor, employment, governance, and the community. The Hawaiian
19 Electric Companies have been intertwined with the entire fabric of Hawai'i for well over
20 a century. The Hawaiian Electric Companies have had a monopoly in supplying power
21 to approximately 90% of our island state, occupying a special and unique role in Hawai'i.
22 And being a company in such a circumstance, comes with high expectations from the

1 State and its residents in a variety of areas, including but not limited to the
2 aforementioned areas.

3 Therefore, when a significant shift occurs to a company of great importance to Hawai'i,
4 such as the Proposed Transaction, it triggers not only the typical rate impact analysis, but
5 also an impacts analysis that is not usually addressed by the PUC. In the instant docket,
6 consistent with its statutory role in providing recommendations to state agencies on
7 conflicts between the Hawai'i State Plan and state programs, the Office of Planning
8 strongly recommends that the PUC consider the issues covered by the Office of Planning
9 in its review of the Proposed Transaction. See HRS § 226-53(1).

10 Q. On the issue of "Whether the Proposed Transaction is in the public interest," what is the
11 Office of Planning's position?

12 A. The term "public interest" is fairly broad; therefore, the Office of Planning focused its
13 attention to whether the Proposed Transaction is in the interests of Hawai'i. The State's
14 interest itself covers not only what I will term as the "business" components of the
15 Proposed Transaction, but also the "societal" components.

16 The testimony of our expert witness Scott Hempling (Planning Office Exhibit 4) will
17 cover the "business" components, and my testimony will touch upon the "societal"
18 components.

19 Q. Please provide a summary of the "societal" component of the Proposed Transaction.

20 A. The societal component examines such items as impacts on corporate citizenship,
21 community benefits, community engagement, impacts to current employees, employment

1 and labor, and the role of local decision-making and accountability. In a number of areas,
2 these topics are intertwined with topics in the “business” component as they touch upon
3 specific areas of the company (i.e., impact to current employees, shareholders, and
4 ratepayers). However, the societal component is much broader than these
5 aforementioned groups. It includes the community and general public.

6 Community Benefits

7 Q. Let’s go through the items that you have mentioned, beginning with community benefits.

8 What does the Office of Planning’s examination of this societal area show?

9 A. The Office of Planning’s examination of the topic of community benefits looked to the
10 Hawai‘i State Plan objectives and policies of socio-cultural advancement (HRS
11 § 226-25). The objective here is to enhance cultural identities, traditions, values and
12 customs, and policies to promote cultural values and customs, encouragement of the
13 effects of proposed public and private actions on the integrity and quality of community
14 lifestyles in Hawai‘i, and encouragement of the essence of the aloha spirit in daily
15 activities to promote harmonious relationships among Hawai‘i’s people.

16 These objectives and policies are difficult to quantify, but over time, Hawai‘i has used
17 sustained community benefits as one measure of progress in societal advancement.

18 As NextEra realizes, community benefits are not merely dollars, but also include
19 community service, the lending of professional services to educational activities, and
20 service on the boards of Hawai‘i’s non-profit organizations. The Hawaiian Electric
21 Companies’ societal role includes not just monetary donations (which are admittedly

1 important), but also an involvement in their communities through the personal
2 involvement of its employees.

3 Q. What will be the impact on community benefits if the Proposed Transaction is approved?

4 It isn't clear.

5 In testimony, Applicant NextEra Energy, Inc. (hereinafter NextEra) stated that it expects
6 to maintain Hawaii Electric Industries' (hereinafter "HEI") overall current level of
7 corporate giving in Hawai'i's communities. Specifically, NextEra has pledged that it
8 would continue HEI's consolidated level of charitable giving of \$2.2 million (2015
9 projected), and claims that the result of the Proposed Transaction being implemented will
10 be additional corporate giving, as NextEra's charitable giving will be in addition to the
11 charitable giving of the then independent American Savings Bank.

12 The dollar amount appears to be a calculation that includes both money and other
13 resources, such as employee time. As discussed above, the Office of Planning believes
14 that both money and community involvement are important parts of the role HEI plays in
15 Hawai'i's society. So, we agree that both should be part of the analysis.

16 But we could not find a clear time period in which NextEra was committed to making
17 these contributions. It is important that NextEra demonstrates a long term commitment,
18 not just a momentary satisfaction of an immediate concern.

19 In addition, even if NextEra provides the equivalent dollar level of community benefits in
20 the future, we are also unsure about the future balance between money and community
21 involvement, or whether the focus of community benefits will shift to different groups.

1 As important as monetary donations may be, they cannot completely substitute for the
2 personal involvement of HEI employees in the community. More importantly, this is
3 information the Commission should have before it can approve the Proposed Transaction.

4 Furthermore, the Office of Planning notes that NextEra is at least ten to fifteen times
5 larger than HEI. Given NextEra's size, one would assume that the corporate giving level
6 of NextEra would be greater than the amount that NextEra agreed to maintain, and that
7 the amount would be a minimum amount that will increase in the future.

8 Ultimately, the Office of Planning feels that simply committing to current levels of
9 corporate giving for a time period that has not been determined does not show a long-
10 term commitment to Hawai'i's communities. The Commission must be able to evaluate
11 the social impacts of the Proposed Transaction before approval and we cannot do so
12 based upon the information provided by NextEra.

13 Impact to Current Employees, Employment, and Labor

14 Q. In terms of impact to current employees, employment, and labor, what does the Office of
15 Planning's analysis of this issue show, and what is the office's position on this issue?

16 A. Again, the Office of Planning looked to the Hawai'i State Plan, in this case HRS § 226-4
17 for the State's goals, and HRS § 226-6 for objectives and policies in terms of the general
18 economy. Within HRS § 226-4, the first State goal notes "...it shall be the goal of the
19 State to achieve (1) A strong, viable economy, characterized by stability, diversity, and
20 growth, that enables the fulfillment of the needs and expectations of Hawai'i's present
21 and future generations." Within HRS § 226-6, it is the objective of the State to achieve

1 “(1) Increased and diversified employment opportunities to achieve full employment,
2 increased income and job choice, and improved living standards for Hawai‘i’s people,
3 ...”

4 In their testimony, NextEra has committed, via a Change of Control Agreement, for at
5 least two years after closing of the Proposed Transaction, there would be no involuntary
6 workforce reductions, and compensation and benefits for active non-union employees
7 would be comparable to those in place before closing, and all union labor agreements will
8 be honored. Applicant’s Ex. 1, p. 16, lines 18-21.

9 However, the obvious question then becomes “what happens after 2 years?”

10 Unfortunately, we don’t know. The Office of Planning notes that a two year timeframe
11 may be a typical timeframe to reorganize a company, dependent upon the complexity and
12 size of the company undergoing a reorganization. There could be certain components of
13 a company that is easier to reorganize, but in this case, there is an obvious concern by the
14 Office of Planning of what will occur – there will be duplication in many of the positions
15 that NextEra will inherit, and usually reductions of staff would result.

16 We are not even sure if the Hawaiian Electric Companies will engage in a reduction in
17 force prior to closing, allowing NextEra to keep its promise by making the companies the
18 harbinger of the bad news.

19 Q. What are potential impacts due to a reduction of staff?

20 A. The obvious impact would be to current employees of the Hawaiian Electric Companies.

21 For many, the Hawaiian Electric Companies is where they started and stayed to grow in

1 their careers. Those who have extensive knowledge in their areas, and are not retained
2 due to their duties or responsibilities being transferred to NextEra's home office, for
3 example, would likely find it difficult to find similar employment in Hawai'i.

4 We have a recurring pattern in buy-outs of Hawai'i companies in which positions are
5 eliminated locally and transferred to the U.S. mainland. The new company, because they
6 may still have operations locally, claim that employees on the mainland count towards
7 "local" employee levels. The key factor, however, is that the position, and thus
8 employment, is not local. There have also been instances where a company buying-out a
9 Hawai'i company has offered positions in other states where the new company operates.
10 However, residents of Hawai'i are not realistically able to move from Hawai'i, at times
11 with such short notice, that they simply terminate their employment with the new
12 company.

13 Hawai'i is isolated from the rest of the United States, so job loss in Hawai'i is a major
14 issue. Unlike states on the U.S. mainland, those employed here in Hawai'i, and
15 specifically those who have worked for a company in Hawai'i for a long period of time
16 and have established roots in our local communities, cannot simply pack-up and head
17 with their family to the next state to find job opportunities or to start a new job. Job loss
18 in Hawai'i reverberates for many years, in terms of impacts not only to the local
19 workforce, but also to areas of State concern such as income tax revenues and
20 unemployment levels.

21 Q. What would be suggested?

1 A. The Commission needs to know what will happen before it approves the Proposed
2 Transaction. The Applicants should fully examine potential impacts to current
3 employees after the 2-year period is completed, have a thorough discussion on their
4 findings, and present their plans to the Commission for mitigating any impacts. From a
5 local corporate and community standpoint, that would be upholding the value of *malama*
6 *pono*, which is prevalent in Hawai‘i’s families and communities. As noted earlier in this
7 testimony, Applicant Hawaiian Electric Companies has been, and continues to be, a large
8 part of the State and its community for over a hundred years, intertwined with the
9 economic and social fabric of Hawai‘i. This must continue, regardless of company
10 ownership.

11 We cannot be satisfied with NextEra’s temporary commitment to maintain current levels
12 of corporate giving for an unknown but limited number of years and an agreement that
13 involuntary workforce reductions will take place two years after closing. The State and
14 its residents have every right to have higher expectations of a company such as NextEra.
15 The Commission needs to know what the impacts of the Proposed Transaction will be on
16 Hawai‘i’s social fabric before it gives its approval.

17 If the Commission, however, decides to approve the Proposed Transaction, then at the
18 very least, NextEra should commit to increase corporate giving levels over time, and
19 commit to keeping all current employees on-staff until such time that an impact analysis
20 approved by the Commission is done before any plans for restructuring or reorganization
21 takes place, either prior to (by the Hawaiian Electric Companies as part of their current
22 transformation initiative) or post-closing of the Proposed Transaction (by NextEra). The

1 commitment should be to maintain, and increase, the current number of positions in the
2 new company as based in Hawai‘i. The commitment should be first and foremost to truly
3 *malama pono* the current Hawaiian Electric Companies workforce and Hawai‘i’s
4 communities.

5 Q. What about the role of local decision-making and accountability? Does OP have any
6 position on the corporate governance structure proposed by NextEra?

7 A. NextEra has proposed the formation of a local, independent advisory board, in place of a
8 local board of directors. This local advisory board, which is envisioned to have 6-12
9 members all of whom will have substantial ties to Hawai‘i’s communities, will provide
10 input on matters of local and community interest.

11 The proposed local advisory board may have some public relations value. But it has no
12 power or authority. As proposed, it is unclear at what level this advisory board exists –
13 either at the level of Hawaiian Electric Holdings, the proposed new parent company of
14 the Hawaiian Electric Companies, or at the electric company level. In any case, being an
15 advisory board, they would not have the authority to make decisions on activities of
16 Hawaiian Electric Holdings or the Hawaiian Electric Companies, only providing input on
17 matters of community interest to the management. While management of the Hawaiian
18 Electric Companies, and perhaps Hawaiian Electric Holdings will be local, it is very
19 evident that decision making for the electric companies and the holding company will be
20 greatly reduced from the current local board of directors for the Hawaiian Electric
21 Companies, and will be transferred to NextEra Energy in Florida. An examination of
22 NextEra Energy’s Board of Directors, as well as future sister subsidiary Florida Power

1 and Light's (FPL) Board of Directors show that the members are predominantly the top
2 executives of NextEra Energy. Therefore, it is evident that local management of
3 Hawaiian Electric Holdings and the Hawaiian Electric Companies will be accountable to
4 a board of directors on the mainland, further reducing accountability to the local advisory
5 board, Hawai'i's residents, and the State. There is also a question as to who will select
6 members of the advisory board, and whether various sectors of Hawai'i's communities
7 will be adequately represented on said advisory board.

8 Q. Anything additional to note?

9 A. Yes. The shift of decision making and accountability to a mainland-based board of
10 directors, and away from the community that NextEra will be involved in, may strain
11 NextEra's relationship with communities in Hawai'i. The Hawaiian Electric Companies,
12 in its day-to-day work over the past 100-plus years of existence, have become very
13 attentive of local community needs and values. While there may be issues that arise from
14 time-to-time concerning the Hawaiian Electric Companies, overall, the Companies,
15 primarily through its diverse, local membership of the board of directors and the
16 Companies' employees, in and of themselves a part of Hawai'i's communities, have
17 gained the trust of the local community to continually strive to address community issues
18 and be in line with values that the community and the State may have.

19 It is uncertain if NextEra fully embraces this relationship that the Hawaiian Electric
20 Companies have with island communities, in terms of corporate decision making,
21 accountability and community trust, albeit NextEra has been in Hawai'i for much less a
22 time period than the Hawaiian Electric Companies. NextEra may say they do. But the

1 Commission needs proof before it can decide whether or not to approve the Proposed
2 Transaction. Notwithstanding the above questions, the Office of Planning feels that
3 NextEra should fully understand the relationship that the Hawaiian Electric Companies
4 have with Hawai'i's communities and residents, especially if NextEra will be in Hawai'i
5 for the long-term, and not have the attitude of understanding these relationships "as-they-
6 go."

7 Summary / Overall Conclusion

8 Q. What is the Office of Planning's overall conclusion of the Proposed Transaction?

9 A. For the most part, the Applicants have focused on the "business" side of the
10 Proposed Transaction, although as evident from the Office of Planning's
11 testimony of witness Mr. Hempling, questions remain that need to be considered
12 and resolved, before approval of the Proposed Transaction is issued by the PUC.

13 Likewise, on the "societal" side of the Proposed Transaction, there remain
14 questions or uncertainty on issues such as commitments to corporate giving,
15 impacts to employees/employment/labor, corporate governance and community
16 values.

17 The Applicants have provided minimal focus on the "societal" side of the
18 Proposed Transaction, often times portraying a social impact that could be
19 resolved via a business transaction. The Proposed Transaction, however, will not
20 have only "business" impacts. The Hawaiian Electric Companies are much more
21 than a business; they are an important institution that touches not only the areas of

1 energy and corporate Hawai‘i, but also those areas related to the social and
2 community fabric of Hawai‘i. The PUC is reminded that as a decision making
3 agency of the State, it must uphold the goals, objectives and policies of the
4 Hawai‘i State Plan, and therefore not only uphold objectives and policies covering
5 the “business” side of the Proposed Transaction, but also the “societal” objectives
6 and policies as well.

7 Based on the analysis of the Proposed Transaction, and the testimony provided
8 above, as well as the testimony of our witness, at this time, the Office of
9 Planning’s recommendation would be for the PUC to not approve the Proposed
10 Transaction, and have further discussion and/or resolution to the issues brought
11 forth by the Office of Planning.

**PLANNING OFFICE EXHIBIT-2
DOCKET NO. 2015-0022**

TABLE OF ISSUES ADDRESSED

Issue	Addressed in Testimony of Leo Asuncion	Addressed in Testimony of Scott Hempling
1. Whether the Proposed Transaction is in the public interest.		
a. Whether approval of the Proposed Transaction would be in the best interests of the State’s economy and the communities served by the HECO Companies.	Yes, pp. 1-15	No
b. Whether the Proposed Transaction, if approved, provides significant, quantifiable benefits to the HECO Companies’ ratepayers in both the short and the long term beyond those proposed by the HECO Companies in recent regulatory filings.	No	Yes, pp. 139-168
c. Whether the proposed transaction will impact the ability of the HECO Companies’ employees to provide safe, adequate, and reliable service at reasonable cost.	No	No
d. Whether the proposed financing and corporate restructuring proposed in the Application is reasonable.	No	Yes, pp. 16-25 and 29-139
e. Whether adequate safeguards exist to prevent cross subsidization of any affiliates and to ensure the commission’s ability to audit the books and records of the HECO Companies, including affiliate transactions.	No	Yes, pp. 70-97, 177, and 184-188
f. Whether adequate safeguards exist to protect the HECO Companies’ ratepayers from any business and financial risks associated with the operations of NextEra and/or any of its affiliates.	No	Yes, pp. 70-104 and 176
g. Whether the Proposed Transaction, if approved, will enhance or detrimentally impact the State’s clean energy goals.	No	Yes, pp. 16-25 and 29-70
h. Whether the transfer, if approved, would potentially diminish competition in Hawai‘i’s various energy	No	Yes, pp. 29-70

markets and, if so, what regulatory safeguards are required to mitigate such adverse impacts.		
2. Whether the Applicants are fit, willing, and able to properly provide safe, adequate, reliable electric service at the lowest reasonable cost in both the short and the long term.		
a. Whether the Proposed Transaction, if approved, will result in more affordable electric rates for the customers of the HECO Companies.	No	No
b. Whether the Proposed Transaction, if approved, will result in an improvement in service and reliability for the customers of the HECO Companies.	No	Yes, pp. 139-162
c. Whether the Proposed Transaction, if approved, will improve the HECO Companies' management and performance.	No	Yes, pp. 139-161
d. Whether the Proposed Transaction, if approved, will improve the financial soundness of the HECO Companies.	No	Yes, pp. 161-166
3. Whether the Proposed Transaction, if approved, would diminish, in any way, the commission's current regulatory authority over the HECO Companies, particularly in light of the fact that the ultimate corporate control of the HECO Companies will reside outside of the State.	No	No
4. Whether the financial size of the HECO Companies relative to NextEra's other affiliates would result in a diminution of regulatory control by the commission.	No	Yes, pp. 98-101
5. Whether NextEra, PPL, or any other affiliate has been subject to compliance or enforcement orders issued by any regulatory agency or court.	No	No
6. Whether any conditions are necessary to ensure that the Proposed Transaction is not detrimental to the interests of the HECO Companies' ratepayers or the State and to avoid any adverse consequences and, if so, what conditions are necessary.	Yes, pp. 1-15	Yes, pp. 175-188

**PLANNING OFFICE EXHIBIT-3
DOCKET NO. 2015-0022**

RESUME OF LEO R. ASUNCION, JR.

**Acting Director, Office of Planning, State of Hawai'i
Planning Program Manager, Hawai'i Coastal Zone Management Program, Office of
Planning**

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PROFESSIONAL EXPERIENCE

Acting Director, Office of Planning; March 2014 - present

Responsible for management, budgeting, and oversight of the Office of Planning. Responsible for overall development of policies, execution of studies and reports generated by all divisions of the office, and represents the office before the State Legislature, Executive Branch agencies, communities, and the public.

Planning Program Manager, Hawai'i Coastal Zone Management Program; June 2011 – present

Responsible for management, budgeting, and implementation of the State's Coastal Zone Management Program. Responsible for developing policies and applicable background information for policies affecting Hawai'i's Coastal Zone Management Area. Oversight on the Update of the Hawai'i Ocean Resources Management Plan, Coastal Non-Point Pollution Control Program, and other planning and environmental aspects of the Program.

Sr. Regulatory Analyst, Hawaiian Electric Company, Inc.; April 2009 – June 2011

Responsible for implementing policies relating to regulatory affairs, and providing substantive direction for the development, preparation, submission, presentation, and execution of significant investigations and other major regulatory matters before the Hawai'i Public Utilities Commission in the focus areas of Integrated Resource Planning, Energy Efficiency, and Renewable Energy. Reviewed and prepared applications, written testimonies, and other regulatory documents consistent with Company policy, Hawai'i regulatory law, and regulatory decisions. Assist in the development, interpretation, and administration of the Company's Tariffs and Rules.

Sr. Resource Planning Analyst, Hawaiian Electric Company, Inc.; Aug 2005 – April 2009

Responsible for management and coordination of the Integrated Resource Planning (IRP) process for subsidiary Maui Electric Co., Ltd., including development of 20-year long-range and 5-year action plans that meet customer needs, corporate/shareholder goals, and regulatory reporting requirements. Coordinated approximately 8 to 10 intra-company and inter-subsiary IRP team members/groups, and outside consultants. Assist in the planning and execution of public Advisory Group and stakeholder meetings.

- 1 • Developed and completed major update of Maui Electric Co., Ltd.'s Integrated Resource
- 2 Plan within target completion date and estimated budget.
- 3 • Analyzed, recommended, and implemented as necessary, new or improved planning
- 4 techniques, processes, procedures, and/or methodologies to increase process efficiency,
- 5 and cost/process timing reductions.
- 6 • Performed analysis of new strategic opportunities and definition of impacts upon the
- 7 company's long-term planning and regulatory activities.

8
9 **Project Planner/Manager, SSFM International, Inc.; Feb 2002 – July 2005**

10 Responsible for planning, permitting, environmental impact assessments and statements, and

11 overall project management for diverse projects worked upon by the Company.

- 12 • Successful management and implementation of planning, engineering, construction, and
- 13 renovation projects totaling over \$25 million for various clients (Federal, State, and
- 14 County agencies, and private entities) in Hawai'i, the Commonwealth of the Northern
- 15 Mariana Islands (Saipan), and the Republic of Palau.
- 16 • Authored and managed various State and Federal environmental impact statements,
- 17 environmental assessments, planning reports, and related documents.
- 18 • Performed technical (qualitative and quantitative) planning analysis for various projects.

19
20 **Planner, Planning and Program Evaluation Division, Hawai'i State Judiciary; Oct 1998 –**

21 **Jan 2002**

22 Responsible for providing planning and program evaluation support to the Office of the

23 Administrative Director, various court jurisdictions (judges and administrators), and

24 affiliated governmental agencies.

- 25 • Staffed and performed research for Judiciary committees examining various topics
- 26 related to judicial administration, including changes to the operational administration of
- 27 the Judiciary.
- 28 • Successfully updated the Statewide Judiciary Security Plan in coordination with
- 29 employees, judges, administrative directors, and stakeholders; developed and
- 30 implemented operational and facility renovation recommendations.
- 31 • Managed annual reviews and periodic updates of contracts and agreements between the
- 32 Judiciary and the State Department of Public Safety, including private vendors for
- 33 provision of materials and services.

34
35 **Staff Planner, State Land Use Commission, Department of Business, Economic**

36 **Development & Tourism, State of Hawai'i; Jan 1992 – Oct 1998**

37 Responsible for providing planning and policy evaluation support to the members of the

38 State Land Use Commission.

- 39 • Reviewed and performed research of boundary amendment petitions, special permit
- 40 applications, county land use applications, environmental impact statements, and other
- 41 related documents to assist Land Use Commissioners in its quasi-judicial decision
- 42 making process.
- 43 • Performed policy research and analysis on land use, infrastructure, utility, and planning
- 44 related activities in Hawai'i.
- 45 • Reviewed and completed major amendments of the Commission's administrative rules.

1

2 **EDUCATION**

3 **Hawai'i Pacific University** – Master of Business Administration degree (With Distinction)

4 **University of Hawai'i – Manoa** – Master of Urban and Regional Planning degree

5 **University of Hawai'i – Manoa** – Bachelor of Arts degree in Political Science

6

7 **PROFESSIONAL AFFILIATIONS/AWARDS**

8 **American Institute of Certified Planners**, July 1994 – present

9 **American Planning Association, National and Hawai'i Chapter**, September 1988 – present

10 **Hawai'i Pacific University Alumni Global Network**, 2008 – present

11 **University of Hawai'i Alumni Association Life Member**, 1992 – present

12 **American Planning Association – Hawai'i Chapter Outstanding Service to Chapter Award**,
13 2001

14 **Department of Urban and Regional Planning AICP Outstanding Graduate Student of the**
15 **Year, 1991**

**PLANNING OFFICE EXHIBIT-4
DOCKET NO. 2015-0022**

**DIRECT TESTIMONY OF
SCOTT HEMPLING**

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1
2 **I.**
3 **Qualifications and Executive Summary**

4 **A. *Qualifications***

5
6 **Q. State your name, position, and business address.**

7
8 **A.** My name is Scott Hempling. I am the President of Scott Hempling, Attorney at Law
9 LLC. My business address is 417 St. Lawrence Drive, Silver Spring, Maryland 20901.

10 **Q. Describe your employment background, experience, and education.**

11 **A.** I began my legal career in 1984 as an associate in a private law firm, where I represented
12 municipal power systems and others on transmission access, holding company structures,
13 nuclear power plant construction prudence, and producer-pipeline gas contracts. From
14 1987 to 1990 I was employed by a public interest organization to work on electric utility
15 issues. From 1990 to 2006 I had my own law practice, advising public and private sector
16 clients—primarily state regulatory commissions, and also municipal systems,
17 independent power producers, consumer advocates, public interest organizations and
18 utilities—with an emphasis on electric utility regulation.

19 From October 2006 through August 2011, I was Executive Director of the
20 National Regulatory Research Institute (NRRI). Founded by the National Association of
21 Regulatory Utility Commissioners, NRRI is a Section 501(c)(3) organization, funded
22 primarily by state utility regulatory commissions. During my tenure, NRRI's mission
23 was to provide research that empowered utility regulators to make decisions of the
24 highest possible quality. As Executive Director, I was responsible for working with
25 commissioners and commission staff at all 51 state-level regulatory agencies to develop
26 and carry out research priorities in electricity, gas, telecommunications, and water. In
27 addition to overseeing the planning and publication of over 80 research papers by NRRI's

1 staff experts and outside consultants, I published my own research papers, advised
2 contract clients (including state commissions, regional transmission organizations, private
3 industry, and international institutions), and wrote monthly essays on effective regulation.

4 In September 2011 I returned to private practice, to focus on writing books and
5 research papers, providing expert testimony, and teaching courses and seminars on the
6 law and policy of utility regulation. I am an Adjunct Professor at Georgetown University
7 Law Center in Washington, D.C., where I teach two seminars: "Monopolies,
8 Competition, and the Regulation of Public Utilities"; and "Regulatory Litigation: Roles,
9 Skills and Strategies." Students study the legal fundamentals in class, then apply that
10 learning, under my supervision, in practicums at state and federal regulatory agencies.

11 I have represented and advised clients in diverse state commission cases, and in
12 federal proceedings under the Federal Power Act of 1935 and the Public Utility Holding
13 Company Act of 1935. The latter proceedings took place before the Federal Energy
14 Regulatory Commission (FERC), the Securities and Exchange Commission (SEC), and
15 U.S. courts of appeals. As a lawyer, expert witness, or commission advisor, I have
16 participated in 15 merger proceedings prior to this one.¹ I have testified many times on
17 electric industry matters before Congressional and state legislative committees.

¹ These proceedings include: Toledo Edison and Cleveland Electric Illuminating (1985); PacifiCorp and Utah Power & Light (1987-88); Northeast Utilities and Public Service of New Hampshire (1990-91); Kansas Power & Light and Kansas Gas & Electric (1990-91); Northern States Power and Wisconsin Electric Power Co. (1992); Entergy and Gulf States (1995); Potomac Electric Company and Baltimore Gas & Electric (1997-98); Carolina Power & Light and Florida Power Corp. (1999); Sierra Pacific Power and Nevada Power (1998-99); American Electric Power and Central and Southwest (2001); Union Electric and Central Illinois Light Company (2001); Exelon and Constellation (2011-12); Entergy and International Transmission Company (2013); Exelon and PHI

1 Between 2004 and 2011, I was an outside advisor to the Hawai'i Public Utilities
2 Commission, and the Commission's moderator, in proceedings addressing the following
3 issues, among others: distributed generation, energy efficiency, competitive bidding,
4 HECO revenue requirements, renewable energy surcharge, integrated resource planning
5 policy, decoupling, and pension accounting.

6 My book *Regulating Public Utility Performance: The Law of Market Structure,*
7 *Pricing and Jurisdiction*, was published by the American Bar Association in 2013. This
8 is the first volume of a two-volume treatise, the second of which will address the law of
9 corporate structure, mergers, and acquisitions. My book of essays, *Preside or Lead? The*
10 *Attributes and Actions of Effective Regulators*, was published by NRRI in 2010. I
11 published a second, expanded edition in 2013. I have written several dozen articles on
12 utility regulation for publication in trade journals, law journals, and books; and taught
13 electricity law seminars to attendees from all fifty states and all industry sectors. I have
14 spoken at many industry conferences, in the United States and in Canada, England,
15 Germany, India, Italy, Jamaica, Mexico, New Zealand, Nigeria, and Peru. As a
16 subcontractor to the U.S. Department of State, I have advised the six nations of Central
17 America on the regulatory infrastructure necessary to accommodate and encourage cross-
18 national electricity transactions.

19 I received a B.A. *cum laude* from Yale University in 1978, where I majored in
20 (1) Economics and Political Science and (2) Music. I received a J.D. *magna cum laude*

Holdings (2014-15) (before the commissions in Maryland and the District of Columbia);
United Illuminating and Iberdrola (2015); and Macquarie, et al. and CLECO Corp.
(Central Louisiana Electric Company) (2015-16).

1 from Georgetown University Law Center in 1984. I am a member of the Bars of the
2 District of Columbia and Maryland.

3 My resume is attached to this testimony. More information is at
4 www.scotthemplinglaw.com.

5 **Q. Have you provided testimony in other regulatory proceedings?**

6
7 **A.** Yes, before the following fora: Louisiana Public Service Commission, Connecticut
8 Public Utilities Regulatory Authority, District of Columbia Public Service Commission,
9 Maryland Public Service Commission, Mississippi Public Service Commission, U.S.
10 District Court for Minnesota, Illinois Commerce Commission, California Public Utilities
11 Commission, Minnesota Public Utilities Commission, U.S. District Court for Wisconsin,
12 New Jersey Board of Public Utilities, Indiana Utility Regulatory Commission, North
13 Carolina Utilities Commission, Wisconsin Public Service Commission, Texas Public
14 Utilities Commission, and the Vermont Public Service Board. These proceedings are
15 listed on my resume.

16 **Q. On whose behalf are you testifying in this proceeding?**

17 **A.** I am testifying on behalf of the State of Hawai‘i, Office of Planning. Under HRS sec.
18 225M-2(b), the Office of Planning is responsible for

19 "gather[ing], analyz[ing], and provid[ing] information to the governor to
20 assist in the overall analysis and formulation of state policies and
21 strategies to provide central direction and cohesion in the allocation of
22 resources and effectuation of state activities and programs and effectively
23 address current or emerging issues and opportunities."
24

25 This responsibility includes, among other things,

26
27 "[f]ormulating and articulating comprehensive statewide goals, objectives,
28 policies, and priorities"; "[i]dentifying and analyzing significant issues,
29 problems, and opportunities confronting the State, and formulating
30 strategies and alternative courses of action in response to identified

1 problems and opportunities"; [and] "[c]onduct[ing] strategic planning by
2 identifying and analyzing significant issues, problems, and opportunities
3 confronting the State, and formulating strategies and alternative courses of
4 action in response to identified problems and opportunities...."

5
6 The Acting Director of the Office of Planning, Mr. Leo Asuncion, is also filing
7 testimony in this proceeding.

8 **Q. What instructions did you receive regarding the preparation of your testimony?**

9
10 **A.** I was instructed to apply my knowledge of and experience in the principles of public
11 utility regulation, including mergers and acquisitions policy, to this transaction;
12 specifically to assess its advantages and disadvantages. I also was instructed to offer
13 recommendations on mergers and acquisitions policy generally, so that the Commission
14 would have a context in which to assess this transaction and future ones. These
15 instructions contained no directives as to the outcome of my assessment or constraints on
16 my analytical methods.

17 **Q. In preparing this testimony, what information did you review?**

18
19 **A.** I reviewed the Application and accompanying testimony, financial reports of NextEra
20 and HEI, NextEra's Amendment No. 3 to Form S-4 (Mar. 24, 2015), Hawaii's public
21 utility statutes, various Commission orders, and responses to data requests submitted in
22 this proceeding.

23 **B. *Executive Summary***

24
25 **Q. Summarize your testimony.**

26 **A.** For any state's electric industry, the central question is this: How can we attract the best
27 companies to help achieve our goals? NextEra and HEI did not design this transaction to
28 answer that question. They designed this transaction to answer two very different
29 questions: HEI asked: How can we obtain the maximum return for our shareholders?

1 NextEra asked: How can we extend our business model--the vertically integrated
2 monopoly--into a new territory?

3 Since the Applicants' real questions are rooted in their private interests, they
4 framed their proposal to sound like a question that serves the public interest: "Which is
5 better: status quo HECO or NextEra-owned HECO?" But this question presents a false
6 dichotomy. For if the goal is to improve Hawai'i's electric industry--to bring more
7 products and services, more innovation, more efficiency, more diversity, and more
8 customer choices—status quo HECO and NextEra-owned HECO are not the only
9 options.²

10 By dismissing this proposal without prejudice, the Commission can create more
11 options. The Commission can create more options by asking questions different from
12 those asked by the Applicants, questions like: What are Hawai'i's needs and wishes?
13 What types of companies can most cost-effectively respond to those needs and wishes?
14 What Commission policies will most likely attract those companies and induce the best
15 performance? And most immediately: Will approving this transaction make answering
16 those questions and creating more options easier or harder?

17 Because the question the Applicants have asked diverges from the questions the
18 Commission should ask, their Application is not a foundation on which we can build
19 Hawai'i's future. This testimony explains the reasons why, in five major Parts.

² For purposes of brevity, when I refer to "HECO" I am referring to all three of the HECO utilities (HECO, HELCO, and MECO), unless the context indicates otherwise. When I refer to "NextEra" I am referring to the holding company and all its subsidiaries, unless the context indicates otherwise.

1 ***Steps to assess NextEra's fit with Hawai'i's needs (Part II):*** The logical first
2 step is to define the State's needs, then define the types of companies most likely to serve
3 those needs. Hawai'i needs companies that (a) use the most cost-effective, innovative
4 practices available; and (b) foster corporate cultures in which the investors, executives,
5 and workers are all pulling toward the goals of the regulators. To attract the best
6 companies, the Commission should articulate clear policies in four key areas: (a) the
7 permissible business activities within the utility's corporate family; (b) the types of
8 corporate governance structures that will control the utility; (c) the permissible financial
9 relationships within the corporate family; and (d) the market structures that will most
10 likely attract and sustain such companies.

11 By applying policies in these four areas, a regulator can assess whether the post-
12 acquisition entity will have motivations, powers, and opportunities consistent with, or in
13 tension with, the utility's obligation to serve. If tensions exist, the regulator can try to
14 design conditions that prevent consumer harm. If conditions are not feasible, due to
15 practicalities, legal authority, or resources, then the acquisition must be rejected.

16 ***Conflicts between NextEra's goals and Hawai'i's needs (Part III):*** NextEra has
17 a "business model": Own vertically integrated monopolies, then seek competitive
18 advantage in the markets served by those monopolies. But that model conflicts with
19 Hawai'i's need for diversity and competition. Indeed, NextEra has said explicitly that
20 customer choice is a negative for its bottom line. Because NextEra is in Hawai'i already
21 (as a developer of generation and of a possible Maui-Oahu cable), buying HECO brings
22 risks of both horizontal and vertical market power.

1 Then there are the risks of management distraction, intra-family conflict over
2 capital resources, and non-utility business failures. Immediately after consummation,
3 HECO's importance to its holding company, in terms of revenue and profit, will shrink by
4 multiples of six and twelve, respectively. And the shrinkage can continue, because the
5 2005 repeal of the federal Public Utility Holding Company Act leaves NextEra free to
6 buy any company anywhere. With HECO's CEO becoming subordinate to NextEra's
7 CEO, these facts do not offer confidence that the Commission's priorities will be
8 NextEra's priorities.

9 Why are there so many conflicts between NextEra's priorities and Hawai'i's
10 priorities? The answer lies in this transaction's origins. Throughout its negotiations with
11 NextEra, HEI had a single priority: maximum gain for the HEI shareholders. HEI
12 treated its utility franchise like a New York City taxi medallion--a government-granted
13 privilege, converted into a private commodity and sold at a profit. During seven months
14 of meetings, calls, and correspondence, not once did the negotiations address customer
15 benefits.

16 ***The absence of real benefits (Part IV):*** NextEra cites its experience. But
17 owning a vertically integrated, non-renewables monopoly in Florida does not give
18 NextEra experience in creating competitive distributed resources markets in Hawai'i. Its
19 talk of operational improvements is not backed by plans, metrics, or commitments. The
20 synergy "studies" NextEra cites are merely predictions that prior merger candidates made
21 to win approval; there is no proof that the predictions came true after approval.
22

1 NextEra says HECO cannot finance a 10-year, \$6.2 billion capital expenditure plan
2 alone. Maybe true, but NextEra is not the State's only option. By using competitive
3 bidding, the Commission can attract other capital sources--and get better prices than
4 relying on either HECO alone or NextEra alone.

5 NextEra wants this proceeding to be about performance, about how NextEra can
6 improve HECO's performance. But under NextEra's own assumptions, an acquisition
7 proceeding cannot be a performance proceeding because the acquirer can make no
8 performance commitments. NextEra makes no performance commitments because it
9 knows too little about HECO to make commitments--an information gap it says is
10 compelled by antitrust law. So all NextEra can offer is self-praise about the past, and
11 noncommittal optimism about the future.

12 There has to be a better way. If the information necessary to make commitments
13 is unavailable when an acquisition is pending, we should address performance when an
14 acquisition is not pending. The path to improving HECO is to make its information
15 available to all. Then offerors can present real plans, real metrics, and real commitments.

16 ***The importance of alternatives (Part V):*** In various orders, the Commission has
17 expressed dissatisfaction with HECO's performance, especially in regard to achieving the
18 State's clean energy goals.³ The Applicants' solution is to have HEI select new owners
19 secretly, based on maximum gain to HEI's shareholders and no consideration of

³ See, e.g., *Commission's Inclinations on the Future of Hawai'i's Electric Utilities* (hereinafter cited as *Inclinations*), Exhibit A to Decision and Order No. 32052 in Docket No. 2012-0036, *In the Matter of Integrated Resource Planning* (April 28, 2014) (hereinafter cited as *Inclinations Order*).

1 consumers, and then present that new owner as the best answer to the Commission's
2 concerns. The illogic of that approach is obvious. The logical approach is equally
3 obvious: Open Hawai'i's doors wide, to see what skills and services others can offer.

4 ***The absence of conditions that are both practical and enforceable (Part VI):*** If
5 the Commission does approve a NextEra takeover, conditions are necessary to eliminate
6 harms, create benefits, and ensure compliance. I tried to design such conditions, but I
7 failed, due to problems of practicality and enforceability. If the Commission accepts this
8 acquisition it will need not only to establish conditions, but also to reserve the power to
9 require disaffiliation if the conditions fail—or are violated—or if the Commission finds
10 that control of HECO by an acquisition-oriented, vertically integrated monopoly, one
11 facing no limits on the scope of its future acquisitions, is no longer in Hawai'i's interest.

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II.
To Assess NextEra's Fit with Hawai'i's Needs,
the Logical First Step is to Define Those Needs

A. *The context for this transaction*

Q. Describe the context for this transaction.

A. There are few decisions more important to a state than what company should control the electricity infrastructure—that combination of hardware, software, skills, and services essential to economic activity and to life. In Hawai'i, that company has always been HECO.

Over the last dozen years, the Commission has sought to align HECO's performance with Hawai'i's central energy objective: reducing dependence on fossil fuels by diversifying supplies and suppliers. Investigations and orders on key subjects—including distributed generation, integrated resource planning, decoupling, infrastructure surcharges, heat rate incentives, cost recovery, rate design, energy efficiency, renewable interconnection, and reliability—have prescribed specific actions by, and expectations of, the HECO companies.

HECO's performance has been unsatisfactory. In its *Inclinations* Order, the Commission made the following findings, among others:

1. HECO's Integrated Resource Action Plan and its proposed 2014 capital expenditure program consisted of "a series of unrelated capital projects without strategic focus."⁴ (The Commission previously had described HECO's IRP as "clearly non-compliant and inconsistent" with the Commission's mandated *IRP Framework*.)⁵

⁴ *Inclinations* Order at 1.

⁵ *In re Integrated Resource Planning*, Docket No. 2012-0036, Decision & Order No. 32052 (April 28, 2014).

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2. HECO has not demonstrated that it "can be cost competitive with independent power producers."⁶
3. HECO has not demonstrated "inherent skills and expertise in developing and managing renewable energy projects."⁷
4. Compared to the nonprofit Kauai Island Utility Cooperative, the for-profit HECO had less vision and more rate increases.⁸

Despite the Commission's dissatisfaction, its work continues. Along with the Legislature and numerous stakeholders, the Commission is striving to answer the most basic questions about Hawai'i's electricity future, including:

1. What is the appropriate mix of conventional generation, renewable generation, storage, energy efficiency, and demand response?
2. From where, and from whom, should we get these resources? For example, should new generation be constructed and owned by the incumbent utility, by independent power producers, or by homeowners?
3. For the "old world" activities of large-scale generation, transmission, and physical distribution, what are our desired metrics for performance, and what measures will most cost-effectively induce that performance?
4. For the "new world" services, especially distributed energy resources, how can we attract the most cost-effective providers?
5. How can we reduce frictions over interconnection, and uncertainty over reliability?
6. Do we need one or more inter-island cables; and if so, who should build, own, and operate it, and under what regulatory and competitive conditions?

