BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of
HAWAIIAN ELECTRIC COMPANY, INC.,
HAWAI'I ELECTRIC LIGHT COMPANY, INC.,
MAUI ELECTRIC COMPANY, LIMITED, and
NEXTERA ENERGY, INC.

For Approval of the Proposed Change of Control
and Related Matters.

DIVISION OF CONSUMER ADVOCACY'S
DIRECT TESTIMONIES AND EXHIBITS

Pursuant to Order No. 32739, Establishing Issues and Initial Procedural
Schedule, and Addressing Related Matters, filed on April 1, 2015, the Division of
Consumer Advocacy hereby submits its DIRECT TESTIMONIES AND EXHIBITS in the
above docketed matter.


Respectfully submitted,

By

JEFFREY T. ONO
Executive Director

DIVISION OF CONSUMER ADVOCACY
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DIRECT TESTIMONY AND EXHIBITS

OF

DEAN NISHINA

THE DIVISION OF CONSUMER ADVOCACY

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1 DIRECT TESTIMONY OF DEAN NISHINA

I. INTRODUCTION.

Q. PLEASE STATE YOUR NAME, POSITION AND PLACE OF EMPLOYMENT.

A. My name is Dean Nishina and I am the Public Utilities and Transportation Officer for the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs ("Consumer Advocate").

Q. PLEASE STATE YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGROUND.

A. Please see CA Exhibit-2.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I am providing testimony on the Consumer Advocate’s policy related to the proposed transaction that will result in the change of control of the Hawaiian Electric Companies ("HECO Companies"),¹ where, if approved, Hawaiian Electric Industries, Inc. ("HEI"), the HECO Companies’ current holding company, would be merged with and survived by Hawaiian Electric Holdings ("HEH"), which would become the HECO Companies’ new immediate parent company. NextEra Energy ("NEE") would be the sole manager of HEH;

¹ The HECO Companies are comprised of Hawaiian Electric Company, Inc. ("HECO"), Maui Electric Company, Ltd. ("MECO"), and Hawaii Electric Light Company, Inc. ("HELCO").
therefore, NEE would be the ultimate parent of the HECO Companies. This transaction is described in greater detail in the application filed by Applicants.\(^2\)

In my testimony, I will summarize the analyses and recommendations offered by the Consumer Advocate’s consultants on the proposed transaction. The following consultants are appearing on behalf of the Consumer Advocate:

- Michael Brosch (CA Exhibit-11 through -13)
- Steven Carver (CA Exhibit-16 through -19)
- Ian Chan Hodges (CA Exhibit-5 through -6)
- Max Chang (CA Exhibit-20 through -21)
- Tyler Comings (CA Exhibit-22 through -23)
- Stephen Hill (CA Exhibit-7 through -10)

Collectively, each of the Consumer Advocate’s witnesses will be discussing the issues in this docket from different perspectives. For instance, for issue 1.a, Mr. Brosch will be looking at this issue from a regulatory accounting and ratemaking perspective, Mr. Comings will be examining this issue from an economic perspective, and Mr. Chan Hodges will be looking at the issue from a local governance perspective. The combination of the Consumer Advocate’s expert witnesses’ testimonies of the Public Utilities Commission’s (“Commission”) issues will provide the Commission with a thorough analysis of the issues in this proceeding. Thus, consistent with the

\(^2\) Hereinafter, “Applicants” will be used to describe the joint applicants of HECO, HELCO, MECO, and NEE.
Commission’s requirement set forth in Order No. 32739, filed on April 1, 2015, (“Order No. 32739”), CA Exhibit-3 is a table that indicates the appropriate references to the applicable Consumer Advocate testimony that specifically addresses the issues set forth in Order No. 32739.

II. APPLICANTS HAVE NOT CLEARLY DEMONSTRATED THAT THE PROPOSED TRANSACTION IS IN THE PUBLIC INTEREST. (ISSUE 1)

Q. PLEASE SUMMARIZE THE RESULTS OF THE CONSUMER ADVOCATE’S ANALYSIS OF THE PUBLIC INTEREST ISSUE.

A. The Applicants have not met their burden of proof and have not justified that the proposed transaction is in the public interest.

Q. PLEASE EXPLAIN HOW THE CONSUMER ADVOCATE REACHED THIS CONCLUSION.

A. The Consumer Advocate supports a thorough and rigorous application of the fitness and public interest criteria. The need for this thorough and rigorous review is heightened by the current efforts by the State of Hawaii to transform the electric industry. Even in the absence of industry transformational objectives, there are significant challenges that present themselves when evaluating a proposed utility sale or transfer of control. These challenges include, but are not limited to, whether reasonable confidence can be supported by analysis of predicted outcomes of organizational and financial
changes in the post-transaction entity or entities, as well as factoring in changes in the industry that may affect the post-transaction entity or entities. In this instance, there are additional layers of complexity related to the ongoing transformational changes occurring in the electric industry as well as the fact that the HECO Companies provide a critical service to the majority of the state.

As a result, the Consumer Advocate recommends that the Commission, in applying its standard of review stated in past proceedings, should only approve the request upon a showing of substantial net benefits. This position contrasts with a less compelling policy of “hold harmless” or an argument to “trust us.” In the absence of the demonstration of substantial net benefits and how those benefits will be delivered to customers, customers could be exposed to significant risks and costs associated with a transition in ownership.

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3 For instance, in Decision and Order No. 22449, filed on May 3, 2006, in Docket No. 05-0242, at 21 – 22, stated:
Commission approval under HRS § 269-7(a) requires a finding that the proposed Transfer of Control is “reasonable and consistent with the public interest.” A transaction is said to be reasonable and consistent with the public interest if the transaction “will not adversely affect the . . . [utility’s] fitness, willingness, and ability to provide” public utility service in the State as authorized in its permit, certificate, or franchise. “When reviewing a proposed transfer and related financing requirements under HRS § 269-19, the commission has applied the standard of review of HRS § 269-7.5, which states that the applicant must be “fit, willing, and able properly to perform the service proposed.” Thus, when reviewing Applicants’ proposed Transfer of Control and proposed Financing Arrangements under HRS § 269-19, the commission must find that TGC will be fit, willing, and able to perform the service it is currently performing in the State under MIC ownership and that the transfer is reasonable and in the public interest (collectively and generically referred to as the “Fitness and Public Interest” standard). [footnotes omitted]
In past proceedings, the Commission has declined to rule on whether to apply the “substantial net benefits” standard for determining what is in the public interest. However, in finding that it was unnecessary to adopt the “substantial net benefits” determination of public interest, the Commission’s decision was based on the fact that the applicants agreed to the Consumer Advocate’s conditions.\(^4\) I urge the Commission to determine that the substantial net benefits test should be applied.

Thus, in order to apply the substantial net benefits filter for the public interest standard, the Consumer Advocate relied on the Applicants’ filed documents, including the application, testimonies and exhibits, and responses to discovery. In general, the Applicants provided very high level assertions or information and did not provide sufficient evidence to support the conclusion that the proposed transaction is in the public interest. Applicants, instead of utilizing this proceeding as an opportunity to establish a good first impression, fell short and appear to rely on a “trust us - the benefits will be there” approach. As a result, the Applicants have not clearly identified and quantified the benefits of the merger nor have they articulated how the customers will receive these benefits.

\(^4\) “We find it unnecessary to decide to adopt the ‘substantial’ net benefits’ standard at this time. We agree that since Applicants have agreed to the Consumer Advocate’s Conditions, we must conclude that the Consumer Advocate is satisfied that the more stringent ‘substantial net benefits’ test would have been met.” Decision and Order No. 21696, filed on March 16, 2005, in Docket No. 04-0140, at 14.
A. WHETHER APPROVAL OF THE PROPOSED TRANSACTION
WOULD BE IN THE BEST INTERESTS OF THE STATE’S ECONOMY
AND COMMUNITIES SERVED BY THE HECO COMPANIES.
(ISSUE 1.A)

Q. APPLICANTS ASSERT THAT THE PROPOSED TRANSACTION WILL BE IN
THE BEST INTERESTS OF THE STATE’S ECONOMY AND COMMUNITIES
BECAUSE OF VARIOUS COMMITMENTS THAT NEE HAS MADE. DO YOU
BELIEVE THAT APPLICANTS HAVE SUPPORTED THEIR ASSERTIONS?

A. No. While Applicants made various assertions regarding how the proposed
transaction will benefit the economy or the communities, many of those
assertions are at a high level and Applicants did not provide sufficient detail as
to the actual value of the benefits nor how the customers will receive those
benefits.

For instance, Consumer Advocate witness Comings conducted an
analysis of Applicants’ consultant John Reed’s economic analysis and the use
of the IMPLAN model. As discussed by Mr. Comings in his testimony,
Applicants’ analysis does not reflect a complete and thorough analysis of the
potential impacts on the economy. Due to Applicants’ focus on only the
benefits without properly considering the actions and costs that will be
necessary to achieve those benefits, the Applicants’ conclusion does not
accurately reflect the net outcome that might result. Thus, the Applicants have
not adequately supported that the proposed transaction will benefit Hawaii’s
economy. The Applicants’ analysis is incomplete and unreliable.
Consumer Advocate witness Michael Brosch analyzed the public interest from a regulatory accounting perspective. Mr. Brosch details how the Applicants have made many assertions that are not sufficiently supported and/or detailed to determine the actual benefits that might be realized by customers. As a result, his analysis also supports the conclusion that it would be incorrect to conclude from a regulatory accounting perspective that the proposed transaction is in the public interest.

Q. BESIDES THE ASSERTION THAT THE PROPOSED TRANSACTION WILL AFFECT HAWAI’I’S ECONOMY IN A POSITIVE MANNER, APPLICANTS HAVE ALSO CLAIMED THAT THE PROPOSED TRANSACTION WILL HAVE POSITIVE IMPACTS ON THE COMMUNITIES SERVED BY THE HECO COMPANIES. DOES THE CONSUMER ADVOCATE BELIEVE THAT THE APPLICANTS HAVE SUPPORTED THIS CLAIM?

A. No. The Applicants outlined a number of NEE commitments, such as: enhancing service reliability; continuing community and charitable support, maintaining local management, delivering savings, and accelerating a cleaner energy future.\(^5\)

However, the Consumer Advocate’s witnesses analyzed the purported positive impacts of these factors and the findings are consistent – the Applicants have not supported their high level assertions.

\(^5\) Applicants Exhibit-1, at 14.
Consumer Advocate witness Ian Chan Hodges discusses in his testimony the Applicants' equivocal support for Hawaii’s unique community and cultural values.

Q. PLEASE EXPAND ON HOW THE CONSUMER ADVOCATE ANALYZED THE APPLICANTS’ CLAIMS?
A. The Consumer Advocate conducted an extensive analysis of the various assertions and estimates offered by Applicants. In addition to what I have already mentioned, Consumer Advocate witness Max Chang analyzed the impacts the merger might have on reliability, employment, and charitable contributions. Consumer Advocate witness Stephen Hill examined the effect the merger will have on HECO’s cost of capital and credit risks associated with a parent company engaged in potentially high risk endeavors such as nuclear plant operation. In conducting these analyses, the Consumer Advocate was not able to find support for the Applicants’ position.

Q. BASED ON WHAT IS YOUR CONCLUSION THAT THE PROPOSED TRANSACTION IS NOT IN THE BEST INTEREST OF THE STATE’S ECONOMY AND THE COMMUNITIES THAT ARE TO BE SERVED BY THE HECO COMPANIES, WHAT IS YOUR RECOMMENDATION?
A. I contend that there are conditions that, if adopted, would result in the State’s economy and communities receiving substantial net benefits and, thus, would
be in the public interest. These conditions are discussed and supported by the
Consumer Advocate’s witnesses. It needs to be made clear that these
conditions must be adopted collectively. The Consumer Advocate’s conditions
will be identified in the discussion of each issue and summarized on
CA Exhibit-4. For ease of reference, I have categorized the
Consumer Advocate’s conditions in the following general categories: Financial
Safeguards; Local Governance; Ring Fencing; Ratemaking; Affiliated
Transactions; Reliability; Employment; Transformational; and Competition.

Q. WHAT ARE THE CONSUMER ADVOCATE’S CONDITIONS RELATING TO
THE BEST INTERESTS OF THE COMMUNITY?

A. Mr. Chang offers a recommendation that charitable contributions should not
diminish on a post-transaction basis (Condition LG9). Mr. Chang also
recommends that NEE work with various agencies, including the Commission
and the Consumer Advocate, to develop specific programs that will directly
benefit low income customers (Condition LG8). In addition, Mr. Chan Hodges
discusses the need for the HECO Companies to become benefit corporations,
or B corporations, to make transparent how the HECO Companies will benefit
Hawaii, its people and the environment (Conditions LG1 through LG6).
Q. WHAT ARE THE CONDITIONS THAT THE CONSUMER ADVOCATE IS PROPOSING WITH RESPECT TO THE BEST INTERESTS OF HAWAII’S ECONOMY?

A. Analyses conducted by Mr. Brosch, from a ratemaking perspective, illustrate how the benefits offered by the Applicants are not well supported and, as a result, Mr. Brosch has drafted a rate plan condition that provides a clear and definite manner in which customers and Hawaii’s economy could benefit (Condition RM3).

In addition, I am sponsoring a condition that relates to a possible impact of moving control outside of the state. Currently, HEI and the HECO Companies are Hawaii corporations and file State of Hawaii income taxes. The proposed transaction, as currently proposed, will result in the formation of HEH as a Delaware corporation, which will be the parent of the HECO Companies. Based on the response to CA-IR-111, it does not appear that the proposed transaction will result in an immediate shift of state income tax liabilities out of Hawaii’s jurisdiction. However, if future corporate decisions may affect how HEH and the HECO Companies report state taxable income and result in state income tax liabilities being shifted to another state, Applicants must first inform the Commission, demonstrate how the change is in the public interest, including how the decrease in State of Hawaii corporate tax liabilities will significantly benefit customers, and obtain Commission approval before the change is made. If adopted, this condition would minimize
the possibility that the State tax revenues may be adversely affected without Commission approval (Condition LG7).

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. (ISSUE 1.B)

Q. APPLICANTS HAVE PROPOSED VARIOUS RATEMAKING CONCESSIONS THAT THEY CLAIM WILL IMMEDIATELY RETURN BENEFITS TO CONSUMERS. DO THE APPLICANTS’ PROPOSALS PROVIDE SIGNIFICANT SHORT AND LONG TERM BENEFITS BEYOND THOSE PROPOSED BY THE HECO COMPANIES IN RECENT REGULATORY FILINGS?

A. No, Applicants’ proposals to forego recovery under the decoupling mechanism of the incremental O&M Rate Adjustment Mechanism (“RAM”) for four years and the four-year rate case moratorium do not provide significant short or long term benefits. Moreover, as addressed by Consumer Advocate witness Michael Brosch, the benefits from these two proposals are either illusory or insignificant. As explained in greater detail by Mr. Brosch, since the Commission’s recent decision in Docket No. 2013-0141, which capped the annual RAM increase for all capital expenditures to an inflationary factor, the
value of foregoing the incremental O&M RAM adjustment is questionable.\textsuperscript{6} Even Applicants seem to question the validity of their own argument when they admitted in an IR response that their proposal to forgo the O&M RAM for four years would not be a “hard” benefit.\textsuperscript{7}

Furthermore, Mr. Brosch points out that the value of a rate case moratorium relies on the reasonableness of the rates at the inception of the moratorium.\textsuperscript{8} Thus, since the currently authorized return of equity has not been updated, unless certain adjustments are made, the Applicants’ proposed rate case moratorium is not in the public interest. Furthermore, the Applicants’ proposed moratorium has the potential of benefiting the Applicants, not customers, because any savings resulting from merger synergies could not be passed on to consumers in the absence of a rate case. Mr. Brosch also points out that even assuming that there might be some realizable short-term benefit, the Applicant’s proposed rate plan could likely result in an immediate rate increase following the end of the four year moratorium.

Moreover, the Applicants’ proposals are conditional. Both the four-year rate case moratorium and foregoing the incremental O&M RAM adjustment, are “subject to exceptions and conditions,” which are detailed in footnotes 42

\begin{footnotes}
\item[6] See, e.g., CA Exhibit-11, at 32.
\item[7] Response to CA-IR-350, wherein Applicants recognized that the original O&M RAM adjustment forebearance would need to be revised due to the modification to the decoupling mechanism.
\item[8] CA Exhibit-11, at 33.
\end{footnotes}
and 45 of the application. Applicants’ proposals are illusory in that the proposals could be withdrawn by Applicants if the Commission implements any changes to the decoupling mechanism that are not to their liking. In recent IR responses, the Applicants claim that the Commission’s order that capped RAM increases to an inflationary factor will not cause them to withdraw the proposals. On the other hand, in their supplemental response to CA-IR-118, Applicants now condition their proposals on the Commission allowing adequate cost recovery above the RAM cap that was established in Order No. 32735, filed on March 31, 2015, in Docket No. 2013-0141.

Q. ARE THERE POSSIBLE SAVINGS, IF THE MERGER IS APPROVED, THAT WILL BENEFIT CONSUMERS IN SPECIFIC PROJECTS THAT ARE ALREADY BEING PURSUED BY THE HECO COMPANIES?

A. Yes. For example, the HECO Companies are proposing to install a new enterprise resources management system (ERP/EAM) that is estimated at over $80 million dollars. After the merger application was filed, the Consumer Advocate requested that the HECO Companies file an updated cost estimate for the ERP/EAM system that recognizes the potential synergy savings from the proposed merger, especially given that Florida Power & Light (“FPL”) recently installed a new ERP/EAM using the same software vendor as contemplated by the HECO Companies for their system. The updated

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9 See Docket No. 2014-0170.
estimate reflected a potential reduction in total project costs of over $20 million dollars.\textsuperscript{10} Although this reflects savings for this one project, it is insufficient to support a conclusion that the proposed merger will result in significant short and long term net benefits to consumers.

Q. ARE THERE OTHER WAYS THAT THE APPLICANTS COULD DEMONSTRATE THAT THERE WILL BE BENEFITS IN THE LONG TERM?

A. Since the 2015 Legislature passed Act 97, which established a renewable portfolio standard (RPS) of 100% by December 31, 2045, Hawaii has to carefully plan its path to ensure that customers are not burdened with unreasonable costs that may be incurred to meet that threshold. Thus, this proceeding provides the Applicants an opportunity to demonstrate how the proposed transaction could greatly advance the public interest in the long term.

\textsuperscript{10} HECO Companies’ response to CA-SIR-42, Docket No. 2014-0170.
The Consumer Advocate sought to determine whether the Applicants could either expedite the realization of the energy plans\textsuperscript{11} that are currently being reviewed and/or lower the anticipated costs to realize the long term energy plans and goals. The Consumer Advocate and other parties submitted discovery inquiring into different aspects of Applicants long term energy plans and what the proposed transaction might mean for those plans.\textsuperscript{12} Based on Applicants’ IR responses, the Applicants did not provide sufficient information to conclude that there will be long term net benefits to customers. While the Applicants assert that, due to NEE’s and FPL’s size, the proposed transaction will result in better purchasing power, reduced labor and non-labor costs due to the availability of NEE and FPL personnel, and lower cost of capital, the Applicants failed to provide specific details in quantifying those benefits.

Further, the Applicants are vague on how any savings synergies will be passed on to consumers in either improved service or lower rates. As part of Mr. Brosch’s efforts to examine possible short and long term benefits, he discusses his analysis of purported synergy savings that might arise from the proposed transaction and questions whether customers would be able to

\textsuperscript{11} The energy plans that I am referring to are the power supply improvement plans (“PSIP”), the integrated demand response portfolio plan (“IDRPP”), and distributed generation interconnection plan (“DGIP”) plan. The integrated resources plan (“IRP”) is another long term energy plan that could have been used to evaluate whether the proposed transaction might be in the consumers’ long term public interest. However, the IRP is not currently under review as the Commission declared that the IRP developed in Docket No. 2012-0036 was deficient (see Decision and Order No. 32052, filed on April 28, 2014).

\textsuperscript{12} See, e.g., CA-IR-209 and 230, where Applicants indicate that the impacts on the PSIP, IDRPP, and DGP cannot be determined until after the merger.
realize any benefit.\textsuperscript{13} Therefore, I conclude that Applicants have not sustained their burden of proving that the proposed transaction will result in significant, quantifiable long term benefits beyond those proposed by the HECO Companies in recent regulatory filings.

Q. ARE THERE CONDITIONS THAT WILL CAPTURE MERGER SAVINGS THAT WILL PROVIDE SIGNIFICANT, QUANTIFIABLE BENEFITS TO CONSUMERS?

A. Yes. As outlined by Mr. Hill, there are long overdue reductions in the cost of capital that, when recognized in rates, will provide immediate benefits to the customers (Condition RM1). In addition, if the proposed transaction is approved, there are modifications to the capital structure that should be made that will also benefit the customers, when those capital structure changes are recognized in rates (Condition RM2). The rate plan described by Mr. Brosch incorporates those changes in the cost of capital determinants so that customers will get the benefit of lowered cost of capital and capital structure, if the merger is approved (Condition RM3). Mr. Brosch also recommended other conditions meant to secure short and/or long term benefits for the HECO Companies’ customers (Conditions RM4 through RM13).

In addition to Mr. Brosch’s proposed rate plan and ratemaking conditions, I recommend conditions that will provide substantial long term

\textsuperscript{13} CA Exhibit-11 at 28.
benefits for customers by way of a commitment from Applicants to Hawaii’s transformation to a renewable energy future. Applicants should create an investment fund to be applied to transformational projects on each of the islands in the HECO Companies’ service territories that would not be recoverable from customers. In other words, that fund would be treated as contributions in aid of construction (“CIAC”). As part of this condition, I recommend that Applicants commit to make the following levels of investment: Lanai and Molokai - $10 million each; Maui and Hawaii - $25 million; and Oahu - $40 million. The total investment of $110 million should be made within seven years of the completion of the proposed transaction (Condition TR1).

This condition is not unprecedented in Hawaii. A very similar condition was approved by the Commission in its Decision and Order No. 30998, filed on February 8, 2013, in Docket No. 2012-0157 (Lanai Island Holdings, LLC’s purchase of three regulated companies on Lanai). In that docket, as part of Larry Ellison’s efforts to purchase property on Lanai, Lanai Island Holding, LLC was formed to acquire the three existing regulated utility and transportation companies on Lanai. As part of that transaction, Larry Ellison agreed to invest $10 million, as CIAC, in the regulated water and wastewater utilities on Lanai as a condition for receiving Commission approval to acquire the regulated companies. If an investment fund of $10 million that would not be passed on to ratepayers was an appropriate amount for infrastructure
improvements for Lanai’s three small utilities, then an investment fund of
$10 million each for Lanai and Molokai would be appropriate for
transformational electricity infrastructure improvements. I then scaled up this
figure to come to the investment fund amounts for Hawaii Island, Maui, and
Oahu. As part of this condition, there should be a reporting requirement that
tabulates the amounts that are spent on each island to ensure that the full
investment has been made within seven years of the transaction’s execution.
None of these amounts would be recoverable from ratepayers.

Another condition that I recommend is that, as a sign of the Applicants’
commitment to Hawaii’s transformational efforts, the Applicants will ensure
that certain events, such as the retirement of certain fossil generation units,
occur as scheduled in the PSIPs. As a further part of this condition, the costs
of retiring them and the remaining net book value of those assets should not
be recovered from customers. Thus, the retirement costs and remaining net
book value of Honolulu 8 and 9, Waiau 3 and 4, Shipman 3 and 4, Kahului 1
through 4, old meters replaced by smart meters, and obsolete back office
systems that will be replaced by smart grid equipment and infrastructure
should be deemed to be unrecoverable from customers (Condition TR2).