⁶ *Id.* at 18.

⁷ *Id.*

⁸ *Id.* at 2 n.3.

- 1 7. Regarding market structures, what is the appropriate mix of monopoly,
2 competition, community ownership, county ownership, microgrids, and
3 self-supply?
4
5 8. Regarding corporate structures, what types of companies do we want to
6 depend on—local or mainland, U.S. or foreign, utility-only or utility-
7 nonutility mix, small or large, progressive or traditional?
8
9 9. Is HECO, as currently owned and organized, part of our future or not? If
10 so, how will improvement occur? If not, what company (or companies)
11 should replace it?
12

13 This work is aimed at advancing the public interest, by making Hawai‘i
14 hospitable to new supplies and suppliers. But now, in the midst of this work, appears a
15 proposal designed to advance the self-interests of two vertically integrated monopolies.
16 HEI seeks to transfer control of its government-granted franchise to NextEra, in return for
17 a control premium worth \$568 million.⁹ HEI chose NextEra not because it promised the

⁹ As I will explain in Part III.G.3, "control premium" refers to the excess of the purchase price over that same HEI's pre-acquisition stock value. The \$568 million figure is calculated as follows: According to NextEra's S-4 (at 38), the purchase price "represented a premium of approximately 26.2% over the \$20.20 per share imputed valuation of HEI's utility business on December 2, 2014." As of the close of business on March 23, 2015, there were 107,416,201 outstanding shares of HEI common stock. *Id.* viii. The arithmetic is $20.20 * 107,416,201 * 0.262 = 568,489,502$. **Caution:** This \$568 million figure is useful only to see the order of magnitude. Applicants assert, credibly, that

it is not possible to reliably calculate the premium attributable to the utility business of HEI, due to uncertainty regarding the value of American Savings Bank in HEI's unaffected stock price (from which the imputed valuations of the utility business referenced in the S-4 were derived). Moreover, any such calculation would not be very meaningful, given uncertainty regarding the relative valuation of the two companies' share prices (since this was a stock merger vs. a cash acquisition).

Response to OP-IR-141.

1 most cost-effective performance for Hawai‘i consumers, but because it offered the
2 highest possible price to HEI shareholders.¹⁰

3 Though the basis of this marriage is the size of the dowry rather than the fit of the
4 partners (indeed, the partners admit they know little about each other¹¹), the Applicants
5 offer it as the single answer to Hawai‘i's many questions. But there can be no single
6 answer. If the main question is "How do we diversify Hawai‘i's markets?" the answer
7 cannot be "By granting control to a Florida company whose preferred business model is
8 vertically integrated monopoly."¹²

9 By rejecting this transaction without prejudice, the Commission loses nothing.
10 NextEra's willingness to buy HEI, to pay \$568 million to get control of Hawai‘i's
11 electricity infrastructure, reveals that Hawai‘i's electric future is an attractive business
12 opportunity. The Commission should not sole-source that opportunity to the first suitor.
13 I recommend instead that the Commission first complete its important work, the work of
14 determining the ingredients for energy policy success: the needs of Hawai‘i's consumers
15 and its economy; the types of companies best suited to serve those needs; and the market
16 structures and regulatory policies that most cost-effectively will attract those companies
17 to Hawai‘i. These determinations must be made methodically and objectively,
18 undistracted by time pressures, public relations pressures, or any other pressures—other
19 than the pressure of serving the state's long-term interest.

¹⁰ As detailed in Part III.G.1 below.

¹¹ As detailed in Part III.C and D below.

¹² As explained in Part III.B below.

1 **B. *Legal standards***

2
3 **Q. What is your understanding of the legal standards applicable to this transaction?**

4
5 **A.** In its order initiating this proceeding,¹³ the Commission identified the following statutory
6 provisions as guiding its assessment of this transaction:

7 HRS sec. 269-6 (a), (b), (c), and (d), providing general supervisory authority over
8 public utilities and establishing additional specific powers.

9
10 HRS sec. 269-7(a), granting powers to "examine" various aspects of each public
11 utility, including "all matters of every nature affecting the relations and
12 transactions between [the public utility] and the public or persons or
13 corporations."

14
15 HRS sec. 269-19(a), prohibiting any public utility from merging or consolidating
16 with any other public utility without Commission approval.

17
18 To approve an acquisition of a Hawai'i utility, the Commission has held that it
19 "must find that (1) the acquiring utility is fit, willing, and able to perform the service
20 currently offered by the utility to be acquired, and (2) the acquisition is reasonable and *in*
21 *the public interest*."¹⁴ In the instant case, the Commission has asked, among other things,
22 "[w]hether approval of the Proposed Transaction would be in the *best interests* of the
23 State's economy and the communities served by the HECO Companies."¹⁵

¹³ Order No. 32695 (Mar. 2, 2015).

¹⁴ *In the Matter of the Application of Citizens Communications Company, Kauai Electric Division and Kauai Island Utility Co-op For Approval of the Sale of Certain Assets of Citizens Communications Company, Kauai Electric Division and Related Matters*, Docket No. 2002-0060, Decision and Order No. 91658, filed Sept. 17, 2002 (emphasis added).

¹⁵ Decision and Order No. 32695 (emphasis added).

1 These legal standards allow the Commission to consider how well an acquiring
2 company fits with Hawai'i's needs. Assessing that fit is the main purpose of my
3 testimony. I will start with a discussion of the appropriate characteristics of an acquiring
4 entity, then apply those characteristics to NextEra.

5 ***C. Appropriate characteristics of an acquiring entity***

6
7 **Q. Is the public interest affected by the characteristics of an acquiring entity?**

8
9 **A. Yes.** Statutory breadth yields regulatory discretion. But that discretion does not allow
10 deference to corporate structures that conflict with the public interest. From next-door,
11 vertically integrated companies to remote financial management firms, the characteristics
12 of prospective acquirers vary. These characteristics can be consistent with a state's needs,
13 or they can be a source of conflict. The job of regulation is to prevent conflict upfront,
14 rather than deal with its consequences once it occurs. To prevent conflict, a regulator
15 needs policies that align the interests of prospective acquirers with the interests of the
16 public. Understanding an acquirer's business activities, corporate structure, and financial
17 structure, and an acquisition's effects on market structures, provides insight into whether
18 the acquirer's interests comport with the public interest.

19 The public interest requires a utility that (a) uses the most cost-effective practices
20 available; and (b) has a corporate culture that aligns the motivations and incentives of its
21 investors, executives, and workers with its regulators' priorities. An acquisition will be in
22 the public interest only if the acquirer, and therefore the post-acquisition entity, satisfies
23 these two criteria.

24 A commission can best determine if that satisfaction exists if it has articulated
25 clear policies in four key areas: (a) the permissible business activities within the utility's

1 corporate family; (b) the types of corporate entities that may own the utility, and the
2 governance structures that may control or influence it; (c) the permissible financial
3 structures and relationships that connect the corporate family's members; and (d) the
4 market structures affected by the acquisition. Common to these four areas is the need to
5 avoid conflict between a utility's public service obligation and its holding company
6 owner's business priorities. Giving consideration to these four areas is especially
7 important here, where the proposed transaction will replace HEI's relatively simple,
8 Hawai'i-only corporate structure with NextEra's complexity. I will discuss each area in
9 turn.

10 *1. Business activities*

11
12 **Q. What considerations should a commission give to the potential for conflicts arising**
13 **from the post-acquisition entity's business activities?**

14
15 **A.** In any utility holding company, conflict can come from at least two sources. The first is
16 business activities. A standalone utility—one affiliated with no other business, serving a
17 single local territory—experiences no inter-business conflict. The potential for conflict
18 grows as the holding company's business activities expand, in terms of either geography
19 or type of business. Geographic expansion (acquiring other utilities in other locations)
20 can benefit customers if there are increasing economies of scale; but it can hurt customers
21 if operations are impaired by managerial remoteness or diseconomies of scale. Type-of-
22 business expansion (acquiring companies that sell other services, to third parties or to the
23 utility itself) is a two-edged sword: Non-utility affiliates can support a utility (as might a
24 subsidiary experienced in acquiring land or buying fuel); or distract it (like affiliates
25 investing in nuclear power or hedge funds).

1 **Q. How can a commission address these conflicts?**

2
3 **A.** A commission can address these conflicts by allowing only those acquisitions whose
4 complexities are justified by benefits. Weighing complexities against benefits is
5 challenging, because the costs of complexity are often intangible or difficult to quantify,
6 whereas benefits can take the form of dollars or observable performance metrics. But the
7 difficulty of weighing does not erase its importance. The first step is to understand the
8 risks from corporate complexity. They come in three forms.

9 The first is management distraction stemming from affiliated non-utility
10 investments. Failures force management to spend time saving or selling the losers;
11 successes spur management to find more winners.

12 The second risk is affiliate abuse, of two types: (a) The utility affiliate overpays
13 the non-utility for services, and (b) the non-utility affiliate underpays the utility affiliate
14 for services. Besides harming consumers, these arrangements harm competition by
15 giving affiliates unearned advantages.¹⁶

16 The third risk is a weakened utility. Every month, customers pay the utility for
17 service, usually in cash. When non-utility affiliates fail, the utility's cash flow tempts the
18 holding company to help the bleeding businesses by drawing dividends from the utility or
19 reducing equity flows to the utility (the holding company being the utility's main source
20 of equity). And because utilities are capital-intensive, their assets are attractive collateral
21 for third-party loans to the failing affiliates. The utility, initially strong from ratepayer
22 support, can be weakened when its siblings sink.

¹⁶ I discuss interaffiliate relations in more detail at Part III.B.3 below.

1 2. *Corporate and governance structures*

2
3 **Q. What considerations should a commission give to the potential for conflicts arising**
4 **from the post-acquisition entity's corporate structure?**

5
6 **A.** In a utility's corporate family, there should be at all levels, from the holding company
7 CEO to the substation repair team, a single focus: the utility's performance for its
8 consumers. When presented with a proposed acquisition, a commission should ask: Will
9 ultimate control be exercised by individuals whose full focus and professional priority is
10 on service to utility customers? Or will control be exercised by companies and
11 executives that have other objectives—objectives that distract from, or conflict with, the
12 public and consumer interest?

13 3. *Financial structures*

14
15 **Q. What considerations should a commission give to the potential for conflicts arising**
16 **from the post-acquisition entity's financial structure?**

17
18 **A.** Financial structure involves the mix of equity and debt, including who holds or controls
19 that equity and debt, and which business activities have priority when financial capital is
20 scarce. How these financial features can affect the utility subsidiary is illustrated by two
21 simple examples relevant here. First, if the utility's holding company pays for
22 acquisitions with debt, this leveraging can cause the holding company to pressure the
23 utility to divert cash flow from operations to the holding company; or to limit the flow of
24 holding company equity into the utility. (NextEra's proposal to acquire HEI would not
25 require new debt. But other NextEra acquisitions—over which the Commission would
26 have no jurisdiction—could.) Second, when a non-utility affiliate fails, investors view
27 the holding company as more risky, raising its finance costs. The utility affiliate's equity
28 (which comes from the holding company) then becomes more expensive.

1 4. **Market structures**
2

3 **Q. How can an acquisition affect the markets in which the post-acquisition entity will**
4 **sell services?**

5
6 **A.**The term "market structure" refers to the number and types of entities selling and buying
7 a particular product or service within a particular geographic area, their market shares,
8 the assets they control, and the ease of market entry and exit. A merger or acquisition
9 can change market structure. As Alfred Kahn has written:

10 The preponderant case for mergers is that they will improve efficiency.
11 The preponderant case against them is their possible impairment of
12 competition, for two reasons: first, the merging companies are typically
13 actual or potential competitors in some parts of their business, and,
14 second, they may be enabled by joining together to deny outside firms a
15 fair opportunity to compete.¹⁷

16
17 An acquisition can make a market more competitive or less competitive, thereby
18 increasing or decreasing efficiency, cost, quality, customer service, and innovation.

19 Before addressing an acquisition, therefore, a commission should envision the type of
20 market structure most likely to produce, cost-effectively, those goods and services the
21 commission wants to be available. Only by envisioning that desirable market structure
22 can a commission assess whether a proposed acquisition assists or impedes progress
23 toward that market structure.

24 In Part III.B.2 below, I will explain that the market structures that NextEra wants
25 for its bottom line are in conflict with the market structures the Commission hopes to
26 encourage. For now, a brief note on Hawai'i's market structure progress would be useful.

¹⁷ *The Economics of Regulation: Principles and Institutions*, Vol. II at p. 282 (1970-1971, 1988).

1 powers to act on those motivations and opportunities. If such conditions are feasible,
2 then the regulator must also find that it has the legal authority to impose those conditions.

3 The Commission also must determine whether it has the resources, and the
4 practical ability, to enforce the conditions. By "practical ability," I mean the ability to
5 impose consequences proportionate to the harm caused by a violation. Practical ability
6 does not exist if those proportionate financial consequences would have to be moderated
7 by the regulator due to the public's dependence on the wrongdoer—when the wrongdoer
8 is "too big to fail."¹⁸ A transaction that puts the regulator in this position of "moral
9 dilemma"—a position of weakness—conflicts with the public interest because it disables
10 the regulator from protecting the public interest.

11 On these four major areas—business activities, corporate structure, financial
12 structure, and market structure—I am not aware that the Commission has an express
13 policy. Until now, it hasn't needed one; because, I assume, it was satisfied with HEI's
14 relatively simple corporate picture. A NextEra acquisition would change this picture,
15 literally overnight. In control of the simply structured HEI would be a company with
16 over 900 subsidiaries, one with a major monopoly in Florida and competitive generation
17 companies throughout the U.S., one with 6174 MW of nuclear generation, one that is

¹⁸ See, e.g., *Gulf States Utilities Co. v. Louisiana Pub. Serv. Comm'n*, 578 So.2d 71 (La. 1991) (upholding commission decision to allow imprudent costs in rates due to concern over the utility's solvency); *Decision on Fines and Remedies to be Imposed on Pacific Gas and Electric Company for Specific Violations in Connection with the Operation and Practices of its Natural Gas Transmission System Pipelines*, Decision 15-04-024 at sec. 5.3.3 (Calif. Pub. Utils. Comm'n Apr. 9, 2015) ("There is no dispute that the Commission must consider PG&E's financial resources in setting the penalty amount").

1 seeking to buy not only HEI but an electric distribution monopoly owned by a bankrupt
2 holding company in Texas.¹⁹ And because NextEra already does business in Hawai‘i, as
3 a developer of generation and transmission, this transaction is simultaneously a vertical
4 merger and a horizontal merger, raising a host of competition concerns that I address in
5 Part III.B.2.b below. So the acquisitions policy that was not necessary with the simple
6 HECO will be necessary before approving control by the complicated NextEra.

7 The above-mentioned characteristics—business activities, corporate structure and
8 culture, financial structure, and market structure— address the features of the post-
9 acquisition entity. There is a whole other category of issues requiring attention: issues
10 relating to the acquisition transaction itself. Any merger of companies involves benefits
11 and costs. These benefits and costs occur at different points in time with varying levels
12 of predictability, certainty, and visibility. I recommend the Commission develop a policy
13 concerning the types of benefits that will be counted, the types of costs that will be
14 counted, and a methodology for discounting the stream of future benefits and costs so as
15 to arrive at a credible net present value to customers. Also essential is a policy on the
16 appropriate relationship of benefits to cost: Must the benefits be merely equal to cost;
17 must they exceed cost by some specified margin; or should we treat the benefit-cost
18 relationship for consumers the way the financial world treats it for investors—that is,
19 seeking the most favorable benefit-cost ratio?

¹⁹ As discussed in Part III.C.6.

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III.
NextEra's Acquisition of HECO's Monopoly
Conflicts with Hawai'i's Needs

A. Overview: The meaning of harm

Q. In the context of public utility regulation, what is the meaning of "harm"?

A. In the context of public utility regulation, "harm" occurs when the incumbent utilities, or the markets that are subject to commission regulation, fail to provide high-quality service cost-effectively. If the government grants a utility protection from competition, the utility must perform as if subject to competition. It must make all feasible, cost-effective efforts to reduce costs and increase quality.

When a merger or acquisition interferes with that obligation, it can cause two distinct types of harm: status quo harm and opportunity cost harm. I discuss each type of harm next.

1. Status quo harm

Q. Explain what you mean by status quo harm.

A. Status quo harm occurs if the transaction diminishes benefits available from the pre-acquisition array of assets and ownership. An acquisition involving a public utility can create at least four kinds of status quo harm.

1. As the holding company's acquisitions grow, the attention paid to each utility by the holding company's leadership—the CEO, executive team, and board—necessarily diminishes. As those individuals become responsible for more businesses and more assets, a utility's specific needs fall in their priorities. Those priorities can conflict with each other, particular when capital resources are scarce.

1 2. As the corporate family invests in ventures less financially secure than state-
2 regulated, monopoly distribution service, the investor portrait can change. Conservative
3 investors—those who buy-and-hold patiently, content with stable dividends and stable
4 share value or modest growth—no longer can treat the corporate family as a predictable
5 place to put their money. A different type of investor enters: one seeking higher-risk,
6 higher-return opportunities. These new investors can bring pressures on the corporate
7 family leadership for more growth. That additional growth requires additional risks,
8 thereby affecting the leadership's priorities and drawing its attention further away from
9 the core utility business. Also, bond rating agencies can no longer give consistently
10 stable ratings based on operational performance and regulatory treatment, because the
11 family's financial health is no longer based solely on those relatively predictable
12 variables. I will discuss this issue further in Part III.C. below.

13 3. To the extent the holding company is acquiring non-utility businesses, utility
14 employees may believe that the best path to advancement is not through the traditional
15 utility activities, but instead through non-utility activities and "corporate strategy." So
16 the traditional utility risks losing good utility workers—people whose development was
17 funded by customers' rate payments—to non-utility ventures. Essential craftspeople—
18 women and men who make things work—face more job risk, because failures in the
19 unrelated businesses can cause the utility to reduce or defer maintenance and
20 modernization. That greater job risk can make recruitment more difficult. It also can
21 deprive the state of the embedded expertise it needs to attract more businesses.

22 4. Where the acquisition gives the incumbent utility a financial incentive to raise
23 entry barriers, there is harm to the potential for competition—the force our economy

1 relies on to improve and diversify service at reasonable prices. The harm can be direct
2 (by allowing incumbents to raise prices, reduce quality, or slow innovation without fear
3 of losing sales to competitors) or indirect (by discouraging prospective entrants, who will
4 view the jurisdiction as uncommitted to competition on the merits).

5 **2. Opportunity cost harm**

6
7 **Q. Explain what you mean by opportunity cost harm.**

8
9 **A.** In the context of utility acquisitions, opportunity cost harm occurs if the proposed
10 transaction displaces some other opportunity that would produce more benefits to the
11 public. A utility is obligated to provide service at a quality and cost comparable to what
12 competition would produce. If a transaction diverts or displaces resources from more
13 productive uses, thereby incurring what economists call "opportunity cost," it fails this
14 test.²⁰

15 In competitive markets, transactions that involve opportunity cost have less
16 success than transactions that do not, all else equal. In the utility acquisition context,
17 disregarding this type of harm violates the principle that regulation should induce
18 performance comparable to what would be produced by competition.

19 **Q. How does the concept of opportunity cost harm apply to utility acquisitions?**

20
21 **A.** A utility acquisition proposal arises, directly or indirectly, explicitly or implicitly, from a
22 competition for control: acquirers competing for control of a target. The target has a
23 fiduciary obligation to pick the acquirer that offers the most to the target's shareholders.

²⁰ "[T]he opportunity cost of an item—what you must give up in order to get it—is its true cost." Krugman, P. R., and R. Wells, *Microeconomics: Third Edition* (Macmillan 2012).

1 But if the target pursues that fiduciary obligation to its shareholders while ignoring its
2 service obligation to its customers, it will choose the acquirer offering the highest price
3 rather than the acquirer promising the best service. Selecting the wrong merger partner
4 necessarily precludes selecting the right merger partner (from the customers' perspective).
5 The resulting loss of benefits is opportunity cost—harm. To see it otherwise, to be
6 indifferent to the opportunity cost, is to allow the merging companies' interests to prevail
7 over the consumers' interest. That is not a public interest outcome.

8 **Q. How will you apply these concepts of status quo harm and opportunity cost harm to**
9 **the instant transaction?**

10
11 **A.** I will describe six sources of harm, as follows:

12 NextEra's "business model"—controlling vertically integrated monopolies while
13 seeking competitive advantage—conflicts with Hawai'i's need for diversity and
14 competition;

15
16 NextEra's business activities—current and future, known and unknown—cause
17 risk to Hawai'i's utilities and their customers;

18
19 The acquisition diminishes the Hawai'i utilities' importance to their holding
20 company owner;

21
22 The character and goals of NextEra's shareholders—and the pressure they put on
23 Hawai'i's utilities—will change in unknown ways;

24
25 HECO's decisions will be subject to NextEra's control;

26
27 This transaction conflicts with Hawai'i's needs because HEI's actions conflicted
28 with Hawai'i's needs.

29
30 Each of these sources can cause status quo harm (by reducing the efficiency of current
31 operations) and opportunity cost harm (by precluding other structural options that would
32 increase the efficiency of current and future utility operations). These harms should not
33 surprise, because as I explain in Part III.G, in choosing NextEra HEI acted on
34 motivations that conflicted with Hawai'i's needs.

1 **B.** *NextEra's "business model"—controlling vertically integrated monopolies*
2 *while seeking competitive advantage—conflicts with Hawai‘i's need for*
3 *diversity and competition*
4

5 **Q.** **How will you address the concerns over NextEra's business model?**

6
7 **A.** In this subsection, I explain first that Hawai‘i's energy future depends on competition and
8 choice. But NextEra's business model for Hawai‘i—owning monopoly assets in a market
9 while seeking competitive advantage in that same market—is inconsistent with
10 competition and choice. NextEra argues that the Commission's rules on inter-affiliate
11 transactions prevent harm, but I will explain how abuse can occur due to the difficulties
12 of detection and the lack of clear consequences for noncompliance. I will conclude this
13 subsection by arguing that the Commission should not make long-lasting, competition-
14 reducing market structure decisions in an acquisition case.

15 **1.** *Hawai‘i's energy future depends on accommodating competition and*
16 *choice*
17

18 **Q.** **What is the connection between Hawai‘i's energy future, and the possibilities for**
19 **accommodating competition and choice?**

20
21 **A.** The traditional market structure model of the vertically integrated, retail monopoly stands
22 in contrast to several trends. One trend is technology that encourages and accommodates
23 competition and choice in the traditionally monopolistic sector of distribution services. A
24 second is the thirty-year trend toward generation competition that has caused formerly
25 vertically integrated utilities to buy generation products through competitive bidding.
26 The third trend is consumer and community awareness that instead of depending solely
27 on a retail monopoly provider, there are alternatives such as microgrids, municipalization,
28 and cooperatives. I do not suggest that the Commission must or should pick any of these
29 paths in this proceeding. I will explain, however, that approving this acquisition is

1 inconsistent with allowing all these options an opportunity to experiment, compete, and
2 prove themselves in a context in which decisions are based on merit rather than
3 incumbency.

4 *a. The potential for competition and choice in the distribution space*

5
6 **Q. What is the potential for competition in the distribution space?**

7
8 **A.** After a century of choicelessness, of buying a uniform electricity product from a single
9 supplier, electricity and gas customers now are gaining access to new distribution
10 technologies. These technologies can lower consumers' costs, raise their comfort, and
11 shrink their environmental footprints. New companies are offering thermostat controls,
12 time-of-use pricing, and renewable energy packages, among other products. Consumers
13 are self-supplying with solar panels. Neighborhood-level microgrids and customer-
14 shared supply arrangements may also become feasible, both physically and economically.
15 Aggregators of demand response are offering to pay consumers to use less, creating load-
16 shifting behaviors that can displace higher-cost generation.

17 These technological, behavioral, and market forces are stimulating discussion of
18 one of regulation's most important questions: What market structures—what mixes of
19 competition, monopoly, and regulation—will produce the most customer-responsive
20 array of distribution services at reasonable cost? For example, Maine is exploring
21 whether to appoint a "smart grid coordinator"; New York is examining the possible roles

1 for a "distribution system platform provider."²¹ Both jurisdictions are examining whether
2 to make this new service provider an entity other than the incumbent utility.

3 Similar questions are raised in the Commission's *Inclinations* order. But there is
4 tension between continuing to ask these questions, and approving an acquisition by a
5 company who has cited these very questions as business risk—meaning, something to
6 avoid.²²

7 ***b. The potential for generation competition***

8
9 **Q. What is the potential for generation competition in Hawai‘i?**

10
11 **A.** The potential for generation competition in Hawai‘i, stimulated initially by PURPA 1978,
12 is embodied in the Commission's competitive bidding rules. But consider how the
13 NextEra acquisition changes the playing field. HECO will be controlled²³ by a holding
14 company that has paid a \$568 million control premium. It paid that premium based on its
15 expectation of the value that will flow from making profit-earning investments in
16 Hawai‘i. Those investments necessarily include generation investments. In the
17 competitions to develop new generation, NextEra will have an advantage because under

²¹ See, e.g., *Investigation into Need for Smart Grid Coordinator and Smart Grid Coordinator Standards*, Maine Public Utilities Commission Docket Number 2010-267; and *Order Adopting Regulatory Policy Framework and Implementation Plan*, Case 14-M-0101 (N.Y. Pub. Serv. Comm. Apr. 24, 2014).

²² See, e.g., Applicants' Ex. 10 (NextEra's 2014 10-K Report to the SEC) at 32: "Any changes in Florida law or regulation which introduce competition in the Florida retail electricity market, such as government incentives that facilitate the installation of solar generating facilities on residential or other rooftops at below cost, or would permit third-party sales of electricity, could have a material adverse effect on FPL's business, financial condition, results of operations and prospects."

²³ I discuss how HECO will be controlled by NextEra in Part III.F below.

1 the banner of "bringing its experience to HECO"²⁴ it will be teaching HECO how to
2 design requests for proposals, how to assess competitors' bids, how to favor those
3 competitors that NextEra favors, and how to favor NextEra. All this teaching can occur
4 outside the competitive bidding process, beyond the limited eyesight of the independent
5 monitor. All this teaching can be paid for by ratepayers, because it consists of NextEra or
6 FPL costs allocated to HECO through an intercompany cost allocation agreement. That
7 opportunity—to teach HECO how to favor NextEra, and to have ratepayers pay for the
8 teaching—will not be available to independent competitors.

9 *c. The possibilities for microgrids, municipalization, and*
10 *cooperatives*

11
12 **Q. What are the possibilities for microgrids, municipalization, and cooperatives?**

13
14 **A.** Dissatisfaction with HECO's performance is converging with two industry facts: the
15 technological potential for microgrids, and a renewed interest in municipalities and
16 consumer cooperatives providing service to their residents or members on a nonprofit
17 basis.²⁵

18 One need not be an advocate for microgrids or municipalization to agree that the
19 public interest is objectively served by a vibrant competition among ideas for the
20 industry's future. Experimenting with alternatives is a necessary part of that competition,
21 because there is no one clear answer to the question "What market structures will serve

²⁴ See, e.g., the Direct Testimony of Alan Oshima. He mentions NextEra's "experience" eight times.

²⁵ See, e.g., HREA-IR-2 (asking about NextEra's interest in spinning off MECO or HELCO to become a municipally-owned or utility cooperative utility).

1 our community most effectively?" The U.S. electric industry has always had a
2 competition among the various forms of electric utility ownership—investor-owned,
3 state-owned, municipality-owned, national government-owned, and cooperatively owned.
4 Now we are having a different debate—about whether it is necessary, as a matter of
5 economics and engineering—for one company to control an entire service territory, or
6 whether instead particular areas can serve themselves in whole or in part. With this
7 debate just beginning, it is illogical to transfer control to a company whose business
8 model—the vertically integrated monopoly—heads in the opposite direction.²⁶

9 On these topics, the Commission therefore should be concerned about NextEra's
10 dismissiveness. HREA-IR-2 asked about the possibility of spinning off MECO or
11 HELCO to a municipally-owned or cooperative utility. The Applicants did not take the
12 question seriously. They "*believe* the customers of three utilities are best served if the
13 three utilities remain part of one enterprise."²⁷ But "belief" is not a basis for a serious
14 conversation about ownership structures. Applicants then turned from dismissiveness to
15 threat—saying that if "MECO, HELCO, or any other part of the businesses and assets [of
16 HEI, other than the bank]" were removed, NextEra might walk away from the
17 transaction, "and the benefits it would bring for customers of the Hawai‘ian Electric
18 Companies could potentially be lost."²⁸ Threats are not conducive to the type of
19 discussion Hawai‘i needs to produce the best ideas. NextEra gives no reason why, if it

²⁶ As I explain in Part III.B.2 below.

²⁷ Response to HREA-IR-2 (emphasis added).

²⁸ *Id.*

1 acquired HECO without MECO or HELCO, it could not bring Hawai'i the benefits it
2 claims it can bring. Lacking facts or policy, NextEra's statement is merely a statement of
3 self-interest.

4 The Applicants then turn to municipalization. They declare, again without factual
5 support, that municipalization is "unlikely to produce benefits to all customers and, in
6 fact, [is] likely to increase costs to at least some customers, namely residential
7 customers."²⁹ This is the intellectual equivalent of schoolboy name-calling. Worse, in
8 fact, because it omits the fact that 2000 public sector entities have served 21.4 million
9 customers (companies and households—the number of humans is much higher), most of
10 them for decades and many since the electric industry's beginnings a century ago.³⁰ If
11 municipal ownership had only "illusory advantages," as Applicants put it (*id.*), municipal
12 systems would not likely have lasted in such large numbers for so many years.

13 Applicants then say that "[m]unicipalization efforts tend to take 5 to 10 years or longer"
14 (*id.*), without noting that these long time periods are due in part to opposition from the
15 incumbent investor-owned utility. Applicants then talk about the "years" it takes to
16 "replicate/duplicate the investor-owned assets necessary to provide that service." But the
17 efficient approach to municipalization is to buy the assets that exist, not "replicate" or
18 "duplicate" them. Again, one need not be an advocate of municipal systems or

²⁹ *Id.*

³⁰ See <http://www.publicpower.org/about/index.cfm?navItemNumber=37583>.
The figures ultimately from the Energy Information Administration in the U.S.
Department of Energy.

1 cooperatives to be concerned about the factual omissions, the reflexive dismissiveness,
2 the lack of curiosity and the overt self-interest that permeates Applicants' response.

3 Finally, Applicants say that "There is absolutely no reason to believe that a newly
4 formed cooperative or municipal electric department will be able to manage any portion
5 of the Hawaiian Electric Companies' system better than NextEra Energy can."³¹ Maybe
6 yes, maybe no. The opposite could be true also, as evidenced by KIUC. As the
7 Commission has noted, KIUC, in "contrast" to HECO, "has clearly articulated a strategic
8 vision and made substantial progress in achieving their goals,"³² and "has been able to
9 manage utility operations over the last decade with far fewer, and substantially less, base
10 rate increases than each of the HECO companies."³³ Hawai'i needs a healthy, open-
11 minded period of debate and experimentation, not an intellectual door-slammung
12 accompanied by non-factual statements, accompanied by an insistence on total
13 acquisition of total control of all HECO assets.

14 * * *

15 **Q. Why is this potential for competition and community choice relevant to NextEra's**
16 **proposed acquisition of the HECO utilities?**

17 **A.** In distributed resource markets, the fragile, nascent status of competition makes it
18 vulnerable to companies with an economic stake in preventing or delaying that
19 competition. Standalone, HECO might have been content to play the role of a small
20

³¹ *Id.*

³² *Inclinations* at 2.

³³ *Id.* at 2 n.3.

1 holding company owning neutral providers of monopoly platform services that facilitate
2 and accommodate new technologies, diverse suppliers, and customer self-supply. But
3 NextEra has different goals—goals whose achievement are in tension with diverse and
4 competitive distribution services markets, and with the incoming companies that could
5 make those markets diverse and competitive. I discuss this tension next.

6 **2. *NextEra's business model for Hawai'i—owning monopoly assets while***
7 ***seeking competitive advantage—is inconsistent with competition and***
8 ***choice***

9
10 **a. *NextEra's business model: owning assets in vertically integrated***
11 ***monopoly markets***

12
13 **Q. What is your understanding of NextEra's business model, and its application to**
14 **Hawai'i?**

15
16 **A.** The Applicants say NextEra will help HECO meet its goals. But NextEra is not a
17 consulting firm. It does not make its money by giving advice. It makes its money by
18 owning assets, and from those assets, making sales. It owns those assets and makes those
19 sales in markets that are subject to regulation because of the presence of a monopoly.

20 Therefore, NextEra's ownership and sales can or could occur in one of three contexts:

- 21 1. sales from monopoly assets into monopoly markets (*e.g.*, FPL, a vertically
22 integrated monopoly owning most of the generation whose output, making
23 sales to its captive retail customers);
24
25 2. sales from competitive assets to monopoly purchasers under long-term
26 contracts approved by the monopoly's regulators (*e.g.*, NextEra Energy
27 Resources owning generation and entering long-term wholesale sales
28 contracts with state-regulated utilities that have gotten state regulatory
29 approval to recover the wholesale purchase costs from their captive
30 customers); or
31
32 3. sales from competitive assets in competitive markets, in which NextEra
33 owns monopoly assets, the access to which is essential to competition
34 (*e.g.*, post-acquisition, a NextEra affiliate competing to sell solar panels or
35 storage facilities in a Hawai'i market, while controlling HECO's
36 distribution and transmission systems).

1
2 This business model—owning and selling from assets in markets where monopoly
3 regulation exists—is the explicit foundation for NextEra's financial goals. NextEra's
4 money flow comes from owning assets under regulatory conditions that allow those
5 assets to produce earnings at relatively low risk:

6 Over the past few years, NEE has been de-emphasizing merchant power
7 activities, and focusing instead on lower-risk contracted or regulated
8 businesses in a credit-positive strategic shift.³⁴
9

10 NEE is seeking new shareholder growth avenues beyond the next few
11 years of identified projects and to circumvent the industry outlook for flat-
12 to-declining power sales due to energy efficiency and new technologies.
13 The company also wants to reduce business risk by increasing the
14 proportion of regulated and contracted assets.³⁵
15

16 In regulated markets, the way to avoid "flat" earnings from "flat-to-declining power
17 sales" is to own assets; and then either put them in a regulated monopoly's rate base or
18 persuade that monopoly to buy the output under a long-term contract approved by
19 regulators. That is why NextEra is buying HECO: to own assets, and either put them in
20 HECO's rate base or persuade HECO to buy the output under long-term contracts.
21 NextEra's expectation is it will have more opportunities to execute that strategy if it owns
22 HECO than if it continues in Hawai'i as an independent developer. Otherwise, NextEra
23 would not be offering \$4.3 billion to buy the three utilities.³⁶

³⁴ Response to PUC-IR-32 (Moody's, 28 Apr. 2015, p.2/7).

³⁵ Response to PUC-IR-32 (Moody's, 28 Apr. 2015, p.3/7).

³⁶ See Response to OP-IR-21 ("The total value of the Proposed Transaction, approximately \$4.3 billion, reflects NextEra Energy's expectations regarding the future value of the Hawai'ian Electric Companies, including the future earnings prospects of those companies....").

1 So NextEra's preferred path, its business model, is to grow earnings by owning
2 vertically integrated monopolies:

3 . . . NextEra Energy supports the vertically integrated model, as
4 supplemented in Hawai'i by competition for new utility-scale generation
5 projects and customer-sited distributed generation options, as a model that
6 is better suited than the alternative (which is inferred in this information
7 request) to deliver the provision of clean, affordable, reliable energy to the
8 customers served by Hawai'i's small island grids.³⁷

9
10 Jim Robo: (Michael), I think this [acquisition of HECO] is very consistent
11 with our - what our strategy has been for a long time, which is to be
12 focused on both regulated operations, as well as on renewables. And I
13 think this is a very unique opportunity for us to *combine those two - those*
14 *two strategies into one opportunity*.³⁸

15
16 ***Combining those two strategies into one opportunity***—that is NextEra's goal, the
17 purpose of this acquisition, the value supporting the \$4.3 billion price. The "two
18 strategies" are owning renewables and controlling regulated assets; the "one opportunity"
19 is to control a vertically integrated monopoly in a state that wants to boost renewables.
20 Mr. Robo's reasoning is impeccable—for his company. But if Hawai'i's vision is to
21 achieve its renewable goals not by increasing its dependence on a Robo-controlled
22 HECO,³⁹ but by diversifying suppliers and empowering consumers, NextEra's business
23 model heads in the wrong direction.

³⁷ Response to COM-IR-7.

³⁸ NextEra Energy/Hawai'ian Electric Industries/December 3, 2014 6:00 p.m. ET (emphasis added).

³⁹ See Part III.F below, explaining that the NextEra-HECO relationship will be hierarchical: the Hawaiian utilities' CEOs will report to Mr. Robo.

1 Once it controls HECO, NextEra's business model calls for it to enter the Hawai'i
2 markets both vertically and horizontally. I explain these concepts next.

3 ***b. NextEra's plans in Hawai'i: Enter vertically and horizontally***

4
5 **Q. How do you characterize this transaction?**

6
7 **A.** On the surface, this transaction looks like a Florida holding company buying a Hawai'i
8 utility—a geographic extension merger. But on examining NextEra's activities, both
9 current and future, one sees that the transaction is both a vertical merger and a horizontal
10 merger, in which the intent is to both expand existing and create new earnings
11 opportunities arising from control of a vertically integrated utility.

12 **Q. Define vertical merger and horizontal merger.**

13
14 **A.** A vertical merger combines a company in an "upstream" (input) market with one in a
15 "downstream" (output) market. The first company is providing an upstream input
16 essential to the production of the downstream output: McDonald's creating a cattle-
17 raising affiliate to supply its hamburger operation; or a generation company merging with
18 a distribution monopoly to supply its power. A horizontal merger combines two
19 companies that provide the same or similar products (*i.e.*, products that are reasonable
20 substitutes for each other), as in a company that owns generation merging with another
21 company that owns generation.

22 In the next two subsections I will explain how NextEra's acquisition has, or can
23 have, both vertical and horizontal features.

i. Vertical features

1
2
3 **Q. In what ways might the proposed acquisition have vertical features?**

4
5 **A.** In at least two ways. First, NextEra has been developing a grid-tie undersea cable system
6 to interconnect Oahu and Maui.⁴⁰ The cable would be an "upstream" input to the
7 distribution services provided by HECO and MECO. It would also be a "downstream"
8 vehicle by which NextEra-owned generation located on either island could reach the
9 HECO and MECO distribution facilities controlled by NextEra.

10 The second way relates to ancillary services. Ancillary services are generation
11 services necessary to maintain the stability of the transmission system.⁴¹

⁴⁰ Response to CA-IR-6, CA-IR-174.

⁴¹ The mandatory tariff accompanying Order No. 888 (Order No. 888, 75 FERC para. 61,080 at app. D, sec. 3 (1996)), issued by the Federal Energy Regulatory Commission, defines and describes six ancillary services as follows:

1. Scheduling, System Control and Dispatch Service ("This service is required to schedule the movement of power through, out of, within, or into a Control Area.")
2. Reactive Supply and Voltage Control from Generation Sources Service ("In order to maintain transmission voltages on the Transmission Provider's transmission facilities within acceptable limits, generation facilities (in the Control Area where the Transmission Provider's transmission facilities are located) are operated to produce (or absorb) reactive power.")
3. Regulation and Frequency Response Service ("Regulation and Frequency Response Service is necessary to provide for the continuous balancing of resources (generation and interchange) with load and for maintaining scheduled Interconnection frequency at sixty cycles per second (60 Hz). Regulation and Frequency Response Service is accomplished by committing on-line generation whose output is raised or lowered (predominantly through the use of automatic generating

1
2 They are necessary input to the final bundle of electric service provided to retail
3 customers. NextEra has explained that its subsidiary, NextEra Energy Resources, LLC
4 (NEER) sells varied forms of ancillary services in various power supply markets. As an
5 example, NEER "owns and operates two battery energy storage systems that sell
6 frequency regulation services in the PJM market...."⁴²

7 *ii. Horizontal features*

8
9 **Q. In what ways does the proposed acquisition have horizontal features?**

10
11 **A.** HECO of course owns much of the generation serving its customers. NextEra also is
12 involved in generation, as follows:

control equipment) as necessary to follow the moment-by-moment changes in load.")

4. Energy Imbalance Service ("Energy Imbalance Service is provided when a difference occurs between the scheduled and the actual delivery of energy to a load located within a Control Area over a single hour.")
5. Operating Reserve-Spinning Reserve Service ("Spinning Reserve Service is needed to serve load immediately in the event of a system contingency. Spinning Reserve Service may be provided by generating units that are on-line and loaded at less than maximum output.")
6. Operating Reserve-Supplemental Reserve Service ("Supplemental Reserve Service is needed to serve load in the event of a system contingency; however, it is not available immediately to serve load but rather within a short period of time. Supplemental Reserve Service may be provided by generating units that are on line but unloaded, by quick-start generation or by interruptible load.")

⁴² Response to CA-IR-149.

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1. Boulevard Associates LLC is securing land leases for potential development opportunities.⁴³
2. NextEra Energy Resources, LLC (NEER) is conducting development related activities such as surveys, environmental studies, meteorological studies, etc. Additionally, NEER is bidding into Request for Proposals for the sale of renewable energy.⁴⁴
3. Ka La Nui Solar, LLC has entered into a power purchase agreement and any future development activities on that project will be conducted under this entity.⁴⁵
4. As of December 31, 2014, NextEra Energy is considering developing utility-scale wind and solar projects on O`ahu, Maui, and the Big Island.⁴⁶
5. The Big Island's Kohala Peninsula, like Kahikinui, has world class wind energy potential. NextEra Energy received approval for a wind energy lease option there.⁴⁷
6. "NextEra Energy signed a land lease [on Oahu] for a 14 MW solar project in Waianae with a local farmer to bid into Hawai`ian Electrics Application for Waiver from the Competitive Bidding Process and won as a participant in the first round of waivers."⁴⁸
7. "NextEra Energy has also investigated the potential for a large land purchase on Oahu while working with Trust for Public Lands (TPL) in support of TPL's land preservation activities...."⁴⁹

⁴³ Response to CA-IR-174.

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ Response to CA-IR-6.

⁴⁸ Response to CA-IR-6.

⁴⁹ Response to CA-IR-6.

* * *

1
2 These details are the asset flesh on Mr. Robo's strategy bones: the strategy of
3 "focus[ing] on both regulated operations [and renewables], with the intent of exploiting
4 this "very unique [sic] opportunity to combine those two." His statement necessarily
5 means this: Combine monopoly operations with competitive operations, in the same
6 market. But that type of market participant creates multiple risks to consumers and
7 competition, as discussed next.

8 *c. The risks to competition: NextEra's possible acquisition of*
9 *vertical and horizontal market power*

10
11 **Q. Given NextEra's apparent intent to grow its generation, transmission, and**
12 **distribution presence in Hawai'i, what actions by the post-acquisition entity could**
13 **conflict with Hawai'i's interest in effective competition and supplier diversity?**

14
15 **A.** With NextEra in control, the post-acquisition entity—having just paid a \$568 million
16 control premium for HECO, NextEra will want to ensure that its acquisition of HECO
17 produces greater earnings than HECO had before. One way to produce greater earnings
18 is to deter entry by newcomers who otherwise would compete for those earnings. Here
19 are four strategies available to NextEra.

20 *1. Enter one of the new distributed energy businesses early, charging low*
21 *prices that recover variable cost but not all fixed cost.* This strategy makes it hard for
22 less-resourced competitors to survive, because if they match the incumbent's price they
23 cannot recover their fixed costs. If they fail and leave, the incumbent can raise prices to
24 recover the fixed costs it did not recover in the prior period. The resulting market
25 dominance is attributable not to the utility's merits but to its access to NextEra's wealth—
26 wealth made possible due to its ownership of the government-protected FPL. NextEra
27 may argue that these discounts are appropriate because they reflect the efficiencies of

1 large size. Assuming, *arguendo*, the truth of that argument, those efficiencies are what
2 economists call "static efficiencies"—short run savings based on better uses of existing
3 infrastructure. If new entrants are discouraged from entering the market, we lose the
4 potential for dynamic efficiencies—long run cost reductions and innovations arising from
5 more vigorous competition.

6 **2. *Refuse to deal with a prospective supplier of distributed energy services.*** A
7 refusal to deal can take different forms. Suppose a seller of storage services, or a
8 company specializing in microgrids, wished to enter a HECO utility territory. Self-
9 interested behavior by UI the NextEra-controlled HECO could include refusing to
10 provide an important input, like timely interconnection, information on interoperability,
11 data on neighborhood-level load and location, or other information necessary to
12 determine the profitability of independently-provided storage. This strategy can include
13 the utility refusing to buy a service, such as storage, distributed generation output or
14 special meters, in favor of making a rate base-increasing (and therefore profit-increasing)
15 investment in a substation or distribution feeder. The refusal to deal could also be
16 indirect, such as discouraging existing customers from buying services from or selling
17 service to the prospective entrant, by offering special discounts on bundles provided by
18 the utility. A variant of refusal to deal is exclusive dealing, where a firm offers a lower
19 price to a party in exchange for its refusal to buy from or sell to the offeror's rival.

20 **3. *Create entry barriers.*** Entry barriers are "additional long-run costs [to enter a
21 new market] that were not incurred [or have already been incurred—my addition] by
22 incumbent firms but must be incurred by new entrants"; also "factors in the market that

1 deter entry while permitting incumbent firms to earn monopoly returns."⁵⁰ NextEra-
2 controlled utilities could create entry barriers by withholding customer load data or
3 expansion plans (*i.e.*, data and plans the utilities rely on for their own competitive entry).
4 Or the utilities can use proprietary protocols (funded by captive ratepayers) for
5 communications between distributed loads and their own distributed generation assets,
6 forcing others to incur the expense of creating their own protocols without the advantage
7 of ratepayer funding.⁵¹

8 The potential for electric utility incumbents to create entry barriers in the
9 distribution space was the subject of detailed study of "smart grid."⁵² The authors'
10 reasoning is readily extendable to the broader market of distributed energy resources,
11 because common to "smart grid" and the broader market are three incumbent-controlled
12 "bottleneck facilities": the "last mile," meter data, and interoperability protocols.

⁵⁰ *Rebel Oil Co., Inc. v. Atl. Richfield Co.*, 51 F.3d 1421, 1439 (9th Cir. 1995).

⁵¹ NextEra insists that its "unregulated subsidiaries are no different than any other unregulated companies and should have the same opportunities to opt in or out of the market as they determine to be in their best interests." Response to PP-IR-7(c). NextEra's unwillingness to admit the obvious—that an affiliate of a monopoly distribution company, especially an affiliate whose owner's CEO has the legal power to control the monopoly distribution company, is not "no different than any other regulated company"—should cause the Commission concern.

⁵² See Johann Kranz and Arnold Picot, *Toward an End-to-End Smart Grid: Overcoming Bottlenecks to Facilitate Competition and Innovation in Smart Grids* (National Regulatory Research Institute 2011), available at <http://www.energycollection.us/EnergyRegulators/TowardEndEnd.pdf>. The study defines "smart grid" as "a communications layer's virtual overlay on the existing power grid. This overlay allows all actors and components within the electricity value chain to exchange information, thereby facilitating supply and demand's coordination. This overlay closes the communication gap between consumers' premises and the rest of the network, but requires the deployment of an [advanced metering] infrastructure."

1 *Last mile:* The "last mile" of infrastructure, and the associated data, are essential
2 for competition but not economically duplicable by competitors:

3 End-to-end communication requires initially developing the missing
4 communications link between consumers' premises and the rest of the
5 energy network (the last mile) by deploying an Advanced Metering
6 Infrastructure (AMI), along with smart meters.... The last mile
7 infrastructure cannot be substituted or replicated within a reasonable time
8 and cost frame. Moreover, together with the meter data, the infrastructure
9 provides an essential input allowing efficient downstream markets, *i.e.*
10 complementary services, products, and applications, to emerge.

11
12 Their recommended solution is nondiscriminatory access:

13 Regulatory intervention, in the form of open (or mandated) access, is
14 needed to secure transparent and non-discriminatory third party access to a
15 smart grid's last mile infrastructure.... If the entry does work out, the
16 transitory entry assistance can be gradually withdrawn to increase the
17 entrants' economic and strategic incentives to invest in their own
18 infrastructure.

19
20 *Meter data:* Non-duplicable bottlenecks can consist not only of tangible assets
21 like poles and wires, but also "intangible" assets like—

22 intellectual property rights, such as proprietary standards, protocols, or
23 interfaces.... The data retrieved from smart meters can also be regarded as
24 essential inputs for authorized actors. The data aids them in improving
25 grid management and monitoring, streamlining business processes, and
26 enabling innovative energy efficiency measures and value-added services.

27
28 These conditions create the recipe for actions by incumbent utilities to block competitors,
29 who can—

30 deter entry by raising rivals' costs through practices such as exclusive
31 dealing, refusals to deal, tying, or defining of proprietary protocols and
32 standards to artificially increase rivals' transactions and consumers'
33 switching costs.... They could also define incompatible data formats or
34 interfaces for each distribution area, or they could intentionally delay data
35 access and provision.

36
37 Their recommended solution is data access:

1 ...[T]o enable an efficient applications market in a future smart grid
2 requires that all authorized parties are guaranteed equal access to an
3 (online) data platform to recall data in (1) as close to real time as possible,
4 (2) a standardized and machine-readable format, and (3) the same
5 granularity in which it is collected (European Regulators Group for
6 Electricity and Gas 2007).⁵³

7
8 ...

9
10 Furthermore, consumers should have access to this data and determine the
11 respective parties' data access rights if the information needs to go beyond
12 essential data for billing, or essential technical information.

13
14 Another structural solution is to place data access questions within the control of an
15 independent platform or party:

16 Several regulatory agencies have recommended establishing an
17 independent data platform accessible to third parties, or have already
18 established such a platform. Others have suggested that the function of
19 data collection, management, and access should be completely decoupled
20 by establishing an independent and neutral data service provider....
21 Moreover, an independent single platform provider may be able to provide
22 the data more cost-effectively, due to economies of scale. This provider
23 can also perform tasks such as meter registration and consumer switching.

24
25 *Interoperability:* New entrants need to connect to and communicate with the
26 distribution system's components:

27 Data's seamless exchange requires open and nonproprietary standards and
28 communication protocols that allow each component and actor within the
29 smart grid to communicate end-to-end.... [P]rotocols and standards can
30 resemble essential inputs (Renda 2004, Renda 2010).... Open systems
31 benefit modular innovation, the number of potential market entrants, and
32 market dynamics.... [Incumbent utilities] may use protocols and standards

⁵³ Citing Smart Metering with a Focus on Electricity Regulation, available at :
http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Customers/2007/E07-RMF-04-03_SmartMetering_2007-10-31_0.pdf.

1 as strategic weapons to build closed systems in which they safeguard
2 interface information.⁵⁴
3

4 Their recommended solution is open standards:

5 Data's seamless exchange requires open and nonproprietary standards and
6 communication protocols that allow each component and actor within the
7 smart grid to communicate end-to-end. As mentioned before, protocols
8 and standards can resemble essential inputs (Renda 2004, Renda 2010)....
9 Open systems benefit modular innovation, the number of potential market
10 entrants, and market dynamics....
11

12 ***4. Bundle products or services for customers while denying the bundling***

13 ***opportunity to competitors.*** Customers and suppliers of distributed energy resources will
14 need input services, such as physical distribution, billing services, interconnection,
15 storage, or supplemental and backup energy, in order to present consumers with an
16 attractive bundle. The Commission's telecommunications experts will recall that 47
17 U.S.C. sec. 251, added to the Communications Act of 1934 by the Telecommunications
18 Act of 1996, required each incumbent local exchange carrier (ILEC) to offer to
19 competitive local exchange carriers (CLECs) a series of "unbundled network elements"
20 and other input options. This requirement's purpose was to prevent the ILEC from using
21 its control of those elements and options to gain an unearned competitive advantage in
22 the developing markets for local phone service.

23 An element need not be a non-duplicable asset to provide a competitive
24 advantage; it can be, as noted in the discussion of entry barriers above, any "factor[]" in

⁵⁴ Citing Renda, A., "Catch me if you can! The Microsoft saga and the sorrows of old antitrust," *Erasmus Law and Economics Review*, Vol. 1, No. 1, pp. 1-22; and Renda, A., "Competition-regulation interface in telecommunications: What's left of the essential facility doctrine," *Telecommunications Policy*, Vol. 34, No. 1-2, pp. 23-35.

1 the market that deter[s] entry while permitting incumbent firms to earn monopoly
2 returns." By controlling HECO, NextEra will have opportunity and incentive to deny
3 these bundling opportunities to its competitors in various distributed energy resources
4 markets.

5 These four strategies will be available to the NextEra-controlled utilities not
6 because of their (or NextEra's) inherent comparative ability or even random luck, but
7 because of two factors: their history of regulatory protection from competition; and their
8 affiliation with NextEra, which will have the motivation and ability to finance these
9 strategies and the corporate governance power to direct them.

10 **Q. Are these practices prohibited by federal antitrust law?**

11
12 **A.** Not necessarily. Section 2 of the Sherman Antitrust Act, 15 U.S.C. sec. 2, prohibits
13 "monopolizing" or "attempts to monopolize." Not every incumbent effort to exploit its
14 government-granted advantages necessarily constitutes monopolizing. Where a market is
15 competitively immature, and where an incumbent in that market has advantages not
16 gained through merit but through government protection, behavior that does not
17 technically violate antitrust law can still prevent that market from becoming competitive.

18 **Q. Is it premature to consider these competitive concerns in this proceeding?**

19
20 **A.** No. It is important for the new distributed energy products to be cost-effective;
21 otherwise, consumers will hesitate to shift the loyalties from the incumbent to new
22 suppliers. The new products will more likely be cost-effective if they are subjected to
23 vigorous distribution-level competition, wherever competition is feasible and economical.
24 But distribution-level competition is unlikely to be welcomed by a utility that has
25 historically been protected from competition, especially when controlled by a holding

1 company that tells investors there will be continued profit growth due to growing
2 investment in low-risk, regulated environments.

3 The history of regulated industries has ample examples of the hard regulatory
4 work necessary to prevent (or remedy, when prevention has failed) the market distortions
5 arising from an incumbent's simultaneous ownership of monopoly and competitive
6 facilities—which is what NextEra intends here. Specifically:

7 1. "Pipelines were using their market power in the transportation market to
8 discriminate (indirectly) in the sale of gas, a commodity that Congress had concluded was
9 produced under roughly competitive conditions."⁵⁵

10 2. FERC's Order 888, mandating nondiscriminatory access to transmission
11 facilities on the mainland, contained an Appendix C entitled "Allegations of Public
12 Utilities Exercising Transmission Dominance"). FERC listed there several dozen
13 examples, contributed by aggrieved transmission customers, of "refusals to wheel,
14 dilatory tactics that so protracted negotiations as to effectively deny wheeling, refusals to
15 provide service priority equal to native load, or refusals to provide service flexibility
16 equivalent to the utility's own use." Order No. 888, 75 FERC para. 61,080 (1996), App.
17 C.

18 3. The Telecommunications Act of 1996 subjected incumbents to "a host of
19 duties intended to facilitate market entry," including sharing their "networks" with

⁵⁵ *Associated Gas Distribs. v. FERC*, 824 F.2d 981, 1010 (D.C. Cir. 1987)
(summarizing FERC decisions).

1 competitors.⁵⁶ These provisions were necessary because the 1984 breakup of AT&T,
2 requiring divestiture of its local exchange carriers from its long distance and equipment
3 company, "did nothing . . . to increase competition in the persistently monopolistic local
4 markets, which were thought to be the root of natural monopoly in the
5 telecommunications industry."⁵⁷ As the Supreme Court explained, in words that can
6 readily apply to markets for distributed energy resources:

7 It is easy to see why a company that owns a local exchange . . . would
8 have an almost insurmountable competitive advantage not only in routing
9 calls within the exchange, but, through its control of this local market, in
10 the markets for terminal equipment and longdistance calling as well. A
11 newcomer could not compete with the incumbent carrier to provide local
12 service without coming close to replicating the incumbent's entire existing
13 network, the most costly and difficult part of which would be laying down
14 the last mile of feeder wire, the local loop, to the thousands (or millions)
15 of terminal points in individual houses and businesses. The incumbent
16 company could also control its local-loop plant so as to connect only with
17 terminals it manufactured or selected, and could place conditions or fees
18 (called access charges) on long-distance carriers seeking to connect with
19 its network. In an unregulated world, another telecommunications carrier
20 would be forced to comply with these conditions, or it could never reach
21 the customers of a local exchange.⁵⁸
22

23 The Applicants might argue that these competitive concerns are premature
24 because unlike Maine and New York, Hawai‘i has not yet opted to investigate market
25 structure options for distributed energy resources. The premise is wrong; the *Inclinations*
26 Order expresses interest in depending on HECO less. Even if the premise were correct,
27 these concerns are not premature. This acquisition changes the competitive picture just

⁵⁶ *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366, 371 (1999).

⁵⁷ *Verizon Communications v. FCC*, 535 U.S. 467, 475-76 (2002).

⁵⁸ *Verizon Communications*, 535 U.S. at 490-91 (footnotes omitted).

1 by taking place. Any potential competitor, knowing of NextEra's motivation and ability
2 to adopt the strategies I have described, and seeing the Commission approve the
3 transaction without addressing these concerns, will have less optimism about competitive
4 opportunities in Hawai'i.

5 In short, it makes more sense to create pro-competitive conditions at the outset,
6 than to allow structures that undermine competition and try to undo the effects
7 afterward.⁵⁹

8 **Q. What if NextEra says it will behave appropriately?**

9
10 **A.** Words don't reduce risks. We can assume, for purposes of argument, that the NextEra
11 officials who sign interrogatory responses and testify before the Commission will not
12 break the rules. But the rule-breakers in these situations are not necessarily those senior
13 officials. In large companies, there can be thousands of employees for whom the
14 incentives to misbehave are sufficiently strong, the chance of detection sufficiently small,
15 and the penalties for misbehaving sufficiently weak, that misbehavior will happen. As I
16 explain in Part III.B.3.d.(ii) below, NextEra's readiness to deter employee misbehavior is
17 unpersuasive.

18 **Q. Couldn't the Commission address these risks by approving this transaction and then**
19 **investigating the potential for competition in distribution services?**

20
21 **A.** Yes in theory, but no in practice. If the Commission approved the acquisition, then
22 discovered the post-acquisition entity undermining distribution-level competition, what

⁵⁹ See, e.g., Federal Communications Commission, WT Docket No. 11-65, "Staff Analysis and Findings" on the proposed (later withdrawn) AT&T and T-Mobile merger (2011) (citing T-Mobile's "disruptive" innovations in retail products and pricing as a reason to keep the companies separate).

1 could the Commission do? It could, I suppose, require NextEra to divest HECO,
2 assuming the Commission had reserved that power as a condition of approval (a
3 reservation I recommend in Part VI.B.3.b.). But that after-the-fact action, dramatic as it
4 is, would not necessarily bring back those prospective competitors who, discouraged by
5 NextEra's actions, already had left Hawai'i to invest elsewhere. Nor would it bring back
6 former HECO employees who might have left, voluntarily or involuntarily, as a result of
7 NextEra's acquisition. And as a practical matter, divestiture will be complicated and
8 time-consuming. The more practical approach—the one that avoids the uncertainty and
9 drama of divestiture—is to prevent anticompetitive effects from occurring to begin with,
10 by rejecting acquisitions by entities espousing business models in conflict with Hawai'i's
11 goals.

12 *d. The risks to NextEra: Retail customers gaining choices*

13
14 **Q. Is there evidence on how welcoming NextEra will be of competition and diversity in**
15 **Hawai'i?**

16
17 **A.** Yes. Should NextEra acquire the HECO utilities, it is reasonable to assume that its
18 financial stake in maintaining a vertically integrated monopoly in Hawai'i will be similar
19 to its financial stake in maintaining a vertically integrated monopoly in Florida. Consider
20 NextEra's words:

21 FPL has limited competition in the Florida market for retail electricity
22 customers. Any changes in Florida law or regulation which introduce
23 competition in the Florida retail electricity market, such as government
24 incentives that facilitate the installation of solar generating facilities on
25 residential or other rooftops at below cost, or would permit third-party
26 sales of electricity, could have a material adverse effect on FPL's business,
27 financial condition, results of operations and prospects....⁶⁰

⁶⁰ Applicants' Ex. 10 at 32 (NextEra's 2014 10-K Report to the SEC).

1 While this language focuses specifically on retail competition and subsidized solar, the
2 larger implication is this: State action that empowers customers to find alternatives to the
3 local utility "could have a material adverse effect." Because NextEra's business model is
4 owning a vertically integrated monopoly, its financial stake—its duty to its
5 shareholders—is necessarily to oppose state actions that give customers alternatives to
6 that model.

7 *e. By emphasizing its intent to improve HECO's operations,*
8 *NextEra diverts attention from its intent to own Hawai'i-based*
9 *assets*

10
11 **Q. Do you see a gap between NextEra's testimonial reasons for this acquisition and its**
12 **business reasons?**

13
14 **A.** Yes. NextEra says it can help HECO improve. But what HECO wants to improve does
15 not match Hawai'i's needs. Here is, in HECO's words, its "focus" for each of seven
16 areas:

17 Customer Experience: Redesign engagement with customers to exceed
18 their expectations and be their trusted energy advisor.

19
20 New Products and Services: Design comprehensive energy solutions
21 around customer's needs and preferences.

22
23 Distributed Energy Resources: Support sustainable growth of DG
24 including rooftop PV on the Companies electric systems.

25
26 Grid Modernization: Modernize the grid by developing and installing new
27 physical infrastructure and technology that will enhance grid intelligence
28 and functionality.

29
30 LNG: Replace oil with cleaner, low-cost LNG.
31

1 Power Supply: Transform Hawai'i's generation portfolio from primarily
2 imported oil-based generation to low cost renewable energy resources
3 enabled by flexible and fuel efficient LNG generation.⁶¹
4

5 For the first six activities, the apparent assumption is that the main actor is HECO. No
6 wonder NextEra wants to help. Having paid a \$568 million premium to control HECO,
7 NextEra will need to control these activities. Each activity involves owning assets and
8 selling the output into a regulated, low-risk market.⁶²

9 But to assume that NextEra will control these activities is to reason in a circle—to
10 assume the answer to the question being asked. If Hawai'i intends to encourage
11 consumer choice, supplier diversity, and island-level (or even neighborhood-level)
12 distinctions in types of services and suppliers, it will not lightly hand the job over to an
13 incumbent monopoly whose business model is consistent with choice and diversity. With
14 the appropriate invitation and policy foundation from the Commission and the
15 Legislatures, entities other than HECO will be willing to be customers' "trusted energy
16 advisor," "[d]esign comprehensive energy solutions around customers' needs and
17 preferences," bring "sustainable growth of [distributed generation]," "develop[] and
18 install[] new physical infrastructure and technology that will enhance grid intelligence
19 and functionality," invest in assets that provide "cleaner, low-cost LNG," and develop
20 "low cost renewable energy resources." The Commission should not signal to these

⁶¹ Response to PUC-IR-177.

⁶² Recall Moody's: "NEE is seeking new shareholder growth avenues beyond the next few years of identified projects and to circumvent the industry outlook for flat-to-declining power sales due to energy efficiency and new technologies. The company also wants to reduce business risk by increasing the proportion of regulated and contracted assets.") Response to PUC-IR-32 (Moody's, 28 Apr. 2015, p.3/7.

1 alternative providers that HECO and NextEra have won the race before that race has
2 begun.

3 NextEra is applying for a job—the job of making HECO a better vertically
4 integrated monopoly. But that is not the job Hawai‘i needs done. HECO's list of
5 emphases is correct. But HECO's assumption, that the entity to all these things is
6 HECO—is not correct. And that is the mismatch between the job NextEra says it is
7 applying for, and the job the Commission needs done.

8 NextEra is not buying HECO merely to advise it; NextEra is buying HECO to
9 beat out others in the race to create and serve new markets. Its testimonial message
10 ("We're here to help") diverts attention from its business model ("We're here to own").
11 That model is simple: Add to its vertically integrated monopoly in Florida a vertically
12 integrated monopoly in Hawai‘i, then use the advantages provided by both companies to
13 gain competitive advantage in Hawai‘i's new markets. If the goal were merely to avoid
14 "flat earnings," NextEra's existing presence in Hawai‘i—developing competitive
15 generation projects through NEER and testing waters on the interisland cable concept—
16 should be sufficient. If NEER wins competitions, in Hawai‘i and elsewhere, NextEra's
17 earnings will not be "flat." But NextEra wants more: It is buying HECO so that it can
18 combine NEER's efforts, FPL's ratepayer-funded knowledge, and HECO's monopoly
19 status to achieve a vertical and horizontal merger whose value, in terms of advantages
20 over competitors, justifies the \$568 million control premium. That is NextEra's business
21 plan. But it is not Hawai‘i's vision.

22 * * *

1 Approving this acquisition affirms NextEra's preferred market structure—
2 vertically integrated monopoly—and rewards HEI shareholders for selling theirs. If the
3 Commission, post-acquisition, tries to unbundle the company's assets, or otherwise invite
4 competition in the various business segments controlled by NextEra, NextEra will argue
5 that the Commission is weakening the very company it has selected and now depends on.
6 Approving this acquisition thus narrows the Commission's options. But if the
7 Commission disapproves the acquisition, it will be preserving, and opening up, options.
8 It will be allowing itself to pause, to continue its analytical work, and thus to find its way
9 to those market structures that will best serve Hawai'i.

10 I do not mean to suggest that vertical integration itself is wrong; coordination of
11 all physical elements in some manner is necessary in any electrical system, and especially
12 one so isolated. The question is who should own and control these elements; and whether
13 they need all to be controlled by the same entity. On these questions, NextEra's business
14 model is not openminded, whereas the Commission's inquiries must be.

15 **3. *Interaffiliate relations rules will not necessarily prevent NextEra from***
16 ***abusing customers or distorting competition***

17
18 **Q. Provide an overview of your discussion of interaffiliate relations rules.**

19
20 **A. This acquisition's purpose is to increase earnings by "combining" NextEra Energy**
21 **Resources's development activities and FPL's ratepayer-funded expertise with HECO's**
22 **vertically integrated monopoly. As Mr. Robo said, "this is a very unique opportunity for**
23 **us to combine those two—those two strategies into one opportunity."⁶³ It is for this**

⁶³ NextEra Energy/Hawai'ian Electric Industries Conference Call, December 3, 2014 6:00 p.m. ET.

1 "very unique opportunity" that NextEra has paid a premium. Yet having paid that
2 premium, NextEra insists that its "unregulated subsidiaries are no different than any other
3 unregulated companies...."⁶⁴ These subsidiaries will have no unfair advantage, because
4 NextEra has internal cost allocation practices and Hawai'i has interaffiliate transaction
5 rules.⁶⁵

6 If one looks beyond these general statements to the facts, one has less confidence
7 that NextEra's "unregulated subsidiaries are no different than any other unregulated
8 companies," and that they will have no competitive advantage. In this subsection I will
9 describe four distinct concerns that can arise in the relationship among NextEra's
10 affiliates: faulty interaffiliate pricing, favorable purchases of utility property, utility loans
11 to NextEra affiliates, and weaknesses in compliance and enforcement. Examination of
12 these four areas reveals a central contradiction: NextEra claims its relationship with
13 HECO will be "arms-length." But NextEra cannot transform HECO at "arm's-length."

14 **Q. Before discussing the four areas, provide a definition of "arm's-length."**

15
16 **A.** When two companies are in an arm's-length relationship, they behave as if unrelated.
17 That means that each company (a) has no economic need to deal with any other affiliate
18 because each one has alternative trading partners, and (b) has no legal obligation to deal

⁶⁴ Response to SunEdison-IR-6.

⁶⁵ Response to COM-IR-14 ("[T]here are already rules and regulations in place to address and prevent anti-competitive activity."). See also Response to CA-IR-73 (citing Hawai'i statutory provisions); and Attachment 1 to CA-IR-127 (containing a draft Corporate Support Services Agreement).

1 with any other affiliate because it is free to choose its own trading partners. As I will
2 explain below, the NextEra-HECO relationship does not satisfy this definition.⁶⁶

3 *a. Faulty interaffiliate pricing*

4
5 **Q. Describe the problem with faulty interaffiliate pricing.**

6
7 **A.** FPL and other NextEra affiliates will provide HECO with advisory services, including
8 "improved project execution" that will "advance the clean energy transformation."⁶⁷

9 The problem is that NextEra will provide these services "on the basis of fully
10 loaded cost."⁶⁸ "Fully loaded cost" means "not at market prices." But NextEra's non-

⁶⁶ NextEra appears to agree with this definition. See Response to OP-IR-137(a):

Applicants believe the definition of 'arms-length' to be the standard of conduct under which unrelated parties, each acting in its own best interest, would carry out a particular transaction. Applied to related parties, a transaction is at arm's length if the transaction could have been made on the same terms to a disinterested third party in a bargained transaction.

But their position becomes unclear, when they say (Response to OP-IR-137(d)):

NextEra Energy believes that the Hawaiian Electric Companies' procurement of corporate services are not held to an arm's length standard, but to a reasonableness standard regarding the cost of those services, while competitively-sourced projects are held to an arm's length standard.

There should be no space between "arm's length" and "reasonable." An interaffiliate transaction, including the utility's use of corporate services, is "reasonable" only if it is at "arm's length."

⁶⁷ Response to DBEDT-IR-17 (stating that HECO will have "improved project execution through NextEra Energy's Engineering and Construction team and other operational specialists who would bring experience and expertise to bear to advance the clean energy transformation"). See also PUC-IR-55 ("Florida Power & Light Company ("FPL") is the primary operating entity that provides traditional corporate services to the NextEra Energy family of companies.)

⁶⁸ Response to CA-IR-127.

1 affiliated competitors will not get NextEra's advice at "fully loaded cost"—cost which has
2 been fronted, by the way, by FPL's captive ratepayers. Because the non-affiliated
3 competitors do not have captive ratepayers, they will have to develop expertise on their
4 own, or buy it at market prices. But competitors in Hawai‘i hiring their own consultants
5 will be paying market price. Market price is what HECO would be paying NextEra, if
6 the relationship was truly "arm's-length." NextEra's assertion of equality in competitive
7 position, between itself and its non-affiliated Hawai‘i competitors, rests on a premise
8 whose error is evident from its own statements. NextEra thus seeks to retain a
9 competitive advantage while denying it has one.

10 *b. Favorable purchases of certain utility property*

11
12 **Q. Describe the problem with favorable purchases of certain utility property.**

13
14 **A.** It appears that NextEra intends to obtain, at a low price or no price (as it unilaterally
15 determines), HECO property whose costs have been recovered from HECO's ratepayers.
16 Asked about a possible requirement that HECO "obtain prior Commission approval to
17 transfer to an affiliate HECO utility property that is already retired or no longer used and
18 useful for utility purposes," Applicants called it an "undue burden."⁶⁹ But if NextEra is
19 going to insist that its "unregulated subsidiaries are no different than any other
20 unregulated companies,"⁷⁰ then it cannot insist on a special right to buy ratepayer-funded
21 property ahead of anyone else, at whatever price it decides. That the property is "retired
22 or no longer used and useful." If the property has competitive value, an arm's-length

⁶⁹ Response to FOL-IR-40.

⁷⁰ Response to SunEdison-IR-6.

1 relationship means NextEra has no special call on it. To avoid distorting competition,
2 and to ensure that the ratepayers whose rates paid for property now get the benefit from
3 their burden, the property must be sold at fair market value, to the highest bidder, with an
4 independent entity running the sale and choosing the buyer. For NextEra to see the
5 situation differently signals that its commitment to "arm's-length" is selective.

6 *c. Utility loans to NextEra affiliates*

7
8 **Q. Describe the problem with utility loans to affiliates.**

9
10 **A.** NextEra wants Hawai'i utilities to be free to loan money to NextEra affiliates: "There
11 could be unforeseen circumstances when HEH loans to a NextEra Energy affiliate could
12 be in the public interest and the Applicants believe the option of seeking Commission
13 approval to do so if such a circumstance arises should be preserved."⁷¹

14 Whoever wrote this jaw-dropping answer⁷² chose not to define "unforeseen
15 circumstances." But we can readily foresee one: A NextEra affiliate bids too low on
16 some project (inside or outside Hawai'i), wins the bid, has trouble paying its contractors,
17 and needs money fast. Instead of having to confess its sins to an independent bank, it has
18 NextEra's Florida-based CEO order HECO's CEO (who reports to him) to make the loan.
19 The very possibility that a NextEra affiliate could have favorable access to the cash of a

⁷¹ See Response to OP-IR-52.

⁷² Yes, jaw-dropping because if any regulatory principle has been treated, at least up to now, as inarguable, it is the rule that utilities should back non-utility affiliates—except possibly in circumstances where the sole purpose of the affiliate is to help the utility carry out its public service obligations.

1 regulated monopoly distorts competition, because it creates a differential in access to, and
2 cost of, the financing necessary for capital projects.

3 Consider another "unforeseen circumstance": Since NextEra insists on the ability
4 to invest in any venture anywhere, without Commission review,⁷³ NextEra could run into
5 trouble, lose credibility with its own sources of capital, and therefore no longer function
6 as source of equity for its affiliates. And so, again, to finance those other affiliates,
7 NextEra turns to HECO, whose customers' loyal monthly payments provide a ready
8 source of cash.

9 **Q. Is there irony in NextEra's insistence on allowing HECO to loan money to NextEra**
10 **affiliates?**

11
12 **A.** Yes. NextEra wanted this transaction to include HEI's spin-off of American Savings
13 Bank.⁷⁴ Now we see that NextEra wants HECO to be a bank. If NextEra wants HECO
14 to be available for loans, the arm's-length principle requires that loans be available not
15 only to NextEra's affiliates, but to their unaffiliated competitors. But that just makes a
16 bad idea worse.

17 The Commission should reject NextEra's bid for structural looseness,
18 emphatically. But beyond rejection, the Commission should ask itself: What kind of
19 acquirer, one that insists it has all the financing Hawai'i needs, one that insists that its
20 "unregulated subsidiaries are no different than any other unregulated companies....",⁷⁵

⁷³ As explained in Part III.C.3 below.

⁷⁴ As explained in NextEra's Form S-4, discussed in Part III.G.1 below.

⁷⁵ Response to SunEdison-IR-6.

1 would yet insist on being able to order its captive utility subsidiary to lend its other
2 ventures money? Is this type of company to control Hawai'i's utilities?

3 *d. Weaknesses in compliance and enforcement*

4
5 **Q. Describe the problem of weaknesses in compliance with and enforcement of rules on**
6 **interaffiliate relations. .**

7
8 **A.** Rules work best when compliance is certain. For compliance to be certain, actions must
9 expect that noncompliance will be detected, and penalized severely. On the existence of
10 rules, NextEra says much, but on detections and penalties, NextEra says little. I discuss
11 these two subjects next.

12 *i. Detection requires resources sufficient to detect*
13 *impropriety*

14
15 **Q. What should be the Commission's concerns regarding detection of interaffiliate**
16 **impropriety**

17
18 **A.** NextEra has over 900 affiliates.⁷⁶ This number can grow without Commission approval
19 (unless the Commission adopts my Condition VI.B.1.a). The more affiliates, the more
20 possible interaffiliate transactions. How many will affect Hawai'i is unknown:
21 "Applicants are not able to describe every service that will be provided to the Hawai'ian
22 Electric Companies by NextEra Energy and its family of companies."⁷⁷ The more
23 possible transactions, the greater the regulatory effort required to track transactions and
24 detect impropriety.

⁷⁶ Response to OP-IR-31.

⁷⁷ Response to PUC-IR-51.

1 NextEra appears to assume that its structural complexity poses no risk because the
2 Commission can catch problems through ratemaking. But ratemaking depends on
3 auditing. Auditing is not like a trip to the dentist who checks every tooth. Auditing is
4 sampling. It cannot promise 100% coverage—especially with limited regulatory
5 resources. Asked this question— "If the merger is approved, what kind of resources
6 should the Commission have to monitor and address anticompetitive activities?"—
7 Applicants answered illogically: "Applicants do not believe that any additional resources
8 would be required. See the response to subpart a above."⁷⁸ ("Subpart a" merely described
9 how whereas 20 years ago HEI was involved in several non-utility businesses, today the
10 sole non-utility business is American Savings Bank. NextEra, with 900 subsidiaries, is
11 not American Savings Bank. HECO acknowledged it is "not familiar with the budgetary
12 requirements of the Commission, and, therefore, [is] not in a position to comment on the
13 nature and amount of resources required for the Commission to perform its mandate."⁷⁹
14 HECO cannot credibly dismiss concerns about interaffiliate abuse based on the assumed
15 sufficiency of Commission resources that HECO does not know exist.

16 If the Commission needs more resources to address NextEra's complexity, it is on
17 its own. Asked whether they were "willing to pay an annual fee (not recoverable from
18 ratepayers) to the Commission to cover the Commission's incremental cost associated
19 with ensuring that there are no cross subsidies arising from the post-acquisition entity,"
20 Applicants responded: "No. The Applicants have in place a robust compliance program

⁷⁸ Response to COM-IR-9.

⁷⁹ Response to COM-IR-14.

1 related to affiliate transactions and disagree that additional transactions mean more
2 oversight is needed."⁸⁰ In other words, "trust us." But "trust us" is never a basis for
3 effective regulation: rules, monitoring, detection and consequences are.

4 HECO states that "concerns over anti-competitive activities should be viewed in
5 light of the fact that HEI has not engaged in diversification activities for well over a
6 decade, except for maintaining ASB."⁸¹ That statement is true, but it is irrelevant,
7 because after the merger it will be controlled by a company with 900 subsidiaries, a
8 company that insists on engaging in unlimited additional "diversification activities,"
9 inside and outside Hawai'i.⁸²

10 *ii. Internal penalties must be sufficient to deter the*
11 *impropriety*

12
13 **Q. What should be the Commission's concerns regarding the sufficiency of penalties**
14 **for noncompliance with rules on interaffiliate relations?**

15
16 **A.** NextEra asserts there is "no meaningful risk" of impropriety because it "has in place a
17 compliance program to help ensure improper cross-subsidization does not occur."⁸³

18 NextEra says it does regular training, uses physical separation, and prevents unauthorized
19 computer access with passwords.⁸⁴ NextEra's compliance program includes (according
20 to its discovery response) these elements:

⁸⁰ Response to OP-IR-50.

⁸¹ *Id.*

⁸² As explained in Part III.C below.

⁸³ Response to OP-IR-48.

⁸⁴ Response to UL-IR-33.

- 1 1. Employees are made aware that the Federal Energy Regulatory
2 Commission ("FERC") can impose civil penalties of up to \$1,000,000 per
3 day per violation and is applicable to any company or person.
4
- 5 2. Employees responsible for NERC Standards compliance are required to
6 participate in training provided by FERC and NERC.
7
- 8 3. NextEra has a Compliance & Responsibility Organization ("CRO") that
9 "works and consults with the Business Units ("BUs") to ensure that they
10 have proper and effective controls in place to prevent and/or detect non-
11 compliance."
12
- 13 4. Applicable NextEra Energy BUs have a direct responsibility or have a
14 secondary supporting role for the execution of compliance activities
15 related to FERC requirements and NERC Reliability Standards. NextEra's
16 "NERC Internal Compliance Program ("ICP") includes, among other
17 detection tools, the use of a comprehensive self-assessment compliance
18 tool and spot checks.
19
- 20 5. On an annual basis, the Director of NERC Reliability Standards &
21 Compliance - CRO meets with the VP of Compliance & Corporate
22 Secretary to determine whether there are any new or revised measures or
23 controls that should be implemented in the next calendar year....
24
- 25 6. NextEra Energy's Internal Audit Department, that reports directly to
26 NextEra Energy's Chairman and the Audit Committee, performs a risk
27 based audit plan each year which includes looking at numerous areas of
28 the company to ensure compliance with rules, regulations and company
29 policy.
30
- 31 7. All employees are required to report any known or suspected violation and
32 are provided numerous methods in which to do so.⁸⁵
33

34 But when asked about the consequences for employees who violate rules, its
35 answer was a generic statement indistinct from any business's policies:

36 Employees of all levels of the Hawai'ian Electric Companies, including
37 executive officers, may be subject to disciplinary action for violations of
38 laws, regulations and company policies. Each instance of unacceptable
39 behavior is regarded as a unique situation to be viewed in the context of its

⁸⁵ Response to OP-IR-123.

1 particular circumstances. The level of discipline takes into account the
2 severity and frequency of the act, the employee's overall record of
3 employment and the particular circumstances, including aggravating and
4 mitigating factors. Disciplinary action generally ranges from documented
5 verbal warning to termination....⁸⁶
6

7 This answer gives the Commission no indication of how strong is the deterrence. Again,
8 "trust us."

9 So much for consequences to employees. As for consequences to the company,
10 should it be caught engaging in inappropriate interaffiliate pricing, HECO insists that the
11 ratemaking solution can be prospective only, due to the prohibition against retroactive
12 ratemaking. Asked whether "[a]ny correction to a charge [*i.e.*, an interaffiliate charge]
13 may be made retroactively back to the date of the improper charge, without violating the
14 prohibition against retroactive ratemaking," HECO replied, in relevant part: "[T]here
15 should not be a basis to make retroactive adjustments, unless the rates are established on
16 an interim basis, subject to further review, and refund, pending a final decision."⁸⁷

17 *e. The central contradiction: NextEra cannot transform HECO at*
18 *"arm's length"*
19

20 **Q. Do you see a contradiction between NextEra's intent to improve HECO's**
21 **performance, and its insistence that its relations with HECO will be "arms-length"?**
22

23 **A.** Yes. I have explained that an arm's-length relationship must mean that the parties behave
24 as if they operated independently and were each subject to competitive forces.⁸⁸ But the
25 heart of this acquisition—in terms of arguments made to the Commission—is that HECO

⁸⁶ Response to OP-IR-45.