I understand that, by not allowing for the recovery of stranded assets
and remediation costs, this proposed condition might discourage early
retirement of HECO’s fossil units. In other words, this condition may create an
incentive for the HECO Companies to run their old fossil units for as long as
possible to fully depreciate those assets. That is why Applicants must be held
to the retirement schedule as proposed by the HECO Companies in the
PSIPs. It should be made clear that the expectation to absorb the costs
related to these retirements is not expected for all future retirements.
However, if Applicants agree to this condition to not recover costs associated
with certain unit retirements, it will show a commitment to transforming the
state toward a renewable energy future and provide clear benefits to the
HECO Companies' customers. As the identified property units are generally
very old, the remaining net book value will not be as significant as a similar
asset that was less advanced in age. Furthermore, since the HECO
Companies were allowed to include estimated net salvage values in the
determination of depreciation rates,\(^\text{14}\) the impact of absorbing the costs
associated with retiring the identified assets is diluted.

One of the Consumer Advocate’s conditions seeks to continue a
decision that HEI and HECO management made as a result of stated
concerns with the level of HEI executive compensation. Thus, no
compensation for executives named in SEC filings for NEE, any NEE affiliates
and HEH should be recovered either through direct or allocated charges in the
HECO Companies’ rates. Mr. Brosch offers additional discussion related to
this concern (Condition RM12).

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\(^{14}\) See Decisions and Orders filed in Docket No. 2010-0053, 2009-0321, and 2009-0286, which
authorized HECO, HELCO, and MECO, respectively, to include net salvage values in the
determination of depreciation rates.
Another ratemaking condition should confirm that the HECO Companies will continue to adhere to past precedent and not attempt to seek recovery of certain costs that have historically been denied by the Commission. This will not only continue to benefit customers, but also benefit the regulatory process by avoiding the need to re-litigate already decided issues. This condition also extends so that the HECO Companies will not seek to recover any NEE or an NEE affiliate direct or allocated charges for costs that have been traditionally disallowed from inclusion in the determination of revenue requirements in Hawaii, such as charitable contributions and image or promotional advertising (Condition RM15).

C. WHETHER THE PROPOSED TRANSACTION, IF APPROVED, WILL IMPACT THE ABILITY OF THE HECO COMPANIES’ EMPLOYEES TO PROVIDE SAFE, ADEQUATE, AND RELIABLE SERVICE AT REASONABLE COST. (ISSUE 1.C)

Q. CAN YOU STATE SOME OF THE CONSUMER ADVOCATE’S CONCERNS RELATED TO RELIABLE SERVICE IN HAWAII AND HOW THE PROPOSED TRANSACTION MIGHT AFFECT SERVICE?

A. Yes. Mr. Max Chang discusses reliability issues in greater detail in his testimony.

Hawaii has been pushing forward with its transition to a renewable energy future and, as part of that push, the levels of distributed generation in the form of rooftop solar have continued to significantly increase. These
increasing levels are causing different system and distribution issues that must be adequately addressed.

The level of rooftop solar penetration in Florida is nowhere near the levels found in Hawaii. Given Florida’s slogan of being the sunshine state, the relative lack of both distributed and utility scale solar generation that is incorporated in FPL’s system seems somewhat counter-intuitive. I recognize that there are a number of factors that might contribute to the lower level of penetration of rooftop solar in Florida, but the fact is that FPL has not experienced the same planning issues that Hawaii has been facing and, thus, cannot reasonably claim expertise that it can lend to immediately assist HECO’s efforts at integrating greater and greater amounts of rooftop solar on to the grid. Similarly, while NEE can point to its record of having installed significant amounts of capacity of renewable energy projects across the United States, neither NEE nor FPL has been responsible for balancing generation and load in an isolated grid with no interconnections to other grids and an increasing amount of intermittent renewable generation, from both controlled (utility scale) and uncontrolled (rooftop solar) sources. Applicants have not shown that NEE’s expertise will benefit system reliability as the HECO Companies incorporate greater amounts of distributed generation and variable utility-scale renewable energy into their systems.

Mr. Chang also examines and discusses the Applicants’ proposed two-year period of no involuntary workforce reduction and disputes whether
Applicants have demonstrated how the proposed transaction will not adversely affect the ability to provide safe, adequate, and reliable service at reasonable cost. That is, Applicants have not provided a clear plan on integration and how the HECO Companies workforce will be affected within and beyond the two-year workforce reduction moratorium. Without such a plan, it is difficult to support any assertions that the employees’ ability to provide reliable service will not be adversely affected.

As a result, Mr. Chang offers a condition that seeks to mitigate concerns that there will be workforce reductions to achieve savings that might adversely affect reliable service by requiring Applicants to provide first quartile reliability performance, but at cost effective measures (Conditions EM1 and RE1).

In addition, Mr. Chang also proposes a condition that should have value to both the HECO Companies as well as to the state’s economy. That is, the Consumer Advocate is proposing that there should be a workforce development training plan that is funded by Applicants. With this condition, the Applicants will help ensure that Hawaii will have qualified individuals able to help realize the State’s clean energy goals and not affect the reliability of that service (Condition EM2).
Q. APPLICANTS HAVE INDICATED THEIR WILLINGNESS TO HONOR EXISTING UNION CONTRACTS AS WELL AS ENSURING THAT POST-TRANSACTION COMPENSATION AND BENEFITS FOR NON-UNION WORKERS WILL BE COMPARABLE TO EXISTING LEVELS. DO YOU HAVE ANY COMMENTS ON THIS?

A. Yes. These kinds of commitments are important for workforce retention. However, Consumer Advocate witness Steven Carver considered how the proposed transaction could affect the current HECO Companies' pension and other than pension employee benefits ("OPEB") plans and trusts and proposed a condition to maintain not only the current integrity of the existing pension and OPEB plans, but also the underlying trusts that are required to fund the pension and OPEB plans (Condition RM14).

HECO Companies' CEO Alan Oshima discusses how the proposed transaction can provide value to HECO Companies' employees by offering professional growth and development opportunities. Mr. Oshima ignores how the proposed transaction could potentially adversely affect HECO Companies' employees and the state's economy.

First, although Applicants commit to no involuntary workforce reductions for two years, Applicants leave open the possibility that HECO employees may be given the choice of quitting their jobs or relocating to a position on the mainland with one of NextEra’s affiliates. Employees and their

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15 Applicants Exhibit-1, at 17.
families leaving Hawaii for jobs on the mainland would remove their contribution to the state’s overall economy. In the alternative, if the employee chooses not to move to the mainland, but chooses to remain in Hawaii but may be unemployed, this will also represent a decrease to the economy. Applicants fail to address this potential problem, but again rely on “trust us” as their answer.

An additional concern is that NEE will seek to extract intellectual expertise in Hawaii for use in other jurisdictions. Given that Hawaii has greater success in the integration of renewables both at the utility scale and distribution levels as compared to other utility companies in the nation, NEE may seek to use that knowledge to leverage investments in other jurisdictions. However, regardless of whether the employee may be in planning, renewable resources procurement or any other area, Hawaii will not only lose the economic effect of that employee (and family) when that employee leaves the state, the HECO Companies’ customers will lose the value of the training that was invested in that employee as well as the employee’s experience dealing with Hawaii specific issues. Thus, I am recommending a condition that will ensure that Hawaii will receive some benefit in those situations. So, if an employee of the HECO Companies is hired, transferred, or otherwise moves to NEE or one of its subsidiaries or affiliates, the following should occur: 1) the NEE entity, which is hiring away the departing HECO Companies’ employee, will be responsible for contributing an amount equal to the employee’s fully
loaded annual compensation to a fund that will be used to return that benefit to customers (e.g., an amount that would decrease the annual decoupling adjustment); 2) the employee that is moving will not make available or take information to the NEE affiliate that is not publicly available or accessible; 3) the employee that is moving shall not use or rely upon intellectual property that is protected by or in the process of being protected by the HECO Companies (e.g., where a patent is in place or being sought) (Condition EM3). Other jurisdictions, such as California, have similar conditions to ensure that regulated customers receive some benefit if, whether through management or employee decisions, the regulated company employee moves to an affiliated employer.
D. WHETHER THE PROPOSED FINANCING AND CORPORATE RESTRUCTURING PROPOSED IN THE APPLICATION IS REASONABLE. (ISSUE 1.D)

WHETHER ADEQUATE SAFEGUARDS EXISTS TO PROTECT THE HECO COMPANIES’ RATEPAYERS FROM ANY BUSINESS AND FINANCIAL RISKS ASSOCIATED WITH THE OPERATIONS OF NEXTERA AND/OR ANY OF ITS AFFILIATES. (ISSUE 1.F)

Q. IN MR. GLEASON’S TESTIMONY, HE STATES THAT NO NEW FINANCING IS BEING PROPOSED TO CONSUMATE THE PROPOSED TRANSACTION AND PROVIDES GREATER DETAIL ON THE ORGANIZATIONAL CHANGES AND IMPACTS ON EXISTING FINANCIAL OBLIGATIONS OF THE HECO COMPANIES. MR. GLEASON CONCLUDES THAT THE PROPOSED CHANGE OF CONTROL WILL IMPROVE THE FINANCIAL STATUS OF THE HECO COMPANIES. DOES THE CONSUMER ADVOCATE BELIEVE THAT APPLICANTS HAVE CLEARLY SUPPORTED THIS CONCLUSION?

A. No. As outlined in Consumer Advocate witness Stephen Hill’s testimony, Mr. Hill conducted an extensive analysis of the proposed transaction and the underlying financing that will be used to consummate the transaction. Based on the information available, it appears that the proposed transaction will be primarily financed by [REDACTED]. Mr. Hill elaborates that, based on already existing levels of debt, the risk associated with the highly leveraged operations of NEE affiliates could adversely affect HEH and the HECO Companies.
Mr. Hill also analyzes the impact of the HECO Companies being placed in an organizational structure that is much more complex than the current organizational structure under HEI, if the transaction is approved. In addition, Mr. Hill discusses the exposure risk to the HECO Companies from a NextEra bankruptcy resulting from NextEra’s regulated and unregulated high risk ventures.

Historically, HECO followed an industry trend at that time to form a holding company that would allow the utility company to diversify its interests beyond just electric service. As a result, HEI was formed. In line with the diversification strategy, HEI moved forward with the creation of a local conglomerate that would cover integral aspects of economic activity in Hawaii besides the electric utility business. Thus, HEI was involved in interisland transportation interests,\(^\text{16}\) banking,\(^\text{17}\) insurance,\(^\text{18}\) and real estate development,\(^\text{19}\) to name a few examples. Later, HEI also sought to diversify its interests beyond Hawaii by forming other subsidiaries such as HEI Investments and HEI Power Corporation, which, through a number of other subsidiaries, sought investment opportunities in other countries. However, a

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\(^{16}\) HEI was the owner of Young Brothers, Ltd. and Hawaiian Tug and Barge.

\(^{17}\) HEI is still the parent of American Savings Bank ("ASB").

\(^{18}\) HEI was the parent of Hawaiian Insurance Group.

\(^{19}\) HEI was the parent of Malama Pacific Corporation, whose main focus was in the real estate industry.
number of these diversified interests actually exposed HEI, and potentially the
HECO Companies, to significant risk. Potential risk became reality with
Hurricane Iniki in 1992, when HEI’s insurance affiliate, the Hawaiian Insurance
Group, entered bankruptcy because of its inability to pay hurricane-related
insurance claims. This resulted in litigation against HEI. In addition, there
were significant write-offs associated with some of HEI’s subsidiaries’
activities, such as the interests in electric generation projects that were
acquired in the Philippines, Guam and China. It was clear that this type of risk
exposure from HEI needed to be stopped or at least mitigated. Gradually, HEI
began to divest much of its holdings, which resulted in HEI’s primary holdings
being the HECO Companies and American Savings Bank.

The proposed transaction could, however, put the HECO Companies
back in a position where its holding company’s investments could adversely
affect its credit rating and/or its access to capital. NEE is a much larger
corporation than HEI ever was and has varied interests not only within
America, but also outside of the United States. An example of how some of
NextEra’s outside interests could expose the HECO Companies to risk is the
recent action taken in Spain to revise the tariff structure to reduce payments to
renewable energy developers. This led to a $300 million write-off by NEE on
its Spanish wind farm development.²⁰

²⁰ http://renews.biz/40616/spanish-solar-a-drag-on-nextera/
Another exposure to the HECO Companies that does not currently exist today would be in NEE’s regulated and unregulated nuclear investments. This concern is discussed further in Mr. Hill’s and Mr. Chang’s testimonies with respect to the possibility of FPL’s nuclear assets resulting in additional financial burdens that might adversely affect FPL, NEE, and the HECO Companies and whether the Commission would be able to investigate the impact on the HECO Companies.

Q. IN DOCKET NO. 2015-0113, THE CONSUMER ADVOCATE SOUGHT INFORMATION AS TO HOW THE PROPOSED TRANSACTION MIGHT AFFECT THE APPROVAL REQUESTED IN THAT DOCKET FOR REFINANCING. AS A RESULT, THE HECO COMPANIES AMENDED THEIR REQUEST TO REFLECT AN AGREEMENT WITH THE FINANCING INSTITUTIONS THAT COULD RESULT IN A 25 BASIS POINTS BENEFIT. DO YOU CONTEND THAT THIS IS INSUFFICIENT TO SUPPORT APPLICANTS’ CLAIMS?

A. Yes, as discussed by Mr. Hill, while the HECO Companies modified their request in Docket No. 2015-0113, the actual realization of the benefit has not been made clear. Further, Mr. Hill observes that this concession was from a lender that has done significant business with the HECO Companies. Thus, it is not entirely clear that the reduction came as a result of an arms-length transaction.
Q. AS PART OF HIS TESTIMONY, MR. REED CONTENDS THAT THE
APPLICATIONS HAVE OFFERED A PACKAGE OF COMMITMENTS,
INCLUDING SOME THAT RELATE TO FINANCING AND THEN
CONCLUDES THAT THESE COMMITMENTS PROTECT THE CONSUMERS
FROM “ANY ADVERSE CONSEQUENCES OF THE MERGER.”21 THE
CONSUMER ADVOCATE’S DISCUSSION AND ANALYSIS CONTRADICTS
MR. REED’S TESTIMONY. IF THERE ARE REMAINING CONCERNS AND
THE APPLICANTS’ IDENTIFIED COMMITMENTS ARE INSUFFICIENT AND
NOT WELL SUPPORTED, WHAT IS YOUR RECOMMENDATION?

A. As proposed, the Commission should reject the proposed transaction because
of insufficient measures to protect Hawaii consumers from the risks to which
Hawaii and its consumers could be exposed. As discussed by Mr. Hill, and
also discussed by Mr. Smith (the Department of Defense’s witness), additional
ring fencing measures are necessary. These ring fencing measures are
critical conditions that must be adopted. I am not sure that sufficient
conditions can be implemented to offset all of the risks that could arise from
the proposed transaction. However, the ring fencing conditions that are
offered address some of the potentially larger areas of risk. Thus, Mr. Hill has
identified three additional measures beyond that which was offered by
Mr. Reed. In addition, beyond the ring fencing measures associated with

21 Applicants Exhibit-33, at 8.
financial protections recommended by Mr. Hill, Mr. Chang also identifies an additional ring fencing measure meant to help protect the HECO Companies' customers from risks associated with FPL's nuclear interests.

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. (ISSUE 1.E)

Q. AS ONE OF APPLICANTS’ ASSERTED BENEFITS, APPLICANTS CONTEND NEE AND FPL HAVE THE ABILITY TO PROVIDE ASSISTANCE TO THE HAWAIIAN ELECTRIC COMPANIES BY REPLACING HIGHER COST OUTSIDE SERVICES WITH EXPERTISE ALREADY WITHIN NEE OR FPL AND HOW THIS ABILITY WOULD BE IN THE PUBLIC INTEREST. DOES THIS PROPOSED BENEFIT RAISE OTHER ISSUES?

A. Yes, it does. With any regulated company that has affiliates, regulators must always be aware of the common issue related to affiliated transactions. In situations where a regulated company has non-regulated operations and/or affiliates, regulators evaluate the risks associated with subsidies or inappropriate transactions between affiliates. There are different forms of subsidization that could occur. The commonly reviewed transactions are between non-regulated affiliates and the regulated entity to ensure that the non-regulated entities are not seeking to push unjustified costs onto the regulated operations and the captive customers.
However, there are also opportunities for subsidization and double counting when regulated entities are involved. These opportunities can occur between regulated affiliates as well as regulated and unregulated affiliates. Thus, if the proposed transaction is approved, Hawaii must be wary of not only receiving direct or allocated charges that may not directly translate into benefits for Hawaii customers, but wary of situations where mismatched allocation factors can be embedded in the ratemaking processes for FPL and the HECO Companies to result in recovery of more than 100% of common expenses.

Thus, it is imperative that adequate measures are in place to mitigate, if not eliminate, the possibility that Hawaii consumers may subsidize other NEE regulated or non-regulated operations.

Q. THE COMMISSION, AS PART OF ITS ISSUE 1.E, SEEKS TO EVALUATE WHETHER ADEQUATE SAFEGUARDS EXIST TO PREVENT CROSS SUBSIDIZATION. HAS THE CONSUMER ADVOCATE ANALYZED THIS MATTER?

A. Yes. Mr. Carver discusses the affiliated transactions issue in his testimony, and, based on his discussion on this matter, I believe that Applicants have not provided sufficient assurances regarding the issues related to affiliated transactions. As set forth in the application, the Applicants’ proposed measures to address this issue were fairly limited and included certain
changes to the 1982 Agreement,\textsuperscript{22} the termination of the effectiveness of the Thomas Report,\textsuperscript{23} and making certain commitments related to financing and capitalization.\textsuperscript{24} Mr. Carver also discusses how, without adequate safeguards in place, the operations of NEE or its affiliates could adversely affect the HECO companies’ customers since the Applicants have not been able to demonstrate that the proposed transaction, if approved, would not actually result in an overall increase of direct and allocated charges from affiliated interests (i.e., as a comparison between what the HECO Companies are charged by HEI and what NEE might charge on a post-merger basis). The potential impacts of affiliated transactions also relate to the Commission’s issue 1.f, where certain affiliated interests could expose the HECO Companies to additional business and financial risks.

Due to the inadequacy of the information in the application, the Consumer Advocate sought additional information to determine whether

\begin{footnotesize}
\textsuperscript{22} In Docket No. 4337, the Commission reviewed the reasonableness of the proposed transaction that would result in all of the issued and outstanding common stock of HECO being owned by HEI. In Decision and Order No. 7070, filed on April 19, 1982, the Commission adopted the Conditions for the Merger and Corporate Restructuring of Hawaiian Electric Company, Inc. (“1982 Agreement”) as a condition precedent to the approval of that transaction.

\textsuperscript{23} In Docket No. 7591, the Commission investigated the relationship between HEI and HECO and, as part of that investigation, the consulting firm of Dennis Thomas and Associates was hired to study the relationship between HEI and HECO and whether HEI and HECO were complying with the conditions set forth in Docket No. 4337, including the 1982 Agreement. Dennis Thomas and Associates provided its final draft in January of 1995 (“Thomas Report”). The Thomas Report also offered a number of recommendations, which the Commission adopted in its entirety (see Decision and Order No. 15225, filed on December 10, 1996).

\textsuperscript{24} Application, at 39.
\end{footnotesize}
sufficient safeguards would exist. Given the specific nature of the Thomas Report, which analyzed the relationship between HEI and HECO, the continued applicability of the Thomas Report may be limited, if the proposed transaction occurs between NextEra and the Hawaiian Electric Companies. However, the Applicants have not advanced any other ideas to replace the Thomas Report. Furthermore, as discussed in greater detail in Mr. Carver's testimony, the Applicants' suggested changes to the 1982 Agreement appear to decrease the amount of oversight that the Commission might have regarding the affiliated transaction and relationships between the HECO Companies and NEE and NEE affiliates on a post-merger basis.

Furthermore, besides the risks associated with subsidization, there is also the potential risk associated with affiliated transactions that may not represent arms-length transactions that could be to the detriment to customers, competitors, or the public interest.

Q. PLEASE DESCRIBE WHAT TYPE OF NON-ARMS-LENGTH AFFILIATED TRANSACTIONS MIGHT BE CONTRARY TO THE PUBLIC INTEREST.

A. There are opportunities for unregulated affiliates that offer goods and/or services to take advantage of the relationship to generate sales and revenues from the consumers of the regulated utility. Examples of this situation can be found when regulated customers are directed by the regulated utility to an affiliate that provides unregulated services. In these instances, the customers’
interests can be adversely affected. One potential adverse effect is when the customer buys an unregulated good or service because the customer is either under the impression that the unregulated good or service is a required step or part of the regulated service. Another potential adverse effect is when the customer of the regulated utility buys an unregulated good or service from an unregulated affiliate of the regulated utility without the ability to determine whether there are competitive alternatives.\textsuperscript{25}

I note that there are publicized incidents when an FPL affiliate has provided a good or service that has caused customer complaints. For instance, one FPL affiliate, FPL Energy Services, offers a SurgeShield program, which provides a surge protector right behind the electric meter.\textsuperscript{26} Since advertising for this program has appeared in utility bill mailings, customers may presume that the program is offered by the regulated entity. The complaints by those who have subscribed to this service/product have been featured in different media sources.\textsuperscript{27}

I was also able to find an example of customers seeking to obtain regulated services from FPL then being transferred to the unregulated affiliate

\textsuperscript{25} How the proposed transaction might affect competition is issue 1.h. That discussion will be offered later. While this potential concern also touches upon competitive issues, since this concern relates to affiliated interactions, it is being discussed in this section.

\textsuperscript{26} http://www.fples.com/residential/surgeshield.shtml

and the transfer occurred in a non-transparent manner that the customer was
being transferred to an unregulated affiliate.\textsuperscript{28} This issue was audited by the
Florida Public Service Commission and, as a result of that audit, changes in
the procedure were required.\textsuperscript{29} This event was also further detailed in the
response to CA-IR-222.\textsuperscript{30}

I contend that these affiliate concerns are legitimate and must be
addressed. The Applicants’ suggested changes to the 1982 Agreement and
confirming that the Thomas Report will no longer apply, if the proposed
transaction is approved, falls well short of addressing these concerns.

Q IF APPLICANTS HAVE NOT ADEQUATELY ADDRESSED THIS ISSUE,
WHAT DO YOU RECOMMEND?

A. Mr. Carver offers a detailed discussion of potential concerns related to
affiliated transactions and sponsors conditions related to cross subsidization
and the ability for regulators to exercise oversight over the HECO Companies.
One of the conditions, when adopted, would ensure that Hawaii customers
realize the benefit of lower of cost or market for goods and services from NEE
or NEE affiliates to avoid situations where NEE or its affiliates might be able to

\textsuperscript{28} http://www.heraldtribune.com/article/20120604/columnist/120609833?p=1&tc=pg
\textsuperscript{29} http://www.psc.state.fl.us/library/filings/10/08458-10/08458-10.pdf
\textsuperscript{30} Later in my testimony, I will discuss a recommended condition to address the concern that unregulated affiliates may take advantage of their relationship to the HECO Companies, if the transaction is approved.
unreasonably profit from Hawaii by charging the higher of cost or market for goods and services. In addition, Mr. Carver has also offered conditions that will facilitate the regulatory review of affiliated transactions between the HECO Companies, HEH, and NEE affiliates. Mr. Carver has also offered a number of recommended modifications to the 1982 Agreement to ensure that customers’ interests and the regulatory process are not adversely affected.