⁸⁷ Response to OP-IR-51.

⁸⁸ See Part III.B.3 above.

1 will receive whatever NextEra has that HECO needs—NextEra's skills, experience,
2 technologies, procedures, "best practices," personnel, financing, and executive leadership.
3 The flow of knowledge from NextEra to HECO, we are asked to accept, will be
4 osmotic—no barriers, no hesitation, no limit. And that flow will be to HECO only. In an
5 arm's-length relationship, either side can walk away at any time, decline the resources,
6 decline the advice, go it alone. That is not possible here, because HECO's CEO will be
7 reporting to NextEra's CEO. There can be no arm's-length relationship.

8 Applicants' narrative thus has a contradiction at its core. When they want to
9 downplay concerns about cross subsidies and unfair competitive advantage, they claim
10 "arm's-length relationship." But when they want to argue improvements to HECO, those
11 arms open wide, assuring us that HECO will get whatever it needs. This contradiction
12 does no favors for NextEra's credibility.

13 **4. *Conclusion on "business model": The Commission should not make***
14 ***long-lasting, competition-reducing market structure decisions in an***
15 ***acquisition case***
16

17 **Q. How should the Commission address the acquisition's effects on competition and**
18 **diversity?**

19 **A.** NextEra has a for-profit interest in developing projects in Hawai'i. Having paid a \$568
20 million control premium, NextEra will want to earn it back, with a return. Under these
21 circumstances, it is unrealistic to expect from NextEra a neutral, objective stance on what
22 projects Hawai'i needs and who should own those projects. NextEra will not only own
23 and control HECO; it will be immersed and enmeshed (at least it will have the power to
24 immerse and enmesh itself) in every major HECO decision about future resources. I do
25 not see how the "arm's-length" mantra can negate these realities.
26

1 The Commission's priority should be preserving its ability—not just its authority,
2 but its ability, to regulate: to guide Hawai'i's electric industry toward a diverse, cost-
3 effective future. Preserving that ability means not creating a situation where the
4 dominant actor has goals that conflict with the Commission's. If the Commission does go
5 approve the acquisition—a result recommend against—it should make clear that its
6 approval is not intended to create any expectation that a NextEra-controlled HECO has
7 any right to (a) continue owning and controlling the poles-and-wires business, (b)
8 become the provider of any new monopoly platform services, or (c) compete in any of the
9 new distributed services markets. The Commission should also make clear that whether
10 any of these three activities will be available to HECO's utilities will depend on further
11 investigation and decision.

12 This three-part condition does no more than preserve the Commission's existing
13 powers. But by stating the condition explicitly, the Commission alerts all affected parties
14 that approval of the acquisition means only that. It does not grant any preferred position
15 in new markets; nor does it guarantee continued control of the franchise which HECO's
16 utilities currently control. The Commission will have sent a signal to prospective
17 distribution service providers that what will matter is merit, not incumbency.

18 Furthermore, if the Commission approves the acquisition, it will need to address
19 the competitive bidding procedures. I doubt that independent generators will trust a
20 bidding process in which a NextEra affiliate is competing while a NextEra-controlled
21 HECO makes the decisions—even if those decisions are overseen by an independent
22 monitor. The necessary solution will be to remove HECO fully from the decision, and
23 turn over all aspects of the process—identifying the need, designing the request for

1 proposal, answering bidders' questions, assigning weights to the selection criteria,
2 selecting the winner and negotiating final details—to the Commission, advised by an
3 independent monitor. But the Commission should ask itself: Is directly running these
4 competitions, rather than relying on HECO and an independent monitor, going to be
5 practical and effective? If not, then the acquisition cannot go forward—except under an
6 alternative condition. That alternative condition would prohibit NextEra from bidding on
7 any generation project, except as a last resort. But given that owning generation in
8 Hawai‘i is NextEra's business model, this condition would cause NextEra to drop its bid
9 for HECO, in favor of remaining an independent competitor. And that result, for all the
10 reasons I have presented in this testimony, is the best result.

11 * * *

12 Back to the basics: To approve a takeover by an acquirer, one motivated to own
13 and control competitive assets in market served by a monopoly controlled by the
14 acquirer, when the Commission itself has not settled on the types of market structures
15 that will best serve the State, is to put cart before horse—NextEra's strategy cart before
16 the Commission's policy horse. The Commission should close the door on this
17 transaction, and reopen the door on its inquiries into the best market structures for
18 Hawai‘i.

19 **C. *NextEra's business activities—current and future, known and unknown—***
20 ***cause risk to Hawai‘i's utilities and their customers***

21
22 **Q. How will you address concerns over NextEra's business activities?**

23
24 **A.** I will begin by describing the regulatory gap states face in holding company oversight,
25 due to the 2005 repeal of the federal Public Utility Holding Company Act of 1935. In the
26 ensuing sections, I will cover the following topics:

1 The acquisition will increase HECO's risk exposure immediately

2
3 "Ring-fencing" is insufficient to protect HECO's utilities from NextEra's
4 business risks

5
6 Additional, unknown risks exist because NextEra insists can buy unlimited
7 additional businesses, regardless of their fit with Hawai'i's priorities

8
9 "After-the-fact" solutions do not work in "too-big-to-fail" settings

10
11 Experience, logic and economic theory show that the risks to HECO's
12 utilities are not "speculative"

13
14 I then will offer solutions and conclusions concerning NextEra's business activities.

15 *1. Hawai'i faces a regulatory gap in holding company oversight*

16
17 **Q. In the area of holding company oversight, is there a regulatory gap that the**
18 **Commission needs to fill?**

19
20 **A.** Yes. Until its repeal in 2005, the federal Public Utility Holding Company Act of 1935

21 (PUHCA) required, subject to certain exceptions, that each utility holding company

22 constitute a "single integrated public-utility system."⁸⁹ The purpose of this mandate was

23 to align each utility's corporate form with its public service obligations. While the Act

24 had many provisions, the key tools were these:

⁸⁹ Section 2(a)(29)(A) of PUHCA defined "integrated public-utility system," as applied to electric utility companies, to mean—

a system consisting of one or more units of generating plants and/or transmission lines and/or distributing facilities, whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more states, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation.

1 Section 11(b)(1) required the SEC to break up holding company systems that
2 owned scattered utility companies and unrelated businesses, so that after the
3 break-ups, each system would be confined to a single "integrated public-utility
4 system," subject to certain exceptions.

5
6 Section 10(b)(1) required the SEC to disapprove any acquisition by a utility
7 holding company, if the acquisition would "tend towards ... concentration of
8 control of public-utility companies, of a kind or to an extent detrimental to the
9 public interest or the interest of investors, or consumers."

10
11 Section 10(c)(2) allowed only those acquisitions that "tended towards the
12 economic and efficient development of an integrated public-utility system."

13
14 Section 7(d) prohibited utility holding companies from issuing securities that,
15 among other things, involved an "improper risk" or were "detrimental to the
16 public interest or the interest of investors or consumers."

17
18 For 70 years, these provisions caused electric and gas utilities to "stick to their knitting":
19 to devote their management attention and financial resources to providing essential utility
20 service, locally. The "integrated system" principle eliminated or limited those features of
21 holding company structure and behavior that cause harm to investors, consumers and the
22 public interest: geographic dispersion of utility properties, arbitrary (from a consumer
23 perspective) mixtures of utility and non-utility businesses, layers of corporate affiliates,
24 excess leveraging, utility financial support of non-utility businesses, and interaffiliate
25 transactions priced unfairly to consumers. In a sentence, the "integrated system"
26 principle prevented acquisitions for the sake of acquisitions—acquisitions motivated by
27 "strategy" rather than consumer welfare.

28 To enforce the "integrated system" principle, the Securities and Exchange
29 Commission, beginning in 1935, broke up the then-existing 13 holding companies into
30 several hundred relatively local systems. (Some multi-state systems remained, in a form
31 called "registered holding companies" that were subject to extra regulatory oversight).

1 Once the SEC completed this work, utility mergers in the electric and gas industries were
2 relatively rare until the mid-1980s.

3 Beginning in the mid-1980s, a merger trend began. The initial mergers involved
4 the joining of utilities with adjacent or near-adjacent service territories. Examples were
5 the mergers of Toledo Edison and Cleveland Electric Illuminating; Kansas Power and
6 Light and Kansas Gas & Electric; Northeast Utilities and Public Service of New
7 Hampshire; Delmarva and Atlantic City Electric; and Pepco, Delmarva and Atlantic City
8 Electric. In these transactions, still bound by PUHCA's "integrated system" requirement,
9 the main regulatory efforts were these: to identify and allocate costs and benefits
10 associated with savings likely to arise from real operational economies of scale and scope
11 (this being prior to the era of regional transmission organizations, whose operations now
12 can provide the scale and scope economies that those early merger proposals claimed to
13 create); to protect against horizontal or vertical market power; and to ensure that the
14 larger, post-merger entity devoted sufficient attention to local quality of service. These
15 initial mergers, for the most part, did not involve the joining of remote electric facilities,
16 or the mixing of utility and non-utility businesses.

17 **Q. How was the Act's integration requirement changed in 1992?**

18
19 **A.** The 1992 amendments⁹⁰ permitted utility holding companies to acquire, exempt from the
20 integrated system principle, geographically dispersed generating companies whose
21 exclusive business was selling electricity at wholesale. Holding companies could own

⁹⁰ See section 711 of the Energy Policy Act of 1992, 15 U.S.C. sec. 79z-5a (repealed in 2005).

1 these "exempt wholesale generators" located anywhere in the U.S., while still owning
2 traditional state-regulated retail utilities.

3 **Q. What changes did the 2005 repeal bring?**

4
5 **A.** The Energy Policy Act of 2005 repealed the entire 1935 Act—all its limits and reviews of
6 utility holding company acquisitions. As a result, there is no federal limit on holding
7 company arrangements involving geographically dispersed utilities, mixtures of utility
8 and non-utility businesses, debt leveraging or complex corporate family structures.⁹¹
9 Corporate family structures prohibited for 70 years are now possible, unless states act on
10 their own. As a result, acquisitions of dispersed utility companies can occur for reasons
11 other than operational efficiencies; no longer does federal law require corporate structure
12 to align with public service obligation.

13 What our grandparents understood as "utilities"—the traditional safe
14 investment—has changed its character. NextEra's acquisition, which would not have
15 been possible under PUHCA 1935, is an example.

16 **Q. Why are these federal statutory changes relevant to the Commission generally?**

17
18 **A.** While PUHCA 1935 was in place, and enforced properly by the SEC, a state commission
19 evaluating a holding company merger could be relatively certain about the current and

⁹¹ There remains some review by the Federal Energy Regulatory Commission under Section 203 of the Federal Power Act, 16 U.S.C. sec. 824b, and under a vestige of PUHCA 1935 now called PUHCA 2005. But there no longer is an integrated public-utility system requirement and thus no longer any federal statutory limits or reviews concerning geographic dispersion, type-of-business scope, corporate layering, financial leveraging or interaffiliate transactions.

1 future business activities within the post-merger family. The Commission would know
2 that HECO's utilities, on being acquired by some other entity, would not—

- 3 1. become affiliates of utility businesses that were not part of the same
4 integrated public utility system;
- 5
6 2. become affiliates of substantial non-utility businesses—at least not
7 without federal regulatory review;
- 8
9 3. become part of a corporate family in which interaffiliate transactions
10 (including transactions anywhere in the family, not just transactions to
11 which one or more HECO utilities were a party) were unbounded by rules
12 on interaffiliate prices aimed at preventing cross-subsidies;
- 13
14 4. become part of a corporate family in which the holding company affiliates'
15 financial structures went unreviewed by regulators obligated to protect
16 consumers; or
- 17
18 5. become part of a holding company system that can acquire any kind of
19 company, anywhere, in any industry, without advance review by some
20 regulator for the effects on consumers and on the public interest.

21
22 Since none of these circumstances were permitted under PUHCA 1935 (with certain
23 limited exceptions), a state regulatory agency could reasonably expect that the family
24 now controlling its utility would continue to focus on local utility service and only local
25 utility service. That is no longer the case. Due to PUHCA's repeal, state commissions
26 now need to develop their own methods of screening mergers and acquisitions, to ensure
27 that the entities that own or influence utility infrastructure remain accountable to
28 regulators, consumers, investors and the public.

29 **Q. Why are these federal statutory changes relevant to NextEra's proposed acquisition**
30 **of the HECO utilities?**

31
32 **A.** Acquisitions are no longer confined to local, integrating acquisitions—acquisitions that
33 must "tend toward the economical and efficient development of an integrated public-
34 utility system" (from old PUHCA Section 10(c)(2)). This proceeding therefore needs to

1 ask and answer this central question: "What corporate family characteristics will produce
2 the best performance?" Without answering this question, there is no objective context for
3 judging this transaction, no clear way to align the Applicants' business aspirations with
4 Hawai'i's priorities. Only by articulating the specific parameters of the public interest—
5 of performance quality, of corporate structures and market structures most likely to
6 produce that quality, and of the merger policies most likely to produce those market
7 structures—can the Commission distinguish between those acquisitions that align with
8 the public interest and those that do not. Without that framework, the Commission will
9 be receiving proposals like NextEra's—proposals in which the acquirer, having acquired
10 HECO, can then make additional acquisitions without limit, as discussed next.

11 **2. *The acquisition will increase HECO's risk exposure immediately***

12
13 **Q. How will this acquisition change the character of HECO's corporate family?**

14
15 **A.** The change will be immediate. What used to be a family of three utilities serving
16 Hawai'i, plus American Savings Bank (whose revenues were only 8.4% of HEI's total),
17 will become a minor part of a holding company owning a major Florida utility and
18 investing in multiple projects throughout the United States. NextEra Energy "has more
19 than 900 subsidiaries of varying size."⁹² While in HECO's family, the non-regulated
20 activity (American Savings Bank) constituted only 8.4% of the total holding company

⁹² Response to OP-IR-31.

1 revenue,⁹³ in the NextEra corporate system the non-regulated activities are nearly 30% of
2 the total holding company revenue.⁹⁴

3 NextEra's subsidiaries have eight nuclear units at five sites, totalling 6174 MW.⁹⁵
4 NextEra's nuclear capacity comprises "one of the largest fleets of nuclear power stations
5 in the U.S.," about 6% of total U.S. nuclear capacity as of December 31, 2013.⁹⁶ Nuclear
6 power accounts for 26% of NextEra's 2014 generation profile (based on MWh
7 produced).⁹⁷ NextEra is adding another 2200 MW of nuclear capacity at its Turkey Point
8 site.[Applicants' Ex. 10 (NextEra 2014 10-K Report) at 16.

9 The risks associated with nuclear investment are undisputed:

10 The construction, operation and maintenance of NEE's and FPL's nuclear
11 generation facilities involve environmental, health and financial risks that
12 could result in fines or the closure of the facilities and in increased costs
13 and capital expenditures.

14
15 In the event of an incident at any nuclear generation facility in the U.S. or
16 at certain nuclear generation facilities in Europe, NEE and FPL could be

⁹³ In 2014, HEI's total revenue was \$3.24 billion. American Savings Bank's contribution to total was \$0.25 billion. The three utilities' contribution was \$2.99 billion. HEI 2014 10-K at 85.

⁹⁴ In 2013, approximately \$4.6 billion of its \$15.1 billion revenue came from unregulated sources; the remaining \$10.5 billion came from rate-regulated utility sources." Application at 25. Most of the \$10.5 billion came from FPL, with a small amount from the Lone Star and New Hampshire Transmission companies. Response to PUC-IR-95.

⁹⁵ Four of those units are operated by FPL and four of those units are operated by NextEra Energy Resources. Response to CA-IR-185. See also NextEra's 2014 10-K Report at 9, 18 (stating that FLP owned 3553 MW and NEER owned 2721 MW.)

⁹⁶ NextEra 2014 10-K at 4.

⁹⁷ Response to OP-IR-2.

1 assessed significant retrospective assessments and/or retrospective
2 insurance premiums as a result of their participation in a secondary
3 financial protection system and nuclear insurance mutual companies.
4

5 NRC orders or new regulations related to increased security measures and
6 any future safety requirements promulgated by the NRC could require
7 NEE and FPL to incur substantial operating and capital expenditures at
8 their nuclear generation facilities.
9

10 The inability to operate any of NEER's or FPL's nuclear generation units
11 through the end of their respective operating licenses could have a
12 material adverse effect on NEE's and FPL's business, financial condition,
13 results of operations and prospects.
14

15 Various hazards posed to nuclear generation facilities, along with
16 increased public attention to and awareness of such hazards, could result
17 in increased nuclear licensing or compliance costs which are difficult or
18 impossible to predict and could have a material adverse effect on NEE's
19 and FPL's business, financial condition, results of operations and
20 prospects.
21

22 NEE's and FPL's nuclear units are periodically removed from service to
23 accommodate normal refueling and maintenance outages, and for other
24 purposes. If planned outages last longer than anticipated or if there are
25 unplanned outages, NEE's and FPL's results of operations and financial
26 condition could be materially adversely affected.⁹⁸
27

28 Additional risks arise from NextEra's other businesses:
29

30 Sales of power on the spot market or on a short-term contractual basis may
31 cause NEE's results of operations to be volatile.
32

33 Reductions in the liquidity of energy markets may restrict the ability of
34 NEE to manage its operational risks, which, in turn, could negatively
35 affect NEE's results of operations.
36

37 NEE's and FPL's hedging and trading procedures and associated risk
38 management tools may not protect against significant
39 losses.
40

⁹⁸ *Id.* at 40-42.

1 NEE and FPL could recognize financial losses or a reduction in operating
2 cash flows if a counterparty fails to perform or make payments in
3 accordance with the terms of derivative contracts or if NEE or FPL is
4 required to post margin cash collateral under derivative contracts.
5

6 NEE and FPL could recognize financial losses as a result of volatility in
7 the market values of derivative instruments and limited liquidity in OTC
8 markets.
9

10 NEE's ability to successfully identify, complete and integrate acquisitions
11 is subject to significant risks, including, but not limited to, the effect of
12 increased competition for acquisitions resulting from the consolidation of
13 the power industry.
14

15 NEE is likely to encounter significant competition for acquisition
16 opportunities that may become available as a result of the consolidation of
17 the power industry in general. In addition, NEE may be unable to identify
18 attractive acquisition opportunities at favorable prices and to complete and
19 integrate them successfully and in a timely manner.
20

21 Certain of NEE's investments are subject to changes in market value and
22 other risks, which may materially adversely affect NEE's liquidity,
23 financial results and results of operations. ... In some cases there may be
24 no observable market values for these investments, requiring fair value
25 estimates to be based on other valuation techniques. ... A sale of an
26 investment below previously estimated value, or other decline in the fair
27 value of an investment, could result in losses or the write-off of such
28 investment, and may have a material adverse effect on NEE's liquidity,
29 financial condition and results of operations.⁹⁹
30

31 **Q. How might these changes in the character of HECO's corporate family affect**
32 **Hawai'i's utilities?**
33

34 **A.** Business risks in a holding company system affect the holding company's access to
35 capital. As Standard and Poor's has stated: "[W]e would lower the ratings on NextEra if

⁹⁹ *Id.* at 37-39, 42.

1 business risk increases through the growing contribution of unregulated operations or due
2 to unfavorable regulatory outcomes."¹⁰⁰

3 And since the holding company will be the Hawai'i utilities' sole source of equity,
4 NextEra's risks affect the utilities. Standard & Poor's has concluded that because HEI
5 and its utilities would be "core" subsidiaries of NextEra Energy, after the acquisition their
6 ratings "would be raised to the level of their ultimate parent, *i.e.*, NextEra Energy."¹⁰¹

7 What goes up can come down. S&P's statement necessarily means that if NextEra's drop,
8 so will the Hawai'i utilities'. Applicants do not disagree:

9 The Standard & Poor's ("S&P") methodology uses a 'top down' approach
10 and as such, there is the possibility that NextEra Energy's business
11 activities outside of Hawai'i could have an adverse effect on the
12 Hawai'ian Electric Companies because of its consolidated view of
13 corporate entities under its Group Ratings Methodology.¹⁰²
14

15 Finally, the possibility of adverse effects is not disputed by HECO's Chief Financial
16 Officer (although she views the likelihood as small):

17 Would Ms. Sekimura agree that there may be situations in which upstream
18 NextEra subsidiaries could endanger the financial health of the Hawai'ian
19 Electric Companies even though those subsidiaries did not "provide
20 services chargeable" to HECO? If not, please explain why not."

¹⁰⁰ PUC-IR-31 at 4 (Standard and Poor's, Dec. 4, 2014).

¹⁰¹ Response to PUC-IR-91.

¹⁰² Response to OP-IR-11. Applicants there contend that the opposite could be true; that the Hawai'i utilities would benefit from an upgrade reflecting S&P's positive view of NextEra. The Applicants also asserted, although without evidence, that "it is highly unlikely that the Hawai'ian Electric Companies would experience a downgrade of such magnitude that would cause the Hawai'ian Electric Companies' credit ratings to fall below those levels that it possesses today." Adjectival phrases like "highly unlikely" do not substitute for substantial evidence, especially where Applicants have the burden of proof.

1
2 Response: Yes, Hawai‘ian Electric would agree that there may be
3 situations in which upstream NextEra subsidiary activities could impact
4 their credit ratings which in turn could affect the credit ratings of
5 Hawai‘ian Electric.¹⁰³
6

7 **Q. How do Applicants view risks?**
8

9 **A.** Applicants acknowledge the risks, but their verbal formulas treat the risks as unimportant.

10 For example, asked about nuclear risk, Applicants state: "To the extent there are issues
11 such as a nuclear event, the financial impacts are expected to be largely, or entirely,
12 limited to the securities of the entities that own those nuclear plants."¹⁰⁴ And asked what,
13 if any, additional financial exposure or risk will the HECO Companies incur as a
14 consequence of this merger, Applicants responded: "No additional exposure is
15 anticipated."¹⁰⁵ Note the passive voice, providing anonymity to the writer. Phrases like
16 "expected to," "is anticipated," and "largely, or entirely," are hedges. They are substitutes
17 for this: "We guarantee, under oath, that under no circumstances will a nuclear event
18 have a negative financial effect on the Hawai‘i utilities; and if such effect does occur we
19 will make the utilities whole immediately, using resources that we guarantee will be
20 available regardless of our own financial condition."

21 This vagueness then turns to inconsistency. For in subsequent answers the
22 hedging disappears, replaced by what looks like absolute denial of the possibility of
23 harm: "[T]here is no basis for concluding that NextEra Energy's activities outside of

¹⁰³ Response to CA-IR-91.

¹⁰⁴ Response to CA-IR-86.

¹⁰⁵ Response to PUC-IR-48.

1 Hawai'i would have an adverse impact on ratepayers of the Hawai'ian Electric
2 Companies Utilities"; and "Hawai'ian Electric Companies would not be faced with risks
3 and vulnerabilities from a nuclear accident at one of Florida Power & Light Company's
4 or its affiliates' nuclear sites."¹⁰⁶ These answers are not realistic. A nuclear problem at
5 FPL would strain the finances of FPL. NextEra then would provide financing to help
6 FPL. That NextEra assistance to FPL would reduce the equity otherwise available for
7 HECO.

8 What probabilities to assign to those events, no one knows. But no one can deny
9 that adverse effects are more likely with this acquisition than without it.

10 **Q. After the acquisition, will the Hawai'i utilities be "pure play" companies?**

11
12 **A.** No. The Hawai'i utilities will be controlled by NextEra, which is not a pure play
13 company because of its many different investments (and no limit on future investments).
14 Today, in contrast, the Hawai'i utilities are nearly "pure play" because the only non-
15 utility in the family, ASB, is small relative to the whole (amounting to only 8.4% of
16 HEI's total revenue).¹⁰⁷

17 There is an irony here. Applicants are arguing the advantage to Hawai'i's utilities
18 of control by a holding company that is not pure play, while emphasizing to HEI

¹⁰⁶ Response to OP-IR-116 (citing responses to OP-IR-11, LOL-IR-24 and CA-IR-86.

¹⁰⁷ HEI 2014 10-K at 85.

1 shareholders that spinning off ASB is good for them because ASB will be pure play.¹⁰⁸

2 Being a "pure play" company, Applicants say,

3 can better position [ASB] with investors and the financial community, by
4 offering an investment profile that does not require that investors choose a
5 pre-determined mix of industry exposure (*e.g.*, utility and banking), or a
6 blended risk and return profile that matches the portfolio of the non-pure
7 play company. By investing in "pure play" companies, investors can more
8 easily create their own portfolios of diversified investments that reflect
9 their objectives and risk appetites, rather than those which are chosen by
10 the diversified company. Pure play companies also have a more easily
11 understandable business strategy, and allow a company and its
12 management team to focus on fewer core competencies whereby they are
13 more likely to develop a deeper expertise vs. less focused competitors.
14 This can lead to a greater probability of success all other factors being
15 equal.¹⁰⁹

16
17 All these "pure play" advantages are available to the Hawai'i utilities today, if they skip
18 the NextEra acquisition and spin off ASB. With NextEra's acquisition, those benefits
19 disappear, because NextEra with its 900 subsidiaries and nuclear risks is not "pure play."
20 Yet the Applicants insist that "[t]he Hawai'ian Electric Companies will be more of a
21 "pure play" after an acquisition by NextEra Energy." They can say that only if they view
22 the combination of conventional generation, transmission and distribution, and renewable
23 energy, as a "pure play."¹¹⁰ But those businesses all differ from each other: Generation

¹⁰⁸ Applicants' Exhibit 16 at 92, 94 (ASB will be "position[ed] ... for success as a focused, independent 'pure-play' company.").

¹⁰⁹ Response to OP-IR-30.

¹¹⁰ Which Applicants do say: "The Hawai'ian Electric Companies will be part of NextEra Energy, which is in the energy generation, transmission and distribution industry. Also, for example, since NextEra Energy is a leader in renewable energy, the Hawai'ian Electric Companies can benefit from that particular focus in which NextEra Energy excels, which one could easily describe as a characteristic of a 'pure play.'" Response to OP-IR-30.

1 is subject to competition in many markets (and is also subject to changing environmental
2 requirements). Transmission and distribution have historically been monopoly products
3 but are gradually being subjected to new forms of competition.¹¹¹ Renewable energy is
4 affected by an continuously changing polyglot of different state and federal incentives,
5 mandates and limits. Applicants conceded, as they must, that "[a]ny characterization of
6 the Hawai'ian Electric Companies as a 'pure play' entity would ultimately depend on the
7 scope of the reference industry space."¹¹²

8 **Q. Aren't NextEra's businesses all in regulated industries, where the business risks are**
9 **relatively low?**

10 **A.** In NextEra's context, that generalization does not work. Besides its ownership of FP&L,
11 NextEra invests in generation companies that sell at wholesale to regulated utilities.
12 Financial outcomes can be adversely affected if regulations affecting those utilities
13 change, or the generation does perform consistently with the contracts. With HECO's
14 current utility businesses serving entirely in Hawai'i, the Commission can both know and
15 influence, and in many aspects control, the utilities' regulatory risks and their
16 performance (although the Commission's frustration as expressed in its *Inclinations*
17

¹¹¹ On competition for transmission projects, see FERC's Order 1000, which among other things eliminated the "right of first refusal" that incumbent transmission owners enjoyed to build transmission having "regional" benefits. *Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities*, 76 Fed. Reg. 49,842 at 49,895-96 (2011). FERC's action means that new entrants can compete against the incumbents to build transmission facilities. As for distribution-level competition, see the New York Commission's order cited in Part III.B.1 above.

¹¹² Response to OP-IR-30.

1 Order makes the latter point less certain). But for regulatory events affecting NextEra's
2 other activities, the Commission has no influence, let alone control.

3 **3. *Additional, unknown risks exist because NextEra insists it can buy***
4 ***unlimited additional businesses, regardless of their fit with Hawai'i's***
5 ***priorities***
6

7 **Q. Is NextEra's self-portrait an accurate guide to the risks Hawai'i customers could**
8 **face?**

9
10 **A.** No. NextEra presents itself as stable and low-risk, by emphasizing its current businesses
11 and finances. But this description is stuck in the present. NextEra is not static; its risk
12 picture will change as NextEra changes. Those changes know no limit because, as I
13 explained in Part III.C.1, the 2005 repeal of PUHCA 1935 leaves NextEra free to acquire
14 additional companies without geographic or type-of-business limit. And NextEra has
15 made clear its intent to make more acquisitions:

16 NextEra "regularly acquires or sells subsidiaries."¹¹³

17
18 NextEra Energy is an entity with a market capitalization of \$46 billion as
19 of Q1 2015. An entity this size makes frequent offers to acquire assets of
20 \$5 million or greater in various areas of its business, some of which
21 ultimately close and some of which do not. NextEra Energy's "plans" to
22 make such acquisitions are ongoing and constantly evolving and it is
23 impossible to answer this question [about current plans to make other
24 acquisitions] with precision at any given point in time."¹¹⁴
25

26 NextEra also opposes a condition requiring Commission review and approval before
27 making additional major acquisitions.¹¹⁵ Because NextEra insists on making additional,

¹¹³ Response to OP-IR-31.

¹¹⁴ Response to OP-IR-15.

¹¹⁵ I present this condition in Part VI.B.1.a below.

1 unlimited acquisitions without the Commission review, its description of the present tells
2 us nothing about the future.

3 **4. "Ring-fencing" is insufficient to protect HECO's utilities from**
4 **NextEra's business risks**

5 **a. Ring-fencing's typical features**

6
7
8 **Q. What is ring-fencing?**

9
10 **A.** The commonly asserted purpose of ring-fencing is to protect the local utility from the
11 risks arising from its holding company owner's other business ventures—ventures more
12 complex and risky than a traditional utility business. Ring-fencing measures fall into the
13 following categories:

- 14 1. Prohibitions against the utility paying dividends to the holding company if
15 the payment reduces the utility's equity level below some specified level.
16
17 2. Corporate separation measures that (a) prevent the utility from being
18 pulled into the bankruptcy filing of its parent or affiliate, and (b) protect
19 the utility's credit ratings from business risks elsewhere in the corporate
20 family.
21
22 3. Prohibitions against the utility loaning money to, or guaranteeing loans to
23 or otherwise supporting the debt of, or otherwise investing in, any holding
24 company affiliate.
25
26 4. Limits on internal reorganizations that would weaken the above-
27 mentioned measures.
28
29 5. Preservation of the regulator's authority to order the utility divested from
30 the holding company should the ring-fencing conditions be violated or
31 become inadequate.
32

33 The phrase "ring-fencing" overstates its effects, for two reasons: "Ring" implies that the
34 protections surround the utilities fully; and "fence" implies that the protections have no
35 holes. In holding company acquisitions of public utilities, ring-fencing is essential for

1 consumer protection, but it is not sufficient. After describing the typical features of ring-
2 fencing, I will describe its insufficiencies.

3 *b. Five risks that "ring-fencing" does not eliminate*

4
5 **Q. Is ring-fencing sufficient to protect utility customers from the risks of holding**
6 **company activities?**

7
8 **A.** No. Ring-fencing does not purport to remove, and does not remove, five risks NextEra
9 brings to HECO's utilities: holding company-imposed limits on the utilities' access to
10 equity capital, increases in the utilities' cost of equity and debt capital, certain bankruptcy
11 risks, NextEra's interference in the utilities' business decisions, and interaffiliate
12 transaction abuse. Nor does ring-fencing add the extra staff the Commission will need to
13 ensure that NextEra complies with the ring-fencing measures. I discuss each of these five
14 problems next.

15 *i. Limits on the utilities' access to equity capital*

16
17 **Q. Does ring-fencing prevent the acquisition from reducing the utilities' access to**
18 **equity capital?**

19
20 **A.** No. Today, the utilities' source of equity capital is HEI. HEI accesses the equity market
21 directly. NextEra's acquisition removes HEI from equity markets, making the utilities
22 dependent on NextEra for equity (other than preferred stock, which typically occupies
23 only a limited role in a utility's capital structure). NextEra will be taking on more
24 business risk (such as by investing in states and countries whose business conditions and
25 regulatory rules the Commission cannot influence). NextEra's business risks can cause it
26 financial troubles, leaving NextEra unable to provide the utilities the equity they need.

1 **Q. But doesn't ring-fencing protect the utilities from NextEra's business troubles?**

2
3 **A.** Ring-fencing can prevent the Hawai'i utilities from being pulled into NextEra's
4 bankruptcy, but that is not my point. NextEra is the utilities' source of equity. If NextEra
5 has business troubles, it could refrain from providing equity to the utilities; or worse, it
6 could impose spending caps on the utilities so as to increase the net utility revenues
7 available to relieve NextEra's troubles. Hawai'i's utilities have no source of external
8 equity other than NextEra. If they need that equity—such as to balance out their debt, to
9 fund expansion of their transmission systems to accommodate new renewables, to install
10 smart meters or invest in other features of advanced metering infrastructure—and
11 NextEra is not available, the utilities will be in trouble.

12 **Q. Can't the utility subsidiaries have the equity they need by issuing preferred stock or**
13 **using retained earnings?**

14
15 **A.** These possibilities are theoretical only. Preferred stock (which has characteristics of both
16 equity and debt) usually makes up only a small part of a utility's capital structure. And its
17 availability and price depend on the market's willingness to risk the investment. Any
18 normal willingness will be diminished by the parent's financial troubles, because these
19 new investors will have no idea whether and when conventional equity will arrive from a
20 parent tied up in bankruptcy court. As for the utility's retained earnings, there is no
21 reason to assume they will be sufficient to fund fully any major new capital expenditures.
22 Retained earnings are not some insurance reserve maintained by a utility for all situations
23 in which equity investment is necessary. If that were true, utilities would never need to
24 access external equity markets; they would fund all capital expenditures internally.

1 NextEra cannot have it both ways: arguing that the acquisition gives Hawai'i
2 utilities access to NextEra's greater financial resources, while saying it makes no
3 difference to Hawai'i if the utilities lose access to those resources.

4 *ii. Increases in the utilities' cost of debt*

5
6 **Q. Does ring-fencing protect against increases in the Hawai'i utilities' cost of debt**
7 **arising from their affiliation with NextEra?**

8
9 **A.** Not fully. As noted in Part III.C above (and as Applicants cannot dispute), the utilities'
10 credit reputation will be influenced by NextEra's financial condition. To the extent some
11 of the utilities' equity capital comes from NextEra debt, a downgrade of that debt can
12 make equity more costly for them. Furthermore, the utilities' own debt ratings can be
13 affected by downgrades of NextEra's debt ratings. Thus, the cost and availability of both
14 equity and debt capital for the utilities can be affected adversely by NextEra's condition.
15 This problem is not addressed by ring-fencing.

16 **Q. But won't the utilities have their own access to debt capital?**

17
18 **A.** Yes. But lenders to the utilities will care about the availability and cost of their equity
19 capital—which comes from NextEra. Why? Because the utilities' access to equity gives
20 lenders confidence that the utilities will repay their loans. Rational lenders will worry
21 that NextEra's own risks and needs for capital will reduce its willingness or ability to
22 supply equity to the utilities. That worry will cause those lenders to raise the cost of
23 loans to the utilities. Nothing about ring-fencing prevents this natural lender reaction.
24 Similarly, while the utilities will have their own credit ratings, those ratings can still be
25 influenced by the parent's access to and cost of capital, since the utilities' ability to pay
26 off their loans depends in part on the availability of NextEra's capital. A NextEra

1 bankruptcy, and NextEra financial stress generally, will not be a matter of indifference to
2 the utilities or their lenders.

3 *iii. Bankruptcy risk*

4
5 **Q. Would ring-fencing remove the risk that NextEra's business failures push the**
6 **Hawai'i utilities into bankruptcy?**

7
8 **A.** No. If NextEra fails, a typical ring-fencing measure would prevent NextEra from using
9 its control of HEI to bring the utilities into bankruptcy. Ring-fencing achieves this
10 protection by interposing between the holding company and the utility a "special purpose
11 entity" (SPE). The SPE is controlled by an independent director whose affirmative vote
12 is required for the utilities to enter bankruptcy. But this measure does nothing to protect
13 HECO's utilities from their own bankruptcy, should they suffer a cash or capital shortage
14 due to NextEra's financial stresses. If NextEra is in bankruptcy, the bankruptcy court
15 could limit NextEra's capital flows, thereby leaving Hawai'i's utilities without financial
16 support. The SPE cannot prevent that result.

17 In summary: NextEra's stresses can lead to utility stresses, resulting in utility
18 bankruptcy. Ring-fencing does not prevent this result, because it does not alter the
19 utilities' financial dependency on NextEra. It is that dependency on NextEra that makes
20 this transaction risky for the utilities and their customers.

1 *iv. NextEra's interference in utility business decisions*

2
3 **Q. Does ring-fencing prevent NextEra from controlling or otherwise interfering with**
4 **the Hawai'i utilities' activities in carrying out their public service obligations?**

5
6 **A.** No. NextEra (a) has business goals that are not readily compatible with the Hawai'i
7 utilities' public service obligations,¹¹⁶ but (b) opposes the Commission reserving power to
8 limit the ventures NextEra buys to advance those goals. Nor does NextEra commit
9 (legally, as opposed to aspirationally—as I will discuss in Part IV.C and D below) to
10 finding the best people and the best practices, giving them the necessary resources and
11 then "ring-fencing" those resources from diversion or distraction. If NextEra chooses to
12 limit the utilities' spending, or to exercise "strategic direction" that causes the utilities to
13 erect entry barriers to new competitors in distributed energy markets (the risk I discussed
14 in Part III.B.2 above), ring-fencing does not help.

15 *v. Interaffiliate transaction abuse*

16
17 **Q. Does ring-fencing ensure arm's-length relationships between HECO's utilities and**
18 **NextEra's affiliates?**

19
20 **A.** No. As I discussed in Part III.B.3 above, when two companies are in a real arm's-length
21 relationship, they behave as if unrelated. That means that each company (a) has no
22 economic need to deal with any other affiliate because each one has alternative trading
23 partners, and (b) has no legal obligation to deal with any other affiliate because it is free
24 to choose its own trading partners. Another feature of an arm's-length relationship is that
25 each affiliate is itself subject to effective competition—so it must act efficiently or risk
26 losing customers to its competitors.

¹¹⁶ As discussed in Part III.B and C above.

1 Like other utility commissions, the Commission has interaffiliate transaction rules
2 that seek to replicate arm's-length relationships. But the NextEra-HECO utilities
3 relationship will not be arm's-length. If it were, NextEra could not (a) impose spending
4 limits on HEI and its subsidiaries, (b) determine unilaterally (based on various business
5 objectives conflicting with the utilities' public service obligations) how much equity
6 NextEra should inject into HEI (and from HEI into the utility subsidiaries), (c) dictate
7 who sits on the boards of HEI and its subsidiaries, (d) choose the top utility executives, or
8 (e) establish what positions HEI its utility subsidiaries should take on regulatory issues
9 (including, for example, the timing of rate cases or ISO New England's transmission
10 priorities). NextEra and the Hawai'i utilities are not in an arm's-length relationship.
11 Nothing about NextEra's ring-fencing changes that fact.

12 Further, the Commission's interaffiliate transaction rules succeed only to the
13 extent they are heeded, and only to the extent noncompliance is detected and punished.
14 NextEra's acquisition of HECO multiplies the number and types of interaffiliate
15 transactions involving or affecting HECO's utilities, including transactions where a party
16 has an interest adverse to the utilities and their ratepayers. More transactions mean more
17 opportunity for breaking the rules. When motivation and opportunity combine with low
18 risk of detection, people run red lights, text while driving, and break regulatory rules.

19 Yet NextEra, as I explained in Part III.B.3.d.ii above, has said nothing memorable
20 or persuasive about how it will deal with the its rule-breakers: what internal enforcement
21 staff it will use; how that staff will be trained, compensated and promoted; what will be
22 the consequences for violators; and who on the executive team will be held accountable
23 for errors of underlings. Nor has NextEra offered to fund the extra Commission staff that

1 its "strategic" acquisition will make necessary. When an acquisition increases the
2 number and types of possible rule violations, the mere existence of rules does not protect
3 the public interest.

4 **Q. Isn't the Commission able to disallow from rates any utility costs associated with**
5 **inappropriate interaffiliate transactions?**

6
7 **A.** Yes, but after-the-fact disallowance does not protect consumers from the abuses that the
8 staff has been unable to detect. These types of costs and cost allocation were formerly
9 subject to review by the SEC under PUHCA, making it less important at that time for
10 states to review them also. With PUHCA repealed, there are more risks but fewer
11 protections.

12 * * *

13 **Q. What if the Applicants assert that eliminating all risk is not practical?**

14
15 **A.** They would be correct. Eliminating all risk is not practical—not where NextEra insists
16 on the right to engage in behaviors that cause risk, without Commission approval. And
17 that is the point. To object that we cannot eliminate all risk implies some right to engage
18 in behaviors that cause risk. NextEra does not have that right—unless the Commission
19 allows it. Allowing new risk to HECO's utilities, where the source of the risk is not
20 efforts to improve their service and lower their costs but NextEra's desire to invest in
21 businesses unrelated to and in conflict with the Hawai'i utilities' obligations, is not
22 consistent with the public interest.

1 5. *"After-the-fact" solutions do not work in "too-big-to-fail" settings*

2
3 **Q. Can't the Commission protect the utility customers by excluding from the Hawai'i**
4 **utilities' rates any increases in their cost of capital caused by NextEra's activities?**

5
6 **A.** Only if the medicine is not worse than the disease. The larger the problem faced by the
7 holding company, the more limited the regulator's options. Rate disallowances exclude
8 from the utility's revenue requirement costs not properly attributable to utility service.
9 Fines disgorge the wrongdoer's ill-gotten gains. But both types of financial penalties
10 share a weakness: The larger the penalty, the weaker the post-penalty company; and so
11 the greater the regulatory hesitance to impose the penalty. Unless there is some
12 alternative company ready, willing and able to replace the incumbent, the public interest
13 in a viable supplier competes with the public interest in assigning full financial
14 consequences for misbehavior. This moral dilemma is inherent in every too-big-to-fail
15 setting.

16 Furthermore, regulatory resources must keep up with regulatory complexity. Yet
17 neither HEI nor NextEra makes any promise to increase, or support any Commission
18 efforts to increase, the Commission's staff as NextEra's acquisitiveness adds complexity
19 that increases the staff's workload. Relying on financial penalties for structural abuse is
20 less effective than preventing risky structures to begin with.

21 6. *Experience, logic and economic theory show that the risks to HECO's*
22 *utilities are not "speculative"*

23
24 **Q. Are your concerns about NextEra's business risks speculative?**

25
26 **A.** No, they are factual:

- 27 1. The Commission does not know what activities the post-acquisition
28 NextEra will undertake, because due to the repeal of PUHCA 1935 there
29 is no legal limit on those activities' geographic or type-of-business scope.
30 That is a fact.

2. NextEra's next-era acquisition activities will occur outside the Commission's jurisdiction and control. That is a fact.
3. NextEra's acquisition aspirations are in tension with the HECO utilities' public service obligations. That is a fact.
4. The Commission does not know how small HECO's utilities will become relative to NextEra. After this acquisition the Hawai'i utilities will account for only 15% of NextEra's revenues, down from 91.5% of HEI's based on 2014 figures.¹¹⁷ Nor does the Commission know how small is too small, or how many unrelated affiliates are too many unrelated affiliates (NextEra has more than 900¹¹⁸), before the utilities' welfare becomes too small to matter to NextEra. That is a fact.

Those who call these concerns speculative are the ones who speculate. They speculate that (a) shrinking the Hawai'i utilities' contribution to the holding company's financial well-being will not reduce the holding company's commitment to the utilities' well-being; (b) NextEra's non-Hawai'i business activities will not conflict with the utilities' service obligations; (c) business failures within the NextEra corporate family will not occur—and if they do, they will have no adverse effect on the utilities; and (d) magnifying the complexity of the regulatory task will not strain the Commission's limited regulatory resources. NextEra cannot prove these negatives. To assume them away is speculation.

Applicants' speculation is underscored by NextEra's refusal to limit its future activities. Applicants say that "the activities in which Hawai'ian Electric Industries ("HEI") subsidiaries were engaged around the time of the Thomas Report, including shipping, insurance and real estate activities, are no longer applicable," and that "NextEra

¹¹⁷ See Response to OP-IR-1 (based on 2014 figures). See also Part III.D.

¹¹⁸ Response to OP-IR-31.

1 Energy does not currently have any plans to create any new nonutility subsidiaries under
2 Hawai‘ian Electric Holdings or the Hawai‘ian Electric Companies."¹¹⁹ That is the
3 picture of NextEra only on the day of the acquisition (and only if we ignore NextEra
4 efforts to buy the \$10-20 billion Texas electric company Oncor from the bankrupt Energy
5 Future Holdings¹²⁰ and also ignore NextEra's 900 subsidiaries). And the issue is not
6 whether the to-be-acquired non-utility subsidiaries are "under" the Hawai‘i utilities. If
7 they are in the same corporate system as the Hawai‘i utilities, their risks can affect the
8 Hawai‘i utilities. Wisconsin's holding company statute recognizes this problem by
9 limiting the size and types of non-utility businesses that may be in the same holding
10 company family as a Wisconsin utility.¹²¹

11 NextEra wants this static picture to fill the Commission's eye-space, to be copied
12 into an order approving the transaction. But by its own public statements, NextEra is not
13 a not a static company; it is a trajectory aiming for "growth" through future acquisitions.
14 Post-acquisition NextEra is all that the application portrays—plus all the motivations,

¹¹⁹ Response to OP-IR-29.

¹²⁰ See N. Sakelaris, "Who's leading the pack in the hunt for Oncor," *Dallas Business Journal* (June 11, 2015) (stating that NextEra has "emerged as the leading contender," and that the company "could be worth as much as \$20 billion"); M. Monks, ""NextEra seen as front-runner for Oncor Electric Delivery," *Star Telegram* (June 11, 2015) (citing Oncor CEO statement that the company is worth at least \$10 billion).

¹²¹ Wisconsin's Holding Company Act limits the "sum of the assets of all non-utility affiliates" in a holding company system to a number derived from a complex calculation related to 25% of the system's utility assets. WISC. STAT. Sec. 196.795(6m)(b)(1)(a). The Seventh Circuit upheld this portion of the Wisconsin statute against Commerce Clause attack. *Alliant Energy Co. v. Bie*, 330 F.3d 904 (7th Cir. 2003). In that Commerce Clause litigation, I was an expert witness for the State of Wisconsin.

1 plans, strategies and tactics that exist within any acquisition-oriented enterprise no longer
2 constrained by the Public Utility Holding Company Act of 1935. NextEra's next moves
3 remain undisclosed to the Hawai'i Commission, just as this acquisition was not disclosed
4 (I assume) to the Florida Commission. Post-acquisition NextEra is the classic black box.

5 **7. *Solutions and conclusions on NextEra's business activities***

6
7 **Q. On the subject of NextEra's business activities, what do you recommend?**

8
9 **A.** The correct solution is to disapprove the transaction. Hawai'i does not need, and is not in
10 a position to manage, NextEra's additional complexity and risk.

11 If the Commission chooses to approve, it should establish a condition requiring
12 the Commission's permission before NextEra makes any acquisition of a size or type that
13 the Commission determines could harm HECO's utilities. I will present this condition in
14 Part VI.B.1.a. I acknowledge that this concept has not been a common feature in other
15 state merger cases. Until recently, it didn't have to be. For the many mergers prior to
16 2005, it was not as necessary as it is now, because Section 10(c)(2) of PUHCA 1935
17 restricted mergers and acquisitions to those that "tend[ed] towards the economical and
18 efficient development of an integrated-public utility system." Further, some states, like
19 Wisconsin, might have statutes that directly limit the amount and type of businesses that
20 may exist in a utility holding company system. For the remaining states, their omission
21 of a condition like this has left them less able to prevent situations where their local
22 utility becomes a smaller part of a more complex holding company system.

1 **Q. What if the Applicants resist this condition?**

2
3 **A.** Resisting this condition is equivalent to insisting on the right to make unilateral decisions,
4 unchecked by the Commission, on what future risk-adding investments to make. That is
5 not a public interest attitude, and it will not produce a public interest result.

6 **D. *The acquisition diminishes the Hawai‘i utilities' importance to their holding***
7 ***company owner***

8
9 **Q. How does this transaction affect the Hawai‘i utilities' importance to their holding**
10 **company owner?**

11
12 **A.** In terms of revenues and net income, the Hawai‘i utilities' importance will shrink six-fold
13 and twelve-fold, respectively. When owned by HEI only, Hawai‘i's electric utilities
14 contribute 92% and 82% of HEI's consolidated revenues and net income, respectively.¹²²
15 When owned by NextEra, "Hawai‘ian Electric Industries' approximate share of NextEra
16 Energy's total (a) revenues would have been 15%, ... [and (c) net income would have
17 been 5%."¹²³ HEI has 450,000 customers; FPL has 4.7 million customer accounts. In
18 terms of generation in operation, HEI has 1787 MW; FPL has 25,586 MW and NextEra
19 Resources has an additional 18,671 MW.¹²⁴

20 **Q. How will the Hawai‘i utilities' diminished role affect the Commission's ability to**
21 **regulate their performance?**

22
23 **A.** As Hawai‘i's relative contribution to shareholder earnings declines, so will NextEra's
24 stake in what the Commission thinks. NextEra will, literally, care less about Hawai‘i

¹²² HEI 2014 10-K Report at 4. HEI's 2014 revenues were \$3.24 billion. The electricity revenues were \$2.99 billion. See HEI's 2014 10-K Report at 38-39.

¹²³ Response to OP-IR-1 (based on 2014 figures).

¹²⁴ Applicants' Exh. 16 at 93.

1 than HEI does today. That is a mathematical inevitability. When a company cares less
2 about its regulator's priorities, internal accountability necessarily diminishes. Then the
3 regulator must work harder to induce the utility's performance.

4 That performance depends on three things: (1) The regulator must set clear
5 expectations, and (2) the regulator must align the utility's compensation with its
6 performance; so that (3) the utility values those expectations as if its life depended on
7 meeting them. Success on each of these three dimensions requires a productive
8 relationship between utility and regulator.

9 **Q. What do you mean by a productive relationship between utility and regulator?**

10 **A.** The utility-regulator relationship is hierarchical. The utility owes its role to the
11 regulator's (or state's) grant of a franchise; the utility's profit depends on the regulator's
12 satisfaction. The utility literally lives by the regulator's rules. But this hierarchical
13 relationship is also a working relationship. For a working relationship to work—for it to
14 produce high-quality performance at relatively low cost—we need more than rules and
15 compliance. We need the prerequisites for any productive relationship: professionalism;
16 mutual respect for each entity's mission; a continuous search for the commonalities and
17 interdependencies between those separate missions; the credibility and trust that grows
18 from communicating with facts, logic and law rather than other forms of persuasion; and
19 a shared understanding of the inputs and outputs that produce and define success.
20

21 Regulators cannot force performance. They cannot create the utility's corporate
22 culture, hire its top executives or set executive and employee compensation. Regulators
23 cannot order excellence. They can try to induce certain behaviors through financial
24 consequences, both positive and negative. But these are blunt, limited tools. Granting

1 extra profits for certain initiatives risks under-investment in other initiatives. And
2 penalties are problematic: Where the regulator has no alternative to the incumbent, a
3 penalty proportionate to the error can leave the utility unable to correct that error.

4 For these reasons, a productive utility-regulator relationship must be more than
5 hierarchical; it must be rooted in mutual commitments to a set of public interest values
6 defined by the regulator and absorbed by the utility. The utility's leadership must be
7 active, focused and cooperative. Its priorities must be aligned, always, with the
8 regulator's.

9 So in assessing a migration of the Hawai'i utilities—all of whose profit currently
10 depends on satisfying the Commission—to an acquisition-oriented holding company
11 whose profit stake in Hawai'i is much lower, on a percentage basis, than HEI's—the
12 Commission needs to know that this alignment exists. That knowledge cannot come
13 from vague, noncommittal verbalizing about "best practices," "financial strength" and
14 other boilerplate phrases that regularly appear in merger proposals.

15 **Q. What is the solution to this problem?**

16
17 **A.** The solution—other than to reject the transaction—is to condition this acquisition on
18 NextEra's binding commitment that there will be no further reduction in the HECO
19 utilities' importance to their holding company owners without the Commission
20 permission. I offer such a condition in Part VI.B.1.a below.

1 ***E. The character and goals of NextEra's shareholders—and the pressure they put***
2 ***on Hawai'i's utilities—will change in unknown ways***
3

4 **Q. How will the acquisition change the characteristics of the ultimate shareholders of**
5 **HECO's utilities?**
6

7 **A.** No one knows. The Applicants "have not conducted an analysis comparing Hawai'ian
8 Electric's current shareholders with NextEra Energy's current shareholders, ... and are
9 therefore unable to detail any differences that may exist."¹²⁵ So they, and the
10 Commission, cannot know if the new set of shareholders owning the Hawai'i utilities
11 (*i.e.*, NextEra's ultimate shareholders) will create pressures inconsistent with Hawai'i's
12 goals.

13 The Applicants do recognize that different types of shareholders have different
14 goals: "Investors who invest in regulated businesses generally do so in pursuit of a stable
15 investment (*e.g.*, consistent earnings and dividends)."¹²⁶ NextEra's has stated that
16 "grow[ing] earnings from regulated businesses"¹²⁷ is "one facet of [its] strategy because
17 the investors who invest in NextEra Energy's stock are attracted to companies with
18 significant earnings from regulated businesses."¹²⁸

19 But NextEra seems to assume an equivalency between the goals of NextEra
20 shareholders and those of HEI's current shareholders: "While the exact makeup of
21 investors may change from utility holding company to utility holding company, the

¹²⁵ Response to OP-IR-26.

¹²⁶ Response to OP-IR-14.

¹²⁷ Exh. 10 at p.6/160.

¹²⁸ Response to OP-IR-14.

1 objectives of the investors are largely consistent."¹²⁹ This assumption has no evidentiary
2 basis; as I just noted, "Applicants have not conducted an analysis comparing Hawai‘ian
3 Electric's current shareholders with NextEra Energy's current shareholders, ... and are
4 therefore unable to detail any differences that may exist."¹³⁰

5 Nor does NextEra's assumption have a logical basis. At least until now, HEI's
6 shareholders were content to own shares in a small, static utility that happened to own a
7 bank, where the utility and the bank are both in one location. NextEra, in contrast, is
8 aiming for dispersed acquisitions, epitomized by its efforts as of this writing make billion
9 dollar buys of utilities in Texas and Hawai‘i. HEI has been a risk-minimizer, having shed
10 the non-utility businesses it owned at the time of the Thomas Report.¹³¹ NextEra is a
11 risk-taker, with its 900 subsidiaries and its major bets on nuclear power on natural gas.
12 And NextEra, unlike HEI, has had no experience causing large amounts of renewable
13 energy and distributed energy resources, at the homeowner level, to penetrate,
14 economically and physically, a market historically controlled by a vertically integrated
15 monopoly. (FPL has very little renewable energy.) NextEra has no experience making
16 compromises necessary on a remote island where cultural factors are prominent and
17 influential.

¹²⁹ Response to OP-IR-27.

¹³⁰ Response to OP-IR-26.

¹³¹ *Review of the Relationship between Hawai‘ian Electric Industries and Hawai‘ian Electric Company* (1995).

1 So NextEra is a very different company from HEI, and its shareholders are likely
2 very different also. One difference, the Commission can logically infer, is that NextEra
3 shareholders are betting on value growth from more acquisitions. That is a risk factor. In
4 contrast, there is no evidence that HEI was attracting shareholders who wanted to bet on
5 acquisitions. HEI's path has been in the opposite direction—getting out of non-utility
6 businesses.

7 And NextEra's capitalization (\$69.3 billion) is over six times HEI's (\$11.2
8 billion).¹³² So when the current HEI shareholders exchange their stock for NextEra
9 stock, they will have a fraction of the influence over holding company decisions than
10 they had before. The Hawai'i utilities' future will be controlled by the pre-existing
11 NextEra shareholders, not the former HEI shareholders. From 100% influence to 1/6
12 influence: that is the path for HEI's current shareholders. Literally outvoted, they will be
13 unable to prevent the pressures the NextEra investors might bring on the corporate family
14 leadership—pressure for more acquisitions and more risks, all of which will affect the
15 leadership's priorities.

16 Further, bond rating agencies will face more complexity when rating bonds issued
17 by HECO's utilities. No longer can they look only at Hawai'i's economy, its electric and
18 gas market structures and its regulatory statutes and orders, along with the performance
19 of four local utilities. They must deal instead with dozens of factors arising from the
20 disparate regulatory environments in NextEra's portfolio—as that portfolio changes over
21 time without the Commission's review.

¹³² See NextEra 2014 10-K at 74; HEI 2014 10-K at 87.

1 In short, whether the dominant shareholder voice will be buy-and-holders or risk-
2 takers, pension funds or hedge funds, entities that buy long or entities that buy short,
3 those that focus on this year's profits or those that focus on the next decade's viability, the
4 Commission today has no idea. Given that different types of shareholders pressure
5 management for different types of decisions, including decisions that affect the cost and
6 quality of service (such as what to build vs. what to buy, when to seek rate increases, and
7 when to pay dividends), that uncertainty is not in Hawai'i's interest.

8 ***F. HECO's decisions will be subject to NextEra's control***

9
10 **Q. Has NextEra made a commitment to local control?**

11 **A.** No. "Commitment" means "a promise to do or give something."¹³³ NextEra had made
12 no promise; that is promise in a legal sense—a commitment, the breach of which, causes
13 a negative consequence to the breach-er.
14

15 Instead of a commitment we have, literally, indecision:

16 No decisions have been made with respect to post merger governance at
17 this time."¹³⁴

18 A list of executive positions for the Hawai'ian Electric Companies (post-
19 merger) and a description of their duties, responsibilities, *and authority*
20 does not exist."¹³⁵
21

¹³³ See <http://www.merriam-webster.com/dictionary/commitment>. The quoted definition is the dictionary's first (and thus primary) definition. The dictionary's third definition of "commitment" is "the attitude of someone who works very hard to do or support something." Regulators cannot rely on "attitude" because attitude is not enforceable. Regulators of monopolies must create obligations and enforce them, because customers have no alternative to the utility should "attitude" become variable.

¹³⁴ Response to PUC-IR-6(b), OP-IR-41 (the latter in response these questions: "What precise restrictions on spending by HECO utilities will NextEra impose? What specific individuals from NextEra will implement these restrictions?")

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Q. What types of utility decisions could NextEra control?

A. As a legal matter, all of them, because NextEra has not agreed to forego controlling any particular category. As for operational decisions—where to locate substations and when to trim trees, whom to buy fuel and wholesale power from, what type of demand response programs to offer, where to locate new infrastructure—there should be no debate over the Hawai‘i utilities' authority to make these decisions without NextEra interference. But since NextEra has yet to agree not to control these local decisions, the Commission should make NextEra's restraint a condition of any approval.

Then there are other utility decisions, integral to any utility's public service obligations, that NextEra will want to control because they affect NextEra's financial picture. Examples include:

1. if and when the utilities should seek rate increases or decreases;
2. how to make the trade-off between reliability and cost, *e.g.*, when to invest in distribution, transmission, generation, demand management or energy efficiency;
3. how to make the tradeoff between profitability and economic efficiency, such as whether to satisfy load by adding to rate base vs. encouraging demand management or energy efficiency;
4. whether, when and how much to spend on cybersecurity and storm response;
5. whether to fund public service investment by using retained earnings vs. accessing capital markets (and in the latter case, whether to issue equity or debt, and from whom to borrow and under what terms);
6. when to pay dividends to the parent, in what amounts; and

¹³⁵ Response to PUC-IR-103 (emphasis added).

1
2 7. what to say to bond rating agencies when they request information on the
3 utilities' earnings potential, cash flow and the "regulatory environment."
4

5 Under HEI's ownership, the utilities can make all these decisions nearly without holding
6 company interference, because except for ASB, HEI had no major business interests
7 other than its three utilities. But when these utilities become only a small part of a
8 holding company system many times their size, the utilities when making these decisions
9 will be subject to the influences and orders of NextEra. And as I explained in Part III
10 above, NextEra's business aims are not aligned with Hawai'i's needs.

11 One thing is definitive: NextEra intends to retain, and exercise, the power to
12 dictate and overrule the utilities' actions whenever NextEra wishes. Consider these
13 statements:

14 *[T]he President of the Hawai'ian Electric Companies will report directly*
15 *to the Chairman and CEO of NextEra Energy, as is the case for NextEra*
16 *Energy's other principal subsidiaries, Florida Power & Light Company*
17 *and NextEra Energy Resources.*¹³⁶
18

19 ...The Applicants envision that local management will be fully responsible
20 for the preparation of the Hawai'ian Electric Companies' capital budget,
21 *which will be subject to the review of the NextEra Energy Chairman and*
22 *CEO, and the approval of the NextEra Energy Board of Directors.*¹³⁷
23

24 ...The level of access and information that would allow NextEra Energy to
25 develop these plans in a prudent manner can only be gained *while*
26 *exercising operational control* as owner of the Hawai'ian Electric
27 Companies, as only then would NextEra Energy be able to fully
28 understand the strengths and any *limitations* in the Hawai'ian Electric
29 Companies' respective electric grids, systems, *operations*, and plans.¹³⁸

¹³⁶ Response to DBEDT-IR-41.

¹³⁷ Response to PUC-IR-41 (emphasis added).

¹³⁸ Response to OP-IR-7 (emphasis added).

1
2 [I]t is expected that NextEra Energy senior executive leaders would be
3 *involved in making decisions* related to ... resource allocations, assigning
4 human resources, budgetary control, technology platform and systems,
5 and availability of out-of-state NextEra Energy executive personnel to
6 address regulatory or service quality issues...."¹³⁹
7

8 NextEra objected to the notion that it would have the power to "overrule": "There is a
9 difference between oversight and overruling. The Hawai'ian Electric Companies will be
10 locally managed with oversight from NextEra Energy, with the President and CEO of the
11 Hawai'ian Electric Companies reporting to the Chairman and CEO of NextEra
12 Energy."¹⁴⁰ But wordplay does not replace reality. True, "oversight" and "overruling"
13 are not synonyms. But "oversight" includes the authority to overrule; otherwise it would
14 be mere monitoring. NextEra says so itself: "NextEra Energy's management and Board
15 of Directors have a fiduciary duty to the company's investors to review and approve,
16 *modify or reject* proposals from each of the company's business units."¹⁴¹

17 Owing includes the power to control—absent a Commission-imposed condition
18 that prohibits overruling without Commission approval. And that is a condition that
19 NextEra resists. In discovery, the Office of Planning asked NextEra's opinion on this
20 tentative condition:

21 NextEra shall guarantee that HECO utility management will create its own
22 budgets, free of any constraints imposed by NextEra, and that such
23 budgets will be approved by NextEra as submitted by HECO to NextEra.
24 HECO shall must its budgets to the PUC at the time it submits them to

¹³⁹ Response to CA-IR-29 (emphasis added).

¹⁴⁰ Response to OP-IR-35.

¹⁴¹ Response to OP-IR-102 (emphasis added).

1 NextEra. NextEra shall ensure that whatever funding is necessary to carry
2 out each HECO budget is made available to HECO. Executives of both
3 HECO and NextEra shall certify, according to a form and schedule
4 established by the Commission, that NextEra took no action to constrain
5 HECO's budget or to constrain HECO from raising the funds necessary to
6 carry out that budget.
7

8 NextEra said no: "The condition described in this request would delegate that duty to
9 others, and effectively strip the duties of business managers from the representatives of
10 the investors."¹⁴² In the unregulated world, managers must obey their investors. But in
11 that unregulated world we rely on competitive markets to induce the discipline that aligns
12 investor goals with the public interest. In HECO's monopoly world, we rely on
13 regulation ensure that alignment. NextEra here gets credit for candor: It does not want a
14 regulator intervening, even if that intervention aims to ensure that local decisions,
15 compelled by Hawai'i's public interest, are not overruled by representatives of the
16 investors' interests.

17 On this topic, NextEra's evidence has a gap. We know that Hawai'i CEOs will
18 report to the NextEra CEO. That fact necessarily means that the decisions about when
19 NextEra will overturn Hawai'i-level management will be made by the NexEra CEO. But
20 NextEra's CEO, Mr. Robo, is not a witness. Questions about whether and when
21 Mr. Robo will overturn Hawai'i-level judgments are not addressed by Mr. Gleason or by
22 anyone else—nor can they be. The only person who can address the question is
23 Mr. Robo. With this evidentiary gap, NextEra cannot carry its burden of proof on

¹⁴² Response to OP-IR-102.

1 whether local control will be maintained. Mere words don't count, especially coming
2 from individuals other than the one person who can give weight to those words.

3 **Q. How might NextEra exercise control over HECO's utilities?**

4
5 **A.** Control can be exercised directly (*e.g.*, by handing down orders from upper board to
6 lower board and on to local management); and indirectly (*e.g.*, by selecting as "local"
7 managers individuals likely to follow such orders). Another way to control is through
8 career ladders. Since NextEra is multiples larger than HECO, Hawai'i's employees will
9 have more opportunities for advancement. Executives aspire to higher positions. They
10 get those higher positions by pleasing their superiors. In an independent HECO, the top
11 managers can go only so far. If they want to advance in their field they must go
12 somewhere else. That means creating a record of excellence that those outside the
13 company will value. The risk here is that employees with ambition focus on pleasing
14 NextEra superiors based on financial factors, rather than achieving performance
15 excellence based on customer satisfaction. And with NextEra continuously considering
16 more acquisitions, there is a risk that managers who want to rise will be thinking about
17 growth through acquisitions—a goal unrelated to, and a distraction from, serving their
18 existing customers.

19 It is not possible to say what will be the effects of NextEra's superimposed
20 presence. But this new fact (NextEra executives above HECO's utility executives) means
21 a new risk (NextEra priorities influencing HECO's utility executives)—a risk that does
22 not exist today and one that is not consistent with Hawai'i's needs.

1 **Q. Are you surprised by the Applicants' failure to respond directly to questions about**
2 **local control?**

3
4 **A.** No. The gap between words and commitment is unsurprising, because hierarchical
5 control is inherent in the holding company form. As the Supreme Court has stated:

6 A parent and its wholly owned subsidiary have a complete unity of
7 interest. Their objectives are common, not disparate; their general
8 corporate actions are guided or determined not by two separate corporate
9 consciousnesses, but one. They are not unlike a multiple team of horses
10 drawing a vehicle under the control of a single driver. With or without a
11 formal "agreement," the subsidiary acts for the benefit of the parent, its
12 sole shareholder.¹⁴³

13
14 **Q. What about NextEra's commitment to create an "independent advisory group"?**

15 **A.** The idea is not objectionable. What is objectionable is NextEra's discomfort with candor.
16
17 To label as "independent" a body whose members and budget are chosen by NextEra is
18 not only to engage in inaccuracy; it is to deploy inaccuracy strategically to create an
19 impression of "good" when the reality is not "good." It is no different than advertising
20 cigarettes using pictures of dynamic sports figures instead of bedridden emphysema
21 patients. The Commission should be concerned about an acquirer who misuses language
22 that way. To call the advisory group "handpicked" would be crass, but accurate.
23 NextEra management will choose the members, who will have no authority but to
24 "advise".¹⁴⁴ If NextEra wants the advisory group to be independent, let it be

¹⁴³ See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984) (holding that "Copperweld and its wholly owned subsidiary Regal are incapable of conspiring with each other for purposes of sec. 1 of the Sherman Act").

¹⁴⁴ "It is envisioned that members of the advisory board will be appointed by the Chairman and Chief Executive Officer ("CEO") of NextEra Energy based upon the advice and recommendation of the President and CEO of the Hawai'ian Electric Companies." Response to CA-IR-19.

1 independent. Let the members be chosen by the Commission, or by intervenors in this
2 case.

3 **G. *This transaction conflicts with Hawai‘i's needs because HEI board placed***
4 ***acquisition price before customer interest***
5

6 **Q. You have explained how this transaction will cause Hawai‘i consumers five**
7 **categories of harm. Does this harm have a common source?**
8

9 **A.** Yes. The common source is the actions of HEI Board in choosing NextEra and
10 negotiating the terms. In Part III.G, I will establish factually that HEI's goal was highest
11 return for its shareholders, not best performance for its utilities' customers. I then will
12 explain that by seeking the highest return for its shareholders, HEI undermined its
13 utilities' obligations to their customers. The value that HEI obtained, known as the
14 control premium, overcompensates HEI shareholders, denies customers benefits
15 proportionate to their burdens, and distorts the market for utility mergers.

16 **1. *HEI's goal was highest return for its shareholders, not best performance***
17 ***for its utilities' customers***
18

19 **Q. Describe the premium to HEI's shareholders from NextEra's acquisition offer.**
20

21 **A.** Although this transaction is largely a stock-for-stock exchange, NextEra is paying a
22 premium to HEI shareholders.¹⁴⁵ The purchase price (in the form of NextEra stock
23 received by HEI stockholders) represents a premium of 26.2% - 29.4% over the implied
24 market valuation of the Hawai‘ian Electric Companies' utility business.¹⁴⁶ Other

¹⁴⁵ See Response to OP-IR-21 (explaining that the transaction "reflects an incremental acquisition premium being paid by NextEra Energy in the form of shares of NextEra Energy stock that are being exchanged for HEI shares").

¹⁴⁶ NextEra Energy Inc., Amendment No. 3 to Form S-4 at 38 (Mar. 24, 2015) (hereinafter referred to as "Form S-4"). See also Response to CA-IR-213: "JPM's [J.P.

1 premium numbers are in the record. For example, Applicants' Exh. 16 (at p.92) states:
2 "Total value to HEI shareholders of app. \$33.50/sh, representing about 21% premium to
3 HEI's 20-day volume-weighted average price through Dec. 2, 2014." Applicants clarified
4 that this 21% premium was worth about \$599 million, but cautioned that it "is an estimate
5 of the premium for all of HEI, including American Savings Bank, and not just for the
6 Hawai'ian Electric Companies." Response to OP-IR-'17. Applicants also caution that
7 "[i]t is not possible to quantify the premium with certainty."¹⁴⁷ I will refer to this
8 premium as the "control premium."¹⁴⁸

9 **Q. What role did HEI play in influencing the size of the premium?**

10
11 **A.** The undisputed facts lead to two indisputable conclusions. First, HEI's Board took the
12 actions it deemed necessary to ensure that its shareholders received the highest price
13 possible. Second, in choosing NextEra rather than consider alternative actions, HEI's
14 Board gave no visible weight to its customers' interest.

Morgan Securities] analysis supported the conclusion that the merger proposal provided a significant value for HEI shareholders, reflecting a 20.9% premium to the 20-day, pre-announcement volume weighted average share price ("VWAP"), and a 29.4% premium to the intrinsic value of the Hawai'ian Electric Companies and HEI (excluding ASB) paid by NextEra Energy based on the 20- day VWAP and assuming research analyst consensus of \$8.00 per share for ASB."

¹⁴⁷ Response to DBEDT-IR-57.

¹⁴⁸ For a discussion of the various uses of the term "premium" see Part III.G.3 below. For the most part, I will focus on this "control premium"—the excess of the value HEI shareholders receive from NextEra over the value of HEI's stock over a specified period.

1 **Q. Describe the relevant facts about how the parties reached the final purchase price.**

2
3 **A.** The leadership of the two entities negotiated roughly from May 2014 to December 2014.

4 NextEra's narrative makes clear that HEI was preoccupied with price, not service.¹⁴⁹

5 May: NextEra Chairman and CEO Jim Robo proposes a price for all of HEI
6 (including both Hawai‘ian Electric and American Savings Bank) of \$30.00 per
7 HEI share, with the price to be paid in either cash or NEE common stock at HEI's
8 option. There was no mention of, let alone commitment to, customer benefits.
9

10 July 21: HEI Board authorizes management to tell NextEra that the price "was
11 insufficient but that if NEE would be willing to consider increasing the proposed
12 merger consideration, HEI would be willing to enter into a confidentiality
13 agreement and allow the commencement of due diligence to support an increase
14 in proposed merger consideration." As clarified by Applicants: "Since the
15 *amount of the merger consideration was a gating issue* for the HEI Board, the
16 HEI Board determined at the July Board Meeting only that the amount of the
17 merger consideration was unacceptable."¹⁵⁰ Again no mention of, let alone
18 required commitment to, customer benefits.
19

20 Aug. 11: HEI's Executive Vice President and Chief Financial Officer Ajello
21 sends letter to NextEra's Vice Chairman and Chief Financial Officer Dewhurst,
22 "reiterating the need for NEE to increase the value of its proposal and attaching
23 initial diligence information with respect to American Savings Bank and
24 Hawai‘ian Electric and a term sheet with respect to certain high level terms of a
25 possible transaction between NEE and HEI... The proposal specified that the
26 operational headquarters of HEI's utility business would remain in Honolulu,
27 Hawai‘i and expressed the need for commitments by NEE relating to employee
28 job protections in connection with the merger and the maintenance of HEI's
29 historic levels of community involvement and charitable contributions." Once
30 again, no mention of, let alone required commitment of, customer benefits.
31

32 Late Aug.: Dewhurst sends letter to Ajello effectively raising the price offer. He
33 acknowledged HEI's wish to spin off American Savings Bank and proposing that
34 NEE would pay HEI shareholders \$24.50 for each share of common stock in HEI

¹⁴⁹ The narrative is contained in NextEra Energy Inc., Amendment No. 3 to Form S-4 at 30-41 (Mar. 24, 2015), from which all quotes are drawn unless otherwise noted. All emphases are added. More detailed excerpts from the Form S-4 appear in Planning Office Exhibit-5.

¹⁵⁰ Response to PUC-IR-110 (emphasis added).

1 (that is, HEI without ASB—so that the \$24.50, while less than the Robo's original
2 \$30, represented a higher offer for what would remain in HEI—namely, HECO,
3 HELCO and MECO). NEE also indicated willingness to absorb up to \$130
4 million of the corporate tax liability resulting from the ASB spin-off.
5

6 Late Aug.: Ajello "indicat[es] that HEI would be seeking improved financial
7 terms."
8

9 Sept. 5: After meeting with management and advisors, HEI Board concluded, "in
10 light of the proposed merger consideration and the regulatory approvals required
11 to complete a transaction, that the likelihood of securing a superior proposal was
12 low, from both a financial and a deal certainty perspective.... [T]he HEI board
13 authorized management to enter into further due diligence and negotiations with
14 NEE *to seek enhanced value* and to negotiate the terms of a potential merger
15 agreement with NEE."
16

17 Sept. 11: "NEE communicated a revised proposal to HEI, in which NEE would
18 pay HEI shareholders \$25.00 per share of HEI common stock and HEI's bank
19 business would be spun off to HEI's shareholders. NEE further agreed that it
20 would bear the full expected corporate tax liability resulting from the bank spin-
21 off." (As distinct from NextEra's late August offer, which as noted under the first
22 "Late August" paragraph, capped its tax absorption at \$130 million.)
23

24 Oct. 16: "Following discussion [at an NEE board meeting of Oct. 16, 2014], the
25 NEE board of directors authorized NEE management to proceed with the
26 proposed transaction at a valuation of up to \$25.50 per HEI share."
27

28 Through mid-November: NEE agreed that HEI could pay HEI shareholders a
29 special cash dividend of \$0.25 per share without reducing the price NextEra
30 would pay. Then, "[f]ollowing further discussion, HEI continued to seek an
31 increase in the merger consideration and proposed increasing the special cash
32 dividend to \$0.50 per share. NEE indicated that the increased special cash
33 dividend was acceptable to NEE. In the context of these discussions, HEI also
34 acceded to NEE's position that the merger consideration be determined by a fixed
35 exchange ratio, while NEE agreed to HEI's position that the fixed exchange ratio
36 should be calculated based on the twenty day volume weighted average price of
37 NEE common stock as of the day prior to the signing of the merger agreement."
38

39 Through the end of November: "Following further discussions, ... NEE indicated
40 that it was unwilling to increase the proposed merger consideration above \$25.00
41 in NEE stock per HEI common share in light of its acceptance of HEI's proposed
42 special cash dividend to HEI shareholders of \$0.50 per share."
43

44 Dec. 2: The parties agree on "a fixed exchange ratio of 0.2413 shares of NEE
45 common stock for each outstanding share of HEI common stock, which was
46 derived by dividing the agreed upon \$25.00 per HEI common share merger

1 consideration by the volume weighted average price of NEE common stock for
2 the twenty trading days ended December 2, 2014." The exchange ratio assumes
3 spinoff of ASB and the \$0.50/share cash dividend to HEI shareholders.
4

5 **Q. Is there evidence that in choosing an acquirer, HEI viewed purchase price as more**
6 **important than utility performance?**
7

8 **A.** Yes; there are two types of evidence—one affirmative, one negative. The affirmative
9 evidence is the narrative in the Form S-4, confirming that the HEI Board sought and
10 received assurance that it could not get a better price from some other suitor:

11 1. "Alternatives to the Merger. The HEI board took into consideration its
12 belief that, after careful consideration of potential alternatives to the
13 merger, the merger with NEE is expected to yield *greater benefits to HEI*
14 *shareholders (including the benefits discussed above) than would the*
15 *range of alternatives considered.* The potential alternatives considered
16 included various standalone strategies, including generation portfolio
17 diversification and business separation, and the attendant risks of each of
18 them, including the risks of HEI's utility's transformation plan. The HEI
19 board also took into account its belief that *no other party was likely to*
20 *offer greater consideration* in a sale of the company, particularly taking
21 into account NEE's agreement to bear the expected corporate tax liability
22 of the bank spin-off."¹⁵¹
23

24 2. "Management Recommendation. The HEI board took into account the
25 recommendation of senior management of HEI that the merger *is in the*
26 *best interests of HEI's shareholders* based on their knowledge of current
27 conditions in the electricity generation, distribution and transmission
28 industry and markets and the likely effects of these factors on HEI's and
29 NEE's potential growth, productivity and strategic options, and on their
30 understanding of the benefits that would flow from the separation of HEI's
31 banking operations."¹⁵²
32

33 3. After receiving NextEra's proposal, HEI's Board "carefully considered
34 other potential strategic alternatives including remaining as a standalone
35 company and *identifying companies that possibly might be interested in*
36 *acquiring the utility business or the bank business.* On the basis of careful

¹⁵¹ NextEra S-4 at 40 (emphases added).

¹⁵² NextEra S-4 at 41 (emphases added).

1 consideration of the information and analysis provided to the Board by its
2 staff and consultants, the Board concluded in the exercise of its business
3 judgment that it was *highly unlikely that a possible counterparty existed*
4 *that would be willing and able to match the terms of the proposed*
5 *transaction agreed to by NextEra Energy* and that the risks of 'shopping'
6 the company under these circumstances exceeded any likely benefits."¹⁵³
7

8 4. "Premium Compared to Other Utility Transactions. The HEI board
9 considered that the premiums described above *compare favorably with the*
10 *premiums reflected in many other transactions* in the utility industry
11 announced since October 2010. For the transactions reviewed by the HEI
12 board, the median premium based on the twenty day volume weighted
13 average trading price as of the announcement date of the transaction was
14 13.5%, with the premiums ranging from 2.5% to 30.1%."¹⁵⁴
15

16 5. "J.P. Morgan reviewed potential third parties, explaining that the
17 likelihood of a superior offer was low, both from a financial perspective
18 and a deal certainty perspective.... To date, no third party has emerged *to*
19 *meet or beat the terms* of the merger agreement negotiated with NEE."¹⁵⁵
20

21 6. "HEI Board of Directors relied upon the advice of HEI's expert financial
22 advisor, J.P. Morgan Securities ("JPM"), to review the transaction and
23 opine on the "fairness" of the merger proposal *relative to the intrinsic*
24 *discounted cash flow value* of HEI's subsidiary business plans and assets,
25 including HEI holding company net liabilities, its current trading levels,
26 other comparable transactions as well as utilizing research analyst price
27 targets as a reference price."¹⁵⁶
28

29 The second type of evidence is the absence of evidence. In their negotiations, as
30 summarized by the Form S-4, the parties never bargained over consumer benefits. They
31 never bargained over consumer benefits because, at least according to the Form S-4, at no
32 point did Ms. Lau, Mr. Ajello, or anyone else from HECO make even a single demand

¹⁵³ Response to DBEDT-IR-12 (emphasis added).

¹⁵⁴ NextEra S-4 at 39 (emphases added).

¹⁵⁵ Response to DBEDT-IR-97 (emphasis added).

¹⁵⁶ Response to CA-IR-213 (emphasis added).

1 for about customer benefits. Customer benefits were, literally, besides the point. No one
2 gathered serious information, conducted serious analysis or made any serious plans,
3 about performance. The managers who will be responsible for making performance
4 happen were nowhere near the negotiations.