Additionally, I am proposing a condition that, if the proposed transaction is approved, requires the HECO Companies to provide the funds necessary for a study that will be under the direction of the Commission that will emulate the scope and objectives of the Thomas Report. This study should be initiated 60 months after the transaction is executed or upon the determination that the integration of the HECO Companies is complete, whichever occurs earlier. I acknowledge that if the proposed transaction is approved, the applicability of the Thomas Report, which analyzed issues related to affiliated transactions between HEI and the HECO Companies would be questionable. However, once the integration process has been completed, commissioning a similar study to ensure that Hawaii customers are not bearing unreasonable risks

31 While it is not a recommendation offered by Mr. Carver, I would like to raise a question for future consideration by the Commission. That question relates to whether it may be in the public interest for the Commission to adopt rules, or through a Commission order, a standard set of rules and/or guidelines related to affiliated transactions and/or relationships. I note that there are a number of regulated utility and transportation companies with affiliated entities that are out-of-state and/or unregulated. Adopting such rules or guidelines are not required to establish the proposed conditions in this or other proceedings. However, adopting a common set of guidelines may be an efficient means by which to eliminate some of the time and effort expended in various rate case, CPCN, and transfer of control proceedings.
and/or costs due to affiliated relationships and transactions is a reasonable step to take to ensure the public interest is protected. (Condition AT8)

Additionally, Mr. Carver offers a discussion on a code of conduct guideline that should be followed until the Commission has the opportunity analyze the current HECO Companies’ code of conduct to determine what modifications, if any, are needed to ensure that the interaction between affiliates do not result in diminished competition or cross subsidization.

F. WHETHER THE PROPOSED TRANSACTION, IF APPROVED, WILL ENHANCE OR DETRIMENTALLY IMPACT THE STATE’S CLEAN ENERGY GOALS. (ISSUE 1.G)

Q. THE APPLICANTS HAVE ASSERTED THAT THE PROPOSED TRANSACTION WILL FACILITATE THE STATE’S CLEAN ENERGY GOALS. DO YOU AGREE WITH THIS ASSERTION?

A. No, I do not believe that the Applicants have clearly shown that the proposed transaction will enhance the State’s clean energy goals. To explain, Mr. Oshima has indicated that the proposed transaction will help Hawaii realize its energy goals since: 1) it will create a partnership between two entities with common vision and goals; 2) NEE is a leading clean energy company; 3) both NEE and the HECO Companies are committed to increasing renewable energy, modernizing the grid, reducing the dependence on imported oil, and integrating more rooftop solar and lowering customer bills;
and 4) the combined expertise of NEE and the HECO Companies will be available.\(^{32}\)

I acknowledge that, with NEE’s balance sheet, NEE could help the HECO Companies access the capital that will be necessary to advance Hawaii’s clean energy goals. It is not clear, however, how readily that capital access will be made available. Like any organization, there is a finite source of capital, even for a corporation as large as NEE. As a result, in order to meet its fiduciary duties, corporation management must make wise decisions regarding capital allocation and, as a result, will be likely to invest in, when ideal situations exist, less risky and more lucrative investments. If the capital investments in Hawaii do not reflect an appropriate risk level and return on investment, NEE may choose to allocate those capital dollars towards other projects that are either less risky and/or more lucrative.

As discussed by Mr. Chang, an analysis of NEE and its regulated entity offers an inconsistent image and, thus, creates confusion as to what Hawaii should expect when evaluating NEE’s vision and goals and NEE’s commitment to renewable energy and rooftop solar. The stark contrast of the amount of renewable energy in FPL’s portfolio as compared to NextEra Resource’s portfolio highlights this issue.\(^{33}\)

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\(^{32}\) Applicants Exhibit-1, at 20-21.

\(^{33}\) As pointed out in Mr. Chang’s testimony, FPL only has 35 MW of solar generation and 0MW of wind generation in its generation portfolio. On the other hand, NextEra Resources has over 19,000 MW of renewable resources in its portfolio (with none in Florida).
Furthermore, as I discussed earlier with respect to the issue regarding reliability, Applicants have not made clear how, with the limited rooftop penetration and limited penetration of utility scale renewable generation in Florida, NEE and FPL would be able to help Hawaii advance its clean energy goals on a technical basis. Additionally, while NEE may own a significant renewable energy portfolio as an IPP, it is not immediately clear that NEE will be able to assist the HECO Companies with the system planning necessary to integrate even higher levels of intermittent renewable energy in Hawaii. In addition, as discussed earlier when evaluating whether the proposed transaction could provide long-term benefits, Applicants have not provided sufficient detail on how the proposed transaction will benefit the long-term planning necessary to realize the transition to 100% renewable energy since Applicants have not offered any details on how they will be able to accelerate and/or complete on a more affordable basis the PSIPs, IDRPP, and DGIP.

Given the importance of the State’s clean energy goals and the role that the HECO Companies are expected to play in the process, the Applicants should be required to clearly articulate, supported by credible analysis and documentation, how the proposed transaction will help Hawaii with its goals. In the absence of such a showing, I contend that it would be difficult for the Commission to find the proposed transaction is in the public interest.
Q. IF THE APPLICANTS HAVE NOT CLEARLY DEMONSTRATED HOW THE
PROPOSED TRANSACTION WILL FACILITATE THE STATE’S CLEAN
ENERGY GOALS, DO YOU HAVE ANY RECOMMENDATIONS?

A. I have already offered recommended conditions as it relates to
the $110 million of transformational investment contributions and the
commitment to retire certain assets expected to be replaced by clean energy
technology, such as renewable generation and advanced metering
technology. Both of these recommendations, which were discussed earlier as
a means to ensure that customers will receive significant, quantifiable benefits
in both the short and long term, also contribute to a Commission finding that
the proposed transaction is in the public interest as it relates to whether the
State’s clean energy goals are enhanced.

G. WHETHER THE TRANSFER, IF APPROVED, WOULD
POTENTIALLY DIMINISH COMPETITION IN HAWAII’S VARIOUS
ENERGY MARKETS AND, IF SO, WHAT REGULATORY
SAFEGUARDS ARE REQUIRED TO MITIGATE SUCH IMPACT.
(ISSUE 1.H)

Q. EARLIER, YOU DISCUSSED POTENTIAL CONCERNS RELATED TO
AFFILIATES AND HOW THOSE CONCERNS MIGHT ADVERSELY AFFECT
CUSTOMERS IF CUSTOMERS ARE CONSTRAINED FROM SEEKING OUT
COMPETITIVE OPTIONS. WHAT IS YOUR RECOMMENDED CONDITION?

A. In order to mitigate the concerns associated with unregulated affiliates taking
unfair advantage of their relationship to the regulated companies and possibly
constraining a customer’s competitive options, I recommend that there should be a condition that requires measures to ensure that there will be no inappropriate advertising or information that might lead a HECO Companies' customer to assume or believe that NEE affiliates are part of or otherwise offer regulated services. In addition, there should be no processes or procedures that will unfairly direct utility customers to an affiliate or suggest that the affiliates’ goods or services are required or part of regulated utility services.

(QO2)

Q. ARE THERE OTHER WAYS THAT COMPETITION IN HAWAII MIGHT BE ADVERSELY AFFECTED?

A. Yes. In addition to the retail competition example, the proposed transaction could also cause wholesale competition issues as well.

Q. IN DOCKET NO. 96-0493, THE COMMISSION INVESTIGATED ELECTRIC UTILITY INFRASTRUCTURE IN THE STATE, WHICH INCLUDED THE FEASIBILITY OF COMPETITION IN HAWAII’S ELECTRIC INDUSTRY. COULD YOU SUMMARIZE THE FINDINGS IN THAT PROCEEDING?

A. Yes. In Decision and Order No. 20584, filed on October 21, 2003, the Commission determined that “it is [not] in the public interest to completely restructure the electric industry at this time.” As part of its findings, the Commission stated that “projections of any potential benefits of restructuring
Hawaii’s electric industry are too speculative and it has not been sufficiently
demonstrated that all customers in Hawaii would continue to receive
adequate, safe, reliable, and efficient energy services at fair and reasonable
prices under a restructured market, at this time.”34 (emphasis added) Instead,
the Commission stated its intent to investigate distributed generation and
competitive bidding for new generation capacity. The Commission conducted
these analyses in Docket No. 03-0371 and 03-0372, respectively. Arguably,
the intent behind Docket Nos. 03-0371 and 03-0372 was an effort to capture
some of the benefits that might be realized in a competitive environment. At
the utility scale level, competitive bidding for new generation was the possible
solution. At the customer level, facilitating the distributed generation market
was the perceived solution.

Q. GIVEN THE ACTIONS TAKEN IN DOCKET NOS. 03-0371 AND 03-0372, DO
YOU BELIEVE THAT THE PROPOSED TRANSACTION COULD
ADVERSELY AFFECT THE COMPETITION THAT NOW EXISTS IN
HAWAII’S ENERGY MARKET?

A. Yes. NEE is an active developer of generation projects across the nation and,
if the proposed transaction was approved, NEE could certainly influence
factors in the project selection process in its favor. Further, given the lack of
distributed generation in Florida, there are unanswered questions.

34 Decision and Order No. 20584, at 14.
It should be made clear that the Consumer Advocate believes that there is significant room for improved competition in the utility scale generation market. While the Competitive Bid Framework that was adopted in Docket No. 03-0372 (“Comp Bid Framework”) has been used to obtain new generation units, I am certain that there are other parties that agree that the process was far from ideal and, thus, the results of the competitive bidding process were also not ideal. In fact, only two projects have been successfully completed as a result of the Comp Bid Framework.\(^{35}\) Otherwise, the generation projects that have been installed since the adoption of the Comp Bid Framework have been the result of either waivers from the Comp Bid Process or “grandfathered.” The Consumer Advocate has always been frustrated by the differences in prices between generation projects on the mainland and Hawaii. That frustration has only grown with the decline in generation project costs on the mainland that has not been mirrored in Hawaii. Hawaii has only seen meaningful decreases in the cost for renewable energy projects in the recent waiver applications\(^{36}\) and, as expressed in those dockets, the Consumer Advocate contends that prices for those projects

\(^{35}\) See Docket Nos. 2011-0051 and 2011-0224.

\(^{36}\) See, e.g., Docket No. 2014-0357.
should be even lower.\(^{37}\) Thus, the issue of whether this transaction could adversely affect competition in Hawaii is of great importance to the Consumer Advocate because the Consumer Advocate wants to see continued downward pressure on capacity and energy prices and not see Power Purchase Agreement (“PPA”) prices that are just below the utility company’s avoided cost.

NEE has expressed interest in developing projects in Hawaii (e.g., interisland cable examined in Docket No. 2013-0169) and is an active developer of generation projects across the nation. Absent the proposed transaction, NEE could provide competitive pressure to encourage the HECO Companies or other developers to present superior bids and/or estimates for future projects.

Additionally, as discussed by Mr. Chang, the proposed transaction could also affect competition in Hawaii if interaction between NEE affiliates (including the HECO Companies, if the transaction is approved), whether intentionally or unintentionally, biases the selection of a NEE project over other competitive proposals. Competition may also be reduced if other potential

\(^{37}\) This issue affects both projects that have been proposed by the utility companies and developers. For instance, in Docket No. 2013-0360, HECO originally proposed a cost of 16.3 cents per kWh, but the Consumer Advocate pointed out that the evidence in that proceeding suggested an even lower rate. Later, this estimate was revised to 13.8 cents per kWh after the Consumer Advocate pointed out possible areas for cost reduction. Similarly, in some of the waiver project dockets, after the Consumer Advocate raised questions regarding the price per kWh, there were indications that suggested that the prices could be even lower. This type of behavior suggests that competitive forces are not yet robust enough to ensure the lowest, reasonable prices.
competitors perceive that the bidding NEE affiliate was somehow able to get
inside information that allowed them to underbid, by a small margin, the next
closest competitor. As a corollary, the concern might be raised that, due to
inside information, NEE (or the NEE affiliate) could have bid even lower, but
chose to bid low enough only to beat the next lowest competitor, thereby
increasing the amount that the winning NEE affiliate is able to collect from
ratepayers. Furthermore, if the proposed transaction is approved and the
regulated utility (e.g., HECO) and NEE (or an affiliate other than the HECO
Companies) are both allowed to offer bids, there may be a concern with the
perception that the affiliates are allowed two bites at the apple as well as
whether customers may have to somehow bear the costs of both bids. All of
these are potential concerns that have not been adequately addressed to
date.

Q. BASED ON IDENTIFIED CONCERNS, WHAT ARE THE
CONSUMER ADVOCATE’S RECOMMENDATIONS?
A. Since the Applicants have not identified sufficient safeguards to address
competitive concerns, the Commission should require conditions to address
those concerns. First, Mr. Chang has also recommended measures to limit
communication related to planning or procurement efforts to minimize the
possibility of the process being rigged to favor selection of an NEE affiliate and
this measure also includes a process that will ultimately generate an annual
independent certification of compliance. In addition, the HECO Companies’ or
NEE affiliates’ bid must be submitted in advance of any other competitor to
address concerns that information from competitors’ bids was used to bias the
selection towards the HECO Companies or NEE affiliates bid. There is also a
recommendation that, regardless of whether it is a HECO Companies’ or NEE
affiliate’s bid, the underlying support for the bid as well as the final report be on
an “open book” basis so that the Commission and Consumer Advocate are
allowed to see the recorded costs and actual return. To address concerns that
the HECO Companies and an NEE affiliate may submit duplicative bids and
pass these costs on to ratepayers, Mr. Chang recommends that, if the
proposed transaction is approved, only one NEE entity should be allowed to
participate in a competitive bidding process, whether it be one of the HECO
Companies or any NEE affiliate. This condition should also address any
third-party concerns that NEE is getting two bites at the apple. To ensure that
any winning proposal sponsored by NEE or a NEE affiliate clearly and
justifiably represents the lowest cost proposal (all other factors being held
equal) it is imperative to ensure that the selection process will be completely
open, fair, and transparent. (Condition CO1)
Q.  DO YOU HAVE ANY FURTHER COMMENTS ON HOW COMPETITION IN HAWAII'S ENERGY MARKET CAN BE IMPROVED?

A. Yes. The State of Hawaii, through its regulators, its legislators, the administration, and consumers, needs to put continued pressure on all developers and vendors, such as the utility companies and independent power producers ("IPPs"), so that customers can realize the benefit of the decreasing unit costs for renewable energy project components and other cost-reducing technological breakthroughs. To this end, the Consumer Advocate recommends the Commission open an investigation into updating the Comp Bid Framework, to ensure that the competitive bidding process for utility scale generation is not only fair and transparent but will yield the most competitive proposals possible to the benefit of all consumers. This is not a condition for the proposed transaction, but is a recommendation nonetheless.
III. WHETHER THE APPLICANTS ARE FIT, WILLING AND ABLE TO PROPERLY PROVIDE SAFE, ADEQUATE, RELIABLE SERVICE AT THE LOWEST REASONABLE COST IN BOTH THE SHORT AND LONG TERM.  
(ISSUE 2)

Q. BESIDES THE STANDARD OF REVIEW RELATED TO WHETHER THE PROPOSED TRANSACTION IS IN THE PUBLIC INTEREST, HAS THE CONSUMER ADVOCATE ALSO REVIEWED THE APPLICANTS’ FITNESS, WILLINGNESS AND ABILITY?

A. Yes. I would offer, however, the Consumer Advocate’s review of these factors is from the perspective of not only looking at the current assessment of the fit, willing, and able standard, but also considering the stated objectives for Hawaii’s transformation and transition to a 100% renewable energy industry. Otherwise, simply looking at whether the Applicants are fit, willing, and able to operate a traditional, vertically integrated utility company would be an easier, but short sighted approach to this question.
A. WHETHER THE PROPOSED TRANSACTION, IF APPROVED, WILL RESULT IN MORE AFFORDABLE ELECTRIC RATES FOR THE CUSTOMERS OF THE HECO COMPANIES. (ISSUE 2.A)

WHETHER THE PROPOSED TRANSACTION, IF APPROVED, WILL IMPROVE THE FINANCIAL SOUNDNESS OF THE HECO COMPANIES. (ISSUE 2.D)

Q. THE COMMISSION ASKS WHETHER THE PROPOSED TRANSACTION, IF APPROVED, WILL RESULT IN MORE AFFORDABLE ELECTRIC RATES FOR THE HECO COMPANIES' CUSTOMERS. DO YOU BELIEVE THAT THE PROPOSED TRANSACTION WILL RESULT IN MORE AFFORDABLE ELECTRIC RATES?

A. I do not believe so. First, I will mention the review standard applied to evaluate these issues. As mentioned earlier, in any transfer of control application, the Commission applies the fit, willing, and able standard. As part of that review, the criteria to determine whether an applicant is fit tends to focus on financial fitness and that determination generally relies on an analysis of the acquiring entity’s financial statements and forecasted cash flow, including the utility’s and, as applicable, owners’ access to capital.  

At its face, NEE appears to have greater access to capital than HEI and has a larger balance sheet and a higher level of income than HEI. Analysis of

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38 See, e.g., Decision and Order No. 19658, filed on September 17, 2002, in Docket No. 02-0060, at 16 -18; Decision and Order No. 22449, at 24; and Decision and Order No. 21696, filed on March 16, 2005, in Docket No. 04-0140, at 25 – 29.
certain financial ratios reflects better results for HEI.\textsuperscript{39} In this proceeding, however, simply assessing whether the potential acquiring entity has a healthy balance sheet and/or income statement is insufficient. This is evident by the Commission’s issues which are seeking answers such as whether the proposed transaction will result in more affordable rates as part of the fit, willing, and able determination. Based on that understanding, the Consumer Advocate offers the following discussion.

Q. BASED ON THAT UNDERSTANDING, WHY DO YOU BELIEVE THAT THE APPLICANTS HAVE NOT SUPPORTED THE ASSERTION THAT THE PROPOSED TRANSACTION WILL RESULT IN MORE AFFORDABLE RATES?

A. As already discussed earlier, the Applicants have offered various high level assertions that the proposed transaction, if approved, will have many benefits. Some of those benefits include, but are not limited to, access to lower cost of capital, improved procurement supply chains, and increased purchasing

\textsuperscript{39} Source: financial information obtained from finance.yahoo.com for the years ended 2014 and 2013. HEI’s current ratios (current assets/current liabilities) were 1.05 and 1.07, respectively, as compared to NEE’s current ratios of 0.72 and 0.64, respectively (higher ratios are preferable as it means that current assets exceed current liabilities). The income ratios (income/gross profit) for HEI were 62.3\% and 62.6\%, respectively, while NEE’s ratios were 53.0\% and 46.4\%, respectively (higher ratios are preferable as it means that there are, generally, less expenses to decrease income).
power. The Applicants also contend that NEE will be able to facilitate the ability to complete large projects on schedule and on budget.\textsuperscript{40}

I believe that the Consumer Advocate’s consultants have demonstrated and articulated how the Applicants have provided insufficient detail and support for their claims that the proposed transaction will result in more affordable rates. For instance, as discussed by Mr. Hill, insufficient evidence precludes a determination that the HECO Companies’ financial soundness will be improved. Similarly, the discussions by Mr. Brosch, Mr. Comings, and Mr. Hill regarding the potential impact of the proposed transaction on the HECO Companies’ and the underlying cost of service elements do not allow a finding that the proposed transaction will result in more affordable rates without certain regulatory conditions.

I contend that the Commission must adopt the conditions outlined above to achieve short and long term net benefits and that, when the Applicants comply with those conditions, the recommended conditions will translate into more affordable rates. In the absence of the adoption of those conditions, one would have to settle for concluding that the proposed transaction might result in rates that that are lower as compared to if the transaction did not occur. The Consumer Advocate’s recommended conditions offers certainty as to how the rates would be more affordable, if the proposed transaction is approved.

\textsuperscript{40} See, in general, Applicants Exhibit-1, at 22 – 24.
B. WHETHER THE PROPOSED TRANSACTION, IF APPROVED, WILL RESULT IN AN IMPROVEMENT IN SERVICE AND RELIABILITY FOR THE CUSTOMERS OF THE HECO COMPANIES. (ISSUE 2.B)

Q. IF THE APPLICANTS HAVE NOT SUPPORTED THE ASSERTION THAT THE PROPOSED TRANSACTION WILL RESULT IN AN IMPROVEMENT IN SERVICE AND RELIABILITY FOR THE HECO COMPANIES’ CUSTOMERS, PLEASE STATE YOUR RECOMMENDATIONS.

A. Please see the earlier discussion related to whether the proposed transaction will impact the ability of the HECO Companies’ employees to provide reliable service.

C. WHETHER THE PROPOSED TRANSACTION, IF APPROVED, WILL IMPROVE THE HECO COMPANIES’ MANAGEMENT AND PERFORMANCE. (ISSUE 2.C)

Q. AS PART OF THE ASSESSMENT OF WHETHER THE MANAGEMENT WOULD BE FIT AND ABLE TO PROVIDE SERVICE, WHAT DID THE CONSUMER ADVOCATE CONSIDER?

A. In other transfer of control proceedings, the review of the fit, willing, and able standard generally considered managerial fitness and experience to operate
and properly maintain the utility assets and continue to provide utility service.\textsuperscript{41}

As with the determination of financial fitness, it seems fair to assume that the Commission is seeking a broader analysis given the subissue seeking to determine whether the proposed transaction will improve the HECO Companies’ management and performance. In the absence of Commission specific metrics and benchmarks to evaluate whether the proposed transaction will improve the HECO Companies’ management and performance, the Consumer Advocate considered the past performance of HEI, the HECO Companies, and NEE.

The proposed transaction will result in the majority of HECO Companies’ management remaining intact for at least two years, due to the commitment not to have any involuntary labor reductions for two years after the execution of the proposed transaction. This should minimize significant, immediate disruptions in the HECO Companies’ operations. In addition, retaining existing management helps to retain institutional knowledge in various areas of operation and maintenance that may be critical to existing service to customers.

\textsuperscript{41} See, e.g., Decision and Order No. 22449, at 24. Additionally, with the anticipated retention of [The Gas Company’s (“TGC”) current employees and management personnel, and with the added expertise and experience of those employed by [MacQuarie Infrastructure Company LLC ("MIC") and its affiliated entities such as the Macquarie group, TGC under MIC should have the necessary expertise and ability to not only ensure a smooth transition from k1 Venture ownership to MIC, but ensure TGC’s ability to provide gas utility services in the State as anticipated under its authority.
This does not, however, answer whether the proposed transaction will improve management. The Commission has admonished the HECO Companies’ management in various filings and expressed concerns with the HECO Companies’ various failures as it relates to a number of various matters. For instance, in Docket No. 2011-0092, the Commission took MECO to task regarding the observed inability “to properly address known renewable energy curtailment issues”\(^{42}\) and, as a result, penalized MECO 50 basis points.

Thus, the Consumer Advocate sought to determine whether there is a means by which the proposed transaction will improve the HECO Companies’ management and performance. In Mr. Oshima’s testimony, he recognizes various areas of improvement and then states that the proposed merger will accelerate and make less costly the necessary improvements. Mr. Oshima also asserts that the transformation within the Company has already initiated but that the proposed transaction will not only facilitate the transformation but the transformation will also facilitate the change in control.\(^{43}\)

To validate these assertions, the Consumer Advocate sought information related to FPL and how its historical performance related to providing customer service, reliable electric service, and facilitated transformational changes in its service territory. If FPL’s historical

\(^{42}\) Decision and Order No. 31288, filed on May 31, 2013, in Docket No. 2011-0092, at 107.

\(^{43}\) Applicants Exhibit-1, at 26 – 27.
performance demonstrated desirable attributes, this could be supportive of the
claim that NEE’s and FPL’s management are capable of helping the HECO
Companies’ management improve.