5 This absence of effort for the consumer is clear from the very documents that
6 begot this transaction. The Merger Agreement (Exhibit 3 to the Application) has 91
7 pages of single-spaced prose. More pages flow from the two "fairness opinions"—each
8 side having bought its own so as to be certain it was receiving maximum value.
9 Thousands of words typed, billions of dollars negotiated, all this effort—solely to ensure
10 that both sets of shareholders receive benefits in appropriate relation to cost, and to
11 protect them from transactional disappointment. But for the utility customers, the
12 Applicants have calculated nothing, written nothing, promised nothing, protected
13 nothing. If the chief motivation for this transaction was to improve performance, one
14 would expect HEI to have extracted *something* from NextEra. The record shows that
15 HEI asked for, let alone extracted, nothing.

16 **Q. Are you saying that in HEI's decisionmaking, consumer benefits were irrelevant?**

17
18 **A.** Almost. I am not suggesting that HEI decisionmaking process ignored, completely, its
19 utilities' customers. I will assume that HEI did enough checking to make an educated
20 guess that its chosen acquirer would (a) at least not make HECO's performance worse
21 (although there is zero evidence that any Hawai'i utility decisionmaker considered the
22 risks I described in Part III.C and D above), and (b) make some improvement in the
23 Hawai'i utilities' performance. But the central factor, the dominant factor, the
24 determinative factor according to Form S-4, the only factor considered by the outside

1 consultants, was value to shareholders, not performance for customers. HEI could have,
2 and should have, done the opposite: It should have caused prospective acquirers to
3 compete first based on customer performance, and only then on offer price. HEI had it
4 backwards.

5 **2. By seeking highest return for its shareholders, HEI undermined its**
6 **obligations to the customers**

7
8 **Q. By placing priority on highest return for shareholders rather than best possible**
9 **service to its customers, how did the HEI Board's behavior square with its utilities'**
10 **obligation to serve?**

11
12 **A.** The HEI Board's behavior was inconsistent with its utilities' obligation to serve. A public
13 utility has an obligation to serve its customers using the most cost-effective practices, and
14 at the lowest feasible cost. Consider these precedents:

- 15 1. A utility must "operate with all reasonable economies."¹⁵⁷
16
17 2. A utility has an obligation to serve at "lowest feasible cost."¹⁵⁸
18
19 3. A utility must use "all available cost savings opportunities...as well as
20 general economies of management."¹⁵⁹
21

22 Had HEI'S Board viewed its utilities' obligations as its primary obligation, it
23 would first have sought and screened prospective acquirers for their ability to meet the
24 above-quoted standards. Then, having selected a sample of performers based on merit, it

¹⁵⁷ *El Paso Natural Gas Co. v. Federal Power Commission*, 281 F.2d 567, 573 (5th Cir. 1960).

¹⁵⁸ *Potomac Elec. Power Co. v. Pub. Serv. Comm'n of the D.C.*, 661 A.2d 131, 137 (D.C. 1995).

¹⁵⁹ *Midwestern Gas Transmission Co. v. E. Tenn. Natural Gas Co.*, 36 FPC 61, (1966), *aff'd sub nom. Midwestern Gas Transmission Co. v. Federal Power Commission*, 388 F.2d 444 (7th Cir. 1968).

1 would have caused to them compete for HEI's favor by offering performance
2 commitments to the customers. And then, having obtained real commitments through
3 competition, the Board could have induced the surviving competitors to compete on
4 price. By making customer benefits irrelevant, HEI failed to consider companies whose
5 acquisition price bids would be lower but whose effectiveness in serving customers
6 would be higher.

7 The Board's behavior has denied the Commission the knowledge it needs to find
8 this transaction in the public interest. Without making objective comparisons between
9 NextEra and others, there is no way to know whether Hawai'i will be receiving, in return
10 for awarding control of a monopoly franchise to NextEra, the quality-cost package that
11 Hawai'i deserves. Given NextEra's burden of proof, its evidentiary failure is fatal.

12 **Q. What's wrong with the seller of an asset seeking the highest possible price?**

13
14 **A.** Nothing, if all parties affected by the transaction are subject to effective competition, or
15 by a regulatory rule that replicates effective competition. Consider the sale of an
16 apartment building, in a city with plenty of apartment vacancies. The interests of the
17 building seller, building buyer and renters are aligned. The building seller will demand
18 the highest possible price, but the buyer will resist paying a price above what he predicts
19 he can recover as he competes for tenants in the rental market. So the building buyer will
20 pay a premium no greater than the new economic value he believes he can create as the
21 new owner. That new economic value is a public interest benefit. In a market where
22 there is competition for the ultimate product (in this example, apartment rentals), an
23 acquisition contest run by the acquiree, based on highest possible price, can produce a
24 public interest result.

1 But monopoly utility service is not like competitive apartment rentals. The
2 consumers who depend on a utility's monopoly distribution service cannot shop
3 elsewhere. That is why the interests of the asset seller, the asset purchaser and the
4 ultimate consumer are not aligned; that is why there is a conflict between the asset seller
5 and the ultimate consumer—between HEI and its utilities' customers. Holding out for the
6 highest price produces an outcome different from holding out for the best performer.

7 **Q. But doesn't regulation replicate the forces of competition?**

8
9 **A.** In theory yes. But in practice, there are problems. Regulation, like competition, has
10 imperfections. In the merger context, one imperfection in regulation is the asymmetry of
11 information. It is unlikely that a regulatory staff could establish for the post-merger
12 utilities, and enforce, the same performance standards that would result had HEI caused
13 suitors to compete based on performance, and then held the winner contractually to the
14 promised performance.¹⁶⁰ With this knowledge advantage, an acquirer of a utility
15 monopoly, unlike the acquirer of an apartment building in a competitive market with
16 vacancies, can pay a premium and recover it by keeping rates above costs, until the
17 regulator discovers the facts and adjusts the rates prospectively.

¹⁶⁰ See, e.g., Department of Justice/Federal Trade Commission, *Horizontal Merger Guidelines* at section 10 ("[Merger] efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms.").

1 In any event, in this instance the regulator did not establish, in advance of HEI's
2 actions, an expectation for performance that would have induced HEI to find the best
3 performer. That is a gap in regulatory policy that I recommend the Commission fill.¹⁶¹

4 **Q. Doesn't the board of a for-profit, publicly traded entity have a fiduciary duty,**
5 **imposed by the law of its incorporation state, to maximize the wealth of its**
6 **shareholders?**

7
8 **A.** I assume so. But a board's fiduciary duty to maximize shareholder wealth is always
9 subject to other obligations imposed by federal and state law. Otherwise, companies
10 could, without legal consequence, emit toxic waste and pay their workers sub-minimum
11 wages. Whatever fiduciary duty the HEI Board has to maximize its shareholders' wealth
12 is constrained by its utilities' franchise obligation to provide the most cost-effective
13 service to their customers. That is the obligation that the HEI Board violated when it bid
14 out its franchise based on highest possible price rather than best possible performance.
15 By rejecting this acquisition, the Commission will signal that the franchise is a privilege
16 to be earned through performance, not an asset to be bought with dollars.

17 **Q. The Commission has never said that a condition of acquisition approval is the target**
18 **company proving that it selected the acquirer based on performance for customers.**
19 **Are you asking the Commission to "change the rules mid-game"?**
20

21 **A.** No, because my position does not change the rules; it applies the rules. Regulatory law
22 requires that a utility provide serve cost-effectively. It also requires that regulators give
23 shareholders an opportunity to earn a reasonable return on investment in assets used and
24 useful in serving the public. These two principles ensure that shareholder return is

¹⁶¹ As discussed in Part VI.B.1.g below.

1 aligned with service to customers. The rule has never been that what commissions owe
2 shareholders is an opportunity to earn a return *at the expense of* customers.

3 Would it have been better for all had the Commission made this point more
4 explicitly and prior to this transaction? Yes. But the rule has existed implicitly.

5 Those who argue otherwise confuse, or blur, the distinction between investing
6 dollars in public utility assets and betting dollars in the stock market. The Applicants'
7 proposal is not a situation in which a utility invested dollars in utility assets based on
8 some Commission policy, and then the Commission changed that policy to the
9 shareholders' detriment. The HECO utilities' rates are lawful rates because they authorize
10 a return consistent with the statutory just and reasonable standard (and if the authorized
11 return falls below what the utilities consider lawful they have a right to seek an increase).
12 If the Commission rejects this acquisition, the utilities' rates still will be lawful, for the
13 same reason. The Commission has never promised more than an opportunity to earn the
14 authorized return investment in utility assets; the Commission has never promised
15 shareholders any particular return on their investment in utility stock. To require the
16 utility, in searching for acquirers, to find the best performer for consumers does not
17 conflict with any regulatory obligation to shareholders. There is, therefore, no "changing
18 the rules mid-game"—at least not for any game relevant to public utility regulation.
19 What would "change the rules of the game" would be to allow a utility board, whose
20 franchise obligation requires putting customers first, that the utility can ignore that
21 obligation whenever it has an opportunity to sell the franchise for a profit.

1 3. *The control premium paid by NextEra overcompensates HEI*
2 *shareholders, denies customers benefits proportionate to their burdens,*
3 *and distorts the market for utility mergers*
4

5 **Q. Explain the two components of the acquisition premium.**

6
7 **A.** The full acquisition premium is the excess of purchase price over book value. It consists
8 of two layers. In this acquisition, the bottom layer is the excess of HEI's pre-acquisition
9 stock value (adjusted to eliminate ASB), over the utilities' book value. The upper layer
10 consists of the excess of the purchase price over that same HEI's pre-acquisition stock
11 value. (Since ASB is being spun off, NextEra's purchase price does not reflect ASB's
12 value.) I will refer to the upper layer as the "control premium," because it is what
13 NextEra is paying to get control of the Hawai'i utilities. As noted in Part III.G.1, HEI
14 shareholders would receive a control premium of 26.2%- 29.4% over the implied market
15 valuation of the Hawai'ian Electric Companies' utility business, worth in the area of \$568
16 million.¹⁶²

¹⁶² This understanding of a two-part premium is shared by the Applicants. See OP-IR-20:

The acquisition premium, as distinct from the control premium defined in OP-IR-18, is the total compensation received by Hawai'ian Electric Industries' ("HEI's") shareholders as part of the transaction in excess of book value of HEI's common stock. A premium existed prior to the merger as HEI's stock was trading above the company's book value. As identified in this question, NextEra Energy is paying an incremental premium in the form of shares of NextEra Energy stock that are being exchanged for HEI shares. This premium in excess of book value, comprised of the component that existed prior to the merger and the component that NextEra Energy is paying to acquire the utility portion of HEI as well as HEI, are compensation for capital supplied and risks accepted by investors in HEI.

1 **Q. Explain your concerns about the control premium.**

2
3 **A.** The control premium overcompensates HEI shareholders for their investment in a
4 government-regulated utility. This conclusion flows from a basic understanding of the
5 statutory and constitutional obligation that regulators have to utility shareholders.

6 A shareholders's legitimate, legally-protected expectation is to receive a
7 reasonable opportunity to earn a fair return on the prudent investment made by the utility
8 in assets necessary to serve the public. As Justice Brandeis has stated, in famous
9 language repeated over the decades:

10 The thing devoted by the investor to the public use is not specific property,
11 tangible and intangible, but capital embarked in the enterprise. Upon the
12 capital so invested the Federal Constitution guarantees to the utility the
13 opportunity to earn a fair return.¹⁶³

14
15 The phrase "capital embarked in the enterprise," Justice Brandeis explained, is the money
16 invested in assets that serve the public, *i.e.*, book value, otherwise known as rate base:

17 The adoption of the amount prudently invested as the rate base and the
18 amount of the capital charge as the measure of the rate of return would
19 give definiteness to these two factors involved in rate controversies which
20 are now shifting and treacherous, and which render the proceedings
21 peculiarly burdensome and largely futile. Such measures offer a basis for
22 decision which is certain and stable. The rate base would be ascertained as
23 a fact, not determined as matter of opinion. It would not fluctuate with the
24 market price of labor, or materials, or money.... It would not change with
25 hard times or shifting populations. It would not be distorted by the fickle
26 and varying judgments of appraisers, commissions, or courts. It would,
27 when once made in respect to any utility, be fixed, for all time, subject

¹⁶³ *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276, 290 (1923) (Brandeis, J., concurring).

1 only to increases to represent additions to plant, after allowance for the
2 depreciation included in the annual operating charges.¹⁶⁴

3
4 When the regulator sets cost-based rates, utility shareholders receive this constitutionally
5 required compensation. The control premium is extra compensation—overcompensation.
6 It does not represent "capital embarked in the [public utility] enterprise"; *i.e.*, funds
7 invested in assets used to provide public utility service. It represents, rather, funds
8 NextEra is willing to pay HEI shareholders to get control of the utility franchises.
9 Because the control premium does not represent investment in utility service assets, HEI
10 shareholders have no legally protected expectation to receive it.

11 NextEra states it will not seek to recover the acquisition premium in rates.¹⁶⁵ But
12 that statement diverts attention from the real question. The real question point is not
13 whether NextEra should recover the premium; the real question is whether HEI's
14 shareholders should receive the premium. To understand this question it is useful to
15 distinguish again the two parts of the premium: (a) the excess of pre-acquisition stock
16 value over book value, and (b) the excess of purchase price over pre-acquisition stock
17 value.

18 Part (a) has nothing to do with the acquisition because it pre-dated the acquisition.
19 It reflects the common tendency for utility stock to trade at levels exceeding book value.
20 In contrast, Part (b), the control premium, reflects new value NextEra seeks to gain by

¹⁶⁴ 262 U.S. at 307-08. For additional discussion of this point, *see* Scott Hempling, *Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction* at 104-05 (American Bar Association 2013).

¹⁶⁵ See Direct Testimony of John Reed at 19-20.

1 taking control of HEI's utilities. There is no clear reason why HEI's shareholders should
2 receive that value. There is no evidence that this value was created by HEI shareholders'
3 risk-taking or its executives' managerial merit. The value, rather, reflects NextEra's
4 desire to control the utilities' franchise. But that franchise has value because of the
5 Hawai'i government's decision to grant HECO a monopoly over retail service, and also to
6 require ratepayers to support that monopoly by paying government-mandated rates
7 calculated to give the utility a reasonable opportunity to earn a fair return. Since the
8 value to NextEra of controlling the franchise results from the combination of
9 government-granted monopoly and government-mandated rates, there is no clear reason
10 why the value should go to HEI shareholders. At least some portion of the control
11 premium is logically deserved by the ratepayers. Yet the Merger Agreement grants 100%
12 of the control premium to HEI shareholders.

13 **Q. Do you have other concerns about the control premium?**

14
15 **A.** Yes. To allow the target shareholders to keep the control premium is to treat the utility
16 franchise like a New York City tax medallion—private good, a mere commodity, to be
17 sold by its owners to the highest bidder. But a utility is not like a taxi—one of thousands
18 of market participants competing for customers who can skip the cab in favor of a bus or
19 subway. A utility is not like a taxi, because a utility's customers are mostly guaranteed.
20 And so the utility franchise is not like a taxi medallion; it is not a private commodity.
21 The utility franchise is a privilege granted by government, an opportunity for private
22 profit accompanied by an obligation to provide a public utility service. The franchise
23 never loses its public character.

1 Here is another way to understand the control premium. When NextEra buys
2 100% of HEI stockholders' shares, NextEra is actually buying two things: the HECO
3 utilities' assets, and the HECO utilities' franchises. The assets were at book value on
4 HECO's books, and they will remain at book value after the acquisition (that is the
5 necessary result of NextEra's commitment not to recover the control premium in rates).
6 So if NextEra is paying only book value for the assets, the control premium must be
7 attributable to the franchises. NextEra is paying HEI shareholders a control premium to
8 get control of the franchises. But the franchises are not private commodities; they are not
9 like taxi medallions. *The franchises are not the HEI shareholders' assets to sell.* A
10 franchise is a government-granted right—the right to be the sole provider of a
11 government-defined service in a government-defined service territory. The franchise was
12 not created by the shareholders; it was created by government; it is not owned by the
13 shareholders; it is owned by the government. The value NextEra sees in the franchise is
14 not value created by shareholders through skill, risk or any other means; it is value by
15 government actions; specifically, the actions of granting HECO an exclusive right to
16 serve and of compelling customers to pay rates that comply with statutory and
17 constitutional standards.¹⁶⁶ And that is why allowing the HEI shareholders to keep the

¹⁶⁶ It is possible to argue that some part of the total premium is attributable to investors' expectation that the utility's *earned* return on equity will exceed the level *authorized* by regulators. Such excess earnings are possible if the utility incurs costs below, or makes sales above, the levels assumed by the regulator when establishing rates. (Or, conversely, if the utility persuades the regulator to set rates that reflect costs higher than, and/or sale volumes lower than, what the utility expects will occur.) But this increment of extra earnings—which can always be corrected prospectively in the next rate case—would not likely explain the control premium that exists here.

1 control premium is illogical: It reflects the franchise being auctioned by shareholders to a
2 bidder they chose based on the value paid them, rather than being awarded by the
3 government to the best performer.

4 As I explained in Part III.G.1, the HEI Board's priority was to get the highest
5 value for its shareholders. In an unregulated context, if corporate acquisition decisions
6 are driven by effective competition, paying and receiving a premium is routine and
7 legitimate. (Take careful note of the "if," because the preceding sentence does not work
8 if the acquirer is seeking to gain market power—the ability to exclude competitors and
9 then charge prices above competitive levels.). In markets subject to effective
10 competition, paying and receiving a premium is routine and legitimate because the
11 shareholder and customer interests are aligned. (Recall the apartment building
12 hypothetical: An acquirer facing effective competition in its ultimate product market will
13 pay no more for the target company than what it predicts it can recover by pricing
14 competitively, setting prices high enough to cover costs and reasonable profit but not so
15 high as to lose customers to competitors.) But in the context of regulated monopolies, the
16 shareholder and customer interests are not aligned. They are not aligned because the
17 acquirer sells its products in a monopoly market, where there is little risk of losing
18 customers. HEI resolved the shareholder-customer conflict by placing shareholder
19 benefit ahead of customer benefit. In doing so, HEI violated its utilities' duty to serve the
20 interests of its utilities' customers.

21 There are only two ways to fix this error. The Commission can either disapprove
22 acquisitions that are rooted in shareholder-customer conflict, or eliminate the conflict by
23 allocating to ratepayers the portion of the control premium attributable to their

1 contribution to its value. Either solution will disappoint those HEI shareholders who bet
2 on the Commission approving the transaction and allowing them to keep the control
3 premium. But the Commission's obligation is not to honor shareholder bets; it is to
4 enforce the utility's obligation to serve—an obligation that, as in a competitive market,
5 puts customers first.

6 **Q. Given your concerns, what is the appropriate treatment of the control premium if**
7 **the Commission approves this transaction?**

8
9 **A.** Since shareholders have no constitutional entitlement to the control premium, the
10 Commission is free to allocate it according to whatever principle that satisfies the
11 statutory public interest standard. I recommend this principle: The control premium
12 should be allocated between shareholders and ratepayers according to their relative
13 contribution to the value represented by the premium. Commissions apply this same
14 principle when they allocate the gain on sale of an asset used for utility service. That is,
15 when a generating asset has been in a utility's rate base, and the utility then sells that asset
16 at a gain above net book value, the gain goes (or should go) to ratepayers. The gain goes
17 to ratepayers because through their historic rate payments (reflecting the asset's presence
18 in rate base), they have borne the economic burden associated with the asset. Benefit
19 follows burden. And when an asset is not in rate base and then is sold at a gain, the gain
20 belongs to the shareholders because they have borne the economic burden associated with
21 the asset. Benefit follows burden.¹⁶⁷

¹⁶⁷ In *Democratic Central Comm. of the District of Columbia v. Washington Metropolitan Area Transit Comm'n*, the court stated:

1 (I caution readers that the gain-on-sale-of-asset analogy works only up to that
2 point: as an example of the principle that value goes to those whose economic
3 contribution produced the value. I am not saying that the ratepayer's burden-bearing in

Ratepayers bear the expense of depreciation, including obsolescence and depletion, on operating utility assets through expense allowances to the utilities they patronize. It is well settled that utility investors are entitled to recoup from consumers the full amount of their investment in depreciable assets devoted to public service. This entitlement extends, not only to reductions in investment attributable to physical wear and tear (ordinary depreciation) but also to those occasioned by functional deterioration (obsolescence) and by exhaustion (depletion). . . . [S]ince customers have shouldered these burdens, . . . it is eminently just that consumers, whose payments for service reimburse investors for the ravages of wear and waste occurring in service, should benefit in instances where gain eventuates—to the full extent of the gain.

485 F.2d 786, 808–11, 822 (D.C. Cir. 1973) (footnotes omitted); *id.* at 808 ("[I]f the land no longer useful in utility operations is sold at a profit, those who shouldered the risk of loss are entitled to benefit from the gain."). *See also Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities*, 2 FCC Rcd. 6283, 6295 ¶¶ 113–14 (Sept. 17, 1987) (order on reconsideration) (observing that "[t]he equitable principles identified in [*Democratic Central Committee*] have direct application to a transfer of assets out of regulation that produces gains to be distributed," and requiring "that ratepayers receive the gains on assets when the market value of the assets exceeds net book cost."); *N.Y. Water Serv. Corp. v. Pub. Serv. Comm'n of N.Y.*, 12 A.D.2d 122, 129 (N.Y. App.Div. 1960) (allocating gain on sale to ratepayers when ratepayers bore the risk of a loss in value of the assets); *N.Y. State Elec. & Gas*, Case No. 96-M-0375, 1996 N.Y. PUC LEXIS 671, at *8 (N.Y. Pub. Serv. Comm'n Nov. 19, 1996) (memorandum opinion) (reserving the net gains on the sale of land for ratepayers is "equitable and reasonable"); *N.Y. Tel. Co. v. N.Y. Pub. Serv. Comm'n*, 530 N.E.2d 843 (N.Y. 1988) (ratepayers entitled to benefits on sale of yellow pages advertisements).

But see Bd. of Pub. Util. Comm'rs v. N.Y. Tel. Co., 271 U.S. 23 (1926) ("Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses or to capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for the convenience or in the funds of the company.").

1 the context of a generating asset sold at a gain is itself analogous to the ratepayer's
2 contribution to the control premium.)

3 The challenge, then, is how to determine, for the control premium offered by
4 NextEra, the relative contribution as between shareholders and ratepayers. There is
5 nothing in the record to support a particular number. There is, however, logic to support
6 a finding that the value of the control premium is attributable to ratepayers. That logic is
7 as follows:

- 8 1. NextEra is paying the control premium to get control of the HECO
9 utilities' franchises.
- 10 2. The value of those franchises is due to their stable source of revenue.
- 11 3. That source of revenue is stable because of the government decision to
12 make the utilities' distribution franchise exclusive.
- 13 4. That exclusivity means that the ratepayers have no choice but to be the
14 source of revenue that creates the value NextEra sees in the franchises.
15
16
17
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19 That is the argument for the ratepayers' contribution. What about the HEI shareholders'
20 contribution? HEI might argue that but for its shareholders' investment, there would be
21 no service for which ratepayers contributed revenue. Looking at the various arguments,
22 the Commission might even decide that the control premium is, technically, a windfall—
23 a value to which no one actually contributed. Given the likely existence of arguments on
24 both sides, and to give both sides a chance to bring forward facts, I recommend that the
25 Commission rebuttably presume that the relative contribution to the franchises' value, as
26 between shareholders and ratepayers, is 50-50. Then the logic of rebuttable presumptions
27 does the work. If facts rebutting the presumption do not emerge, the presumption
28 becomes the result. My Condition VI.B.2.c reflects this approach.

1 **Q. Aren't the HECO shareholders entitled to the control premium because their**
2 **investment is subject to risk, or because of the utilities' operational effectiveness?**
3

4 **A.** No. As to shareholder risk, it is necessary to distinguish (a) the utility's investment in
5 public utility assets, from (b) a shareholder's investment in stock purchases. Regulatory
6 law, embodied in the Constitution's Fifth Amendment Takings Clause and the statutory
7 just and reasonable standard, is concerned only with the former: compensating the utility
8 for its investment in public utility assets. As I explained above, the "private property"
9 protected by the Fifth Amendment is the utility's investment in utility assets, not the
10 shareholder's investment in utility stock. Justice Brandeis again: "The thing devoted by
11 the investor to the public use is capital embarked in the enterprise", *i.e.*, "rate base." In
12 the public utility context, shareholder risk-taking on stock purchases lies outside the
13 constitutional analysis. And while a utility's investment in public utility assets involves
14 some risk, ratepayers already compensate investors for that risk through the authorized
15 return on equity that is included in the utility's annual revenue requirement.

16 As for justifying the premium to HEI shareholders due to its utilities' operational
17 effectiveness: Effective operation is what customers pay for when they pay commission-
18 mandated rates reflecting the utility's reasonable cost. There is no logical basis for extra
19 compensation in the form of an acquisition premium.

20 Since the control premium is justified by neither HEI shareholder risk-taking nor
21 the utilities' operational effectiveness, we must infer that NextEra is paying the premium
22 to get the utilities' franchises—those government-granted, exclusive rights to provide an
23 essential service in return for monthly customer payments mandated by statutory and
24 constitutional standards. (Consider this: If the Commission, prior to NextEra committing
25 to pay a premium, had declared that the utilities' exclusive franchises would be subjected

1 to a nationwide competition, with the Commission selecting the best performer to replace
2 HECO, would NextEra have offered a same control premium? Unlikely.)

3 **Q. Doesn't the control premium necessarily belong to HEI's shareholders because they**
4 **are HEI's legal owners?**

5
6 **A.** No. The Applicants assert that the "value [of the control premium] will be paid directly
7 to the shareholders and cannot be 'shared' with other parties that don't have title to the
8 securities being purchased."¹⁶⁸ This assertion assumes, incorrectly, that the franchise is a
9 private good to which the shareholders have "title;" then it incorrectly equates "title"
10 with "entitlement." We cannot facilely transplant concepts from unregulated markets into
11 a regulated utility market. In an unregulated market, one with no government
12 intervention, buyers and sellers trade freely. They are entitled to the value of that to
13 which they have title. If you want what I own, you must pay me what I want for it—its
14 full value. But in regulation, and utility regulation in particular, legal ownership does not
15 always entitle the owner to full value. Otherwise, utilities with monopolies could charge
16 whatever price the market could bear, thereby earning full value. That is not how
17 regulation works. When utility shareholders volunteer to enter a government-regulated
18 market, they necessarily accept that regulators can take action to limit the value of what
19 they own. That has been the law since medieval times, memorialized today in the
20 landmark case of *Munn v. Illinois*, 94 U.S. 113, 126 (1877) (reasoning that when
21 someone "devotes his property to a use in which the public has an interest, he, in effect,
22 grants to the public an interest in that use, and must submit to be controlled by the public

¹⁶⁸ Response to OP-IR-18.

1 for the common good, to the extent of the interest he has thus created. He may withdraw
2 his grant by discontinuing the use; but, so long as he maintains the use, he must submit to
3 the control.")

4 In sum, to argue that shareholders are entitled to the control premium because
5 they paid money for their stock is to misunderstand what the Constitution protects. As I
6 explained above, the "just compensation" guaranteed by the Fifth Amendment's Takings
7 Clause is the reasonable return on dollars invested in public utility assets used to carry
8 out the obligation to serve. Expectations of a premium arise from shareholders betting on
9 the stock market, not utilities investing in public service assets. The regulatory
10 obligation, and the legitimate shareholder expectation to which that obligation applies,
11 relate only to the latter.

12 Applicants also argue that "the value paid for HEI shares is paid to the owners of
13 those shares who provided equity capital to HEI (forgoing other competitive investment
14 opportunities) and took on the risk of loss in value of HEI stock and therefore are entitled
15 to any appreciation or control premium in the stock if realized."¹⁶⁹ This argument is
16 circular—it assumes the answer the question being asked. It assumes that in "provid[ing]
17 equity capital to HEI," the shareholders had a reasonable expectation of receiving the
18 control premium. But since the control premium represents the value of controlling the
19 franchise, which value is not theirs to sell, they are not entitled to receive it. (Note also
20 the imprecision in the phrase "any appreciation or control premium." This phrase mixes
21 together the distinct layers of the full acquisition premium. The portion of the premium

¹⁶⁹ Response to OP-IR-18.

1 represented by pre-acquisition appreciation, *i.e.*, the appreciation from book value to
2 market value, is not at issue. As Applicants point out, that portion "existed prior to the
3 merger as HEI's stock was trading above the company's book value."¹⁷⁰ See also:
4 "[S]hares of HEI are sold at a premium above book value every day on the New York
5 Stock Exchange, and these ordinary sales certainly do not trigger any form of gain
6 recapture by customers."¹⁷¹ That is not the premium portion at issue. At issue is the
7 premium portion on top of that appreciation—the control premium.)

8 In particular cases, there might be a factual basis for dividing up the premium
9 between shareholders and customers. But to argue that all of it goes to the shareholders,
10 merely because they are the "owners," conflates what they own (the company and its
11 assets) with what they do not own (the government-granted franchise). Under this
12 mistaken reasoning, were the government to exercise its power to revoke the incumbent's
13 franchise and award it to some other company, the government would have to pay the
14 incumbent not only the unrecovered book value of the assets, but also some value
15 associated with the franchise, *i.e.*, a premium. That makes no sense, because the
16 incumbent did not create the franchise. The same result holds if the incumbent were to
17 seek permission to withdraw from the franchise; if, say, the company wanted to depart
18 from the utility business. We would not award the shareholders a special payment on top
19 of their unrecovered prudent investment. And if the incumbent's shareholders have no
20 right to a premium when their utility's franchise is revoked or when their company

¹⁷⁰ Response to OP-IP-20.

¹⁷¹ Response to CA-IR-213.

1 chooses to exit the utility business, then they have no right to a premium when they "sell"
2 it voluntarily. The franchise is not theirs to sell.

3 **Q. What about NextEra's commitment not to recover the premium from ratepayers?**

4
5 **A.** In NextEra's commitment not to recover the premium from ratepayers, we must
6 distinguish what is stated from what is not. NextEra says HECO's utilities will not seek
7 to recover the premium explicitly, *i.e.*, by placing it explicitly into the rate base as an
8 element of their revenue requirements. But that commitment does not preclude the
9 utilities from attempting to recover the premium implicitly, by charging rates exceeding
10 reasonable cost. The Commission needs to prevent both means of recovering the
11 premium. That is the purpose of my Condition VI.B.2.b.

12 Assuming we prohibit recovery of the control premium through rates, explicitly or
13 implicitly, one might then argue that the premium causes no problem: If NextEra wants
14 to pay more for HECO than it can recover from HECO's customers, that is NextEra's
15 business; the Commission need not care. That view ignores two problems. First, once
16 NextEra pays the premium it must absorb it, thereby weakening its own fiscal picture,
17 including its ability to finance HECO's utilities as necessary.

18 Second, by approving a transaction that pays a control premium, absent evidence
19 that the recipients created the value associated with that premium, the Commission would
20 be validating and stimulating a market for acquisitions that operates inconsistently with
21 economic efficiency. The acquisitions market would embody a mismatch between risk
22 and reward, between performance and compensation. Acquisitions would be based on
23 who is willing and able to pay the most for the target company, rather than on who is
24 willing and able to offer the most to customers. By entertaining and approving such

1 transactions, the Commission would be rewarding acquirers based on ability to pay rather
2 than on ability to perform. The competition to control a franchise would be based on
3 making the target's shareholders more affluent rather than making ratepayers better off.
4 Allowing such results denies utility customers what they pay for: service at a quality and
5 cost that replicates competitive market outcomes.

6 For all these reasons, the control premium is a cost to ratepayers, even if it never
7 enters the rates.

8 * * *

9 This Part III has explained that NextEra's acquisition of HECO's monopoly
10 conflicts with Hawai'i's needs in multiple ways. Each harm described in this Part causes
11 a distinct risk to customers: competition risk, business risk, size risk, type-of-shareholder
12 risk, loss-of-local-control risk, and shareholder-customer conflict risk. Each of these
13 risks has a probability of occurrence above zero and a cost of occurrence above zero. In
14 hundreds of pages of submissions—Application, exhibits, testimony, discovery—
15 Applicants made no effort to quantify these costs. Nowhere do they identify possible
16 negative events, estimate their probabilities and apply those probabilities to the likely
17 costs. Even if they had made that effort, they could have addressed only the risks that are
18 known—the risks from NextEra's current holdings. We still would face the risks that are
19 unknown: the risks associated with all the future acquisitions that NextEra will make
20 without the Commission approval.

21 If NextEra's acquisition motivation was to serve the public interest, its
22 Application would present specific ideas for improving HECO's utilities, and binding

1 commitments to do so. As discussed next, on the topic of real benefits the Applicants are
2 silent again.

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IV.
NextEra's Claimed "Benefits" are Mostly
Claims Without Commitments

Q. NextEra's claims that the acquisition will bring consumer benefits. Describe the context for your critique of these claims.

A. In a competitive market, an acquirer that overestimates its benefits risks losing its shirt.

To reduce that risk, it makes real calculations based on real plans. But NextEra is buying a utility in a monopoly market, so it does not risk losing its shirt. Rather than make real calculations based on real plans, it praises its past and makes claims without commitments. In this Part IV, I will address each category of claim, as follows:

NextEra cites its "experience." But owning a vertically integrated, non-renewables monopoly in Florida does not give NextEra experience creating competitive distributed resources markets in Hawai'i.

The claimed "synergies" are guesses without commitments.

The claimed operational improvements cannot be attributed to the merger because the Applicants lack plans, metrics and commitments.

NextEra's size does not guarantee quality.

The "financing" benefit mistakenly assumes that the only way to finance new electricity infrastructure finance is through HECO.

Before addressing NextEra's claims, I would like to address the concept of "benefit," so that we can distinguish (a) benefits that are truly attributable to the acquisition, and therefore deserve to be counted, from (b) benefits that are unrelated to the acquisition but that can distract from an assessment of its merits.

1 **A. *The multiple meanings of "benefit"***
2

3 **Q. In determining whether an acquisition satisfies the public interest, how should**
4 **regulators evaluate an applicant's assertions of benefits?**
5

6 **A.** Assertions of benefits are relevant because of the relation of benefits to costs. Part III
7 explained the risks and costs arising from this acquisition. An acquisition should not be
8 approved if the relationship of its benefits to its costs is less favorable than other
9 alternatives (including no acquisition). Otherwise, the acquisition incurs opportunity
10 costs—harm to consumers.

11 If the purpose of benefits is to compare them to costs, what benefits should count?
12 This subsection describes the three categories of benefits typically asserted by merger
13 proponents. I explain that only one category—so-called "synergies"—should be counted,
14 and then only if the assertions are backed by commitments. The other two categories—
15 improvements in the to-be-acquired utility's performance, and payouts unrelated to the
16 transaction, should not be counted because they distort the market for acquisitions.

17 After describing the three categories of benefit and distinguishing them in terms
18 of appropriateness, I turn to the sufficiency of the benefit: How do we know if there is
19 enough benefit to justify the cost?

20 **1. *The appropriateness of the benefit: Three categories***
21

22 **Q. Discuss the first category of benefits—synergies.**
23

24 **A.** Synergies are benefits arising because two companies operate more efficiently together
25 than apart. When a winter-peaking utility merges with a summer-peaking utility, or a
26 renewables-heavy utility merges with a gas-heavy utility, these couplings can reduce the
27 cost of energy and capacity because of how the resources mesh. When a merger results
28 in economies of scale, scope or integration, or allows resource-sharing that reduces

1 overhead expense, that is a merger benefit also—a benefit caused by the merger and
2 unavailable without the merger. This type of benefit should be counted because it is
3 caused by the coupling and could not be achieved without it.

4 **Q. Discuss the second category of benefits—performance improvements.**

5
6 **A.** When an acquirer improves the target's performance, this benefit arises not because two
7 operations mesh, but because we substitute higher quality practices for lower quality
8 practices. The acquirer is using its control of the target to bring superior performance to
9 the target. It is a benefit, but it is not a benefit attributable to the merger.

10 Consider this exaggerated hypothetical: The target company was using quill pens
11 and Roman numerals; the acquirer introduces computers. This benefit arises not from the
12 meshing of operations; it occurs because an under-performing target learned new lessons.
13 Those new lessons don't need a merger to be learned. The target could have hired new
14 managers or consultants, learned from peers, attended professional conferences, or raised
15 internal standards by sharpening its recruitment and compensation policies. Or the
16 regulator could raise standards and consequences for failing to meet those standards; or
17 even hold a competition to find the best performer for a particular function (as Hawai'i,
18 Maine, Oregon and Vermont did in choosing energy efficiency companies to replace their
19 utilities' energy efficiency efforts¹⁷²).

¹⁷² See *How Efficiency Vermont Works*, EfficiencyVermont.com, http://efficiencyvermont.com/about_us/information_reports/how_we_work.aspx (describing Efficiency Vermont's responsibility to provide "technical assistance and financial incentives to help Vermont households and businesses reduce their energy costs with energy-efficient equipment and lighting" and "energy-efficient approaches to construction and renovation"); *About Us*, Hawai'i Energy.com, <http://www.Hawai'ienergy.com/4/our-team> (describing Hawai'i Energy's ratepayer-

1 To attribute to an acquisition benefits that can occur without the acquisition
2 therefore conflicts with economic efficiency. We count merger benefits to justify merger
3 costs (like the costs and risks described in Part III above). Counting performance
4 improvements as merger benefits means that customers bear extra costs—merger costs—
5 merely to cause their company to perform prudently. To credit consolidation as a
6 solution to imprudence, rather than addressing imprudence directly, is illogical. Worse,
7 the more suboptimal the target's pre-merger performance, the "better" an acquisition
8 (with all its costs) looks, and so the higher the acquisition premium that regulators will
9 view as justified. Put another way, the poorer the target's performance, the higher the
10 customers' cost and the greater the target shareholders' gain. That is illogical also. If
11 HECO's utilities are performing below standards that other utilities meet, then the
12 Commission should find out why, instead of entertaining an acquisition that brings other
13 costs and risks.

14 This category of benefit has another problem: It is often unquantifiable, and
15 therefore incapable of tracking, proof and accountability. As the Maryland Public
16 Service Commission has stated:

17 [P]rojections of benefits through synergies, 'shared services' or 'best
18 practices' are inherently speculative and, to the extent they materialize,

funded conservation and efficiency programs); *About Us*, EnergyTrust of Oregon, <http://energytrust.org/about> (describing Energy Trust of Oregon's responsibility to invest in cost-effective energy efficiency and assist with the above-market costs of renewable energy); *About Efficiency Maine*, EfficiencyMaine.com, <http://www.energymaine.com/about> (describing Efficiency Maine's technical assistance, cost-sharing, training, and education programs to reduce the use of electricity and heating fuels through energy-efficiency improvements and the use of cost-effective alternative energy).]

1 will likely benefit ratepayers only as 'forgone requests for rate relief,'
2 which we have previously held to be too intangible to qualify as a benefit
3 under PUA sec. 6-105 [*i.e.*, Maryland's merger statute, which require
4 benefits from the acquisition]."¹⁷³
5

6 In short, making customers pay extra for something they are already supposed to
7 receive is a form of customer abuse that would not occur in an effectively competitive
8 market.

9 **Q. Discuss the third category of benefits—financial offers unrelated to the acquisition**
10 **transaction.**

11
12 **A.** Financial offers unrelated to the acquisition transaction arise from merger strategy rather
13 than merger execution. They become available not because two companies have
14 combined to make operations more efficient, but because the acquirer is willing to offer
15 resources it already has, to persuade others to grant what it does not have. Treating these
16 offers as "merger benefits" favors acquirers who have those extra resources, over
17 alternative acquirers who have fewer resources but could make a better fit. We would be
18 valuing an acquisition not for its intrinsic merit but for inducements that distract from its
19 lack of merit. Doing so undermines the purpose of regulation: to induce high-quality
20 utility performance. A student should get an A for excelling at her schoolwork, not for
21 planting flowers in the schoolyard.

22 Finally, counting non-merger inducements also invites discrimination, because the
23 benefits flow only to some customers, usually current ones, while the merger's risks fall
24 on all customers, including future ones.

¹⁷³ *In the Matter of the Merger of Exelon Corporation and Constellation Energy Group*, Order No. 84698 (Feb. 17, 2012), 2012 Md. PSC LEXIS 12 at text accompanying note 356.

1 **Q. Do other jurisdictions reject merger benefits not uniquely attributable to the**
2 **merger?**
3

4 **A.** Yes. Applying the Communications Act of 1934, the Federal Communications
5 Commission has rejected non-merger benefits repeatedly: "[T]he claimed benefit must
6 be transaction- or merger-specific. This means that the claimed benefit 'must be likely to
7 be accomplished as a result of the merger but unlikely to be realized by other means that
8 entail fewer anticompetitive effects.'"¹⁷⁴ That principle was applied by the FCC Staff to
9 the proposed merger of AT&T and T-Mobile. The Staff rejected benefits that the
10 applicants claimed would result from "the adoption of each company's best business
11 practices, including customer service best practices . . . because the improvement of
12 specific business functions by either AT&T or T-Mobile could be achieved absent the
13 proposed transaction."¹⁷⁵

14 In the antitrust context, the Department of Justice and the Federal Trade
15 Commission disregard benefits achievable without a merger. Their Horizontal Merger

¹⁷⁴ *AT&T, Inc. & Bellsouth Corp.*, 22 FCC Rcd at 5761 (quoting *EchoStar/DirecTV Order*, 17 FCC Rcd 20,559, 20,630 (2002) (citing *Ameritech Corp. & SBC Communications Inc.*, 14 FCC Rcd 14,712, 14,825 (1999) ("Public interest benefits also include any cost saving efficiencies arising from the merger if such efficiencies are achievable only as a result of the merger")); *Comcast Corp.*, 17 FCC Rcd 23,246 (2002) (Commission considers whether benefits are "merger-specific").