As discussed earlier, however, NEE and its affiliates do not provide a
consistent picture. While FPL has low rates and one might argue that these
low rates are due to management control over costs, the low rates may be
related to the fact that FPL has ready availability of low cost natural gas
resources, which allowed them to retire older, less efficient fossil fuel units.
Furthermore, when one considers that the HECO Companies’ bills are
primarily driven by fuel and purchased power costs, FPL’s experience in
Florida and its access to natural gas does not support a finding that the
proposed transaction will improve the performance of the HECO Companies
since Hawaii does not have ready access to natural gas resources. Further,
even though NEE has a subsidiary responsible for installing significant
amounts of renewable energy, FPL’s service territory has limited renewable
energy resources. Thus, even though, Applicants may point to the low rates in
Florida or the significant renewable energy investments made by NEE in other
jurisdictions as an example of how the proposed transaction will improve the
HECO Companies’ performance, it is unclear how Applicants can assert that
the proposed transaction will improve the HECO Companies’ management
and performance and facilitate the realization of Hawaii’s stated clean energy
goals.
Q. DOES THE CONSUMER ADVOCATE HAVE ANY RECOMMENDED CONDITIONS TO ADDRESS THIS ISSUE?

A. I contend that some of the necessary conditions are already being considered in other proceedings. The Consumer Advocate has already asserted that there are areas that the HECO Companies’ management and employees can improve. Further, as part of the discussion in Docket No. 2013-0141, the Consumer Advocate recommended the establishment of appropriate incentives to ensure that management’s objectives would be aligned with the public interest. Given the recommendations in Docket No. 2013-0141, the Consumer Advocate does not have any recommended conditions related to improving operational efficiency at this time.

Q. DOES THE CONSUMER ADVOCATE HAVE ANY OTHER DISCUSSION TO OFFER WITH RESPECT TO THIS ISSUE?

A. Yes. As part of the analysis of management, Mr. Chan Hodges also considered improvements in management related to being a more responsible corporate citizen in Hawaii. Thus, as mentioned earlier, Mr. Chan Hodges has offered recommended conditions related to the HECO Companies becoming B

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44 See, e.g., the Consumer Advocate’s discussion in Docket No. 2013-0007, where the Consumer Advocate suggested that the HECO Companies should seek to initiate efficiency improvements, assuming that management supported such efforts (CA-T-1, at 44 – 45). In this discussion, it is also recognized that the HECO Companies have initiated efforts to realize some of those benefits.
corporations, which would facilitate the improvement of the HECO Companies’
management and its focus on how to make Hawaii a better place.

IV. 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. (ISSUE 3)

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. (ISSUE 4)

Q. PLEASE DISCUSS THE CONSUMER ADVOCATE’S ANALYSIS OF THE
ISSUES OF WHETHER THE PROPOSED TRANSACTION COULD AFFECT
THE COMMISSION’S OVERSIGHT EITHER DUE TO LOCATION OF THE
PARENT COMPANY AND/OR RELATIVE SIZE OF THE PARENT
CORPORATION.

A. The Applicants contend that the proposed transaction will have no effect on
the authority over the HECO Companies. In general, I agree. Short of the
applicable statute or rules changing, the Commission’s authority would not
change.

I would offer, however, that both size and location of the ultimate parent
could adversely affect the oversight over the regulated companies. For
instance, the relative size could translate into diminished focus and attention
on a smaller subsidiary. In those instances, due to the lack of focus on the

45 See, e.g., Applicants Exhibit-1, at 28 – 29.
small subsidiary, the parent company may not be as responsive to local  
regulatory concerns and there might be a delay from the parent when awaiting  
a response to regulatory concerns. Another example might be, if a relatively  
small utility is acquired by a larger conglomeration that has a complex  
corporate structure, it becomes more difficult to properly analyze various  
factors, such as intercompany transactions and the impact of the parent  
company’s impact on the cost of capital. Mr. Hill discusses the potential  
impact of the proposed transaction on the Commission’s authority over  
capitalization and financing matters and how various concerns would arise on  
a post-merger basis. Thus, while the authority does not change, the  
effectiveness of the oversight becomes more challenging.

I would also note, however, that the proposed transaction should not be  
rejected just because the ultimate parent company has a significant balance  
sheet and is headquartered outside of Hawaii. There are a number of utility  
companies that are regulated by the Commission that have parent companies  
that are located outside of Hawaii (e.g., Hawaii Gas) and the balance sheets  
for these Hawaii regulated utility companies represent a very small percentage  
of the parent company’s balance sheet. In the proceedings where a utility  
company was acquired by an out-of-state parent, however, the Commission  
approved conditions to protect the public interest. If the proper measures  
are not in place, approval of the proposed transaction could result in adverse  
effects for customers and/or regulators.
As emphasized by the discussion in Mr. Hill’s and Mr. Carver’s testimonies, it is not just the size of the ultimate parent that will cause issues, it is the complexity of the organization and the transactions that might occur that will affect effective regulation of the post-merger HECO Companies.

As discussed by Mr. Carver and Mr. Hill, there are conditions that should be adopted to address some of the potential risks associated with how the proposed transaction might affect regulatory oversight. One of the conditions, as discussed by Mr. Hill, relates to the need to have a local board of directors to aid in the retention of regulatory authority by the Commission. Mr. Carver’s proposed cost allocation manual will also facilitate document review and continued regulatory oversight over affiliated transactions.

Q. THERE HAVE BEEN CONCERNS REGARDING THE PROPOSED TRANSACTION AND HOW THE HECO COMPANIES SHOULD BE KEPT LOCAL. PLEASE DISCUSS THE CONSUMER ADVOCATE’S CONSIDERATION OF THESE LOCAL GOVERNANCE ISSUES?

A. The Consumer Advocate retained Mr. Chan Hodges to evaluate whether the existing management or the expected version of future management would meet expectations as it relates to doing business in Hawaii and being a good corporate citizen in Hawaii. As discussed by Mr. Chan Hodges, there are continued concerns that the measures proposed by Applicants fall short in terms of addressing these local governance issues. To that end,
Mr. Chan Hodges has proposed conditions to mitigate some of those concerns, such as an annual Hawaii specific corporate responsibility report and periodic meetings, where the NextEra CEO will be required to travel to Hawaii for meetings with the Commission and other stakeholders.

V. WHETHER NEXTERA, FPL, OR ANY OTHER AFFILIATE HAS BEEN SUBJECT TO COMPLIANCE OR ENFORCEMENT ORDERS ISSUED BY ANY REGULATORY AGENCY OR COURT. (ISSUE 5)

Q. PLEASE DISCUSS WHAT KIND OF ENFORCEMENT AND COMPLIANCE ACTIONS HAVE BEEN TAKEN AGAINST NEE OR NEE AFFILIATES.

A. This could be a fairly lengthy and arduous undertaking. In Applicants Exhibit-18, Applicants have provided a high level discussion of some of the compliance filings that are placed upon NEE, including FPL. In addition, Applicants Exhibit-18 also highlights certain enforcement actions, such as the $25 million settlement related to an extended outage in Florida in 2008. Mr. Carver also discusses three events that were identified in various responses. A more detailed response to this issue would likely list a number of other actions taken by other regulatory agencies or court actions.

Some of the identified actions and Mr. Carver’s selected discussion does, however, highlight certain enforcement actions that are directly relevant to the issues in this proceeding (e.g., the Commission’s concern about reliability and how the $25 million fine for the extended 2008 outage in Florida might relate; the financial risks that the HECO Companies may be exposed to
due to large fines imposed on NEE and/or its affiliates; the Florida Public Service Commission audit that found FPL’s practice of transferring calls to one of its non-regulated affiliates should be modified; and how FPL took actions seeking to prevent a Florida Public Service Commissioner from participating in any proceeding that involved FPL). Thus, these events do highlight the need to carefully consider the Consumer Advocate’s conditions to mitigate concerns regarding the proposed transaction.

VI. CONCLUSION.

Q. CAN YOU PLEASE SUMMARIZE YOUR TESTIMONY?

A. Briefly, I contend that while Applicants have made various assertions regarding the potential to help Hawaii with its transformational goals, the Applicants have not fully utilized their opportunity to provide a compelling case that supports the requested approval of the proposed transaction. If, however, the Commission adopts the Consumer Advocate’s recommended conditions, I believe that the results will reflect substantial net benefits, both in the short and long term, that would support a finding that the proposed transaction is in the public interest. Furthermore, given the issues identified by the Commission in this proceeding, the Consumer Advocate’s recommended conditions should also help to establish certain guidelines that will ensure that the Applicants can demonstrate that they are fit, willing, and able to provide affordable, quality electric service. I have identified or summarized a number
of conditions relating to the various Commission issues throughout my testimony. However, I have summarized all of the Consumer Advocate's conditions in CA Exhibit-4.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes. It does.
# DEAN NISHINA

## Educational Background and Experience

**Business Address:** 335 Merchant Street  
Honolulu, Hawaii 96813

**Position:** Public Utilities/Transportation Officer

**Years of Service:** Since October 1992

**Business Affiliations:** Division of Consumer Advocacy, Department of Commerce and Consumer Affairs, State of Hawaii


**University or College:** Northwestern University, Evanston, Illinois  
DePaul University, Chicago, Illinois

**Degree:** Bachelor of Arts in Economics and Psychology and Certificate of Asian Studies  
Master of Science in Accountancy

**Certification:** 1993 -- Certified Public Accountant

**Regulatory Experience:** People’s Gas, Light & Coke Co. Chicago, Illinois  
1992 rate case.

**Other Curriculum:** Certificate - Center for Public Utilities NARUC - Regulation and Rate Making Process, New Mexico State University, 1993 and 1999.

**Previously Testified:** I have testified and/or participated in all utilities and transportation areas regulated by the Commission.
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<td>1.g. Whether the Proposed Transaction, if approved, will enhance or detrimentally impact the State’s clean energy goals.</td>
<td>CA Exhibit-20 (Chang testimony)</td>
</tr>
<tr>
<td>1.h. Whether the transfer, if approved, would potentially diminish competition in Hawaii’s various energy markets and, if so, what regulatory safeguards are required to mitigate such adverse impacts.</td>
<td>CA Exhibit-20 (Chang testimony)</td>
</tr>
<tr>
<td>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.</td>
<td>CA Exhibit-7 (Hill testimony); CA Exhibit-11 (Brosch testimony); CA Exhibit-16 (Carver testimony)</td>
</tr>
<tr>
<td>2.a. Whether the Proposed Transaction, if approved, will result in more affordable electric rates for the customers of the HECO Companies.</td>
<td>CA Exhibit-7 (Hill testimony); CA Exhibit-11 (Brosch testimony)</td>
</tr>
<tr>
<td>2.b. Whether the Proposed Transaction, if approved, will result in an improvement in service and reliability for the customers of the HECO Companies.</td>
<td>CA Exhibit-20 (Chang testimony)</td>
</tr>
<tr>
<td>2.c. Whether the Proposed Transaction, if approved, will improve the HECO Companies’ management and performance.</td>
<td>CA Exhibit-5 (Chan Hodges testimony)</td>
</tr>
<tr>
<td>2.d. Whether the Proposed Transaction, if approved, will improve the financial soundness of the HECO Companies.</td>
<td>CA Exhibit-7 (Hill testimony)</td>
</tr>
<tr>
<td>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.</td>
<td>CA Exhibit-5 (Chan Hodges testimony); CA Exhibit-16 (Carver testimony)</td>
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<tr>
<td>ISSUE</td>
<td>CA EXHIBIT REFERENCE(S)</td>
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<tr>
<td>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.</td>
<td>CA Exhibit-7 (Hill testimony); CA Exhibit-16 (Carver testimony)</td>
</tr>
<tr>
<td>5. Whether NextEra, FPL, or any other affiliate has been subject to compliance or enforcement orders issued by any regulatory agency or court.</td>
<td>CA Exhibit-16 (Carver testimony)</td>
</tr>
<tr>
<td>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.</td>
<td>CA Exhibit-1 (Nishina testimony); CA Exhibit-5 (Chan Hodges testimony); CA Exhibit-7 (Hill testimony); CA Exhibit-11 (Brosch testimony); CA Exhibit-16 (Carver testimony); CA Exhibit-20 (Chang testimony)</td>
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## Consumer Advocate’s Recommended Conditions

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<th>Category</th>
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<tbody>
<tr>
<td><strong>FINANCIAL SAFEGUARDS</strong></td>
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<tr>
<td>Financial Safeguards</td>
<td>FS1</td>
<td>Hill (p66)</td>
<td>Condition 16 of the 1982 Agreement be retained (except for necessary name changes)</td>
</tr>
<tr>
<td>Financial Safeguards</td>
<td>FS2</td>
<td>Hill (p65)</td>
<td>Remove the phrase &quot;as in the pre-corporate-restructuring period&quot; from the 1982 Agreement condition 8</td>
</tr>
<tr>
<td>Financial Safeguards</td>
<td>FS3</td>
<td>Hill (p83)</td>
<td>HEH and HECO Companies should not participate in any NEE (affiliates or subsidiaries) short-term debt money pool operations</td>
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<tr>
<td><strong>LOCAL GOVERNANCE</strong></td>
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<tr>
<td>Local Governance</td>
<td>LG1</td>
<td>Chan Hodges (p26-27)</td>
<td>Immediately following approval of the proposed Change in Control, HEH will elect to become a Sustainable Business Corporation pursuant to HRS Chapter 420D. In addition to the general public benefit purpose required by HRS §420D-5(a), the articles of HEH will identify the following specific public benefits: (1) Providing low-income or underserved individuals or communities with beneficial products or services; (2) Promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business; (3) Preserving the environment; (4) Improving human health; (5) Promoting the arts, sciences, or advancement of knowledge; (6) Increasing the flow of capital to entities with a public benefit purpose;</td>
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<td>(7) Accomplishing any other particular benefit for society or the environment; and (8) Using the primary power of intellectual property (and excluding others from making, using or selling the invention) conferred by any and all patents to which HEH has an interest in to create and retain good jobs, uphold fair labor standards and enhance environmental protection.</td>
</tr>
<tr>
<td>Local Governance</td>
<td>LG2</td>
<td>Chan Hodges (p27-28)</td>
<td>Within 90 days of approval of the proposed Change in Control, HEH will have elected its public Benefit Director pursuant to HRS §420D-7 and selected its public Benefit Officer pursuant to HRS §420D-9. The articles of HEH will prescribe the additional qualification that both HEH's public Benefit Director and its Benefit Officer will be selected with the advice and consent of the Commission. In addition to their reporting obligations under HRS §420D-11, HEH's public Benefit Director and Benefit Officer will report quarterly to the Commission and the Consumer Advocate on progress made in the previous quarter by HEH in improving delivery of each of the eight specific public benefits listed in HRS §420D-5(b). NextEra, HEH and HECO will not restrict nor impede through non-disclosure agreement or other means the public benefit reporting duties of HEH's public Benefit</td>
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<tr>
<td>Local Governance</td>
<td>LG3</td>
<td>Chan Hodges</td>
<td>Within 18 months of approval of the proposed Change in Control, the HECO Companies will have met all standards of accountability and transparency as well as social and environmental performance that are required to obtain certification as a B Corporation from B Lab. The HECO Companies will make whatever changes to its corporate policies, practices and governance that are necessary to achieve the minimum score of 80 required for B Corp certification. The HECO Companies will supply all documentation used to support its responses on the B Corp assessment to the Commission and the Consumer Advocate. During the biennial B Corp recertification process, the HECO Companies will commit to increase its score on the B Corp assessment by a minimum of 5 points.</td>
</tr>
<tr>
<td>Local Governance</td>
<td>LG4</td>
<td>Chan Hodges</td>
<td>In addition to its national Corporate Responsibility Report, NextEra will complete an annual report specifically for Hawaii. This Hawaii Corporate Responsibility Report will include separate sections describing in detail with relevant and up-to-date metrics the activities of every NextEra subsidiary and affiliate doing business in Hawaii. NextEra's Hawaii Responsibility Report will also include separate sections on each of the Hawaiian islands where any NextEra</td>
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<tr>
<td>Local Governance</td>
<td>LG5</td>
<td>Chan Hodges (p29)</td>
<td>NextEra's CEO will travel to Hawaii for quarterly meetings with the Commission, the Consumer Advocate and other Hawaii stakeholders. NextEra's CEO will also hold annual community meetings open to the public on every island where NextEra does business.</td>
</tr>
<tr>
<td>Local Governance</td>
<td>LG6</td>
<td>Chan Hodges (p30)</td>
<td>NextEra will work with the Commission, Consumer Advocate and other relevant stakeholders to develop an inclusive energy innovation ecosystem strategy that will enable Hawaii — over the next 30 years — to achieve the specific energy goals set forth in the policy framework established by the Commission and the Legislature.</td>
</tr>
<tr>
<td>Local Governance</td>
<td>LG7</td>
<td>Nishina (p10-11)</td>
<td>In the event that corporate decisions result in shifting state income tax liabilities from Hawaii to any other jurisdiction for the</td>
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<tr>
<td>Local Governance</td>
<td>LG8</td>
<td>Chang (p8)</td>
<td>NextEra will work with the Commission, Consumer Advocate, and other relevant agencies to develop specific programs that will benefit low-income customers directly.</td>
</tr>
<tr>
<td>Local Governance</td>
<td>LG9</td>
<td>Chang (p12)</td>
<td>NextEra will maintain or increase its current charitable contributions. NextEra will also ensure that, as part of the spinoff of ASB Hawaii, the new owner maintains or increases its current level of charitable contributions.</td>
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<tr>
<td>RING FENCING</td>
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<tr>
<td>Ring Fencing</td>
<td>RF1</td>
<td>Hill (p85)</td>
<td>A voting board of directors should be installed at HEH</td>
</tr>
<tr>
<td>Ring Fencing</td>
<td>RF2</td>
<td>Hill (p85)</td>
<td>Four of the directors should be from Hawaii</td>
</tr>
<tr>
<td>Ring Fencing</td>
<td>RF3</td>
<td>Hill (p85)</td>
<td>One of the HEH board members should be an independent director and, without the approval of this director, the HECO Companies cannot be moved into bankruptcy</td>
</tr>
<tr>
<td>Ring Fencing</td>
<td>RF4</td>
<td>Hill (p85)</td>
<td>Following the close of the transaction, NEE to submit a non-consolidating legal opinion that confirms that it will not attempt to consolidate HECO assets with NEE assets in the event of either financial stress or bankruptcy proceedings at the parent company</td>
</tr>
<tr>
<td>Ring Fencing</td>
<td></td>
<td>Chang (p37-38)</td>
<td>NextEra will put in place, within six months of the Merger’s closing, ring-fencing measures to protect</td>
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</table>

HECO Companies, HECO Companies must show that the potential benefits must be significant enough to warrant the change as well as how the benefits will be delivered to customers before the change is made.
Hawaiian Electric Companies’ ratepayers the costs associated with NextEra’s or FPL’s nuclear plant retirements (premature or otherwise.) These protections should extend as far as the potential end to decommissioning of each of the Applicants’ nuclear plants and be subject to Commission approval.