¹⁷⁵ *Applications of AT&T Inc. and Deutsche Telekom Ag for Consent to Assign or Transfer Control of Licenses and Authorizations*, WT Docket No. 11-65, Staff Analysis and Findings 6 241 (2011), available at <http://www.wirelessestimator.com/publicdocs/ATT-TMO-FCC.pdf>. The FCC Staff's document is not an official Commission document; nor was it part of the official record in the named Docket. It was a draft report prepared by the Staff and released to the public by the FCC Chairman. No FCC order was issued in this proceeding, because the merger applicants withdrew their proposal.

1 Guidelines (2010) states (at Section 10): "The Agencies credit only those efficiencies
2 likely to be accomplished with the proposed merger and unlikely to be accomplished in
3 the absence of either the proposed merger or another means having comparable
4 anticompetitive effects." *See also id.* at n.13: "The Agencies will not deem efficiencies
5 to be merger-specific if they could be attained by practical alternatives that mitigate
6 competitive concerns, such as divestiture or licensing."¹⁷⁶

7 **2. The sufficiency of the benefit: The proper relationship of benefit to cost**
8

9 **Q. For the benefits that deserve to be counted, how should regulators determine if their**
10 **quantity is sufficient?**

11 **A.** For an acquisition to be consistent with the public interest, it must promise an appropriate
12 level of benefits in relation to its costs. When a rational person makes an investment
13 (costs), she seeks the highest possible return relative to other investments of comparable
14 risk (benefits). A prospective acquirer of a utility has the same goal: a benefit/cost ratio
15 at least as high as the most attractive alternative investment of comparable risk. And the
16

¹⁷⁶ Some state commissions have adopted a similar policy. In the proposed Southern California Edison-San Diego Gas & Electric merger, the California Commission rejected the applicants' claimed labor savings. Given the smaller utility's (SDG&E's) growth, "some of the efficiencies SDG&E might realize by merger into Edison may be achieved if SDG&E remains independent and becomes larger." *SCEcorp, Southern California Edison Co. & San Diego Gas & Electric Co.*, Decision No. 91-05-028, 1991 Cal. PUC Lexis 253, at *25. And when a merger applicant offered ratepayers 90 percent of the net proceeds from divesting a fossil fuel plant, the New York Commission disregarded this "benefit" because the Commission had full authority to determine the proceeds' disposition without any merger. *NextEra, S.A., Energy East Corp., New York State Electric & Gas Corp. & Rochester Gas & Electric Corp.*, Case 07-M-0906, 2008 N.Y. PUC Lexis 448, at *10. *See also* NextEra-Constellation Merger, Order No. 84698, 2012 Md. PSC Lexis 12, at *162-163 (finding the possibility of BGE adopting its post-merger affiliates business practices "too intangible to qualify as a benefit").

1 target utility's shareholders also have that goal: Given the cost and risk incurred to buy
2 stock, they want the highest possible return relative to comparable alternatives.

3 If utility ratepayers had competitive options, they would choose suppliers based
4 on that same standard: they would shop to receive the greatest value for the dollars they
5 spend. When evaluating a proposed acquisition, therefore, regulators should ask the
6 same question investors (and shopping consumers) ask: Will this transaction produce for
7 customers the best possible benefit-cost relationship, compared to alternative actions the
8 utility could take? This question repeats the principle that regulation always applies to
9 utilities: Having received protection from competition, a utility must perform as if it were
10 subject to competition; it must provide its customers the best possible benefit-cost ratio.

11 This transaction fails that standard. To understand why, one need only contrast
12 what HECO's shareholders got from NextEra with what the Applicants are offering
13 HECO's customers. Like any rational investor, NextEra and HECO each sought "biggest
14 bang for the buck."¹⁷⁷ While each applicant received biggest bang for buck, what they
15 are offering HECO's utilities customers is, literally, nothing. That asymmetry of outcome
16 makes this merger inconsistent with the public interest.

17 Returning to the relationship between regulation and competition: Effective
18 competition serves the public interest because it forces a never-ending search for
19 improvements, from horses to stage coaches to street cars to buses to jet engines; from
20 telegrams to telephones to faxes to cell phones to the internet to the world wide web. The
21 same dollars spent on a computer 25 years ago buys a much better computer today. If we

¹⁷⁷ As described in Part III.G.1 above.

1 protect a utility from competition, we need regulation to make it perform as if it were
2 subject to competition. That means assuring that a transaction offering biggest-bang-for-
3 buck to the target and its acquirer provides comparable benefit to the utility's customers.

4 ***B. Owning a vertically integrated, non-renewables monopoly in Florida does not***
5 ***give NextEra experience creating competitive distributed resources markets in***
6 ***Hawai'i***

7
8 **Q. Is NextEra's experience consistent with Hawai'i's needs?**

9
10 **A.** No. Hawai'i has a mission: to transform a decades-old, vertically integrated,
11 unidirectional monopoly market into a dynamic set of unbundled, bidirectional
12 competitive markets. Today's market structure provides plain vanilla electric service to
13 captive consumers. Hawai'i's new markets will provide diverse services to
14 entrepreneurial "prosumers."¹⁷⁸ Integrating diverse suppliers, electrically and
15 commercially, along bi-directional, distribution-level networks: These are the steps
16 required to fulfill the new statutory command of 100 percent renewables by 2045.

17 NextEra claims to have experience. But its majority experience, and its majority
18 source of profit, is from owning and maintaining FPL's vertically integrated monopoly.
19 That is not the experience Hawai'i needs. NextEra has no experience in—nor has it
20 demonstrated any commitment to—supplementing (and possibly supplanting) a vertically
21 integrated monopoly market with diverse product markets. FPL's generation sources are
22 the opposite of diverse: The dominant owner of generation serving FPL's customers is

¹⁷⁸ See *Inclinations* at p.13 (discussing goal of "open[ing] the opportunity for the DER-equipped customer to become a "prosumer", that is a customer who both consumes or uses utility services and may also provide services to the utility").

1 FPL;¹⁷⁹ and the amount of renewable energy in FPL's service territory is token.¹⁸⁰
2 Substantial renewable energy projects in Florida are utility-owned.¹⁸¹ Regardless of the
3 reasons (FPL says its own low costs create a "significant hurdle to-date for many
4 renewable energy sources"¹⁸²), FPL lacks experience stimulating and managing the entry
5 of numerous small renewable producers.¹⁸³

¹⁷⁹ As of December 31, 2013, of the 26,236 MW necessary to serve its load, FPL owned 24,273 MW. Only 1,963 MW came from non-FPL sources. NextEra 2014 10-K at 4, 7.

¹⁸⁰ "FPL's 2014 fuel mix, based on MWh produced, as shown on page 9 of the 2014 10-K, includes less than 1% of solar and oil generation collectively and no wind generation." Response to OP-IR-3.

¹⁸¹ FPL is undertaking various utility-owned solar projects, as NextEra describes in its Responses to OP-IR-4, but their size is small compared to FPL's total generation.

¹⁸² Response to CA-IR-2.

¹⁸³ NextEra seems to acknowledge this point. In OP-IR-136, NextEra was asked: "What experience does NextEra have in creating markets that attract the best renewable competitors?" NextEra responded:

NextEra Energy rejects the premise of the information request as inferring [sic—the word is "implying"] that a company, such as NextEra Energy, creates markets. Rather, NextEra Energy participates in various energy markets and has experience as a leader in successfully competing to provide renewable energy to utilities and businesses throughout North America. Having successfully participated in hundreds of solicitations, NextEra Energy's low cost position and technical expertise can help ensure that customers are receiving the most affordable and cost-effective energy, whether that is provided by NextEra Energy- or third party-owned renewable generation.

NextEra has made my point. To develop the distributed services and renewable markets to their full potential, Hawai'i will need a neutral entity creating a neutral platform so that the best performers win roles. NextEra is not neutral; it wants to win roles.

1 The experience FPL claims thus relates not to stimulating diverse new markets
2 but to running a vertically integrated monopoly. That is what FPL claims to do well in
3 Florida. But Hawai‘i is not Florida. While HECO does need help being a better
4 vertically integrated monopoly,¹⁸⁴ Hawai‘i's goal is to reduce its dependence on this
5 vertically integrated monopoly.¹⁸⁵

6 NEE does have experience with renewable energy. But that experience is in
7 owning and controlling renewable energy: developing its own projects and arguing for
8 their selection. NextEra has neither experience nor motivation concerning soliciting bids
9 from other companies and encouraging their selection.

10 In short, NextEra is a vertically integrated monopoly, seeking to buy and control
11 another vertically integrated monopoly. Its experience, skill set and its business model
12 do not match Hawai‘i's long-term needs. Worse, they conflict.¹⁸⁶ If we approve an
13 acquisition by a company with conflicts, we then will need "incentives" to overcome the
14 conflicts. The better approach is to invite to Hawai‘i companies whose business models
15 are consistent with the structural transformation Hawai‘i wishes to induce.

¹⁸⁴ As the *Inclinations* document details.

¹⁸⁵ See, e.g., *Inclinations* at 19 ("The Commission will consider whether it is reasonable and in the public interest to preclude the HECO Companies ... from ownership of new generation").

¹⁸⁶ As detailed in Part III.B and C above.

1 **C. *The claimed "synergies" are guesses without commitments***

2
3 **Q. Should the Commission count as merger benefits NextEra's claims of synergies?**

4
5 **A.** No. Applicants mention "expected savings"—savings that "*should* be achieved through
6 such means as shared services, productivity improvement and improved contracting,
7 among other means."¹⁸⁷ Behind that ambiguous "should" (Actual prediction, or
8 normative statement?) is—nothing. Applicants confess that "a detailed quantification of
9 "synergies" has not been performed. A breakdown by functional category has not been
10 developed."¹⁸⁸ And they "have not developed specific plans or details on how and when
11 merger savings will be realized."¹⁸⁹ There are "no plans of reorganization, restructuring
12 and/or alignment of responsibilities under development, and considered and/or approved
13 for post-sale implementation in Hawai`i."¹⁹⁰

14 Lacking any "specific plans or details," any "breakdown by functional category"
15 or any "detailed quantification," Applicants' synergy claims boil down to guesswork.
16 And this guesswork is not a projection based on anything that actually happened, like a
17 study of prior mergers. The guesswork is based on prior mergers, yes. But it is not based
18 on merger outcomes; it is based on merger advocacy. It is based on applicant testimony
19 advocating for prior mergers. The nine things Mr. Reed calls "studies" are "estimates by
20 the merger applicants of what the savings the [prior merger advocates] hoped to produce,

¹⁸⁷ Response to PUC-IR-50 (emphasis added).

¹⁸⁸ Response to PUC-IR-10.

¹⁸⁹ Response to PUC-IR-50.

¹⁹⁰ Response to PUC-IR-134.

1 not savings they actually produced."¹⁹¹ Each "study" was all filed in a regulatory
2 proceeding by a merger applicant seeking approval.¹⁹² No one at NextEra troubled
3 themselves to see if the savings prior applicants advertised actually occurred. No one
4 bothered to see whether the witnesses who offered these studies were in any way
5 accountable, to their companies or respective commissions, if their predictions turned out
6 to be wrong. Mr. Reed is basing his advocacy on their advocacy.

7 Worse, Mr. Reed's "studies" come from transaction bearing no resemblance to a
8 merger of utilities located 4600 miles apart. Asked which of the cited transactions was a
9 "reasonable proxy" for the NextEra-HECO transaction, Mr. Reed avoided the question,
10 substituting a *non sequitur*: "No two transactions are exactly the same."¹⁹³ The question
11 did not ask which transaction were "exactly the same"; it asked for which ones were
12 "reasonable proxies." Mr. Reed could have answered this straightforward question
13 straightforwardly, explaining for each of the nine their similarities and differences from
14 the NextEra proposal. He chose instead to evade—an evasion tolerated by NextEra, who
15 filed his non-answer rather than instruct him to give an answer. If this is the type of
16 witness cooperation we get before the transaction, the Commission cannot hope for better
17 after the transaction.

¹⁹¹ Response to OP-IR-81(a) (OP's wording, with which Mr. Reed agreed).

¹⁹² Response to CA-IR-102, referring to Applicants' Exhibit-33, Page 31, Lines 1-8.

¹⁹³ Response to PUC-IR-164.

1 All this factlessness could be forgiven if the claims were accompanied by
2 commitments. But on the issue synergies, NextEra has made no commitments—other
3 than the four-year moratorium, whose weakness I will discuss in Part IV.G below.

4 ***D. The claimed operational improvements cannot be attributed to the transaction***
5 ***because the Applicants lack plans, metrics and commitments***

6
7 **Q. Should the Commission counts as merger benefits NextEra's claims that it will**
8 **improve HECO's operations?**

9
10 **A.** No, because there are no plans, metrics or commitments. There is, therefore no evidence
11 of causation—no link between the acquisition and any benefits of the appropriate type
12 and magnitude to justify the acquisition's costs. Without such a showing, there is no
13 accountability; there is only advertising.

14 ***I. No plans***

15
16 **Q. What do Applicants say about plans to bring improvements?**

17
18 **A.** They say that "[t]he specifics of potential best practices have not yet been evaluated or
19 decided."¹⁹⁴ There are no plans because "the integration planning team is still in the
20 early stages of formalization. Oversight and administrative processes are in the process
21 of being identified and will be presented for approval by the Applicants' joint executive
22 steering committee once developed."¹⁹⁵

¹⁹⁴ Response to PUC-IR-28.

¹⁹⁵ Response to PUC-IR-104.

1 2. *No metrics and no commitments*

2
3 **Q. What do Applicants say about metrics and commitments for improving HECO?**

4
5 **A.** They say they "have not identified or developed measurement tools for quantifying how
6 NextEra Energy will strengthen and accelerate the Hawai‘ian Electric Companies' clean
7 energy transformation relative to what would be accomplished on a standalone basis."¹⁹⁶
8 "Except for reliability..., the specific metrics for improvement to be used to evaluate all
9 areas currently under the responsibility of Mr. Ching - one year, three years and five
10 years from now - have not been determined."¹⁹⁷ And as for reliability, Applicants insist
11 on establishing the "baseline"—against which improvements would be measured—only
12 after the acquisition's closing.¹⁹⁸ But once the acquisition occurs, the Commission's
13 influence over the baseline declines, while NextEra's influence rises.

14 3. *No causation*

15
16 **Q. In Part IV.A.1 above, you stressed causation—that only benefits attributable to the**
17 **merger, meaning not achievable without the merger, should count. On causation,**
18 **how do the Applicants fare?**

19
20 **A.** To attribute HECO improvements to the acquisition, the Applicants have to assume that
21 HECO would not be required to make those improvements without the acquisition. But
22 that assumption has no basis, legally or factually. Legally, any utility receiving
23 protection from competition is obligated to use "best practices." Indeed, "[t]he Hawai‘ian
24 Electric Companies do not contend that these cost-saving methods are currently

¹⁹⁶ Response to DBEDT-IR-17.

¹⁹⁷ Response to OP-IR-56.

¹⁹⁸ Response to PUC-IR-88.

1 unavailable to the Hawai‘ian Electric Companies...."¹⁹⁹ A utility's failure to learn and
2 apply best practices is grounds for revoking its franchise, not approving a sale of that
3 franchise at a profit to the shareholders.

4 Factually, "best practices" are, by definition, practical, not imaginary. They are
5 not some secret formula; they are available to the intelligent and entrepreneurial. And so
6 they are available without the acquisition; they are not properly attributable to the
7 acquisition. That HECO itself might lack the competence to achieve best practices is
8 beside the point. Best practices are an obligation of the franchisee, whoever that is; best
9 practices are therefore not made possible by the NextEra's acquisition.

10 **4. Result: Acquisition without accountability.**

11
12 **Q. When there are claims of post-acquisition improvement, but no plans, metric or**
13 **commitments, and no showing of causation, what should the Commission find as the**
14 **result?**

15
16 **A.** Because there are no plan, metrics, or commitments, and no evidence of causation, the
17 Commission has no way to determine either the probability or the value of the
18 improvements. Without evidence of probability and value, the Commission cannot
19 weigh the transaction's benefits against its costs.²⁰⁰ And so if improvements occur after
20 the acquisition, the Commission will be unable to determine which ones were attributable
21 to the acquisition (as opposed to one ones that would have, or should have, occurred

¹⁹⁹ Response to CA-IR-14.

²⁰⁰ For the discussion of the necessary relationship between benefits and risks, see Part IV.A.2 above.

1 without the acquisition). If there is nothing the Commission can count on, there is no
2 way to hold anyone accountable. Regulation will have lost its purpose.

3 Contrast the way in which a commission approves a new purchased power
4 agreement or generating unit. No utility proposes these things without presenting a year-
5 by-year, lifetime benefit-cost path comparing life with and without the expenditure,
6 accompanied by alternative scenarios and sensitivity studies. Specific witnesses present
7 these numbers, their reputations (and the utility's finances) at stake if they are wrong.
8 The utility's contracts with its vendors will assign accountability for performance
9 shortfalls. But in the testimonies of Mr. Chung, Mr. Reed, Mr. Olnick, Mr. Gleason, and
10 Mr. Oshima, and others, nothing remotely like these methods of accountability appears.
11 There is less clarity, commitment and accountability in this \$4 billion dollar transaction
12 than there is in the purchase of a used car.

13 By committing to nothing, the Applicants keep expectations low. But doing so
14 denies the Commission any objective, credible basis on which to judge this transaction.
15 In competitive markets, things don't work that way. If NextEra had to compete for the
16 privilege of serving Hawai'i customers, it would have to supplant self-praise and
17 vagueness with real facts and commitments. The Commission then could compare those
18 facts and commitments to alternatives; and, if it chose NextEra, impose conditions on the
19 acquisition approval that made NextEra accountable for its claims. Competition produces
20 accountability. But as the S-4 narrative demonstrates,²⁰¹ when NextEra and HECO
21 designed this transaction, competition for the consumer was not what they had in mind.

²⁰¹ See Part III.G.1 above.

1 5. ***The antitrust argument***
2

3 **Q. Are Applicants' reasons for the absence of plans, metrics and commitment**
4 **persuasive?**

5
6 **A.** No. As I understand it, Applicants have no plans, metrics or commitments because
7 NextEra has not been able to get inside the HECO utilities to acquire the necessary
8 information and familiarity. On reliability, for example, they say: "The specific details
9 for these improvements cannot be known until NextEra Energy has sufficient opportunity
10 as owner to better understand Hawai'ian Electric Companies' resources and the strengths
11 and any limitations in the Hawai'ian Electric Companies' respective electric grids,
12 systems, operations and plans."²⁰²

13 Asked why they could not acquire the necessary information and familiarity now,
14 Applicants give five reasons:

- 15 1. "The concept of gun-jumping under antitrust law restricts an
16 acquirer from exercising control prematurely. The Hart-Scott-
17 Rodino Act, Section 7A of the Clayton Act, 15 U.S.C. sec. 18a
18 ("HSR") prohibits an acquirer from exercising "substantial
19 operational control" prior to expiration of the HSR mandated
20 waiting period. In addition, the Sherman Act, 15 U.S.C. sec. 1
21 prohibits anti-competitive agreements between independent
22 firms."²⁰³
23
24 2. "[T]he Merger Agreement itself does not allow NextEra Energy to
25 assume operational or managerial control, nor would ceding such
26 control to a third party prior to consummation of the merger be
27 reasonable, customary, or in the best interests of the Hawai'ian
28 Electric Companies' customers and other stakeholders...."²⁰⁴

²⁰² Response to PUC-IR-88.

²⁰³ Response to OP-IR-7; OP-IR-128.

²⁰⁴ *Id.*

- 1
2 3. "NextEra Energy's ability to develop plans and projects in
3 coordination with the Hawai'ian Electric Companies prior to the
4 transaction's consummation is impeded by the desire to allow the
5 Hawai'ian Electric Companies to remain focused on their
6 transformation efforts. NextEra Energy is consciously avoiding
7 activities that might adversely impact or slow down those
8 efforts."²⁰⁵
9
- 10 4. "[T]he Applicants did not contemplate, and NextEra Energy should
11 not be exposed to the risk of using its proprietary information,
12 expertise and models to develop valuable business plans for the
13 Hawai'ian Electric Companies and, at the end of one year, give the
14 Hawai'ian Electric Companies the ability to terminate the
15 transaction. Had that been contemplated, the negotiated break-up
16 fee would have been much higher to compensate for the increased
17 risk."²⁰⁶
18
- 19 5. "The level of access and information that would allow NextEra
20 Energy to develop these plans in a prudent manner can only be
21 gained while exercising operational control as owner of the
22 Hawai'ian Electric Companies, as only then would NextEra
23 Energy be able to fully understand the strengths and any
24 limitations in the Hawai'ian Electric Companies' respective electric
25 grids, systems, operations, and plans."²⁰⁷
26

27 Each of these points has a hole:

28 1. The antitrust argument implies that it is impossible to make any study of
29 HECO's internal workings without "exercising control" or making an "anti-competitive
30 agreement." One can study one's counterpart without exercising control and without
31 making an agreement. Applicants in fact "agree that the applicable law does not prohibit
32 NextEra Energy from developing more generalized integration plans for post-merger

²⁰⁵ *Id.*

²⁰⁶ OP-IR-7.

²⁰⁷ OP-IR-128.

1 activities, as long as the plans are not implemented to the point where they are construed
2 to constitute control of the Hawaiian Electric Companies." But they insist that "though
3 'developing plans and projects' does not necessarily constitute control in and of itself,
4 from NextEra Energy's perspective it will need to have full and complete access and
5 control prior to the prudent development of plans and projects that will guide the future
6 operation of the Hawaiian Electric Companies."²⁰⁸ It appears, then, that the problem is
7 not antitrust law's requirement but NextEra's preference. It wants control first, plans
8 second.

9 2. The same argument goes for the Merger Agreement's restrictive language—
10 language which, by the way, is entirely within the Applicants' power to revise so that the
11 necessary study can occur.

12 3. There is no reason why NextEra's internal study of HECO's operations would
13 have to "adversely impact or slow down" HECO's "transformation efforts." Those

²⁰⁸ Response to OP-IR-138. NextEra also says (*id.*) that

the level of access and information that would allow NextEra Energy to prudently develop the type of detailed plans necessary and appropriate to the future operation of the Hawaiian Electric Companies can only be gained while exercising operational control as owner of the Hawaiian Electric Companies. Only then would NextEra Energy be able to fully understand the strengths and limitations of the electric grids, systems, operations and plans of the Hawaiian Electric Companies, all of which will need to be addressed in future plans and projects.

One can agree that the level of detail in plans depends on the "level of access and information," but still find that some type of detail useful in creating some type of plans can be achieved without the type of control that triggers antitrust concerns. And NextEra's response still cites no antitrust cases or guidelines for its inflexible position. My position remains: NextEra has not offered a sufficient basis for asking the Commission to take on faith NextEra's insistence that it will cause improvements.

1 "transformation efforts" did not seriously begin until after the Commission's *Inclinations*
2 Order, as Mr. Oshima admitted.²⁰⁹ ("In the summer of 2014, based on the direction and
3 guidance provided by the Commission in its [*Inclinations* Order], our Companies set in
4 motion a companywide transformation effort that will change the way we do business
5 and, even more importantly, deliver the value and results our customers want.").
6 Transformation can wait a few more months, if the result is to give the Commission (and
7 NextEra, actually) information they need to evaluate this transaction on its merits.

8 4. NextEra said it had not "contemplated" the "risk of using its proprietary
9 information, expertise and models to develop valuable business plans." And so a
10 company that lauds its ability to manage risks is using its failure to "contemplate" a risk
11 to justify its literal ignorance about the improbability of assets, operations and personnel
12 for which it is paying \$4 billion. Instead of taking the risk of "develop[ing] valuable
13 business plans, "NextEra took a different risk: that self-praise and generic aspirations
14 would substitute, as substantial evidence, for serious knowledge about and accountability
15 for the benefits that will accompany its control. But NextEra's failure to "contemplate" is
16 not cause for lessening its burden of proof. As for the breakup fee, nothing prevents the
17 parties from renegotiating that clause. If their goal is Hawai'i's well-being, and if they
18 trust the Commission to make good decisions, they can revise their agreement, gather the
19 necessary information and present real commitments that the Commission can weigh
20 against the costs.

²⁰⁹ See Oshima Direct Testimony at 7.

1 *E. NextEra's size does not guarantee quality*

2
3 **Q. The Applicants have argued that one advantage to Hawai'i is NextEra's large size.**
4 **What value should the Commission place on this argument?**

5
6 **A.** The argument lacks evidentiary value. NextEra offers no evidence on whether, or how,
7 its size (or any utility's size) is causally related to performance. I don't doubt that under a
8 given set of circumstances, there is likely some size range within which cost-effective
9 performance is more likely to occur, compared to sizes above and below that range. But
10 NextEra gives us no evidence about what size range fits with Hawai'i's circumstances.
11 NextEra could have offered statistical studies to prove its point, but did not. (I am
12 reasonably sure that the cost of such studies would be less than the \$90 million break-up
13 fee.²¹⁰) Lacking statistical studies, NextEra at least could have offered anecdotal
14 evidence comparing small utilities like Madison [Wisconsin] Gas & Electric with large
15 utilities like Pacific Gas & Electric. NextEra could have compared the HECO utilities
16 with larger utilities. NextEra could have compared the HECO utilities with KIUC—a
17 much smaller entity that seems to draw more praise from the Commission. NextEra did
18 none of this. Nor did it compare the utilities' current costs with their likely post-
19 acquisition costs, to test the bare verbal statement that "size" matters at all, let alone
20 matter at NextEra's post-acquisition size. This reference to size is mere advertising—
21 possibly true, possibly false, but in no way resembling substantial evidence.

22 In short, there is no evidence that HECO's performance is suboptimal because of
23 its size; that its costs would decline and performance would improve if only it were part

²¹⁰ See Ex. 1 to the Application (NextEra Form 8-K, Dec. 3, 2014) at 2.

1 of a larger organization. One could just as facilely say that HECO needs to shrink to
2 improve.²¹¹ Indeed, a serious investigation of Hawai'i's future market structure would
3 consider that very possibility. It would look into whether different combinations of asset
4 ownership (such as allowing for separate distribution grids within one or more islands,
5 managing their own consumption while purchasing generation, transmission and/or
6 ancillary services from a central organization), would better serve the customer than the
7 status quo. As I explained in Part III.B.2 above, allowing one vertically integrated
8 monopoly to acquire another, under circumstances where the acquirer has intention and
9 expectation to continue controlling a vertically integrated monopoly, heads precisely in
10 the opposite direction. That is why the Commission should reject this transaction.

11 ***F. The "financing" benefit mistakenly assumes that the only way to finance new***
12 ***electricity infrastructure finance is through HECO***

13
14 **Q. Describe your concerns with NextEra's argument that its financial strength will**
15 **assist with HECO's capital expenditure demands.**

16
17 **A.** Applicants describe a 10-year capital expenditure plan of approximately \$6.2 billion.²¹²

18 They add:

²¹¹ See, e.g., the recent statement by the President of the California Public Utilities Commission, that in reference to safety issues at Pacific Gas & Electric, "[t]he question may not be whether PG&E is too big to fail, but instead 'Is the company too big to succeed?'" David Baker, "Too Big? PUC Chief suggests breaking giant utility apart," *San Francisco Chronicle* (10 April 2015), available at <http://www.pressreader.com/usa/san-francisco-chronicle/20150410/282295318721865/TextView>.

²¹² Response to PUC-IR-138 (referring to other sources). See also Response to UL-IR-50 (noting that the PSIPs identified, according to the Response, "\$8 billion of capital to be deployed over the next 15 years").

1 Given Hawai‘ian Electric Industries' market capitalization absent the
2 proposed merger with NextEra Energy, it is apparent that the Hawai‘ian
3 Electric Companies would be challenged to raise the common equity
4 necessary to fund the growth set forth in the PSIPs. The PSIP capital is
5 three to four times the size of Hawai‘ian Electric Industries' market
6 capitalization (excluding the value of its subsidiary American Savings
7 Bank....).²¹³
8

9 They then reason:

10 Applicants believe that the annual incremental savings to the Hawai‘ian
11 Electric Companies resulting from the three-notch upgrade by Standard &
12 Poor's from BBB- to A- and anticipated capital expenditure spend and
13 following the approximate 43.7% debt funding based on the existing
14 equity ratio of 56.3% will approximate \$0.5 million. This annual savings
15 amount builds to \$6.8 million by the tenth year (2024) of capital
16 deployment, with the nominal interest savings accumulating over the life
17 of the 30-year financings totaling \$203.0 million."²¹⁴
18

19 I will leave to financial experts the task of assessing the assumptions about
20 differentials in bond ratings and interest rates (along with the necessary job of translating
21 the nominal \$203 million over 30 years into a net present value the Commission needs to
22 make sense of the statement. I will focus instead on the two-part assumption NextEra
23 makes to support its point.

24 The assumption is that (a) without the acquisition, HECO would be the only entity
25 to carry out the capital expenditure plan; and (b) with the acquisition, NextEra would be
26 the only entity to carry out that plan. The comparison of (a) to (b) favors NextEra. But
27 the comparison is false, because (a) and (b) are not the only outcomes. Under either the
28 no-acquisition or yes-acquisition scenarios, the Commission could—and should—require

²¹³ *Id.*

²¹⁴ Applicants' Response to PUC-IR-138.

1 competitive bidding for one or more major capital projects. Indeed, "Mr. Reed
2 recognizes that some of these investments are likely to be made by nonutilities."²¹⁵ As
3 do the Applicants, when challenged: "The Applicants understand and support that the
4 Commission may require competitive bidding on various components of the PSIPs."²¹⁶
5 Under that assumption—an assumption consistent with the Commission cost-minimizing
6 responsibilities rather than the Applicants' profit-maximizing aspirations—each
7 investment opportunity will go to the least cost supplier, all else equal. NextEra's false
8 comparison will be irrelevant. Financial savings will result from the competition, not
9 from the acquisition.

10 NextEra thus has tied financial benefit to control. NextEra's offer to finance
11 Hawai'i infrastructure does not apply to projects developed by third-parties; it applies
12 only to projects developed by NextEra. Its private interest strategy of control conflicts
13 with the public interest goal of diversity.

14 Furthermore, NextEra again makes no commitments, so it has no obligation to
15 invest. Since NextEra is not "pure play," and since its growth is unconstrained by the
16 now-repealed PUHCA 1935 or any Commission condition (if NextEra has its way in
17 opposing my proposed Condition VI.B.1.a), NextEra is free to invest its capital
18 elsewhere—unless it agrees to a condition requiring it to invest capital in Hawai'i on
19 command of the Commission. NextEra is trying to have it both ways: It argues that its

²¹⁵ Applicants' Response to UL-IR 69.

²¹⁶ Response to OP-IR-117.

1 capital availability will be a major benefit from this transaction, while retaining the
2 unrestricted ability to make that very capital available for non-Hawai'i destinations.

3 And in terms of HECO's access to financial resources, this acquisition moves in
4 the opposite direction. As I explained in Part III.C.2 above, interposing NextEra between
5 HECO and the equity markets creates three problems for the utilities. First, their access
6 to equity will depend on NextEra's unilateral decisions (which could involve conflicting
7 demands from NextEra's other family members—the number and international dispersion
8 of which has no limit, as explained in Part III.C.3). Today, the Hawai'i utilities' access to
9 equity depends on HECO, whose near-exclusive business is providing low-risk monopoly
10 utility service in Hawai'i. Second, after the acquisition, equity may come to HECO's
11 utilities at a higher cost should NextEra's profile become riskier—a possibility that the
12 Commission cannot control unless it conditions this acquisition on NextEra getting the
13 Commission approval for future acquisitions. Third, the risks NextEra incurs could leave
14 the utilities' bond ratings at levels lower than they would be without the transaction—
15 again due to NextEra investments that the Commission cannot control. By blocking
16 HECO's access to the equity markets, and by exposing the utilities to new and unknown
17 business risks that can affect their access to the bond markets, this acquisition cannot
18 claim, except rhetorically, to make the utilities financially stronger.

19 **Q. Does it matter if the rating agencies view this transaction favorably?**

20
21 **A.** Only if one ignores the long term. The factual basis for these ratings is necessarily
22 limited to the Applicants' current loans and current activities, plus the Applicants'
23 generic, non-committal statements about future plans. Positive outlooks last only as long
24 as positive facts do. Current ratings therefore tell us nothing about the future—the future

1 NextEra insists on keeping unknown and under its exclusive control. Extrapolating from
2 an allegedly positive present into an indefinite future is an insufficient basis for a public
3 interest finding.

4 **G. *The rate moratorium's benefit to consumers is only 1/11th the acquisition's***
5 ***benefit to HEI Shareholders***

6
7 **Q. What value should the Commission place on the Applicants' proposed "rate**
8 **moratorium"?**

9
10 **A.** The Applicants propose that the HECO utilities "will not file for a general base rate
11 increase for at least four years following closing of the transaction, and will forego
12 recovery under the decoupling mechanism of the incremental 'O&M RAM Adjustment'
13 during that period...." This commitment, they say, is worth "an estimated \$60 million in
14 customer savings."²¹⁷ I will leave to the more technical witnesses to address the clarity
15 of the proposal and the quality of the estimate. Recall that HEI's shareholders will
16 receive a control premium of \$568 million—9 times the \$60 million offered here. This
17 lopsidedness reflects HEI's strategy of seeking shareholder gain rather than customer
18 benefit.²¹⁸

19 * * *

20 NextEra wants this proceeding to be about performance; specifically, how
21 NextEra can improve HECO's performance. But making an acquisition proceeding a
22 performance proceeding creates an awkwardness: By the Applicants' own admission,
23 their ignorance of each other's costs and practices—an ignorance they blame on antitrust

²¹⁷ Application at 13.

²¹⁸ As explained in Part III.G above.

1 law and other factors²¹⁹—makes performance promises impossible. So we have a
2 performance proceeding in which the acquirer can offer only self-praise about the past,
3 and noncommittal optimism about the future.

4 If the information-sharing necessary to improve performance is not possible when
5 an acquisition is pending, it is more sensible to address performance when an acquisition
6 is not pending. Then we can open the information windows, allowing offerors to present
7 real plans and make real commitments. That is how generation competition works. We
8 do not make generation bidders guess about HECO's needs. Nor do we evaluate their
9 offers based on their boasts. We give them access to HECO's operational information
10 and we require binding offers. To do less in this acquisition proceeding, when the stakes
11 are so much greater, is neither logical nor necessary.

²¹⁹ As discussed in Part IV.D.5 above.

V.

**Rather Than Let HEI Sell Its Monopolies to NextEra,
the Commission Should See What Skills and Services Others Can Offer**

A. *This proceeding's unstated purpose: To address the Commission's dissatisfaction with HECO*

Q. Having discussed the presence of harms and the absence of benefits, what are your recommendations to the Commission?

A. I recommend the Commission reject this application, without prejudice to a future application that is submitted in a context in which multiple paths to Hawai'i's future can be compared based rigorous criteria and information requirements. I will explain my recommendation in the three ensuing subparts.

Q. What is the relationship between this proceeding and HECO's performance?

A. If this transaction were a pure takeover for profit, say by a leveraged buyout firm without no electricity expertise, no one would take it seriously. The reason to consider this transaction—and to divert months of Commission and intervenor time and resources away from essential efforts to assess Hawai'i's needs—is because NextEra argues it can run Hawai'i's utilities better than HECO has. (The key verb is "can," not "will," because "can" becomes "will" only with commitments. NextEra has made no performance commitments.) In name and procedure, this proceeding is about an exchange of stock between two holding companies. In reality, this proceeding is about one alleged path toward pushing HECO to improve its performance.

But if the goal is to improve performance, the logical path is not accepting the first applicant that walks in the door. The logical approach is to seek out the entities that can do the job the best, then cause them to back their claims with commitments. That approach is exactly what Applicants resist, as discussed next.

1 **B.** *The illogical way to address dissatisfaction with HECO: Have HEI select its*
2 *successor secretly, based on maximum gain to HEI's shareholders*
3

4 **Q.** **If our main concern is HECO's future performance, is this transaction a logical way**
5 **to address it?**
6

7 **A.** No. Whether choosing a college, a spouse or a business partner, no rational person
8 makes a lifetime decision by taking the first option that appears—especially if one is still
9 trying to define one's goals. If I am dissatisfied with my physician, I don't ask her to
10 recommend another—let alone accept a successor she chose based on how much they
11 paid her.

12 But these examples are close analogies to the proposed HECO-NextEra
13 succession. And they are all equally illogical. The franchise—the right to provide an
14 essential service, free from competition—is a valuable privilege. Created by government
15 action, it can be transferred only with government approval. And since government
16 created the value, government should receive the value. This transaction takes a different
17 approach. Its proponents have agreed on the value—it's the \$568 million control
18 premium. But they insist that entire value go to HEI's shareholders, even though those
19 very shareholders elected the HEI Board that hired the management responsible for
20 HECO's suboptimal performance that has created the Commission dissatisfaction that is
21 at the core of this case. To any neutral observer, the illogic should be clear. Having
22 expressed unprecedented dissatisfaction with the incumbent,²²⁰ the Commission should
23 not hand the job over to a company hand-picked by the incumbent.

²²⁰ In 31 years in the utility business I have seen very few orders as articulate, vigorous and fact-specific as the Commission's *Inclinations* order.

1 To see that approving this transaction is not logical path, one must remove two
2 mental obstacles created by the Applicants. The first is to see that the solution to HECO's
3 performance problems need not be one vertically integrated monopoly buying another.
4 HECO needs help, but NextEra has no monopoly on the necessary assistance. Consider
5 these points:

- 6 1. If we focus on cost-effective supply and customer-empowered choices, on
7 diversity of supply and democratization of demand, we must put on the
8 table all possible market structures. To pick NextEra because it is a
9 vertically integrated monopoly is to assume without question the answer
10 that Maine, New York and others are asking: Is vertically integrated
11 monopoly—the market structure that dominated the 20th century—
12 necessarily the solution for the 21st century? Or do technology and
13 economics support multiple suppliers—even within the distribution space?
14
- 15 2. Financing for the billions in new infrastructure need not come from one
16 source. Individual segments can be subjected to competition, resulting in
17 multiple winners each financing their own piece. Utilities use this model
18 routinely for generation competition, and FERC has required it for
19 transmission competition.
20

21 The second is to recognize that there is no emergency requiring approval of NextEra.
22 Hawai'i's situation is urgent. The urgency involves clarifying choices, specifying
23 tradeoffs and inviting options. But urgency does not mean emergency. There is no
24 emergency requiring us to choose NextEra.

25 Yet Applicants warn that if the Commission does not approve the transaction in
26 time for the contractual "End Date," the deal could dry up:

27 If the transaction closing does not occur before the End Date, neither party
28 to the Merger Agreement (NextEra Energy or HEI) has an obligation to
29 proceed and either could decide not to do so for any number of reasons,
30 including a change in market conditions and other unforeseen changes in
31 circumstances.²²¹

²²¹ Response to PUC-IR-92.

1
2 This is the language of transactional impatience. The End Date is the boundary on the
3 time period within which both sides were comfortable with the exchange ratio they
4 negotiated. What disappears on the deadline is not the public interest value allegedly
5 created by having NextEra control HECO; what disappears is the negotiators' comfort
6 with the price they negotiated. Hawai'i's needs, its ability to pay for those needs, and the
7 availability of human and financial capital suited to meet that needs, do not disappear on
8 some End Date imposed by outsiders. If a corporate coupling has public interest value,
9 that value survives the End Date; what needs to be renegotiated is merely the price. If the
10 parties choose to walk away, they expose the truth: Their priority was not Hawai'i's
11 long-term interest; their priority was the price.

12 I am not saying that the Commission should be indifferent to commercial
13 pressures, including the pressures of time. Hawai'i needs investors willing to make bets;
14 and all financial bets are time-sensitive. Investors will be attracted to Hawai'i not only
15 for its willingness to pay for transformational help but also for its disciplined procedures
16 that recognize the realities of time. But those realities of time should reflect the
17 Commission's priorities, not Applicants' ultimatums.

18 ***C. The logical way to address dissatisfaction with HECO: Open Hawai'i's door***
19 ***wide, inviting all to offer their skills and services***

20
21 **Q. Is it enough for the Commission to reject this transaction?**

22
23 **A.** No. Rejection opens the door for alternatives. I recommend the Commission focus on
24 how to attract those alternatives. The question is how.