**Ratemaking**

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<tr>
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<tbody>
<tr>
<td>Ratemaking</td>
<td>RM1</td>
<td>Hill (p87)</td>
<td>Reduce the going-forward cost of equity to 9.0%</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM2</td>
<td>Hill (p89-90)</td>
<td>Reset capital structure to reflect 47% equity and 53% debt</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM3</td>
<td>Brosch (p64)</td>
<td>The HECO Companies shall each file tariffs reducing each of the non-fuel base energy charge rates to each customer class by $0.007 (seven tenths of one cent) per kWh, to be effective upon consummation of the proposed Change in Control, with corresponding prospective downward adjustment to the target revenues of each utility for Revenue Balancing Account purposes.</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM4</td>
<td>Brosch (p64)</td>
<td>The HECO Companies shall not submit an application seeking a base rate/revenue increase prior to the date 48 months subsequent to the date of closing of the proposed Change in Control. This condition shall not preclude requests for base revenue reduction filings or revenue-neutral tariff modifications during this moratorium period. If there is a financial need for a base rate/revenue increase that violates this rate case moratorium period, the base revenue increase shown</td>
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<td>to be justified under such circumstances shall be revised downward to reflect a rate of return on common equity penalty reduction of 100 basis points (1.0 percent) from the otherwise appropriate common equity return levels.</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM5</td>
<td>Brosch (p64)</td>
<td>The modified decoupling mechanism approved by the Commission in Order No. 32735 shall remain in effect during the rate case moratorium period, subject to any Commission authorized changes.</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM6</td>
<td>Brosch (p65)</td>
<td>The Rate Base RAM filings submitted by each of the Hawaiian Electric Companies, for all periods after closing of the proposed Change in Control and until a next general rate case order, shall be revised to reflect an approved return on Common Equity of 9.0 percent and a Common Equity ratio of 47 percent (with corresponding upward adjustment to the long term debt capital ratio). The same return on Common Equity and Common Equity Ratio assumptions should be utilized in AFUDC rate determination calculations for all periods after closing of the proposed Change in Control and until a next general rate case order.</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM7</td>
<td>Brosch (p72)</td>
<td>All costs directly incurred by or allocated to the HECO Companies as a result of the proposed Change in Control, including transaction-related fees and expenses to seek and receive shareholder and regulatory</td>
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<td>approvals, shareholder litigation costs, business integration and transition expenses and other costs to achieve merger savings shall be recorded in non-operating expense accounts that are not reflected in utility operating income accounts and such recorded costs shall be excluded from any base rate increase requests and in determining annual utility earnings for Earning Sharing calculations within the decoupling mechanism.</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM8</td>
<td>Brosch (p75)</td>
<td>No costs arising from any Acquisition Premium or Goodwill amortization, impairment or related charge to expense or income shall be directly incurred by, recorded on the books of or allocated to the Hawaiian Electric Companies as a result of the proposed Change in Control.</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM9</td>
<td>Brosch (p79)</td>
<td>No costs arising from incentive compensation payable to any employee of NextEra Energy, Inc. or any NextEra subsidiary, including Hawaiian Electric Holdings (or successor) and Hawaiian Electric Companies, or affiliated entity shall be charged or allocated to any Operating Expense accounts or to any Plant in Service accounts of the Hawaiian Electric Companies.</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM10</td>
<td>Brosch (p82)</td>
<td>No deferred tax assets recorded by the HECO Companies that arise from income tax net operating loss carryforwards, federal tax credit carryforwards or alternative minimum tax carryforwards shall be included in the rate base of the HECO.</td>
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<td>Companies within either future base rate case filings or Rate Base Return on Investment decoupling filings that are submitted by the HECO Companies.</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM11</td>
<td>Brosch (p84)</td>
<td>No costs associated with aviation assets owned or leased and/or operated by NextEra, or any entity affiliated with NextEra, shall be charged or allocated to, or recorded to any Operating Expense accounts or to any Plant in Service accounts of the HECO Companies.</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM12</td>
<td>Brosch (p86)</td>
<td>No costs for compensation of NextEra’s most highly compensated “Named Executive Officers”, for purposes of financial reporting, shall be assigned or allocated to any Operating Expense or Plant in Service accounts of the HECO Companies.</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM13</td>
<td>Brosch (p89)</td>
<td>No costs for insurance services or coverage from any NextEra Energy affiliated company shall be assigned or allocated to any Operating Expense or Plant in Service accounts of the HECO Companies.</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM14</td>
<td>Carver (p23)</td>
<td>Following the proposed Change in Control, the following terms and conditions will apply as a condition of continuing the current pension/OPEB tracking mechanisms: (a) NEE will maintain the HECO Companies’ pension and OPEB plans and trusts on a stand-alone basis in substantially the current form; (b) NEE will not transfer, spin off or commingle any of the HECO Companies.</td>
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<td>Companies’ pension/OPEB assets with any comparable assets of NEE affiliates; (c) NEE will file an application with the Hawaii Public Utilities Commission formally seeking approval to transfer, spin off or commingle any HECO Companies’ pension/OPEB assets with comparable assets of other NEE affiliates, should it desire to do so at some future date; and (d) NEE will file an application with the Hawaii Public Utilities Commission formally seeking approval prior to materially altering the HECO Companies’ pension/OPEB plans or transferring HECO Companies employees to the NEE pension/retirement plans, should it desire to do so at some future date. [SC will review to see if can modify without seeming to tie PUC’s hands]</td>
</tr>
<tr>
<td>Ratemaking</td>
<td>RM15</td>
<td>Nishina (p20)</td>
<td>Agreement that Hawaii customers will not be directly charged or allocated by NEE or NEE affiliates, including HECO Companies, any of the following types of costs: - Charitable contributions - Image or promotional Advertising/Marketing</td>
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<tr>
<td>AFFILIATED TRANSACTIONS</td>
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<tr>
<td>Affiliated Transactions</td>
<td>AT1</td>
<td>Carver (p11)</td>
<td>In all future transactions between the Hawaiian Electric Companies and 1) NextEra Energy Inc. or 2) NextEra Energy, Inc. affiliates, other than Florida Power &amp; Light Company (“FPL”); transactions</td>
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| Affiliated          | AT2 | Carver (p11)    | Within 90 days after the closing of the proposed Change in Control, the HECO Companies shall provide the Consumer Advocate a draft Hawaii-specific Cost Allocation Manual (“CAM”), containing detailed affiliate transaction policies, practices and guidelines (including, asymmetrical pricing for transactions between regulated and unregulated affiliates, direct charging of corporate costs when possible, apportionment of common or shared costs using direct measures of cost causation when identifiable, and allocation of shared services costs using general allocation techniques as necessary among all benefiting affiliated entities) designed to protect against cross-subsidization of NEE affiliates by the HECO
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<td>Companies. Representatives of the HECO Companies and the Consumer Advocate shall collaboratively review, discuss and revise the draft CAM with the objective of filing a joint CAM recommendation for consideration and approval by the Commission. Pending Commission approval, NEE will apply the FPL CAM methodologies and approaches for all transactions between NEE affiliates and the HECO Companies.</td>
</tr>
<tr>
<td>Affiliated Transactions</td>
<td>AT3</td>
<td>Carver (p41-42)</td>
<td>In all general rate cases following the proposed Change in Control, the respective filing of each of the HECO Companies shall include direct testimony and exhibits explaining and quantifying all affiliate transactions of each type. Additionally, testimony shall include information needed to explain and reconcile the proposed amount of test year shared services costs charged or allocated by FPL or any other NextEra affiliate in comparison to the actual costs charged/allocated to the HECO Companies by HEI in calendar year 2014, escalated by GDPPI thereafter.</td>
</tr>
<tr>
<td>Affiliated Transactions</td>
<td>AT4</td>
<td>Carver (p12)</td>
<td>Following the proposed Change in Control, NEE and FPL shall cooperatively provide information requested by the Commission and the Consumer Advocate supporting the need for and basis of corporate and shared services costs directly charged and/or allocated to the HECO Companies. The information shall include, but not be limited to:</td>
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<td>detailed overhead loading factor development and application; source documentation and calculations supporting the development of allocation factors based on direct measures of cost causation or general allocation factors (e.g., Massachusetts Formula); sufficiently detailed data to allow for testing, analysis and verification of corporate and shared services costs allocated to the HECO Companies, including quantification support for alternative allocation factor applications; access to studies and detailed support underlying any rent compensation calculations used in affiliate overhead loading rate charges or for purposes of allocating FPL or NEE affiliate-owned office space to affiliates via corporate or shared services allocations; information explaining the basis for the inclusion or exclusion of other NEE affiliates from the allocation of specific corporate costs or shared services cost pools; and accounting, financial and operational data necessary to test and analyze the basis for and reasonableness of including or excluding the HECO Companies or other NEE affiliates from participation in the allocation of corporate or shared services costs.</td>
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<tr>
<td>AT5</td>
<td>Carver (p12)</td>
<td>The HECO Companies shall file a report annually with the Commission and the Consumer Advocate disclosing the nature of the transactions and the annual</td>
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<td>value of those activities between each HECO Company and each NEE affiliate.</td>
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<tr>
<td>Affiliated Transactions</td>
<td>AT6</td>
<td>Carver (p44)</td>
<td>In determining annual utility earnings for Earning Sharing calculations within the decoupling mechanism in all periods prior to the completion of each utility's next general rate case, the amount of shared services costs charged or allocated by FPL or any other NextEra Affiliate shall not exceed the actual costs charged/allocated to the HECO Companies by HEI in calendar year 2014, escalated by GDPPI thereafter.</td>
</tr>
<tr>
<td>Affiliated Transactions</td>
<td>AT7</td>
<td>Carver (p57-62)</td>
<td>Changes to the 1982 Agreement</td>
</tr>
<tr>
<td>Affiliated Transactions</td>
<td>AT8</td>
<td>Nishina (p37-38)</td>
<td>Agreement that 24 months after the transaction has been consummated, NEE/HECO Companies will participate in a study that is commissioned by the Commission and paid for by NEE/HECO similar to the Dennis Thomas Report.</td>
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<tr>
<td>RELIABILITY</td>
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<td>NextEra will develop, within six months of the Merger’s closing, a long-term plan to achieve first quartile reliability performance as established through benchmarking studies. The reliability performance metrics should include standard reliability indices such as SAIDI, SAIFI, and CAIDI and should be based on IEEE 2.5 beta methodology. The plan should include budgets with supporting justification and analysis to ensure that the plan can achieve these first quartile</td>
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<tr>
<td>EMPLOYMENT</td>
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<td>goals at reasonable cost.</td>
</tr>
<tr>
<td>Employment</td>
<td>EM1</td>
<td>Chang (p32)</td>
<td>NextEra will provide workforce estimates and supporting analysis to identify the specific staff requirements necessary to achieve post-merger reliability commitments.</td>
</tr>
<tr>
<td>Employment</td>
<td>EM2</td>
<td>Chang (p32)</td>
<td>NextEra will provide shareholder funding to implement a workforce development plan between the Hawaiian Electric Companies and local Hawaii institutions similar to FPF’s partnerships in Florida to foster energy sector workforce development.</td>
</tr>
<tr>
<td>Employment</td>
<td>EM3</td>
<td>Nishina (p24-25)</td>
<td>If a HECO Companies’ employee is hired, transferred, or otherwise moves to NEE or one of its affiliates/subsidiaries, the following guidelines should be followed: 1) the NEE affiliate will contribute an amount equal to that employee’s fully loaded annual compensation to a fund that will return that benefit to customers; 2) the employee that is moving will not make available or take information to the affiliate that is not publicly accessible; 3) not use or rely upon intellectual property (to benefit the affiliate) that is protected by or in the process of being protected by the HECO Companies</td>
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<tr>
<td>TRANSFORMATIONAL</td>
<td></td>
<td>Nishina (p16-18)</td>
<td>NEE/HECO Companies to supply monies for an “investment fund” (akin to CIAC) for transformational capital investments   - $10 million each for Lanai and Molokai   - $25 million each for Maui and Hawaii</td>
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<tr>
<td>Category</td>
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<td>Sponsor/Source</td>
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<td><strong>$40 million for Oahu</strong>&lt;br&gt;- investment should be made within seven years of the transaction completion</td>
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<tr>
<td>Transformational</td>
<td>TR2</td>
<td>Nishina (p18-19)</td>
<td>Agreement not to seek recovery of remaining net book value of retired assets to facilitate transformational efforts&lt;br&gt;- Retirement of Honolulu units 8 &amp; 9&lt;br&gt;- Retirement of Waiau units 3 &amp; 4&lt;br&gt;- Retirement of Shipman units 3 &amp; 4&lt;br&gt;- Retirement of Kahului units 1 through 4&lt;br&gt;- old meters and obsolete back office systems that will be replaced by AMI infrastructure</td>
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<tr>
<td>COMPETITION</td>
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<td><strong>Pending the completion of an independent Commission investigation into updating the competitive bidding framework:</strong>&lt;br&gt;- Any NextEra affiliate and Hawaiian Electric Companies’ operating entity should not both be allowed to participate in the same competitive RFP. Only one or the other entity should participate.&lt;br&gt;- The HECO Companies and NextEra should not directly or indirectly communicate on matters of planning or procurement efforts. Measures to prevent improper communication should be presented to the Commission for review and approval, and an annual independent certification of compliance</td>
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<tr>
<td>Competition</td>
<td>CO1</td>
<td>Chang (p47-48)</td>
<td>Pending the completion of an independent Commission investigation into updating the competitive bidding framework:&lt;br&gt;- Any NextEra affiliate and Hawaiian Electric Companies’ operating entity should not both be allowed to participate in the same competitive RFP. Only one or the other entity should participate.&lt;br&gt;- The HECO Companies and NextEra should not directly or indirectly communicate on matters of planning or procurement efforts. Measures to prevent improper communication should be presented to the Commission for review and approval, and an annual independent certification of compliance</td>
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<td>- The HECO Companies or any NextEra affiliate should submit its bid in advance of any procurement deadline to ensure that its bid does not reflect information inappropriately gained from competitors’ bids.</td>
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<td>- Any NextEra proposal should be submitted under “open book” requirements to allow the Commission and the Consumer Advocate to review its inputs and assumptions. If a NextEra proposal is selected, a final cost report should be required.</td>
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<tr>
<td>Competition</td>
<td>CO2</td>
<td>Nishina (p41-42)</td>
<td>There will be no utility procedure or process that will unfairly direct utility customers to an unregulated affiliate or suggest that an affiliate’s services is part of the regulated company’s service offerings. The regulated utility company should avoid any advertising or informational brochures that might be interpreted by customers or potential customers to mean that affiliated goods or services are required or available as part of regulated utility services.</td>
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DIRECT TESTIMONY AND EXHIBITS

OF

IAN CHAN HODGES

ON BEHALF OF
THE DIVISION OF CONSUMER ADVOCACY

SUBJECT: HAWAII BUSINESS CULTURE, CORPORATE GOVERNANCE, THE NECESSITY OF INNOVATION AND THE PUBLIC INTEREST
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DIRECT TESTIMONY OF IAN CHAN HODGES

I. INTRODUCTION.

Q. PLEASE STATE YOUR NAME, POSITION AND PLACE OF EMPLOYMENT.
A. My name is Ian Chan Hodges and I am the Managing Member of Responsible Markets LLC. I have been retained to provide testimony in this proceeding on behalf of the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs (“Consumer Advocate”).

Q. PLEASE STATE YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGROUND.
A. Please see CA Exhibit-6.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?
A. The purpose of my testimony is to offer a narrative perspective on what it means to do business in Hawaii; how doing business in the islands may be different from doing business anywhere else; what a loss of local governance means for HECO;¹ whether or not a “local advisory board” can mitigate that loss; how Hawaii’s economy and local communities could benefit from the inventions and innovations that are necessary to meet the state’s 100 percent renewable portfolio standard (“RPS”) by 2045; and whether or not NextEra

Energy, Inc. (“NextEra”) can catalyze the significant innovations in energy that are needed. My testimony specifically looks at these issues as they pertain to the Change in Control application submitted to the Commission by HECO and NextEra. In my testimony, I will refer to the proposed Change in Control as the “proposed transaction” and will refer to NextEra and HECO collectively as the “Applicants.”

Q. WHAT ARE YOUR AREAS OF RESPONSIBILITIES IN THIS PROCEEDING?
A. My testimony will address the following issues as set forth by the Commission in the matter of the Change in Control Application (“Application”):

1a) Whether approval of the proposed transaction would be in the best interest of the state's economy and the communities served by the HECO Companies

2c) Whether the proposed transaction, if approved, will improve the HECO Companies' management and performance.

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; and,

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.

Q. HAVE YOU INCLUDED EXHIBITS IN SUPPORT OF YOUR TESTIMONY?
A. Yes. A copy of my CV is included as CA Exhibit-6.

Q. WHAT HELPED YOU IN PREPARING FOR YOUR TESTIMONY?
A. I have engaged in numerous discussions regarding how business can better serve society and achieve multiple bottom lines, how to catalyze and nourish ingenuity, how to determine the best path forward towards a clean energy future — with a particular focus on Hawaii’s role — as well as, and most recently, how to evaluate the merits of the proposed transaction. These deliberations have resulted at times in proposed legislation, new law, policy change, unexpected alliances and business/investment model transformation. I have engaged in the majority of these discussions over a significant period of time prior to the public announcement of the proposed transaction on December 3, 2014. A number of discussions took place between December 3, 2014, and when I was retained on June 19, 2015, to provide testimony in this proceeding on behalf of the Consumer Advocate. In addition, since I was retained in June, I have read hundreds of pages of direct testimony, Information Requests (“IR”) from the interveners in this docket and responses from the Applicants. The preparation that I just described will
provide the basis for the positions and recommendations that I outline in the
testimony that follows.

Q. WHAT PARAMETERS HAVE YOU USED IN YOUR TESTIMONY?
A. First, I have worked to make my testimony relatively concise. Because I am
addressing issues that are likely to be of interest to members of the public who
have a direct stake in the outcome of the proposed transaction, I have tried to
make my testimony accessible. Given how busy people are in the
communities that HECO serves, I have made an attempt to be as succinct as
possible. Ideally, an interested party should have time to read through this
testimony during a flight from Maui to Oahu, whether that person is the Chair
of the Commerce and Consumer Protection Committee heading to the Capitol
or a Commissioner commuting to Honolulu or a kupuna visiting family in
Waimanalo. An article in Hawaiian Airlines’ inflight magazine can run to
2,000 words. My testimony is probably three times too long to meet that
standard, but I have kept it as brief as possible.

Second, my testimony is primarily built on the “soft” analytics of what I
learned listening to the people I referenced earlier. I also read the other
testimony as well as the IRs related to this docket in the context of the
knowledge I have gained from the work I have done and my experiences of
being a lifelong resident of Hawaii. My analysis and conclusions are the result
of my own judgment based on information and evidence I believe to be most
relevant. I also use a form of analytics similar to what NextEra employed when it *intuitively* identified specific opportunities to deliver more affordable energy to HECO’s ratepayers that it believes will result from approval of the proposed transaction (more on this later).

I have been impressed by the expertise, experience, intelligence and commitment to the public interest that the others working for the Consumer Advocate have shown. It is a privilege to be working with them on this docket and it is clear to me that I don’t have the capability to do what they do so well.

II. HOPES, DREAMS, CHALLENGES & OPPORTUNITIES.

Q. IN ANNOUNCING HIS OPPOSITION TO THE TRANSACTION "AS PROPOSED," GOVERNOR DAVID IGE SAID, "WE ARE LOOKING FOR A PARTNER WHO SHARES OUR HOPES AND DREAMS." WHAT ARE HAWAII’S HOPES AND DREAMS AS FAR AS ITS ENERGY FUTURE IS CONCERNED?

A. While I certainly cannot speak for Governor Ige, he was likely referring to the legislative objectives found in House Bill (“HB”) 623, which he signed into law on June 8, 2015. According to the office of the Governor, the new law “strengthens Hawaii’s commitment to clean energy by directing the state’s utilities to generate 100 percent of their electricity sales from renewable
energy resources by 2045.” In the preamble to HB 623 the Legislature found that:

Hawaii’s dependency on imported fuel drains our economy of billions of dollars each year. A stronger local economy depends on a transition away from imported fuels and toward renewable local resources that provide a secure source of affordable energy. The legislature further finds that alternative energy technologies have advanced significantly in recent years, leading to an explosion of new markets, jobs, and local energy sources.

This provides a reasonable synopsis of the hopes and dreams of Hawaii with regard to energy and the economy. Passage of HB 623 sets an ambitious policy framework that seeks to make these dreams achievable over a 30-year timeframe by reaching 100% RPS. The potential for an “explosion in new markets, jobs, and local energy sources” is real, but the Governor is correct in saying that we need to work with a partner who shares Hawaii’s hopes and dreams. This partner must also have the right human capabilities, organizational commitment and corporate character in order to help lead Hawaii towards achieving its 100% RPS target in a manner that creates the maximum possible benefit for the state’s economy and our island communities. Whether NextEra has what it takes to be the partner that Hawaii needs is one of the primary questions before the Commission.
Q. WHAT CHALLENGES WILL HAWAII FACE AS IT PURSUES 100% RPS?
A. It is clear that Hawaii is already recognized as a place that is pushing the envelope with the integration of renewable energy. But all of the parties to this docket likely already know this to be the case. The real challenges and economic opportunities will come as Hawaii pushes ahead towards 100% RPS. The Applicants acknowledge the general challenges ahead on page 3 of their Application:

Because Hawai‘i stands at the forefront in addressing a vast array of complex and interrelated issues associated with a clean energy transformation, the Hawaiian Electric Companies have been and will continue to be challenged to break new ground in areas such as renewable energy integration, interconnection with customer-sited solar photovoltaic systems, energy storage, and customer demand response programs.

Q. DOES NEXTERA SAY ANYTHING ELSE IN ITS TESTIMONY THAT YOU BELIEVE IS PARTICULARLY RELEVANT IN EXAMINING CHALLENGES AND OPPORTUNITIES?
A. Yes. In responding to the challenges in Hawaii of integrating distributed energy, particularly rooftop solar, Mr. Gleason makes the following observation (Applicants’ Exhibit 7, page 36):
[A]s in the rest of the country, the relative amount of distributed generation in Florida is much less than in Hawai‘i, due mainly to FPL’s [(Florida Power & Light Company)] comparatively low electric rates. So, from an industry-wide perspective, the Hawaiian Electric Companies’ interconnection challenges are in largely uncharted territory. Having exposure to and having the opportunity to help address these challenges is one of the attractions for NextEra Energy in pursuing the combination with the Hawaiian Electric Companies.

Q. GIVEN HECO’S EXPERIENCE TO DATE WITH CLEAN ENERGY TRANSFORMATION HAS NEXTERA INDICATED THAT IT BELIEVES IT HAS ANYTHING TO LEARN FROM THE LOCAL WAY OF DOING THINGS IN HAWAII?

A. Yes. In outlining its commitment to HECO employees in the Application NextEra identifies a need “to tap into the knowledge base of employees with experience operating in Hawai‘i” (page 10) and “recognizes that the Hawaiian Electric Companies’ existing employees possess unique experience and knowledge regarding operating and providing electric utility service in the Hawai‘i communities that they serve.” (page 33)

Q. HOW DOES HAWAII’S CULTURE IMPACT THE WAY BUSINESS IS DONE IN THE ISLANDS AND HOW IS THIS DIFFERENT FROM DOING BUSINESS ANYWHERE ELSE?

A. In an article entitled Doing Business Island Style published in the August 2014 issue of Hawaii Business magazine, Mike McCartney, who was CEO of Hawaii
Tourism Authority at the time and now serves as Governor Ige’s Chief of Staff,

summed up Hawaii’s business culture succinctly:

“No talk stink. No make big body. And no hog cheese.” For

non-pidgin-speakers, that’s, “Don’t badmouth people; don’t act

entitled and arrogant; and don’t take more than your share

without giving back more than you get.”

The article goes on:

In our June issue’s feature on leadership, Hawaii Business quoted Hawaiian Electric Industries CEO Connie Lau as saying that people and companies in Hawaii most often don’t have a single bottom line: “In Hawaii, we talk much more about double or triple or even quadruple bottom lines. … We’re not so strongly financially oriented; we also care about quality of life, balance of life and preserving what’s special about Hawaii.”

Having multiple criteria for success means a more complicated business equation than just financial profit and loss. When you and the person on the other side of the boardroom table share an island and a community, when you’ll run into each other at Longs, when you both intend to stick around, your questions become longer range: Is this good for Hawaii? By doing this, am I strengthening my place in the community or weakening it? How is what we’re doing going to affect others?

Ben Godsey, president of ProService Hawaii, has a term for this long-range business approach, borrowed from psychology: Hawaii has a “relational culture.” A more transient, dispersed population focuses on short-term deals with a clear-cut outcome, because social and other reverberations won’t be felt; the person you’re doing business with may disappear next year and, in the interim, you’re not as likely to run into them in any other context. A “transactional culture,” says Godsey, asks, ‘I’m doing this for you; what are you doing for me?’ Here, it’s a relational culture. Over a long period of time, what are the relationships you’re building?”
Q. WHAT THOUGHTS DO YOU HAVE ON HOW MR. MCCARTNEY SUMS UP HAWAII’S BUSINESS CULTURE?

A. He is right on the money, so to speak, because Hawaii business culture is definitely about more than just money. It is also about showing respect for others in the community, demonstrating humility, resisting greed and giving back. And the fact that Mr. McCartney — who has held prominent positions in both Hawaii’s public and private sectors — would decide to sum up Hawaii business in pidgin to a business reporter is significant in itself. At the risk of oversimplification, speaking pidgin in Hawaii is an effective way to communicate within Hawaii’s diverse communities in a manner that honors distinct cultures while acknowledging shared local values that are historically tied to how Hawaii’s various ethnic groups have worked together. So pidgin is both a means and a metaphor for how work gets done in Hawaii.

Q. IS IT NECESSARY TO BE A KAMA’AINA (HAWAII BORN) TO HAVE SOME UNDERSTANDING OF HAWAII’S BUSINESS CULTURE?

A. No, of course not. For example, the president of ProService — who talks about Hawaii’s relational business culture in the Hawaii Business article — was born and raised on the Mainland. Being a Kama’aina is not required. What is necessary is showing respect to everyone, demonstrating humility, resisting greed and giving back along with other Hawaii values.
Q. IN THE HAWAII BUSINESS ARTICLE, HEI’S CEO CONNIE LAU TALKS ABOUT MULTIPLE BOTTOM LINES. DOES NEXTERA ACKNOWLEDGE THAT HAWAII HAS A UNIQUE CULTURE AND THAT THERE IS A DISTINCT WAY OF DOING BUSINESS IN THE ISLANDS?

A. Yes. In his Direct Testimony (Applicants’ Exhibit 7, pages 24-25), Mr. Gleason recognizes that Hawaii has a distinct cultural and business environment:

We are cognizant that as a mainland corporation seeking to combine with a company with roots dating back to the days of the Hawaiian monarchy, we have a lot to learn. To this end, we are focused on building partnerships and engaging collaboratively with community and non-governmental organizations to meet the needs of Hawai‘i in a culturally respectful and environmentally sensitive manner.

Also, the Hawaiian Electric Companies will continue to be headquartered in Honolulu following the Proposed Change of Control and will continue to operate under their respective current company names and from their existing operating locations. The president and management team of the Hawaiian Electric Companies will be based in Hawaii. And in lieu of the existing Hawaiian Electric board of directors, NextEra Energy commits to establish a local, independent Hawaiian Electric advisory board that will meet quarterly to provide input on matters of local and community interest. NextEra Energy anticipates that this board will have 6 to 12 members, all of whom will have substantial ties to the Hawai‘i community and will be compensated for their services.

Finally, some have suggested that a key test of our fitness to acquire the Hawaiian Electric Companies should be whether our corporate values are sufficiently aligned with what has been described as "Hawai‘i's triple bottom line" of kuleana, malama pono and aloha. Our core corporate values of commitment to excellence, doing the right thing and treating people with respect are closely aligned and very compatible with those of Hawai‘i.
Q. HOW DOES NEXTERA ENERGY PROPOSE THAT ITS MANAGEMENT CAPABILITIES AND PERFORMANCE METRICS WILL DELIVER MORE AFFORDABLE ENERGY?

A. In answering this question in his Direct Testimony (Applicants’ Exhibit 7, page 16), Mr. Gleason refers to NextEra’s long-term use of Six Sigma — a data-driven approach to continuously improve work processes, productivity and efficiencies:

FPL’s world-class performance, on cost as well as other key elements of its customer value proposition, did not happen by chance. Building what we believe to be the best utility in the nation required decades of thoughtful planning, cultural growth, and hard work. Our journey on the path of continuous improvement in customer value began in the 1980s, when FPL became the first non-Japanese company to win the prestigious Deming Prize for quality. (Pictures of this event are included in Applicants Exhibit-9.)

In the next paragraph Mr. Gleason reveals how NextEra identified the sources of post-transaction energy cost savings:

Joining NextEra Energy will provide the Hawaiian Electric Companies with access to the technologies, best practices and expertise of an industry leader, all under the direction of local management. While the integration planning process is just getting underway, most specific opportunities for cost savings enabled by the merger likely will not be identified until the companies begin operating together. **Intuitively**, we expect these opportunities to cut across nearly all the major components of customer bills: fuel, purchased power, operating costs, depreciation, and cost of capital. [emphasis added]

By paying the nation’s highest electric rates month after month, HECO ratepayers created a market opportunity that NextEra found attractive enough
to offer a control premium of hundreds of millions of dollars in order to acquire HECO. At the same time, NextEra testified that it relied on intuition to make the determination that it is capable of delivering lower costs for HECO ratepayers. This appears to be inherently inequitable for two reasons. First, HECO ratepayers have not been offered the equivalent of a "control premium" as beneficiaries of the utility franchise and as consideration for the costs ratepayers have borne in creating what is arguably one of the most attractive markets for renewable energy in the U.S. Second, for a large corporation that takes pride in its history of using data analytics to drive continuous improvement, it seems to be an odd approach for NextEra to intuitively identify opportunities for HECO ratepayer cost savings in its Change in Control Application to the Commission.

Q. THAT BEING SAID, IS THERE A ROLE FOR INTUITION AND OTHER LESS ANALYTICAL APPROACHES IN CREATING HAWAII’S ENERGY FUTURE?

A. Yes. Intuition, ingenuity and innovation are all necessary. I know from my work with inventors that intuition has a significant role to play in innovation, particularly with truly ingenious inventions that are disruptive of business as usual. It seems clear that in order for Hawaii to have hope of achieving its dream of reaching 100% RPS by 2045 we will need to catalyze significant disruptive innovation. This innovation will likely be driven by a number of factors, including the on-the-ground knowledge, experience and commitment
of HECO employees. Also necessary will be a culture that supports intuition and ingenuity, which are critical to discerning and designing each non-obvious inventive step as Hawaii encounters what will surely be numerous challenges in moving towards 100% RPS.

In his testimony Mr. Gleason discussed two approaches to making decisions and drawing conclusions that are very different and in tension with each other. But this tension is not necessarily a negative factor if it can be skillfully and artfully managed. In order to succeed in achieving Hawaii’s “hopes and dreams,” HECO will need a greater measure of both. But this is something that large corporations find particularly difficult to execute.

As I have worked on building alliances between inventors and labor unions, people have often asked me, “What's in it for the inventors? Why would they want to work with unions and vice versa?” I understand that it seems counterintuitive, but in fact intuition was the initial catalyst for pursuing these alliances. Interestingly, it is seldom the inventors themselves who ask this question, but more often those with little experience in commercializing innovation. What most inventors who have experienced commercial success recognize is that the front line workers who make, use, sell or otherwise utilize their inventions are invaluable allies in the hard work of continuous innovation and periodic reward of game changing breakthroughs.

This is where understanding and embracing Hawaii’s values and business culture are so critical. Kuleana, malama pono and aloha are not just
a triple bottom line for Hawaii. They are values that when lived out will provide
a foundation from which to embrace the disruptive innovation necessary to
achieve the hopes and dreams for Hawaii’s energy future identified by the
governor. Disruptive innovation is actually disruptive. It can make profitable
business models obsolete, undermine job security and often results in initial
customer confusion/frustration (deployment of something new rarely works
perfectly the first time). The common human response to this situation can be
instinctual: fight or flight. It is easier to avoid this natural reaction, if those you
are working with and for, know their kuleana, practice malama pono and live
aloha. And it certainly helps if they also no talk stink, no make big body and
no hog cheese. In order to be successful overall in Hawaii (not just with its
Change of Control Application), NextEra needs to make it clear to HECO
employees, HECO customers (95% of the state’s population), the
Commission, as well as state and county leaders, that it understands,
embraces and is willing to be held accountable for upholding Hawaii’s values.
NextEra needs to demonstrate this commitment through what is says (and
doesn’t say) and what it does (and doesn’t do). The message that Hawaii
needs to get from NextEra is this: *We know what matters most to you and
we’ve got your back.* I believe that it is not an exaggeration to state that this is
definitely not the message that Hawaii is currently hearing from NextEra.
Q. CAN HAWAII DEFINE ITS VALUES IN SUCH A WAY THAT THEY CAN BE UNDERSTOOD BY A BIG MAINLAND CORPORATION SUCH AS NEXTERA AND ALSO MEASURED IN AN EQUITABLE MANNER SO THAT THE CORPORATION CAN BE HELD ACCOUNTABLE TO THESE VALUES?

A. The simple answer is that it will be difficult, if not impossible, for a corporation as large and distant as NextEra to learn and live Hawaii values in the same way that this happens on a day-to-day basis in Haiku, Honolulu, Hilo or Hanalei. While the law treats a corporation as a legal "person" distinct from its employees and stockholders, corporations are obviously not people. However, I believe there are ways to come relatively close and I outline a number of recommended approaches in my proposed conditions at the conclusion of my testimony. Then there are stories. Listening to stories told by kupuna, “talking story” and passing stories on to keiki are ways of conveying the experiences of living Hawaii values which both teach these values and create a system for accountability that is definitely not data driven. With stories, measurement is still possible, but the metrics are different.

Q. DO YOU HAVE STORIES THAT YOU BELIEVE ARE RELEVANT?

A. Yes.
Q. WHERE DO YOU WANT TO START?

A. At the beginning:

Since time immemorial, Kānaka Maoli (Native Hawaiians) have pondered a fundamental question: “Aia i hea ka wai a Kāne?” Where are the waters of Kāne, the waters of life? A traditional oli (chant) from the island of Kaua‘i explains that fresh water, as the source of all life in Hawai‘i, can be found from the rising of the sun in the east to the setting of the sun in the west; it runs from the mountain peaks out into the ocean and resides in the heavens above (as clouds, rain and rainbows) and the earth below (as aquifers and gushing up as springs). “He wai e mana, he wai e ola, no ‘ehā.” It is the water that empowers and the water that provides life.


Q. WHY IS THIS STORY RELEVANT?

A. First, I know the author and first met her years ago near Hanalei, Kaua‘i in a Lo‘i kalo (wetland taro patch) that she and her family were helping to restore. I believe that she lives what she writes about.

Second, in finance, water is a metaphor for money (underwater, liquidity, cash flow, etc.). In Hawaiian the word wai (water) is also the basis for waiwai (wealth) and kānāwai (law). If a water metaphor was used to explain NextEra’s corporate structure it would likely be a description of water flowing through a very extensive series of interlocking pipes that are buried under ground. But only a few people know where these pipes are buried, exactly how they are connected, which way the flow is going at any given time, and how to get the water out.
Third, business in Hawaii is different in large part because of the relationship Hawaii’s people have to water. The thousands of miles of the Pacific Ocean that must be crossed to reach Hawaii from the U.S. Mainland or Asia mean that the Hawaiian islands are the most geographically isolated population center on Earth. Everything about life in Hawaii is shaped by this fact of geographic isolation in the middle of the Pacific. The waters of the Pacific also define our relationship to each other in Hawaii. The major populated islands have developed distinctive ways of life in large part because they are separated by water. In Hawaii, the beaches are public and the ocean is accessible to everyone. A majority of residents of Hawaii have a relationship with Hawaii’s shoreline and water. Dedication to surfing, fishing, paddling, diving and numerous other water-related pursuits brings Hawaii’s people together (along with visitors) in a manner that is not restricted by income, social status, ethnicity or other potentially divisive factors as long as mutual respect for and love of the water is maintained. One of the best ways to get grounded in Hawaii is to help clean a Lo‘i kalo (taro patch) by taking off your shoes (or more likely your slippers) and getting knee deep in the mud.
Q. DO YOU HAVE OTHER STORIES FROM YOUR DIRECT EXPERIENCE
THAT TELL OF BUSINESSES LEADERS WHO ARE NEW TO THE ISLANDS
LEARNING AND PRACTICING HAWAII VALUES?

A. Yes. I will relate two brief stories about business leaders from the Mainland
who learned from and tried to practice Hawaii values.

Seventeen years ago this month, a team of bank executives flew to
Honolulu while seeking approval from federal regulators for what at that time
was the second largest bank merger in U.S. history. They had come to
discuss a previous commitment made to native Hawaiians so that merger
approval would not face regulatory delays. Meetings had been scheduled with
the Governor and other leaders and the bankers were eager to “get down to
business.” But hundreds of Hawaiian kupuna where gathered at the Iolani
Palace on that day and the bankers learned that it would be a breach of
protocol not to meet with them before walking to the Governor’s office. The
team of bankers was led by a woman executive who is now one of the top
female bankers in the country, with 100,000 financial services employees
currently reporting to her. Seventeen years ago she ran the acquiring bank’s
community development group and was highly skilled at placating grassroots
organizations. She was smart, highly competent and determined to get the job
done so that the merger could proceed without delay. Then she and her team
spent a couple of hours meeting with the kupuna. She was visibly moved by
the genuine aloha the kupuna showed her and what they said about their
kuleana with regard to the Hawaiian people. After her meeting with the kupuna at the Iolani Palace, the bank’s interactions with native Hawaiians became noticeably more relational and less transactional for a time. However, a number of factors have made relational interactions based on Hawaii’s culture difficult to maintain with the bank over the past seventeen years, including the thousands of miles separating the bank’s primary decision makers from Hawaii’s people and a deterioration of institutional memory regarding Hawaii as subsequent acquisitions, integrations and reorganizations by the bank have moved thousands of its employees up, laterally or out.

Q. WHAT IS YOUR SECOND STORY?

A. At the beginning of the new millennium, residents of Hana, Maui were concerned that foreign investors would redevelop the Hotel Hana-Maui — the largest private sector employer in East Maui — in a manner that wasn’t in the best interest of the community. Another investor was needed who would respect the community, show humility by listening and not treat the hotel as an asset to be drained of value and its employees as liabilities to be controlled. Through a combination of an analysis of the available options, acting on gut instinct (Mr. Gleason might call this intuition) and what many came to think of as divine intervention, an investor was found to purchase the Hana Hotel. After the transaction closed in August of 2001, the new owner spent significant time in Hana, attending church, participating in community events, playing
volleyball with the employees and “talking story” with employees and residents. One month later, on September 11, the United States was attacked by terrorists. Travel came to a halt and only recovered slowly in the following months. The day after the attacks on D.C. and New York, the first case of dengue fever was discovered in Hana. Within two weeks nearly 6,000 Hawaii workers had lost their jobs because of the dramatic decline in tourism following the attacks. Hotel occupancy at the Hana Hotel dropped to basically zero. The new hotel owner had to make a decision that would dramatically impact his business and the lives of Hana’s residents. The action chosen was costly in the short term, but demonstrated a real understanding of how to live kuleana, malama pono and aloha. Not surprisingly, the leader of the local union representing the hotel employees said the new owner was the most labor friendly in the state.

Q. 1A) DO THESE STORIES RELATE TO COMMISSION ISSUES 1A)
ECONOMY AND COMMUNITIES, 2C) MANAGEMENT AND PERFORMANCE, 3) REGULATORY AUTHORITY, AND 6) CONDITIONS?
A. I believe they do. I will explain as I summarize my recommendation for each of these issues.
Q. WOULD APPROVAL OF THE PROPOSED TRANSACTION BE IN THE BEST
INTEREST OF THE STATE'S ECONOMY AND THE COMMUNITIES
SERVED BY THE HECO COMPANIES?

A. No. The Applicant has neither offered a credible rationale for why the
proposed transaction would be a net benefit to the state's economy nor
provided a plan for how the post-transaction entity will better serve the diverse
communities within the five islands where the HECO companies operate.
As mentioned earlier, the potential for an “explosion in new markets, jobs, and
local energy sources” is real as Hawaii makes progress towards 100% RPS.
Hawaii is already becoming a “test bed” for clean energy technologies and the
possibility of building a vibrant innovation economy around the commitment to
reach 100% renewables doesn’t need to be a dream. A real commitment to its
community kuleana would likely have NextEra put forth a plan for how
approval of the proposed transaction could lead to job creation outside of the
HECO companies in the communities served. Earlier I related a brief story of
water in Hawaii and provided some examples of its significance. Because
Hawaii is an island society with mauka (mountains) and makai (ocean)
providing orientation for navigation as well as natural separation between
many of Hawaii’s neighborhoods, very distinct communities have developed
with specific needs. NextEra has also not put forth a plan that demonstrates
that it understands this basic reality of Hawaii.
Q. 2C) WILL THE PROPOSED TRANSACTION, IF APPROVED, IMPROVE THE HECO COMPANIES’ MANAGEMENT AND PERFORMANCE.

A. Not likely. NextEra has shown a lack of knowledge of and interest in the culture within which business operates in Hawaii. The proposed transaction differs in significant ways from other acquisitions of large regulated corporations in Hawaii by mainland and foreign entities in that the island market that NextEra is proposing to enter is being rapidly and dramatically transformed in response to a major policy push from all levels of government and a clear pull of demand from the market. There will be very little room for missteps in execution, miscommunication with a distant corporate bureaucracy, and misalignment of objectives and incentives between Hawaii and Florida. The tension between the need for innovation and the focus on performance metrics also needs to be faced. These differences make embracing and understanding of local culture and business practices critical.

With this in mind, NextEra was asked the following in an Information Request (CA-IR-379a):

With respect to Hawaii’s distinct cultural environment, what differences does NextEra recognize that currently exist between its corporate values and Hawaii’s cultural values, including the “triple bottom line” referenced by Mr. Gleason of kuleana, malama pono and aloha? Please describe these differences with sufficient detail to highlight specific contrasts between the respective value systems.
NextEra’s 300 word response (Applicants’ Response to CA-IR-379a) references a number of Hawaiian proverbs and makes use of a lot of Hawaiian words. However, NextEra’s basic conclusion is that its corporate values are functionally equivalent to Hawaii’s cultural values and triple bottom line. NextEra’s ability to improve management and performance at the HECO companies will likely be significantly impeded if it continues to demonstrate an unwillingness to learn how its corporate values differ from Hawaii values.

By way of contrast, the stories about the new Hana hotel owner and the female bank executive demonstrate that a different approach is possible. These two business leaders were arguably facing greater challenges than NextEra — business collapse during a national crisis along with an outbreak of an infectious disease and significant regulatory hurdles during a multi-state, multi-billion merger coupled with related corporate power struggles. Despite these challenges, these two leaders took the time to listen and to learn and then made decisions that were difficult, costly in the short run, but ultimately wise.
Q. 3) WILL THE PROPOSED TRANSACTION, IF APPROVED, 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?

A. Yes. Because it shifts the nexus of control, realigns governance and decreases incentives for c-suite responsiveness, the post-merger corporate structure as currently outlined in the proposed transaction is very likely to diminish the Commission's regulatory authority over the HECO companies.

Q. 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?

A. Yes. While my testimony does not support approval of the transaction as proposed, I am sponsoring conditions that are designed to mitigate to some degree the negative impact of the proposed transaction on Hawaii's economy and communities, the management and performance of HECO as well as the PUC's diminished regulatory authority.
III. CONDITIONS.

A. HAWAIIAN ELECTRIC HOLDINGS AS A SUSTAINABLE BUSINESS CORPORATION.

Immediately following approval of the proposed Change in Control, Hawaiian Electric Holdings ("HEH"), the new parent company of the Hawaiian Electric Companies, will elect to become a Sustainable Business Corporation pursuant to Hawaii Revised Statutes ("HRS") Chapter 420D. In addition to the general public benefit purpose required by HRS §420D-5(a), the articles of HEH will identify the following specific public benefits for which HEH was created pursuant to the following numbered subsections of HRS §420D-5(b):

1. Providing low-income or underserved individuals or communities with beneficial products or services;
2. Promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business;
3. Preserving the environment;
4. Improving human health;
5. Promoting the arts, sciences, or advancement of knowledge;
6. Increasing the flow of capital to entities with a public benefit purpose;
7. Accomplishing any other particular benefit for society or the environment; and
(8) Using the primary power of intellectual property — the right to exclude others from making, using or selling the invention — conferred by any and all patents in which HEH has an interest in to create and retain good jobs, uphold fair labor standards and enhance environmental protection.

It is expected that as the new holding company for HECO, HEH will commit to pursuing continuous improvement in delivering each of the above specific public benefits to the communities that the HECO companies serve.

B. PUBLIC BENEFIT DIRECTOR AND BENEFIT OFFICER.

Within 90 days of approval of the proposed Change in Control, HEH will have elected its public Benefit Director pursuant to HRS §420D-7 and selected its public Benefit Officer pursuant to HRS §420D-9.

The articles of HEH shall prescribe the additional qualification that both HEH's public Benefit Director and its Benefit Officer will be selected with the advice and consent of the Commission.

In addition to their reporting obligations under HRS §420D-11, HEH's public Benefit Director and Benefit Officer will report quarterly to the Commission and the Consumer Advocate on progress made in the previous quarter by HEH in improving delivery of each of the eight specific public benefits listed in HRS §420D-5(b).
NextEra, HEH and HECO will not restrict nor impede through non-disclosure agreement or other means the public benefit reporting duties of HEH's public Benefit Director and Benefit Officer as required by HRS §420D-11 and this condition.

C. HAWAIIAN ELECTRIC COMPANIES B CORPORATION CERTIFICATION.

Within 18 months of approval of the proposed Change in Control, the Hawaiian Electric Companies will have met all standards of accountability and transparency as well as social and environmental performance that are required to obtain certification as a B Corporation from B Lab, the nonprofit which administers the certification process. With the support of NextEra and HEH, HECO will make whatever changes to its corporate policies, practices and governance that are necessary to achieve the minimum score of 80 required for B Corp certification. HECO will supply all documentation used to support its responses on the B Corp assessment to the Commission and the Consumer Advocate. During the biennial B Corp recertification process HECO will commit to increase its score on the B Corp. assessment by a minimum of 5 points.
D. HAWAII SPECIFIC CORPORATE RESPONSIBILITY REPORT.

In addition to its national Corporate Responsibility Report, NextEra will complete an annual report specifically for Hawaii. This Hawaii Corporate Responsibility Report will include separate sections describing in detail with relevant and up-to-date metrics the activities of every NextEra subsidiary and affiliate doing business in Hawaii. NextEra’s Hawaii Responsibility Report will also include separate sections on each of the Hawaiian islands where any NextEra subsidiary or affiliate has done business during the year covered by the report. Additionally, the Hawaii Responsibility Report will include a detailed description with relevant metrics on the progress that NextEra is making in operating as a Hawaii business, including progress in creating value for Hawaii’s triple bottom line of Kuleana, Malama Pono and Aloha. NextEra will work with the Commission and the Consumer Advocate to develop metrics and assessment tools specifically for use within its Hawaii Responsibility Report.

E. PERIODIC MEETINGS WITH NEXTERA CEO IN HAWAII.

NextEra’s Chief Executive Officer will travel to Hawaii for quarterly meetings with the Commission, the Consumer Advocate and other Hawaii stakeholders. NextEra’s CEO will hold annual community meetings open to the public on every island where NextEra does business.
F. COMMITMENT TO AN OPEN ENERGY INNOVATION ECOSYSTEM IN HAWAII.

NextEra will work with the Commission, Consumer Advocate and other relevant stakeholders to develop an inclusive energy innovation ecosystem strategy that will enable Hawaii — over the next 30 years — to achieve the specific energy goals set forth in the policy framework established by the Commission and the Legislature. NextEra will seek input for best practices in this area from industry leaders such as Green Mountain Power in Vermont, which became a certified B Corp in December and is considered by Hawaii’s Energy Excelsiorator and others to be a leader in energy innovation.

Within 90 days of approval of the proposed Change in Control, NextEra shall take the following initial steps to demonstrate its commitment to Hawaii’s energy innovation ecosystem:

1. Commit $60 million from NextEra’s venture capital arm, ClearSky Power & Technology, to invest in clean power and technology ventures that will have a substantial Hawaii presence and impact;

2. Provide funding to hire a chief innovation officer at HECO; and,

3. Assent to the presumption that data collected by the HECO companies that can be considered reasonably relevant and of value to the achievement of 100% RPS in Hawaii is public information and will be made accessible to the public.
IV. CONCLUSION.

Q. DO YOU HAVE CONCLUDING THOUGHTS?

A. Yes. Before I began writing this conclusion, I had the opportunity to speak with a senior officer at Green Mountain Power — an electric utility in Vermont — about a number of the key issues raised in my testimony. As mentioned above, Green Mountain Power (“GMP”) was certified as a B Corp in December of last year and is considered one of the most innovative electric utilities in the nation.

GMP is the first utility to receive B Corp certification. Here’s what the company had to say about becoming a B Corp:

Green Mountain Power is part of a community of more than 1,100 companies across 60 industries with one unifying goal: redefining success in business. We meet rigorous standards of performance, accountability, and transparency, and are using the power of business to alleviate poverty, address climate changes, and build strong local communities and great places to work.

According to the executive I spoke with, the reasons GMP became a B Corp centered around that fact that they have a desire to be the un-utility. Looking into the future, they see that the industry is ready for a big disruption. But rather than fight these changes, GMP wants to run towards the disruptive models. GMP focuses on testing technologies and banging on them in real life. For example, GMP is Tesla’s utility partner for the Powerwall.
A minimum of 80 points out of 200 is required to achieve B Corp certification. Because GMP was already committed to corporate responsibility, they did not need to change anything significant with their business model in order to receive a score of 84. GMP has set a goal to add 2 to 5 points annually to its B Corp score. They incorporate this objective into each year's strategic plan. Every year GMP wants to have a B Corp assessment theme they work on. This year the focus is on community service/volunteerism and adding retirement plan options that meet certain sustainability and non-fossil fuel investment criteria.

A final point that was made to me during my call with GMP is something that I found to be particularly relevant to this docket. A few years ago GMP acquired another Vermont electric utility. The integration process is ongoing and has been successful thus far. But integration is really hard work. Even in Vermont, the culture of two utilities can be very different.

I believe that it’s fair to say that integration of HECO and the Hawaii culture with NextEra business culture with will be significantly more difficult than any challenges GMP may be facing in Vermont. This is particularly true given the fact that NextEra believes that a local decision making board may be deemed to be a "burdensome condition under the Merger Agreement." (FOL IR-62, page 3). It also appears that NextEra is planning to pack its proposed “local advisory board” with people they believe they can control.
This command and control approach is not in the public interest nor in the long run is it in the interest of NextEra’s stockholders.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes. It does.
Experience

**Ingenuity Underwriters Ltd., President**

Founded Ingenuity Underwriters to facilitate the development and commercialization of inventions and other forms of intellectual property in a manner that enables the creation and retention of good jobs as well as promotes scientific innovation and supports inventors. Recruited leadership who have the collective experience of representing the interests of thousands of prolific inventors and other creators of intellectual property.