25 In Part II I recommended the Commission to develop a vision for the types of
26 companies it wishes to have in the state—by defining the mix of products and services it

1 seeks, then considering the types of companies—in terms of business mix, corporate
2 structure, financial structure and market structure—most likely to excel in providing
3 those products and services. We can fashion that vision only after studying and
4 answering these questions:

- 5 1. What are the products and services that offer the diversity of supply, and
6 democratization of demand, that Hawai‘i most needs?
7
- 8 2. For providers of essential services, what should be the corporate structure,
9 in terms of the mix of utility and non-utility businesses, and layers of
10 affiliates between the utility and the board that ultimately controls it?
11
- 12 3. What should be the relationship of debt to equity in the corporate family's
13 various levels?
14
- 15 4. Which markets should be monopoly markets and which should be
16 competitive markets?
17
- 18 5. What rules will be necessary to prevent temptations that misalign
19 executive decisions with consumer needs?
20
- 21 6. What regulatory resources and statutory authority will the Commission
22 need to prevent inappropriate behavior and induce performance
23 excellence?
24
- 25 7. What consequences must the Commission be prepared to impose on those
26 who fail to get the message that consumers come first?
27

28 Finally, what procedure should we expect a Hawai‘i utility to follow, so that the acquirer
29 it picks is the one that offers consumers the best services rather than the one that offers
30 shareholders the highest price?

31 With that clear vision in place, the Commission will be positioned to invite
32 alternatives to this transactions. It then can issue requests for proposals to find the best
33 companies, and design a procedure for comparing, assessing and selecting those
34 proposals. (The Commission's experience with the energy efficiency contract awarded to
35 SAIC will provide important insights.) That is how businesses find the best employees,

1 how government agencies find the best consultants, and how customers find the best
2 home improvement contractors. To look only at the NextEra acquisition, giving it merely
3 an up or down vote, is to judge its merits in isolation from all other possibilities,
4 including not only acquisitions of all HEI stock, but partial acquisitions (of one company,
5 or of certain assets of one or more companies), creations of cooperative or municipal
6 systems, construction of microgrids, and other structural possibilities.

7 By inviting alternative applicants to offer diverse services and structures, the
8 Commission also will improve the quality of the applications. Had NextEra thought it
9 was competing for the Commission's favor, it would have offered what it thought was
10 necessary to win. It would offer real commitments—commitments it believed would
11 exceed those offered by its competitors. But because NextEra saw its sole objective as
12 winning over HEI's Board, it offered what the HEI Board wanted—a premium over
13 market price high enough such that "no other party was likely to offer greater
14 consideration in a sale of the company...."²²² And to the Commission it offered nearly
15 nothing. HEI's Board insisted on the best deal for its shareholders, while the Commission
16 has not required the best deal for consumers. That is why the ratio of shareholder gain to
17 customer gain—nine to one—is so lopsided. The difference in positioning yields a
18 differential in the benefits.

19 In short, to prevent future lopsidedness, and to get for Hawai'i the service
20 excellence it deserves, we must require each future acquisition applicant to show why it,

²²² NextEra Form S-4 at 40.

- 1 above any other company, deserves the extraordinary privilege of controlling a
- 2 government-granted, exclusive franchise to serve the state's citizens.

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VI.

**If the Commission Does Approve a NextEra Takeover,
Conditions Will be Necessary—but not Sufficient—
to Reduce the Risk of Harm and Increase the Probability of Benefits**

A. *The cost-benefit imbalance*

Q. On the transaction presented here, HEI's sale of its stock to NextEra's, what is your recommendation?

A. I recommend the Commission reject the transaction. HEI's decision to sell out to NextEra conflicts with its utilities' obligations to their customers. This transaction brings all the risks and costs described in Part III, including the risks from NextEra's current and unknown future holdings, the costs associated with adding Commission staff to monitor those holdings, and the risks associated with HECO's shrinkage in size and importance relative to its new holding company owner. HECO will face inter-family conflicts over capital access and cost allocation that it does not face today. Weighed against these risks and costs are benefits which, as explained in Part IV, are nearly non-existent.

Although I recommend rejection, I believe an expert witness should, where possible, offer options that diverge from his recommendation. Part VI.B therefore presents conditions that could reduce the risk of harm. But as I will explain in Part VI.C, even if all of these essential conditions were practical and enforceable (and some are not, as I will explain), taken together they are insufficient to correct the transaction's imbalance between and benefit, and between private and public interests.

B. *Conditions to address the imbalance*

Q. How have you organized your recommended conditions?

A. I have organized the conditions according to three objectives: eliminate harms, create benefits, and ensure compliance.

1 **1. *Eliminate harms***
2

3 **a. *Protect Hawai'i's utilities from NextEra's business risks***
4

- 5 i. No member of the NextEra corporate family shall
6 acquire any interest in any business, where such
7 interest exceeds a dollar level established by the
8 Commission to eliminate the possibility of harm to
9 HECO's utilities, unless the Commission has
10 determined that the acquisition and continued
11 ownership of such interest will cause no harm to a
12 HECO utility or increase the cost of the
13 Commission oversight. The Commission will make
14 such determinations using a procedure to be
15 developed in a separate Commission rulemaking,
16 before the completion of which NextEra shall make
17 no additional acquisitions. Such procedure may
18 include a combination of safe harbors (no
19 Commission review necessary), advance notice
20 (after which the transaction may proceed unless the
21 Commission determines that review is necessary),
22 and express decisions granting or denying approval,
23 all as necessary to distinguish, expeditiously,
24 acquisitions that pose risks to consumers from those
25 that do not.
26
- 27 ii. The Commission shall have access, in Honolulu, to
28 the books and records of any NextEra affiliate
29 whose business activities the Commission
30 reasonably believes could affect HEI's utilities
31 adversely.
32

33 **Comment:** The Applicants have offered books and records access only with
34 respect to affiliates engaged in interaffiliate transactions with Hawai'i utilities.²²³ But

²²³ See Response to PUC-IR-174 (restricting access to "the books and records of [NextEra affiliates] ... that provide services chargeable to the Hawai'ian Electric Companies, to the extent necessary for the Commission to fulfill its statutory responsibilities over the Hawai'ian Electric Companies").

1 given the risks to the Hawai‘i utilities of affiliate ventures, as described in Part III.C
2 above, regulatory access is necessary to the affiliates engaged in those ventures.

3 ***b. Prevent inappropriate movement of capital away from the***
4 ***Hawai‘i utilities***

5
6 NextEra shall maintain the elements of the Hawai‘i utilities'
7 capital structure within the ranges established by the
8 Commission from time to time. Accordingly:
9

- 10 i. NextEra shall inject equity into the HECO utilities
11 consistent with Commission policies.
12
13 ii. HECO utilities shall not pay dividends except to the
14 extent consistent with the Commission policies.
15
16 iii. HECO utilities shall not incur debt except to the
17 extent consistent with Commission policies.
18
19 iv. HECO utilities shall not provide financial support
20 of any type to any NextEra business venture, other
21 than through the purchase of goods or services
22 consistent with the Commission's rules in
23 interaffiliate transactions.
24

25 ***c. Prohibit inappropriate interaffiliate transactions***
26

- 27 i. NextEra shall not consummate this transaction until
28 it has submitted to the Commission, and the
29 Commission has approved, internal procedures
30 designed to ensure that all employees will comply
31 with the Commission's rules and conditions. Such
32 procedures shall include not merely rules and
33 training, but procedures for monitoring, detecting
34 and penalizing inappropriate actions.
35
36 ii. No HEI utility shall undertake any obligation to
37 make any payment to an affiliate for any service, or
38 to sell to any affiliate any service, unless the
39 Commission first has determined, by advance rule
40 or transaction-specific review, that such transaction
41 produces the maximum cost-effective benefit to that
42 utility's ratepayers relative to all feasible
43 alternatives.
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- iii. No Hawai‘i utility shall become a party to any NextEra interaffiliate agreement, including agreements for the allocation of overhead costs, unless the Commission first has found that such agreement is in the best interest of Hawai‘i utility customers and is otherwise consistent with the Commission requirements. In any Commission rate proceeding, the utility shall have the burden of proof (including the burden of producing evidence supporting such proof), that any payment made or received by any Hawai‘i utility under any interaffiliate agreement was reasonable.
 - iv. A utility's decision to use its own employees or services, rather than using corporate shared services, shall not be overruled or influenced by any NextEra official outside such utility.

19
20

d. Prevent NextEra interference with local management

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46
- i. Subject to paragraph (ii) below, NextEra shall guarantee that (a) HECO utility management will create its own budgets unconstrained by NextEra, and (b) such budgets will be approved by NextEra as submitted by each HECO utility to NextEra. NextEra shall provide each HECO utility with any funds required by such utility to carry out its budget. Executives of both HECO and NextEra shall certify, according to a form and schedule established by the Commission, that NextEra has taken no action to constrain any utility's budget or to constrain any utility from raising or receiving the funds necessary to carry out that budget.
 - ii. In the event that NextEra executives wish to modify a budget originally submitted to them by a Hawai‘i utility, NextEra shall submit to the Commission the original budget and NextEra's proposed modifications, with full explanation of the original budget, the desired modifications, and the reasons for the modifications. This paragraph shall not apply to modifications below a dollar threshold established by the Commission.
 - iii. NextEra shall guarantee that if the Commission orders any HECO utility to make any expenditure

1 that causes such utility to exceed its budget, no
2 NextEra entity or official will prevent such utility
3 from carrying out such order. This condition does
4 not preclude such utility from acting on its own to
5 contest such order.
6

7 iv. Prior to consummation of this acquisition, NextEra's
8 CEO shall certify, under penalty of perjury, that no
9 one within the NextEra corporate system and
10 outside a HECO utility has authority to overrule any
11 decision made by a HECO utility, except under the
12 circumstances described in paragraph (ii) of this
13 condition. On December 31 of each year, the CEOs
14 of NextEra and the HECO utilities shall certify,
15 under penalty of perjury, that in the preceding year
16 no one within the NextEra corporate system and
17 outside a HECO utility has overruled any decision
18 made by a HECO utility.
19

20 v. Without advance Commission approval, NextEra
21 shall make no corporate governance rules affecting
22 the HECO utilities' decisionmaking autonomy.
23

24 ***e. Eliminate unearned advantages in the markets for distributed***
25 ***energy services***
26

27 i. No NextEra affiliate providing in Hawai'i a
28 competitive or potentially competitive service (as
29 defined by the Commission) may receive from any
30 other NextEra affiliate any form of support unless
31 such support is consistent with Commission rules
32 designed to ensure that no NextEra affiliate has any
33 unearned advantage in any market subject to the
34 Commission's jurisdiction.
35

36 ii. No NextEra affiliate shall deny to any provider of
37 distributed energy services any service, or access to
38 any facility, if the Commission determines that such
39 service or access is necessary for such provider to
40 compete effectively. The Commission shall ensure
41 reasonable compensation to NextEra or its affiliate
42 for any such service or access.
43

44 ***f. Clarify HECO's franchise privilege***
45

1 Approval of this transaction creates no expectation that
2 NextEra or any of its affiliates has any right, beyond what it
3 had prior to this transaction, to provide any service within
4 Hawai‘i for any time period.
5

6 ***g. Protect against strategic sale of HECO***
7

8 NextEra shall not begin any effort to sell HEI or any
9 Hawai‘i utility except according to competitive procedures
10 that the Commission has determined will result in the
11 selection of that acquirer able and willing to provide the
12 most cost-effective, responsive and innovative service for
13 the utility customers.
14

15 ***h. Payment of regulatory fee***
16

17 The HECO utilities shall pay to the Commission pay an
18 annual fee, not recoverable from utility customers, to cover
19 the Commission's incremental cost, as determined by the
20 Commission, associated with ensuring that this acquisition
21 causes no harm to utility customers or to the market for any
22 services subject to the Commission's jurisdiction.
23

24 ***2. Create benefits***
25

26 ***a. Improve operations***
27

28 Prior to consummating the proposed acquisition, NextEra
29 and the HECO utilities shall jointly submit a plan that
30 identifies each improvement the acquisition will make in
31 the Hawai‘i utilities' performance, and the schedule for
32 such improvements, along with specific metrics by which
33 the Commission can determine whether such improvement
34 occurs. The parties shall not consummate the proposed
35 acquisition until the Commission has approved such plan,
36 along with any conditions.
37

38 ***b. Flow "synergy" savings to customers***
39

40 ***i.*** Prior to consummating the acquisition, the HECO
41 utilities shall submit for Commission approval a
42 tracking mechanism that identifies all costs and cost
43 reductions attributable to the transaction, for the
44 first five years after consummation.
45

- 1 ii. The Applicants shall agree that all cost reductions
2 attributable to the acquisition (net of costs to
3 achieve) shall flow to customers, regardless of the
4 timing of such costs and cost reductions in relation
5 to a general rate case. The HECO utilities shall
6 propose methods, which may include interim rates,
7 deferrals or other methods, by which to achieve this
8 result without resulting in prohibited retroactive
9 ratemaking.

10
11 **Comment:** My understanding is that Applicants oppose this method of ensuring
12 that utility customers receive the savings that occur between rate cases. Applicants state,
13 in relevant part:

14 This proposal, as drafted, would represent an inequitable "one way" rate
15 adjustment mechanism, in which rates could go down to reflect merger
16 savings without any ability to increase rates if other factors dictate that an
17 increase is warranted. In addition, such a proposal would reduce or
18 eliminate the incentives that exist under the current ratemaking approach,
19 as modified by the Applicants' merger commitments, to achieve merger
20 savings as promptly and fully as possible. Such a proposal would also
21 create four years of significant rate uncertainty which would create risk for
22 both investors and consumers.²²⁴

23
24 The Applicants misunderstand the concept. Making rates interim or using a deferral, can
25 preserve the possibility of a rate increase or a rate decrease. That is what a tracker does:
26 It records the information, positive and negative, during a specified period, to allow for a
27 true-up at the end of that period. With that information, the Commission can decide what
28 to do. Perhaps the Commission will flow through to customers all costs and cost
29 reductions, regardless of how they net out, such that customers gain the benefits and bear
30 the risks. Or the Commission could say "During the acquisition proceeding, the
31 Applicants always expressed optimism while dismissing any basis for pessimism. So

²²⁴ Response to OP-IR-87.

1 they must now lie in the bed they made: net cost reductions flow to consumers, net cost
2 increases are borne by Applicants." Or the Commission could create some kind of risk-
3 sharing arrangement, where above and below some "deadband" various percentages are
4 applied to determine who bears what portion of positive and negative results. The point
5 is to eliminate the asymmetry of information arising from the Applicants' control of the
6 data. Using a tracker and "true-up" procedure gets the Commission after-the-fact the
7 information the Applicants have throughout, thus allowing the Commission to make
8 decisions that induce efficient performance. When the Commission makes those
9 decisions, the Applicants can object if they wish, but there is no legitimate reason to hide
10 information the Commission needs to make the decisions.

11 Supporting the need for a tracker is the Applicants' necessary acknowledgment
12 that the four-year "moratorium" is a moratorium on rate decreases as well as rate
13 increases. It is a rate freeze during a period when cost reductions might occur: "If during
14 the proposed four year moratorium the Hawai'ian Electric Companies' actual revenues
15 and costs differ from what was allowed in its most recent general base rate case, both
16 savings and costs will be 'retained' by the Hawai'ian Electric Companies to the extent that
17 they are not flowed back to customers through other normal ratemaking channels (*e.g.*,
18 the earnings sharing mechanism, energy cost adjustment clause, rate adjustment
19 mechanism)."²²⁵ If net cost decreases occur during the four years, they increase
20 NextEra's profit rather than decrease consumers' rates.

²²⁵ Response to OP-IR-129.

1 The Applicants have discretion over the timing of their integration efforts. The
2 possibility therefore exists that they take net-cost-reducing actions during the four-year
3 moratorium, thereby increasing their profits without reducing rates; while leaving the net-
4 cost-increasing actions to the period following the moratorium, when they can seek a rate
5 increase to recover the cost. The tracking concept gets the Commission the information it
6 needs to ensure appropriate treatment of costs and benefits over the full implementation
7 period (whose length we do not know because there are no plans or commitments).

8 ***c. Allocate control premium between shareholders and customers***
9

10 The Commission shall allocate the control premium
11 (defined as the excess of purchase price over market value
12 as of a day determined by the Commission) between
13 shareholders and ratepayers according to each group's
14 relative contribution to the premium's value. There shall be
15 a rebuttable presumption that each group's relative
16 contribution is 50-50. Upon the Commission's final
17 determination of the contribution by ratepayers, the post-
18 acquisition entity shall pay that amount to the HECO
19 utilities' customers according to terms determined by the
20 Commission.
21

22 ***3. Ensure compliance***
23

24 ***a. Ensure internal procedures for compliance***
25

26 Prior to consummation of the acquisition, NextEra shall
27 demonstrate to the Commission's satisfaction that (a)
28 NextEra has instituted internal procedures, with
29 consequences for violations, sufficient to prevent or detect
30 all violations of these conditions; and (b) NextEra
31 employees face no incentives to violate these conditions.
32

33 ***b. Preserve Commission authority to order spin-off for***
34 ***noncompliance***
35

36 NextEra agrees that in addition to any power the
37 Commission has under current law, by accepting these
38 conditions the Applicants recognize, and commit not to
39 contest, the Commission's authority to order NextEra to

1 spin off HEI (or one or more of its utilities) to NextEra's
2 shareholders, or to require HEI or its utilities otherwise to
3 disaffiliate from NextEra, should the Commission find that
4 (a) there is any violation of any of these conditions or (b)
5 one or more HEI utilities' affiliation with NextEra can
6 cause harm to Hawai'i ratepayers.
7

8 **Comment:** Even marriages have divorces. Some marriages have "pre-nups."

9 This marriage has a special need for one because, as the companies have admitted, they
10 know so little about each other. So everyone—NextEra, HEI, the Commission and the
11 public—needs clarity about how things will unwind. It is a matter of simple symmetry.
12 If this transaction does not work out for NextEra, it has clear paths for departure: selling
13 the Hawai'i utilities to a third party or spinning them off to the shareholders. If the
14 transaction does not work out for the Commission, it needs similarly clear paths to cause
15 NextEra's departure.

16 **C. *Problems with the conditions: Practicality and enforceability***

17
18 **Q. Do you have concerns about the practicality and enforceability of your conditions?**

19
20 **A.** Yes. Some of these conditions apply not to HEI or its utilities, but to NextEra and its
21 other affiliates. NextEra might argue that conditions as outside the Commission's current
22 legal powers. The direct answer would be that if the condition is necessary to protect the
23 public interest, then NextEra has a choice: accept the condition or lose the transaction.
24 But that leads to the next problem: It is not clear whether NextEra's acceptance of
25 conditions can vest in the Commission the power to enforce them, if the Commission
26 would not otherwise have that power. The Commission therefore must assure itself of
27 these conditions' lawfulness and enforceability before relying on them. If a particular
28 condition is necessary to the public interest but it is not clear that the Commission has the

1 statutory authority to impose it, the acquisition cannot go forward—at least not until the
2 Legislature acts to clarify the Commission's authority.

3 **Q. Is there another way for the Commission to protect against the possibility of the**
4 **conditions' non-enforceability?**

5
6 **A.** Yes. If the Commission believes there is doubt about a condition's enforceability, it can
7 make clear that a Commission finding of a NextEra violation will empower the
8 Commission to order the Hawai'i utilities to disaffiliate from NextEra—or give up its
9 franchise privilege. My Condition VI.B.3.b reflects this reasoning. I will refer to this
10 condition as the "spin-off" condition because to satisfy it, NextEra would need to transfer
11 ownership of the utilities to NextEra's ultimate shareholders, or to some other company
12 approved by the Commission to be the utility's new owner.

13 **Q. Under what circumstances would the Commission consider taking this action?**

14
15 **A.** The Commission would consider this spin-off option whenever it determines that a
16 utility's affiliation with NextEra has become, or is likely to become, detrimental to the
17 utility's ability to carry out its public service obligations at cost and quality levels that
18 meet the Commission's standards. A non-exhaustive list of such situations would include
19 the following:

- 20 1. NextEra has blocked a utility's initiatives required or approved by the
21 Commission.
- 22 2. NextEra has declined to provide capital to a utility in amounts and types
23 the Commission deems necessary.
- 24 25 3. The cost to a utility of equity or debt is higher than it would have been
26 absent its affiliation with NextEra.
- 27 28 4. The magnitude or nature of the business activities in which NextEra or its
29 affiliates are engaged has exceeded some level determined by the
30 Commission to cause a risk of harm to a utility.
31
32

- 1 5. A rating agency has downgraded, or has indicated the possibility of
2 downgrading, a utility's debt due to its affiliation with NextEra.
- 3
- 4 6. The Commission discovers an interaffiliate transaction that violates
5 appropriate interaffiliate transaction standards to the possible detriment of
6 a utility.
- 7
- 8 7. A NextEra affiliate resists reasonable requests, by the Commission or
9 others, for information about business activities that could affect a Hawai'i
10 utility's well-being.
- 11
- 12 8. The Commission determines that NextEra has intervened in a utility's (or
13 an affiliate's) decision-making in a manner potentially detrimental to the
14 utility or its customers.
- 15
- 16 9. An event external to NextEra changes the risk level of NextEra's business
17 activities negatively, so as to affect a utility detrimentally.
- 18

19 If one of these events occurred, the Commission would have the option of initiating a
20 proceeding to determine whether spin-off or franchise revocation is necessary. In that
21 proceeding, the Commission would take into account any possible advantages accruing to
22 the utility from the affiliation that would be lost with a dis-affiliation. I am not
23 suggesting that spin-off is a necessary response to a violation of a condition. Penalties
24 must be proportionate to violations. I am saying that because there can be violations that
25 justify spin-off or franchise revocation, the public interest requires that the Commission
26 have this option available, and be willing and ready to invoke it when necessary.

27 **Q. Do you have concerns about the feasibility of the spin-off option?**

28

29 **A.** Yes. Even if NextEra accepts such a condition now, some interested party (*e.g.*, an
30 NextEra shareholder, bondholder, vendor or contract partner) could later challenge the
31 Commission's authority to order a spin-off. If that possibility is real, the Commission
32 should pause, because if a condition necessary to the public interest is not clearly
33 enforceable, then the acquisition itself cannot be in the public interest.

1 Another concern is practical: There is no way to know now whether there will be
2 an alternative provider willing to take over the spun-off utility, or whether in that
3 situation the spun-off utility will be able to serve effectively on its own. That fact too
4 must give the Commission pause. If the Commission lacks the legal and practical means
5 to undo the affiliations it has approved, then it must avoid those affiliations to begin with.
6 A plane without landing gear should not be allowed to leave the runway.

7 **Q. If NextEra objects to these conditions, what does that say about its priorities?**

8
9 **A.** NextEra will likely object that these conditions impede its plans for its future. But the
10 relevant concern is not NextEra's future; it is Hawai'i's future. To return a utility to
11 simpler times, to its prior low-risk, public interest-dedicated context, might
12 inconvenience NextEra but it will benefit Hawai'i's consumers.

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**VII.
Conclusion**

Q. Does NextEra support its application with facts?

A. No. Since the mid-1980s, there have been dozens of utility mergers. These transactions provide a large data set from which the Applicants could have compiled drawn evidence to back up its many unsupported claims. Instead of hypotheses, data, logic and conclusions—the foundations of serious policymaking—the Applicants offer vagueness, self-praise, and the same adjectival formulas that appear in every merger case.

But words cannot offset risks. Each of the conflicts and risks discussed in Part III causes some level of harm. How much harm is unknowable. One can try to quantify the costs of the risks we know about, by identifying cost-causing scenarios, then estimating the costs of each scenario and the probability of their occurrence. NextEra has made no effort to do so; implicitly it treats the harm as "zero." But treating the harm as "zero" does not make the harm "zero."

There is, therefore, an absence of proof for the very issue on which the statute requires proof. Even if NextEra had made the effort, and done so properly, that effort would have addressed only the conflicts and risks that are known. There still would be the unknown: all future acquisitions that NextEra will make, without the Commission approval—all without geographic or type-of-business limit, all without any customer-benefitting rationale. NextEra's application, like its future, is too indefinite to deserve the Commission's approval.

Q. Does this conclude your Direct Testimony?

A. Yes.

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PLANNING OFFICE EXHIBIT-5
DOCKET NO. 2015-022

EXCERPTS FROM NEXTERA'S FORM S-4

From NextEra Energy Inc., Amendment No. 3 to Form S-4 at pp. 30-41 (Mar 24, 2015).

[May 2014] NEE Chairman and CEO Robo gives Connie Lau, Pres and CEO of HEI with a "preliminary, confidential written proposal valuing HEI in its entirety (including both Hawai'ian Electric and American Savings Bank) at \$30.00 per HEI share, with the merger consideration to consist of either cash or NEE common stock at HEI's option."

[HEI Board's July 21, 2014 mtg.] "Following discussion, the HEI board authorized HEI's management to communicate to NEE that the amount of the proposed merger consideration was insufficient but that if NEE would be willing to consider increasing the proposed merger consideration, HEI would be willing to enter into a confidentiality agreement and allow the commencement of due diligence to support an increase in proposed merger consideration."

[Aug. 11, 2014.] "James A. Ajello, Executive Vice President and Chief Financial Officer of HEI, delivered a letter to Mr. Moray Dewhurst, Vice Chairman and Chief Financial Officer of NEE, reiterating the need for NEE to increase the value of its proposal and attaching initial diligence information with respect to American Savings Bank and Hawai'ian Electric and a term sheet with respect to certain high level terms of a possible transaction between NEE and HEI." ... "The proposal specified that the operational headquarters of HEI's utility business would remain in Honolulu, Hawai'i and expressed the need for commitments by NEE relating to employee job protections in connection with the merger and the maintenance of HEI's historic levels of community involvement and charitable contributions. Finally, HEI proposed a strong commitment to obtaining regulatory approvals for the proposed transaction and the payment by NEE of a termination fee if regulatory approvals were not obtained." [no required commitment re customer benefits]

"In late August 2014, Mr. Dewhurst [Vice Chairman and Chief Financial Officer of NEE,] delivered a letter to Mr. Ajello acknowledging HEI's preference to separate American Savings Bank through a spinoff to HEI shareholders in connection with any transaction and proposing that NEE would pay HEI shareholders \$24.50 for each share of HEI common stock, in cash or NEE stock at HEI's election, with HEI's bank business to be spun off to HEI's shareholders immediately prior to completion of the NEE/HEI transaction. NEE also indicated that it would be willing to absorb up to \$130 million of the corporate tax liability resulting from the spin-off of American Savings Bank. The letter also discussed NEE's commitments regarding job protections and obtaining necessary regulatory approvals."

1 "In late August 2014, Mr. Dewhurst and Mr. Ajello discussed by telephone the terms of
2 NEE's letter, with Mr. Ajello indicating that HEI would be seeking improved financial
3 terms."
4

5 "On September 5, 2014, the HEI board met, together with management and
6 representatives of J.P. Morgan and Skadden. Mr. Ajello provided an update on the
7 ongoing negotiations with NEE, and J.P. Morgan provided an updated valuation analysis
8 based on NEE's revised proposal. The HEI board, together with HEI's management and
9 representatives of J.P. Morgan and Skadden, also engaged in further discussion of the
10 benefits and risks of contacting third parties who might have an interest in engaging in a
11 strategic transaction with HEI. The HEI board concluded, in light of the proposed merger
12 consideration and the regulatory approvals required to complete a transaction, that the
13 likelihood of securing a superior proposal was low, from both a financial and a deal
14 certainty perspective....[T]he HEI board authorized management to enter into further due
15 diligence and negotiations with NEE to seek enhanced value and to negotiate the terms of
16 a potential merger agreement with NEE."
17

18 "Following this board meeting [of Sept. 5, 2014], management of HEI and NEE
19 continued to negotiate the terms of the proposed transaction. On September 11, 2014,
20 NEE communicated a revised proposal to HEI, in which NEE would pay HEI
21 shareholders \$25.00 per share of HEI common stock and HEI's bank business would
22 be spun off to HEI's shareholders. NEE further agreed that it would bear the full expected
23 corporate tax liability resulting from the bank spin-off."
24

25 "Following discussion [at an NEE board meeting of Oct. 16, 2014], the NEE board of
26 directors authorized NEE management to proceed with the proposed transaction at a
27 valuation of up to \$25.50 per HEI share."
28

29 "Through mid-November, HEI and NEE continued to discuss the level and calculation of
30 the proposed merger consideration. In addition, HEI proposed that it would pay a special
31 cash dividend to HEI shareholders immediately prior to completion of the proposed
32 merger. NEE agreed that HEI could pay such a special cash dividend in the amount of
33 \$0.25 per share without impacting the merger consideration. Following further
34 discussion, HEI continued to seek an increase in the merger consideration and proposed
35 increasing the special cash dividend to \$0.50 per share. NEE indicated that the increased
36 special cash dividend was acceptable to NEE. In the context of these discussions, HEI
37 also acceded to NEE's position that the merger consideration be determined by a fixed
38 exchange ratio, while NEE agreed to HEI's position that the fixed exchange ratio should
39 be calculated based on the twenty day volume weighted average price of NEE common
40 stock as of the day prior to the signing of the merger agreement."
41

42 "Through the end of November, HEI and NEE continued to negotiate the terms of the
43 merger agreement. Following further discussions regarding the merger consideration,
44 NEE indicated that it was unwilling to increase the proposed merger consideration above
45 \$25.00 in NEE stock per HEI common share in light of its acceptance of HEI's proposed

1 special cash dividend to HEI shareholders of \$0.50 per share. On December 2, 2014, the
2 parties agreed to embody the proposed merger consideration to HEI shareholders in a
3 fixed exchange ratio of 0.2413 shares of NEE common stock for each outstanding share
4 of HEI common stock, which was derived by dividing the agreed upon \$25.00 per HEI
5 common share merger consideration by the volume weighted average price of NEE
6 common stock for the twenty trading days ended December 2, 2014."
7

8 "Alternatives to the Merger. The HEI board took into consideration its belief that, after
9 careful consideration of potential alternatives to the merger, the merger with NEE is
10 expected to yield greater benefits to HEI shareholders (including the benefits discussed
11 above) than would the range of alternatives considered. The potential alternatives
12 considered included various standalone strategies, including generation portfolio
13 diversification and business separation, and the attendant risks of each of them, including
14 the risks of HEI's utility's transformation plan. The HEI board also took into account its
15 belief that no other party was likely to offer greater consideration in a sale of the
16 company, particularly taking into account NEE's agreement to bear the expected
17 corporate tax liability of the bank spin-off."
18

19 "Management Recommendation. The HEI board took into account the recommendation
20 of senior management of HEI that the merger is in the best interests of HEI's shareholders
21 based on their knowledge of current conditions in the electricity generation, distribution
22 and transmission industry and markets and the likely effects of these factors on HEI's and
23 NEE's potential growth, productivity and strategic options, and on their understanding of
24 the benefits that would flow from the separation of HEI's banking operations."
25

26 As stated in the response to DEBDT-IR-12: "Subsequent to receiving NextEra Energy's
27 formal proposal for the merger, Hawai'ian Electric Industries, Inc.'s ('HEI') board of
28 directors ('Board') carefully considered other potential strategic alternatives including
29 remaining as a standalone company and identifying companies that possibly might be
30 interested in acquiring the utility business or the bank business. On the basis of careful
31 consideration of the information and analysis provided to the Board by its staff and
32 consultants, the Board concluded in the exercise of its business judgment that it was
33 highly unlikely that a possible counterparty existed that would be willing and able to
34 match the terms of the proposed transaction agreed to by NextEra Energy and that the
35 risks of 'shopping' the company under these circumstances exceeded any likely benefits."

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Education

B.A. *cum laude*, Yale University (majors: Economics and Political Science, Music),
 1978. Recipient of a Continental Grain Fellowship and a Patterson Research Grant.
 J.D. *magna cum laude*, Georgetown University Law Center, 1984. Recipient of
American Jurisprudence Award for Constitutional Law; editor of *Law and Policy in
 International Business*; instructor, and legal research, and writing.

Professional Experience

President, Scott Hempling, Attorney at Law LLC (2011–present)
 Adjunct Professor, Georgetown University Law Center (2011–present)
 Executive Director, National Regulatory Research Institute (2006–2011)
 Founder and President, Law Offices of Scott Hempling, P.C. (1990–2006)
 Attorney, Environmental Action Foundation (1987–1990)
 Attorney, Spiegel and McDiarmid (1984–1987)

Past Clients

Independent Power Producers and Marketers

California Wind Energy Association, Cannon Power Company, Electric Power Supply
 Association, EnerTran Technology Company, National Independent Power Producers,
 SmartEnergy.com, and U.S. Wind Force.

Investor-Owned Utilities

Madison Gas & Electric, Oklahoma Gas & Electric.

Legislative Bodies

Vermont Legislature, South Carolina Senate.

Municipalities and Counties

Connecticut Municipal Electric Energy Cooperative; Iowa Association of Municipal
 Utilities; City of Winter Park, Florida; Montgomery County, Maryland; and American Public
 Power Association.

1 Public Interest Organizations

2 Alliance for Affordable Energy, American Association of Retired Persons, Consumer
3 Federation of America, Energy Foundation, Environmental Action Foundation, GRID2.0
4 (Washington, D.C.), Illinois Citizens Utility Board, and Union of Concerned Scientists.

5 Regulatory Commissions and Consumer Agencies

6 Arkansas Public Service Commission, Arizona Corporation Commission, Connecticut
7 Department of Public Utility Control, Connecticut Office of Consumer Counsel, Delaware
8 Public Service Commission, Hawai'i Public Utilities Commission, State of Hawai'i Office of
9 Planning, Indiana Utility Regulatory Commission, Kansas Corporation Commission, State of
10 Maryland, Maryland Energy Administration, Maryland Attorney General, Massachusetts
11 Attorney General, Massachusetts Department of Public Utilities, Mexico's Comisión Reguladora
12 de Energía, Minnesota Public Utilities Commission, Mississippi Public Service Commission,
13 Mississippi Public Utilities Staff, Missouri Public Service Commission, Montana Public Service
14 Commission, National Association of Regulatory Utility Commissioners, Nevada Consumer
15 Advocate, Nevada Public Service Commission, New Hampshire Public Utilities Commission,
16 New Jersey Division of Ratepayer Advocate, North Carolina Utilities Commission, Ohio Public
17 Utilities Commission, Oklahoma Corporation Commission, Pennsylvania Office of Consumer
18 Advocate, Puerto Rico Energy Commission, South Carolina Public Service Commission, Texas
19 Office of Public Utility Counsel, Vermont Department of Public Service, Virginia State
20 Corporation Commission, and Wisconsin Attorney General.

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Testimony Before Legislative Bodies**24 United States Senate**

25 Committee on Energy and Natural Resources, May 2008 (addressing the adequacy of
26 state and federal regulation of electric utility holding company structures).

27 Committee on Energy and Natural Resources, Feb. 2002 (analyzing bill to amend the
28 Public Utility Holding Company Act) (PUHCA).

29 Committee on Energy and Natural Resources, May 1993 (analyzing bill to transfer
30 PUHCA functions from SEC to FERC).

31 Committee on Banking and Urban Affairs, Sept. 1991 (analyzing proposed amendment to
32 PUHCA).

33 Committee on Energy and Natural Resources, March 1991 (analyzing proposed
34 amendment to PUHCA).

35 Committee on Energy and Natural Resources, Nov. 1989 (analyzing proposed
36 amendment to PUHCA).

1 **United States House of Representatives**

2 Subcommittees on Energy and Power and Telecommunications and Finance, Commerce
3 Committee, Oct. 1995 (regulation of public utility holding companies).

4 Subcommittee on Energy and Power, Energy and Commerce Committee, July 1994
5 (analyzing future of the electric industry).

6 Subcommittee on Energy and Power, Energy and Commerce Committee, May 1991
7 (analyzing proposed amendment to PUHCA).

8 Subcommittee on Environment, Energy and Natural Resources, Government Operations
9 Committee, Oct. 1990 (assessing electric utility policies of FERC).

10 Appropriations Subcommittee on Commerce, Justice, State and the Judiciary, Apr. 1989
11 (discussing proposals to increase staff administering PUHCA).

12 Subcommittee on Energy and Power, Sept. 1988 (discussing "independent power
13 producers" and PUHCA).

14 **State Legislatures**

15 Committee on Energy and Public Utilities, California Senate (December 1989)
16 (discussing relationships between electric utilities and their non-regulated affiliates).

17 Interim Committee on Electric Restructuring, Nevada Legislature (1995-97) (discussing
18 options for structuring the electric industry).

19 Committees on General Affairs, Finance, Vermont Senate (February-March 1997)
20 (discussing options for structuring the electric industry).

21 Task Force to Study Retail Electric Competition, Maryland General Assembly (1997).

22 Electricity Restructuring Task Force, Virginia General Assembly (1999).

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33 utility holding company (2015).
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41 North Carolina Utilities Commission: Effect of merger on state regulatory powers
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2 New Jersey Board of Public Utilities: Affiliate relations in telecommunications sector
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5 Illinois Commerce Commission: Affiliate relations and mixing of utility and non-utility
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16 **Books**

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33 Heggie, *Energy Law and Policy* (Carswell 2011).

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Speaker and Lecturer

2 **United States:** American Antitrust Institute; American Association of Retired Persons;
 3 American Bar Association; American Power Conference; American Public Power Association;
 4 American Wind Energy Association; Chicago Bar Association (Energy Section); Columbia
 5 University Institute for Tele-Information; Columbia University Institute for Tele-Information;
 6 Electric Cooperatives of South Carolina; Electric Power Research Institute; *Electric Utility*
 7 *Week*; Electricity Consumers Resource Council; *Energy Daily*; Executive Enterprises; Exnet;
 8 Federal Energy Bar Association; Federal Energy Bar Association; Harvard Electricity Policy
 9 Group; Infocast; Louisiana Energy Bar; Management Development Institute at Gurgaon, India;
 10 Management Exchange; Maryland Resiliency Through Microgrids Task Force; Mid-America
 11 Association of Regulatory Commissioners; MidAtlantic Demand Resources Initiative; Mid-
 12 Atlantic Conference of Regulatory Utility Commissioners; National Association of Regulatory
 13 Utility Commissioners; National Association of State Utility Consumer Advocates; National
 14 Conference of Regulatory Attorneys; National Governors Association; National Independent
 15 Energy Producers; New England Conference of Public Utility Commissioners; New England
 16 Public Power Association; New York Bar Association (Energy Section); North Carolina Electric
 17 Membership Corporation; Pennsylvania Bar Institute; Puerto Rico Energy Policies Forum;
 18 Regulatory Studies programs at Michigan State University, New Mexico State University and
 19 University of Idaho; Society of American Military Engineers; Society of Utility and Regulatory
 20 Financial Analysts; Southeastern Association of Regulatory Utility Commissioners; U.S.
 21 Department of Energy Forum on Electricity Issues; U.S. Environmental Protection Agency;
 22 World Regulatory Forum; and Yale Alumni in Energy.

23 **International:** Canadian Association of Members of Utility Tribunals; Canadian Energy
 24 Law Forum; Central Electric Regulatory Commission (India); Comisión Reguladora de Energía
 25 (Mexico); Independent Power Producers Association of India; India Institute of Technology-
 26 Kanpur; Ludwig-Maximilians-Universität (Munich, Germany); National Association of Water
 27 Utility Regulators (Italy); New Zealand Electricity Authority; New Zealand Commerce
 28 Commission; Nigeria Electric Regulatory Commission; Office of Utility Regulation of Jamaica;
 29 OSIPTEL (the Peruvian Telecom Regulator) Training Program on Regulation for University
 30 Students; Regulatel (an international forum of telecommunications regulators); Regulatory
 31 Policy Institute (Cambridge, England); and The Energy and Resources Institute (India).

32

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Community Activities

35 Member, PEPCO Work Group, appointed by County Executive of Montgomery County,
 36 Maryland (2010–2011).

37 Sunday School Teacher, Temple Emanuel, Kensington, Maryland (2002–2006, 2008).

38 Board of Trustees, Temple Emanuel (2005–2006).

39 Musical performer (cello), Riderwood Village Retirement Community (2003–present).

40

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of) Docket No. 2015-0022
)
HAWAIIAN ELECTRIC COMPANY, INC.,)
HAWAII ELECTRIC LIGHT COMPANY,)
INC., MAUI ELECTRIC COMPANY,)
LIMITED, and NEXTERA ENERGY, INC.)
)
For Approval of the Proposed Change of)
Control and Related Matters.)
_____)

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the Office of Planning, State of Hawai‘i’s Exhibit List, Direct Testimonies, and Supporting Exhibits in PUC Docket Number 2015-0022, upon the following parties, by delivering the original and eight copies to the PUC, two copies to the Consumer Advocate, and one copy by electronic transmission to each of the other parties listed below.

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