- Developed the ingenuity strategy in consultation with national leaders in labor, investment, invention, economic development, manufacturing, engineering and law. The ingenuity strategy seeks to leverage the right to exclude in patents and other types of intellectual property for the purpose creating good jobs, upholding fair labor standards and protecting the natural environment while increasing the overall value of the underlying intellectual assets. Ingenuity Underwriters is working to champion invention and innovation as a new asset class for investors, a key source of competitive advantage for local communities, a dynamic tool for labor unions in the 21st century and a catalyst for the creation of quality jobs. The strategy is designed to proactively address a number of the fundamental causes of economic inequality — capital mobility, global labor arbitrage and the broken link between increased productivity and equitable compensation.

**Responsible Markets LLC, Managing Member**

Founded Responsible Markets with investment from Silicon Valley for the purpose of leveraging market imbalances profitably for long-term good. Responsible Markets has been guided by this principal objective in all of its paid and pro bono engagements, including work in the following areas:

- **Investment:** 1) Responsible Markets organized a national summit held at Hawaii’s state capitol on “double-bottom line” investing. Participants included key Hawaii and mainland representatives from pension funds, foundations, trusts, state government, venture capital and intellectual property. 2) Recruited the Hawaii Capital Stewardship Advisory Committee to provide a forum for those involved in capital strategies initiatives to consult with national experts from unions, pension funds and labor-friendly financial firms. 3) Engaged in brainstorming sessions with trustees from large pension funds to develop new models of investment in healthcare, clean transportation and intellectual property. 4) Conceptualized and helped to write a comprehensive guide to responsible investment for institutional investors.

- **Invention:** 1) Retained by a national labor federation to develop partnerships with inventors and to champion innovation as a key source of competitive advantage and a foundation for job creation/retention. 2) Retained by prominent inventors to build alliances with those who will advocate for inventors.

- **21st Century Labor Union Strategies:** 1) Facilitated meetings between nationally prominent inventors and labor leaders. 2) Worked with the United Auto Workers during the auto crisis on strategies for using automaker patents to anchor good jobs in the United States. 3) Assisted in creation of ‘value for value exchange’ model for use within bankruptcy proceedings to promote asset maximization and job creation potential of intellectual property. 3) Worked with a labor/environmental coalition to introduce new technologies into port operations in a manner that would increase wages for drayage truck drivers.

- **Rural Economic Development:** 1) Developed alternative economic development strategies for Hana and Molokai. 2) Played an instrumental role in the community friendly buyout of a Hawaiian hotel. 3) Advocated successfully on a number of occasions for technology firms to move certain operations to Hawaii.
Clean Energy: 1) Worked with auto makers and unions to develop strategy for scaling adaptation of electric vehicles in rental car fleets in a manner that supports grid balancing and renewable energy integration. 2) Brainstormed with leaders in California, Oregon, Washington and British Columbia regarding Hawaii’s potential role as a center of incubation, prototyping, and pilot projects in order to assess the feasibility of taking next generation clean energy and infrastructure development to scale on the west coast.

American Ingenuity Alliance, National Coordinator 2006 — Present
- American Ingenuity Alliance works to facilitate joint ventures between inventors, investors and unions to support game changing innovation for the purpose of creating and retaining good jobs.
- Spearheaded the drive to pass legislation in Hawaii that created the statutory framework for the ingenuity corporations, providing the legal structure to effectively implement the ingenuity strategy.
- Developed the framework for creating a new asset class based on intellectual property, which would deliver multiple bottom line returns for institutional investors. Conferred with trustees from large pension funds as well as prominent inventors and the nation’s top intellectual property judge (ret.) during this process.
- Organized an intensive workshop on intellectual property during a national meeting of pension fund trustees at the Hawaii Convention Center.
- Organized a national summit for industrial unions to explore building strategic alliances with inventors.

Democratic Party of Hawaii, Maui County Chair 2005 — 2006

Pacific Monitor, Co-Editor 1996 — 1998
- Edited the Pacific Monitor, a digital newspaper focusing on economic diversification, technology, and Asia-Pacific news. The Pacific Monitor was sent by fax three times a week to nearly 1,000 Maui businesses.

Pacific Knowledge, Principal 1993 — 2000
- Secured a commitment from one of the nation’s largest banks to provide $150 million in financing for Hawaiians on their homelands. During this bank’s merger with another large national bank, negotiated a multi-million dollar commitment to capitalize a Hawaiian community development financial institution.
- Organized and led a Silicon Valley brainstorming session with Hawaii’s governor and key legislators for the purpose of creating economic development strategies which focused on utilizing intellectual property to anchor jobs.
- Played an instrumental role in the creation of a number of community development finance entities in Hawaii, including the development of a rural micro-enterprise loan program as well as the organization of a statewide community loan fund.

Education

Eastern University 1986 — 1990
BA, Sociology (graduate level course work in economic development)

Kalani High School 1980 — 1984
DIRECT TESTIMONY AND EXHIBITS

OF

STEPHEN G. HILL

ON BEHALF OF
THE DIVISION OF CONSUMER ADVOCACY

SUBJECT: FINANCIAL ISSUES RELATED TO THE PROPOSED MERGER BETWEEN HAWAIIAN ELECTRIC INDUSTRIES AND NEXTERA ENERGY
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DIRECT TESTIMONY OF STEPHEN G. HILL

I. INTRODUCTION / SUMMARY.

Q. PLEASE STATE YOUR NAME, OCCUPATION AND ADDRESS.

A. My name is Stephen G. Hill. I am self-employed as a financial consultant, and principal of Hill Associates, a consulting firm specializing in financial and economic issues in regulated industries. My business address is P.O. Box 587, Hurricane, West Virginia, 25526 (e-mail: hillassociates@gmail.com). A detailed account of my educational background and occupational experience appears in CA Exhibit-8, attached to this testimony.

Q. ON BEHALF OF WHOM ARE YOU TESTIFYING IN THIS PROCEEDING?

A. My firm has been retained by the Hawaii Department of Commerce and Consumer Affairs, Division of Consumer Advocacy (“Consumer Advocate” or “CA”).

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My task in this proceeding is to analyze the financial aspects of the proposed merger between Hawaiian Electric Industries (“HEI”), parent company of Hawaiian Electric Company, Inc. (“HECO”), Maui Electric Company, Limited (“MECO”), and Hawaiian Electric Light Company, Inc. (“HELCO”), and NextEra Energy, Inc. (“NextEra” or “NEE”). In addition to its regulated electric utility subsidiaries, HEI also currently owns American Savings Bank (“ASB”), a
federal savings bank. In the course of the proposed transaction, the ownership of ASB will be distributed to HEI’s shareholders. That is, HEI’s non-utility bank investment will be “spun-off” to HEI’s stockholders as NEE proposes to acquire only HEI’s regulated electric utility assets. I will refer to the proposed Change in Control in my testimony as the “Transaction” and will refer to the NEE and HEI parties to the Transaction collectively as the “Applicants.” My review of the financial aspects of the proposed transaction is undertaken in order to assess the financial benefits and risks to HECO’s ratepayers that will obtain as a result of the Hawaii Public Utilities Commission (“HPUC” or “Commission”) approval of the transaction.\(^1\)

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\(^1\) For ease of reference in this testimony I will refer to the regulated utility operations of HEI as “HECO” or the “HECO Companies”, rather than listing HECO, MECO and HELCO every time the regulated utility operations of HEI are referenced.

\(^2\) While there are other approvals necessary in order for the completion of the proposed transaction to occur, in my view, this Commission’s approval is the key element in the ability of the Companies to effectuate the merger between HEI and NEE.
Q. THE COMMISSION HAS PROVIDED A LIST OF ISSUES TO BE ADDRESSED BY THE PARTICIPANTS IN THIS PROCEEDING. TO WHICH OF THOSE ISSUES WILL YOUR TESTIMONY APPLY?

A. My testimony will address financial issues designed to investigate the following questions set forth by the Commission:

1. Whether the Proposed Transaction is in the public interest;
   
   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;
   
   d. Whether the proposed financing and corporate restructuring proposed in the Application is reasonable;
   
   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;

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;
   
   d. Whether the Proposed Transaction, if approved, will improve the financial soundness of the HECO Companies;
4. Whether the financial size of the HECO Companies relative to the NextEra’s other affiliates would result in a diminution of regulatory control by the Commission; and,

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.

Q. HAVE YOU PREPARED EXHIBITS IN SUPPORT OF YOUR TESTIMONY?

A. Yes, CA Exhibit-9 and CA Exhibit-10, along with the data request responses submitted by the Applicants and cited in my testimony provide analytical support for the conclusions reached regarding the financial aspects of the proposed transaction. The Exhibits were prepared by me and are correct to the best of my knowledge and belief.

Q. PLEASE SUMMARIZE YOUR TESTIMONY AND FINDINGS CONCERNING THE PROPOSED MERGER AND ITS FINANCIAL IMPACT ON THE HECO COMPANIES’ HAWAII RATEPAYERS.

A. My testimony addresses the Commission’s questions set out above through an examination of the expected benefits and the drawbacks of the proposed transaction from a financial point of view. According to the Applicants’ testimony, the financial benefits of the proposed transaction are grounded on two primary factors: 1) an expected improvement in the HECO Companies’ credit rating resulting in lower debt financing costs, and 2) a four-year rate
moratorium, which could be beneficial to ratepayers by making rates lower than they might otherwise have been. The total amount of direct savings to ratepayers resulting from the rate moratorium and other ratemaking aspects of the proposed transaction, according to NEE witness Reed was originally $60 million over a four-year period. In his Direct Testimony and in supplemental responses to CA Information Requests, Mr. Reed also identified other expected operational-related savings.

My review of the facts underlying the expected financial savings for ratepayers associated with the proposed transaction indicates that they are more tenuous than implied by the applicants. In other words, while it is possible that there could be financial-related cost reductions realized as a result of the proposed transaction, those cost reductions are not certain and, if realized, are likely to be less significant than depicted by the applicants.

For example, the debt cost savings estimates are based primarily on the Companies’ focus on one credit rating agency (Standard & Poor’s or “S&P”) that expects an improvement in HECO’s bond rating if the proposed Transaction proceeds. However, the two other major credit rating agencies expect no change in bond rating for HECO. Also the much-cited 25 basis point reduction in debt costs is based on a bid solicited by HECO from a lender that has done significant business with both HECO and NEE. Therefore, the 25 basis point debt cost reduction does not appear to be an arms-length evaluation of the risk differences related to the pending
transaction and is not a reliable estimate of probable long-term
Transaction-related financial savings.

With regard to the second pillar of the Companies’ promised ratepayer
savings cited by Applicant’s witness Reed, according to the testimony of
CA witness Brosch, that, too, appears to be based on questionable
assumptions and is likely to be overstated. Therefore, the financial benefits of
the proposed transaction are likely to be significantly lower and appear to be
more tentative than those promised by the Applicants in this Transaction.

Although the Companies do not discuss the financial drawbacks for
Hawaii ratepayers that are associated with this proposed Transaction, they
do exist. This Commission has, in my experience, sought to have a thorough
understanding of the HECO Companies’ operations and their inter-corporate
financial relationships, with an ability to review, assess and alter, if necessary,
factors that could unnecessarily harm the Companies’ ratepayers. That level
of thoroughness can be seen, for example, in the recent Power Supply
Improvement Plan (“PSIP”) filings, outlining each of the HECO Companies’
long-term power supply plans, which were instigated by this Commission’s
order and which are crucial to the HECO Companies’ future viability. It can
also be seen in the 1982 Agreement, which address the financial risks related
to holding company diversification, which the Applicants wish to alter in this
proceeding, limiting the Commission’s control over the HECO Companies. It
is difficult to estimate the value of the Commission’s ability to protect Hawaii’s
ratepayers from unnecessary financial risk, but ratepayers would certainly
view that ability as valuable. Most importantly, that valuable ability to assess
the inter-corporate financial relationships in order to know when and how to
intercede on ratepayers’ behalf would be compromised by the proposed
transaction.

NextEra is a financially complex company, and, while financial
complexity, per se, does not connote lack of transparency and financial risk, in
this instance, I believe it does. NEE has more financial risk than HECO
because, on a consolidated basis (i.e., including all of the companies owned
by NEE) the parent company uses more debt to capitalize operations than
HECO does. Moreover, that debt is used most heavily in the unregulated
operations while keeping the amount of debt low (amount of equity high) on
the books of NEE’s regulated operations (primarily Florida Power and Light
(“FPL”)). This arrangement shifts the cost of the financial leverage of NEE’s
unregulated operations to the regulated ratepayer, and allows the unregulated
operations to be capitalized more inexpensively than they otherwise would be.

In addition, the source of unregulated debt within NEE is NextEra
Energy Capital Holdings (“NEECH”), the parent company of NextEra Energy
Resources (“NEER”—the holding company for NEE’s myriad unregulated
operations). Neither NEECH nor NEER file financial statements with the
Securities and Exchange Commission (“S.E.C.”) or provide financial
statements to stockholders in NEE’s annual reports. The only capital structure
we have been able to discover and evaluate in this proceeding for NEECH is a “deemed” capitalization of about 30% equity and 70% debt. (CA-IR-60)

Therefore, it is not possible for this Commission to directly assess the capital structure of the primary source of financing for NEE’s unregulated operations, although NEE is the ultimate guarantor of that debt.

This lack of transparency in the corporate organization of NEE regarding the manner in which it finances its riskiest operations is troubling for HECO ratepayers, in my view. That is because it is the operational and financial risk of those unregulated subsidiaries that could significantly impact NEE, the ultimate guarantor of its subsidiary’s debt and, eventually, HECO if a financial disruption within the unregulated business operations is large enough.

NEE’s lack of transparency regarding parent-level financial leverage also directly impacts HECO and Hawaiian Electric Holdings (“HEH”). HEH is an intermediate-level parent-holding company that is to be created for the HECO Companies and will, in turn, become a direct subsidiary of NEE. HEH will organizationally appear on parallel with NEECH and FP, currently NEE’s other electric utility operation. NEE indicated in response to interrogatories (CA-IR-85) that, although it could, HEH it would not issue its own debt. However, the Applicant’s financial projections show
common equity ratio of the acquired HECO asset. NEE's financial projections indicate that NEE intends to issue approximately $1 billion in debt capital over the next five years, which will be used to buy back common equity. With that additional debt leverage, the effective consolidated capital structure supporting NEE's investment in HECO would average approximately 42% common equity and 58% debt over the next five years. That means that NEE plans for Hawaii ratepayers to pay utility rates based on the much higher common equity ratios that are reflected within the capitalization of the HECO companies while using upstream debt at the NEE level to lower the actual financing costs of NEE's utility investment and leverage upward the return on equity that the parent companies receive. NEE elects not to discuss its intent with the additional debt leverage and, therefore, is not being transparent in its financial intentions related to the proposed transaction.

Another area in which NEE is being less than forthcoming regarding its corporate financial picture is NEE’s current pursuit of another, much larger, utility acquisition. According to a recent report in the financial media Bloomberg News, NEE is involved in the potential acquisition of Oncor, the electric distribution utility operations of Energy Future Holdings Corporation, which is a major Texas electric utility that is currently involved in bankruptcy

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3 Applicant’s response to CA-IR-128.

4 Applicant’s response to CA-IR-332.
proceedings.\(^5\) The acquisition price of Oncor is projected to be in the neighborhood of $18 billion—more than 4 times the amount offered for HECO. Any acquisition of Oncor, in addition to the acquisition of the HECO Companies, would certainly impact the financial profile of NEE. However, the fact that NEE was simultaneously pursuing another utility acquisition many times the size of HECO was not mentioned in NEE’s testimony in this proceeding could be alarmingly reflective of NEE’s unwillingness to share financial information with the Commission.

The Applicants have promised “safeguards” related to certain financial aspects of the transaction, for example, promising that the HECO Companies would not issue debt on behalf of NEE. The appearance of that safeguard is that the assets of the HECO Companies would not be used to secure debt utilized by NEE. However, NEE does not need HECO to issue debt or to use HECO assets to secure that debt. If the proposed transaction is completed, NEE will own the revenue and income stream created by HECO and that income stream will serve as security for the issuance of additional debt by NEE (or NEECH).

Therefore, because, 1) the financial benefits are less substantial than those enumerated by the Companies in their testimony, 2) the lack of

\(^5\) Energy Future Holdings Corporation was acquired in a leveraged buyout, which, because of too much debt at the parent company level and an unfavorable power market for its generation assets, was forced into bankruptcy in April, 2014. The distribution utility asset (Oncor) are expected to be either sold or reorganized as part of the pending bankruptcy proceedings.
transparency with regard to the financial engineering undertaken by NEE,
3) the complexity of the financial structure of NEE, 4) the planned use of

for the benefit of stockholders rather than ratepayers, and 5) the lack of strict financial insulation from NEE for HECO, I believe the
proposed transaction is not in the public interest from a financial point of view, and should be rejected for that reason.

If, however, the Commission decides, for other reasons, that this transaction, in its entirety, is beneficial for HECO’s Hawaii ratepayers and wishes to approve the transaction, then I believe additional financial conditions that would help protect the HECO companies from financial contagion and over-reach by NEE should be required. In order to ensure that the financial risks residing at the parent company level do not affect the operations of the HECO Companies it would be necessary to include additional “ring-fencing” requirements that would prevent parent company access to Hawaii utility subsidiary assets in the case of financial distress or bankruptcy by the parent. In addition, by safe-guarding HECO from NEE’s unregulated debt and other financial risks, additional ring-fencing measures would help to support and could improve HECO’s credit ratings. Those additional ring-fencing requirements, in my view, would be necessary to protect the financial viability of the HECO Companies in order for the proposed transaction to be approved by this Commission. Finally, in order to secure actual, certifiable rate benefits for ratepayers from the proposed transaction, the CA recommends a rate
reduction utilizing current equity capital costs and an industry-average capital structure. As noted in the testimony of CA witness Brosch, the CA rate plan would reduce the HECO Companies’ base rates and revenues approximately $250 Million over a four-year period.

II. CLAIMED FINANCIAL BENEFITS.

A. DEBT COST REDUCTION.

Q. THE HECO COMPANIES INDICATE THAT THE PROPOSED TRANSACTION WOULD IMPROVE THE CREDIT RATINGS OF THE HECO COMPANIES AND LOWER MARGINAL DEBT COSTS GOING FORWARD. WHAT ARE YOUR COMMENTS?

A. Much of the Applicants’ claim regarding financial benefits of the transaction is based on a predicted credit rating improvement and an assumed reduction in future debt costs due to that credit rating improvement. Whether or not the cost of issuing debt for the HECO Companies would actually improve if the proposed Transaction is approved is open to question. While one major rating agency, Standard & Poor’s, has indicated that completion of the proposed transaction would be likely to improve the corporate credit rating of the HECO Companies, the two other major credit rating agencies (Moody’s and Fitch) indicate that the corporate credit rating of the HECO Companies would remain unchanged following the completion of the proposed transaction.

As HECO witness Sekimura notes at page 24 of Applicants Exhibit-28,
only S&P expects a credit rating improvement for HECO if the proposed
transaction is completed; the other two credit rating agencies expect HECO
credit rating to remain the same:

Table I

<table>
<thead>
<tr>
<th>Credit Rating Agency Response to Merger Announcement</th>
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<tbody>
<tr>
<td>Fitch</td>
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<tr>
<td>HECO</td>
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In addition, there are other factors to consider when assessing whether
or not the credit rating improvement predicted by S&P would noticeably impact
HECO’s cost of issuing new debt. First, two of the three major credit rating
agencies already have HECO’s corporate credit rating at the upper end of the
triple-B rating level, and it is not clear that a change in one credit rating agency
rating would impact investor opinion sufficiently to cause a discernable
difference in the Company’s marginal debt cost rate.

Second, the factors considered to be important are different for the
credit rating agencies, and those factors can impact the letter-grade rating
while not necessarily affecting the resulting debt cost. Standard & Poor’s, for
example, adheres very strongly to a “family” credit rating approach. That is, all
companies within a holding company “family” effectively assume all the risks

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6 “BBB+” by Fitch and “Baa1” by Moody’s are equivalent ratings, both indicate the uppermost
tier of the triple-B investment grade credit rating.
pertinent to the holding company and will have a corporate credit rating no higher than the parent.\(^7\) That means that the pre-merger HECO credit rating by S&P is a “family” credit rating associated with HEI and its bank subsidiary and not for HECO as a stand-alone entity.

With regard to utility ratings, S&P’s “family” ratings methodology incorporates its belief that regulation is not likely to intervene to assist a utility in financial difficulty and the utility, therefore, is subject to the risks of the unregulated parent. Moody’s and Fitch, on the other hand, believe that regulation does offer support for utilities in financial stress and they tend to assign ratings more on a stand-alone basis, recognizing the lower-risk nature of utility regulation.

For example, prior to the merger announcement, Fitch assigned a “BBB” rating to HEI and a “BBB+” rating to HECO, seeing greater risk in the unregulated holding company. Those credit ratings indicate that Fitch considered the unregulated holding company, HEI, to be riskier than HECO. If those relative risk opinions were mirrored at S&P, the “BBB-” credit rating S&P assigned HECO as a “family” member of HEI would likely understate HECO’s stand-alone credit rating. For that reason, any impact of a credit rating change by S&P for a stand-alone HECO following the completion of the proposed merger would be less than implied by the projected “family” credit

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\(^7\) See, for example, Applicants Exhibit-32, p. 15, where S&P awards FPL (a firm with significantly lower financial risk) the same corporate credit rating as its parent company NEE.
rating change that would occur as a result of the completion of the proposed transaction.

Therefore, the difference between S&P and the other two credit rating agencies in the predicted merger-related credit rating changes for HECO is related, in part, to a difference in ratings style or philosophy rather than the actual risk differences of the subject utility before and after the proposed merger. The degree to which the credit rating change from the HEI “family” to the NEE “family” of companies identified by S&P is actually related to particular changes in the risk of HECO (and the resultant marginal cost of debt for HECO post-merger) is difficult to discern.

Again, while one of the three major credit rating agencies shows a higher credit rating for HECO following a merger with NEE, the other two do not, and it is not clear that that change in one credit rating would foster a reduction in the Company’s post-merger marginal cost of debt.

Q. YOU HAVE USED THE TERM “MARGINAL COST OF DEBT” IN YOUR EXPLANATION OF DEBT COST DIFFERENCE, WHY?

A. It is important to understand that when we use the term “cost of debt” in this context of considering any change in the debt cost that may or may not occur because of the completion of the proposed transaction, we are referring only to the cost rate of any new debt the HECO Companies will issue. That is the “marginal cost” I am referencing—the cost of any new debt HECO might issue
following the merger if the requested transaction is approved. The embedded cost rate of HECO's current debt will not change. A change in bond rating (if one occurs) will not change the cost rate of any of the debt the HECO Companies currently have outstanding.\(^8\) Thus, any improvement in credit ratings and corresponding lower debt cost rates can produce savings only gradually in future years, at the time new debt is issued by the HECO Companies.

Q. DO THE APPLICANTS RECOGNIZE THAT THE PROJECTED CREDIT RATING CHANGE CITED BY S&P IS UNLIKELY TO REPRESENT A REDUCTION IN HECO DEBT COSTS CONSISTENT WITH A MULTI-NOTCH CHANGE IN CREDIT RATING?

A. Yes. In response to PUC-IR-138, the Applicants indicate that the credit rating change posited by S&P is not representative of the likely potential change in the debt cost for the HECO Companies because the other two rating agencies rate HECO higher than S&P and expect no change in credit rating due to the proposed merger. The Applicants believe that a reduction of 25 basis points in HECO’s marginal debt cost following the completion of the proposed merger is more reasonable, and base their merger-related financial savings estimates on

\(^8\) As newer, and presumably lower-cost debt is added to the total amount of debt the HECO Companies have already issued, the total embedded cost of debt will decline, but the cost rate of existing debt will not change.
the assumption that, post-merger, the marginal cost of debt for HECO will
be 25 basis points less than it is now.

Q. WHAT IS THE SOURCE OF THE PROJECTED 25 BASIS POINT MARGINAL
DEBT COST REDUCTION?
A. The 25 basis point estimate for lower marginal debt costs for the
HECO Companies (post-merger) was obtained by Applicants from an
investment bank. In response to CA-IR-90 and CA-IR-297, the
HECO Companies provided the following details regarding the estimated debt
cost reduction.

The HECO Companies made the initial contact with the bank to
investigate how its financing needs could be structured following positive
ratings reports “in particular [the] Standard & Poor’s publication.” According to
the HECO Companies’ response to CA-IR-297(b), that same investment bank
has worked with the HECO Companies since 2004 as a lender, paying agent,
placement agent, and trustee related to HECO’s commercial paper program,
also with debt issuances, and credit card facilities.
NEE and its subsidiaries also have a relationship with the same
investment bank:

The bank is currently a lender under both the Florida Power
& Light Company ("FPL") and NextEra Energy Capital
Holdings ("NEECH") core credit facilities. In April 2014, the
bank entered into a one-year, variable rate term loan for
$200 million for NEECH. The bank also provides NEECH
with a $150 million Canadian credit facility that was renewed
in December 2013 for a three-year term. In the past, the
bank has acted as co-manager or joint lead on several first
mortgage bond issuances for FPL. While the bank is not a
direct lender or arranger of any of the Company’s
non-recourse project finance transactions, they do act as
Trustee on several of the transactions. The bank also
provides corporate credit card services to the Company.9

In addition, the investment bank, in making its assessment of the
proposed transaction, blind bond ratings.

Q. WHAT WAS THE RESULT OF THE ANALYSIS OF MERGER DEBT COST
IMPACTS THAT WAS PERFORMED BY THE APPLICANTS’ INVESTMENT
BANK?

A. 

9 Applicant’s response to CA-IR-297.
companies. It was not clear from the bank's review of recent transactions that the acquisition of lower-rated companies by higher-rated companies improved the bond rating of the lower-rated companies.

The bank also investigated the recent average yield differential between "BBB+" debt and "BBB-" debt (the debt cost differential identified by S&P's methodology) to arrive at an estimate of the potential debt cost savings for HECO. Therefore, the 25 basis point differential is not based on recent merger experience, but on an estimate based on average bond yield differences between rating categories predicted only.

Q. DOES THE FACT THAT THE DEBT COST REDUCTION ESTIMATE IS PROVIDED BY AN INVESTMENT BANK THAT IS A CLIENT OF BOTH HECO AND NEE AFFECT THE CREDIBILITY OF THE ESTIMATE OF THAT REDUCTION?

A. I believe it does, yes. While the investment bank contacted by the HECO Companies to structure a debt issue with and without the completion of the proposed merger provides a legitimate estimate of the value of a potential bond rating increase, there is reason to be cautious regarding reliance on that estimate for predicting long-term debt cost savings. First, that differential is simply an estimate based on and

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10 Applicant's response to CA-IR-297(d).
which are based on the predicted by only major rating agencies. Second, the is not provided by an independent agent; it is provided by an investment bank that has done and expects to continue to do business with both parties involved in the proposed transaction. As such, an that supports the idea that the proposed merger would for HECO would be viewed favorably by the bank’s clients and possibly lead to additional business in the future. Third, the 25 basis point estimate applies only to the debt issue currently proposed by the investment bank and is not guaranteed to be applicable to all future debt issues (as is the assumption in the Companies’ financial benefits analysis).

Q. WHAT ARE YOUR CONCLUSIONS REGARDING THE APPLICANTS’ PROJECTED FINANCIAL BENEFITS OF THE PROPOSED TRANSACTION RELATING TO REDUCED DEBT COSTS FOR HECO?

A. While it is possible that a credit rating improvement from one of the three major rating agencies could lower debt costs for HECO, it is far from a certainty. Also, while one investment bank client for HECO and NEE has offered to arrange a debt issuance for HECO with a merger-related 25 basis point reduction, it is not possible to know if that level of cost reduction

See response to CA-IR-297.
represents broad investor opinion or would be sustainable in the future. Therefore, the calculations offered by the Companies that take annual savings (based on a 25 basis point debt cost rate reduction) and multiply them out thirty years to show the magnitude of debt cost savings benefits, while within the wide realm of possibility, are also uncertain.

For example HECO witness Sekimura, on page 26 of Applicants Exhibit-28, indicates that a 25 basis point debt cost reduction would amount to a one-year reduction in debt costs of $200,000, which, over thirty years, would build to $6 million. While those promised savings are impressive, it is important to keep them in context. According to HEI’s 2014 S.E.C. Form 10-K (p.90), the HECO Companies’ revenues were $2.987 billion in 2014. If there were no rate increases over the next thirty years (most unlikely), ratepayers would provide $89.61 billion to HECO during that time period. The debt cost savings indentified by the Applicants, if they occur in full with certainty, would amount to 0.007% or less of revenues ratepayers will provide to HECO.

The projected debt cost reduction benefits of the proposed transaction, then, are uncertain and, in my view, if they occur they are likely to be less than that predicted by the Companies. The merger, however, is not uncertain. That is, once it occurs, HECO is no longer an independent entity and the Hawaii utility franchise is transferred to NEE for as long as NEE wishes to retain it. In return for that transfer of utility ownership, the financial benefits
that might be realized by Hawaii ratepayers due to debt cost reduction must be
classified as uncertain.

B. RATE REDUCTION BENEFITS.

Q. ANOTHER PROJECTED FINANCIAL BENEFIT OF THE PROPOSED
MERGER IS THE APPLICANTS’ PROMISE TO FOREGO RAM O&M RATE
INCREASES FOR THE NEXT FOUR YEARS, CORRECT?

A. Yes. As noted by the Applicant’s witness Reed at page 7 of Exhibit-33, a
four-year rate moratorium would suspend increases that would otherwise
occur pursuant to “the operations and maintenance expense rate adjustment
of the decoupling Rate Adjustment Mechanism (“O&M RAM”).” Mr. Reed’s
estimate of the direct financial benefit obtained by HECO ratepayers from an
O&M RAM rate moratorium over four years was originally $60 million.
In response to CA-IR-96, asking if Mr. Reed had re-evaluated his savings
estimate in response to the Commission’s imposition of an inflation-based cap
on RAM increases in Order 32735, which had occurred shortly before the
Company’s filing, he replied that he had not re-calculated the projected rate
savings for HECO customers and noted that the adjustments to base rates
would depend on future changes in the inflation index. In response to
CA-IR-350, however, Applicants have revised their plan, where they are now
offering to fix an adjustment so that there will be about $60 million of
reductions in the annual decoupling over four years. Although he provided no
dollar estimate of the savings associated with a rate case moratorium in his
Direct Testimony (Applicant’s Exhibit-33, p. 17), subsequent to the data
response noted above, Mr. Reed, in a July 9, 2015 supplemental response to
CA-IR-303, provided a re-evaluation of the potential savings from a four-year
rate moratorium. Mr. Reed's estimate of the potential rate savings from a
four-year rate case moratorium now exceeds $132 million in addition to
the $60 million originally claimed for the O&M RAM increases foregone.12

As discussed in some detail in the testimony of CA witness Brosch, the
rate case moratorium savings cited by Applicant’s witness Reed do not
provide reliable estimates of Transaction enabled savings for ratepayers.

Q. ARE THERE OTHER FACTORS THAT ADD TO THE UNCERTAINTY OF
THE RATE SAVINGS PROMISED TO RATEPAYERS BY THE
APPLICANTS?

A. Yes. Applicant’s Exhibit 15 contains the “Qualifications” to the promised base
rate moratorium and lists the factors that would void that commitment.
Generally, the Applicants state that the 4-year stay-out commitment would be
voided if HECO suffers financial distress or encounters other circumstances
“that create a compelling financial need for a base rate increase.”

The base rate moratorium is also subject to there being no changes in

12 Applicants’ Supplemental Response to CA-IR-303 dated 7/9/15 at p. 2. See also Direct
Testimony of CA witness Brosch for additional details.
the formulation of the decoupling mechanisms that existed at the time of the
merger agreement. As noted above, the Commission has changed the
manner in which RAM is calculated which, technically, is a change to the
pre-existing decoupling mechanisms and could mean that the rate moratorium
could be cancelled, although the Applicants indicate that such is not the case,
currently. Additional changes to the RAM or to the Energy Cost Adjustment
Clause (“ECAC”) remain under consideration in Docket No. 2013-0141, which
add uncertainty to Applicants asserted rate case moratorium. Moreover,
Applicants now condition the rate case moratorium on the Commission
granting the HECO Companies an above-RAM-cap recovery mechanism,
which the CA opposes.

The base rate moratorium is also contingent on the following regulatory
risk-reducing (automatic rate recovery) mechanisms staying in effect:

1. the RBA tariff provisions;
2. the Rate Base RAM – Return on Investment Adjustment tariff provisions;
3. the Depreciation & Amortization RAM Expense provision;
4. the Renewable Energy Infrastructure Program, including the Renewable Energy Infrastructure Program Surcharge;
5. the IRP/DSM Cost Recovery tariff provisions;
6. the ECAC tariff provisions;
7. the PPAC tariff provisions; and
8. the Pension and OPEB tracker mechanism.

The Applicants also require accelerated accrual accounting for RAM revenue increases; the ability to file revenue-neutral tariff changes; and having the ability to request rate changes related to legislation enacted during the moratorium period.

In summary, the broad range of “out clauses” attached to the Applicant’s offered four-year rate moratorium indicates that there are many factors that the Applicants could use to nullify that commitment, rescind the moratorium, and reduce or eliminate completely any savings to ratepayers.

More importantly, as explained by CA witness Brosch, an extended rate case moratorium is likely to be harmful to ratepayers by leaving in place existing based rates that have not been updated in years to capture the benefits of:

1) cost savings from recent debt refinancing, 2) currently lower equity cost rates for HECO and HELCO, and 3) the benefits of lower post-Transaction equity ratios.

As with the Applicants’ projected debt cost savings, the financial benefits to Hawaii ratepayers associated with the proposed base rate moratorium are far from certain and could actually represent detrimental ratepayer impacts.
Q. WHAT ARE YOUR CONCLUSIONS WITH REGARD TO THE RATE SAVINGS THAT ARE LIKELY TO BE REALIZED BY HECO RATEPAYERS AS THE RESULT OF THE PROPOSED MERGER?

A. A close review of the Applicant’s claims regarding reduced future financing costs and potentially lower charges to HECO customers indicates that there could be somewhat lower costs incurred by the HECO Companies that result from the approval of the proposed transaction, and those lower costs could modestly reduce the utilities’ revenue requirements over the next four years. Even if those currently committed debt cost savings are realized it is not clear that similar savings would be available to the HECO Companies from other debt investors in the future.

In addition, the amount of claimed rate case moratorium benefits from the forgone O&M RAM is undermined by the RAM Cap (ordered by the Commission in Docket No. 2013-0141). Also, the rate case moratorium proposed by the Applicants is subject to many conditions that could further undermine those savings or cause the moratorium to be unenforceable. Moreover, as explained by Mr. Brosch, it is appropriate to reduce rather than freeze the utilities’ existing base rates, if ratepayers are to participate in lower capital costs and be credited with a reasonable share of projected merger cost savings.
III. **FINANCIAL DRAWBACKS.**

A. **PARENT-LEVEL DEBT.**

Q. **DOES NEXTERA ENERGY EMPLOY PARENT-LEVEL DEBT?**

A. Yes. According to NEE’s 2014 S.E.C. Form 10-K, it is capitalized with approximately 40% common equity and 60% total debt. That same S.E.C. report also indicates that Florida Power and Light, NEE’s largest regulated subsidiary is capitalized with approximately 55% common equity and 45% debt—much more common equity than the parent company. The other primary subsidiary of NEE is NEECH. This entity is the parent company of NEER, the intermediate holding company for all of NEE’s unregulated operations.

NEE, the ultimate parent company does not issue any debt. Therefore, in order for the ultimate parent, NEE, to have a consolidated 40% common equity ratio while its largest subsidiary (FPL) has a much thicker 55% common equity ratio, the other primary subsidiary (NEECH) must be capitalized with substantial amounts of debt and relatively small amounts of common equity capital.\(^{13}\) Moody’s Investors Service, in a recent publication entitled “High Leverage at the Parent Often Hurts the Whole Family” indicates that approximately 40% of the total debt appearing on the consolidated balances

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\(^{13}\) Because the subsidiary capital structures necessarily sum to that of the consolidated parent company (NEE) capital structure (40% equity/60% debt) and one of the primary subsidiaries (FPL) has a capitalization of 55% equity and 45% debt, the other primary subsidiary (NEECH) capital structure, therefore, must be comprised of a relatively lower common equity and higher debt ratio than that of the parent in order to create the resulting consolidated capital structure.
sheet of NEE is holding company debt.\textsuperscript{14,15} Therefore, within the NEE hierarchy of holding companies, there is substantial debt at the parent company level.

It is important to note that some of the debt issued by NEECH is “non-recourse” debt, which means that, even though NEE is the ultimate guarantor of the debt incurred by its subsidiaries, some of that debt is secured by the individual project assets and is considered by the rating agencies as “non-recourse” to the parent, NEE. Therefore, in considering the debt obligations of the parent company, the rating agencies analyze the credit metrics of NEE’s debt obligations without that non-recourse debt.\textsuperscript{16}

Q. IS THE PROJECTED NEW INTERMEDIATED HOLDING COMPANY FOR HECO, HAWAIIAN ELECTRIC HOLDINGS, LLC (HEH), EXPECTED TO ISSUE ITS OWN DEBT?

A. No. The Applicants response to CA-IR-85 states that Hawaiian Electric Holdings (HECO’s post-merger parent), could issue debt without HPUC approval, but will not:

\textsuperscript{14} Moody’s Investors Service, Sector In-Depth, US Regulated Electric and Gas Utilities, High Leverage at the Parent Often Hurts the Whole Family, May 11, 2015.

\textsuperscript{15} Note: It is not possible to directly determine parent company debt loads from published S.E.C. filings because the primary source of debt for NEE’s unregulated operations (NEECH) does not file reports with the S.E.C. This lack of transparency makes it difficult to assess the financial risk of the parent’s unregulated operations, an issue that will be discussed in more detail subsequently.

\textsuperscript{16} Applicant’s response to CA-IR-35.
Although Hawaiian Electric Holdings will not be a public utility regulated by the Commission, and therefore would not need Commission approval to issue debt (unless such debt was guaranteed by, or secured by the assets of, the Hawaiian Electric Companies), Hawaiian Electric Holdings will not be issuing debt.

However, a review of the Applicant’s financial model shows that the acquisition is modeled with Confidential Information Deleted Pursuant To Protective Order No. 32726.

Confidential Attachment 1 to the Company’s response to CA-IR-128 is the Applicant’s financial forecasting model used to evaluate and quantify the financial results expected to be achieved upon completion of the requested transaction.

However, when asked directly about the financial modeling of Confidential Information Deleted Pursuant To Protective Order No. 32726, the Applicants responded that the Confidential Information Deleted Pursuant To Protective Order No. 32726 cited above was not the pertinent portion of the financial forecast. Rather, the final financial projection, the one that the Applicants indicate is representative of the manner in which operations will be financed in the future, was contained in a

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17 Applicant’s response to CA-IR-333 and CA-IR-334.
different portion of the spreadsheet and showed. However, it should be noted that in
the spreadsheet in the financial projections there exists a "Base Case," which shows
which shows which does not.

Q. IF ADDITIONAL DEBT IS NOT ISSUED AT THE NEW HOLDING COMPANY,
HAVE APPLICANTS ASSUMED THAT TRANSACTION-RELATED DEBT
WILL BE ISSUED AT A CORPORATE LEVEL ABOVE HEH, IF THE
PROPOSED TRANSACTION IS APPROVED?
A. Yes. The data shown in the transaction financial model provided in response
to CA-IR128 indicates allow NEE to earn a return on its equity investment in HECO that is higher
than the equity return allowed in rates by the HPUC. While the portion of the
Applicants’ financial model cited by the Applicants as representative of future
financial projections shows HEH issuing no debt, it also shows
which does not. most probably NEECH.
The Applicant’s financial projections for the transaction show a total
According to the financial projections in CA-IR-128, that
Therefore, if debt is not issued at the immediate holding company (HEH), the Applicants plan for additional debt to be issued at a higher corporate level (which would not be visible to the HPUC, except for the information provided in the current financial projections) and used to buy-down NE E's common equity balances. That action will effectively add debt to the financing mix used to buy HECO, and reduce the amount of common equity invested. Increasing the debt and lowering the amount of equity invested will result in increasing the resulting equity return earned by NEE in its investment in HECO.

Q. IS ADDITIONAL LEVERAGING BY NEE OF ITS HECO INVESTMENT UNEXPECTED IN THE FINANCIAL COMMUNITY?

A. No. According to the Applicant’s response to DOD-IR-3, Attachment 4, which provides certain equity analysts’ review of the pending transaction, an Evercore ISI (International Strategy & Investment Group) analyst recognizes that in order to achieve the financial results expected by NEE, additional leverage will be necessary.

We estimate the NEE is paying a little more that [sic] 23x ’15 EPS (including tax liability absorption). NEE expects the deal to be neutral to EPS in the first full year post-close and accretive thereafter. We have done a preliminary pro-forma using our current NEE and HE financial models and conclude that this is feasible assuming NEE uses leverage
to repurchase 30-40% of the shares they issue [sic] to HE holders. [DOD-IR-3, Attachment 4, p. 24]

Q. WITHOUT ANY ADDITIONAL DEBT ISSUANCE OR EQUITY BUY-BACK, WHAT IS THE PROJECTED CAPITAL STRUCTURE OF HECO, ACCORDING TO THE APPLICANT’S FINANCIAL PROJECTION?

A. HECO, with no parent debt, is projected in the Applicants’ financial model to have a capital structure consisting of approximately and through 2020.

Q. WHAT WOULD BE HECO’S EFFECTIVE AVERAGE CAPITAL STRUCTURE THROUGH 2020?

A. CA Exhibit-9 shows the projected capital structure for HECO, absent any through 2020. As noted, the average common equity ratio is approximately of total capital. CA Exhibit-9 also shows that if only the is allocated to HECO, the average common equity ratio through 2020 declines to approximately—a much lower common equity ratio. Finally, CA Exhibit-9 shows when that if, the average common equity ratio for HECO through 2020 would be approximately.
Clearly, issuing transaction-related debt and using that debt to repurchase common equity would have the effect of significantly leveraging NEE’s investment in HECO (i.e., to what is purported to be an all-equity transaction).

That leverage at the parent company means that the manner in which NEE’s HECO investment is effectively capitalized, contains more debt than that shown on HECO’s balance sheet. Because debt is much less costly a form of capital than is equity, means that NEE would be able to less expensively capitalize its investment in HECO than would be the case without the leverage, i.e., if HECO were actually capitalized with common equity. Moreover, NEE intends to garner those capital cost savings for investors, not ratepayers.

Q. YOU DESCRIBE THE CAPITAL STRUCTURES YOU SHOW IN CA EXHIBIT-9 AS “EFFECTIVE” CAPITAL STRUCTURES. IF THE PROPOSED TRANSACTION IS APPROVED WILL THOSE “EFFECTIVE” CAPITAL STRUCTURES SHOW UP ON ANY BALANCE SHEET WITHIN THE NEE ORGANIZATION OF COMPANIES?

A. No. The capital structures I show on CA Exhibit-9 are designed to show the impact of on the capital

Confidential Information Deleted Pursuant To Protective Order No. 32726.
structure of the HECO companies, as if the additional debt and reduced equity were recorded on the HEH/HECO balance sheet accounts. However, the debt that will be issued to buy down common equity will reside at a parent company above HEH (probably NEECH) and the equity reductions will involve NEE common stock. Those transactions will not be recorded on either the HEH or HECO books. Therefore, absent the availability of the Applicant’s financial modeling in this proceeding, which describes the financial engineering, this Commission would not be aware of any such financial engineering. The inability of the HPUC to be able to assess the manner in which HEH/HECO is effectively capitalized is, in my view, an issue of concern in this transaction, which is discussed more fully in the following section of my testimony.

Q. YOU HAVE DISCUSSED UTILITY CAPITAL STRUCTURES THAT RANGE FROM OF TOTAL CAPITAL. WHAT IS NORMAL FOR UTILITY OPERATIONS?

A. Historically, electric utilities have been able to maintain investment-grade credit ratings with capital structures that contain as much as 55% to 60% debt capital (only 40% to 45% equity). The current average capital structure for the electric utility industry according to the June edition of A.U.S. Utility Reports is 47% common equity and 53% fixed-income capital (debt and preferred stock). According to that same source, that 47% equity capital structure
currently supports an average corporate credit rating of approximately “A-/BBB+” (i.e., well above the lowest end of the investment-grade bond rating spectrum, “BBB-”, or “Baa3”).

Q. PLEASE EXPLAIN WHY DEBT AT THE PARENT COMPANY LEVEL CAN BE PROBLEMATIC FOR A REGULATED UTILITY OPERATION.

A. The revenue stream provided by ratepayers of a regulated utility will support a limited amount of debt capital if the utility is to maintain an investment-grade bond rating. Because the payments to debt holders are contractual as set out in the bond indenture and must be met before other obligations (e.g., common stock dividends) are paid, the revenue stream of a public utility must be sufficient to consistently meet those fixed debt payments, or the utility will not be solvent. Moreover, credit rating agencies require that the funds available to meet a utility’s interest costs be greater than those costs in order to qualify as an investment-grade credit. Therefore, those interest requirements determine a finite amount of debt that the utility revenue stream will support while maintaining an investment-grade bond rating. If the amount of debt encumbering the revenue or income stream of the utility exceeds that amount necessary to support an investment-grade bond rating, it will increase financial risk for the utility and raise the probability of default and the probability of sub-investment grade credit ratings, which would cause debt costs to rise substantially and increase capital costs to customers. That concern regarding
below investment grade bond ratings and necessary credit support is
well-recognized by utility regulators, as noted by Moody’s.\textsuperscript{18}

As long as all of the debt financing that can be supported by the
ratepayer-supplied revenue stream is issued \textit{at the utility level}, the overall cost
of capital for the utility is minimized, and ratepayers enjoy the direct benefit of
the lower-cost capital (debt). However, if some portion of the supportable debt
financing is actually issued at the parent company level, the benefits of the low
cost of that parent-level debt are not shared with ratepayers when rates are
set, and the overall cost of capital of the utility increases (as debt is shifted to
the parent). Instead, the parent company debt works to raise the returns
actually earned by stockholders to a level higher than the return allowed by the
utility regulators, but does not lower costs to ratepayers.

In summary, debt issued at the utility subsidiary level directly benefits
ratepayers by lowering the overall cost of capital of the utility. However, if
some of that debt capacity created by the utility revenue stream is instead
utilized at the parent company level, ratepayers do not realize the benefit of
that lower cost capital and that parent company debt will act to raise the equity
return realized by the parent’s common stock investors above the ROE
allowed by utility regulators.

\textsuperscript{18} Moody’s Investors Service, Rating Action: Moody’s places ratings of most US regulated
utilities on review for upgrade, Global Credit Research, November 6, 2013.
Q. CAN YOU PROVIDE A NUMERICAL EXAMPLE TO SHOW HOW ISSUING DEBT AT THE PARENT COMPANY LEVEL RAISES CAPITAL COSTS FOR RATEPAYERS AND ALLOWS PARENT COMPANY EQUITY INVESTORS TO EARN RETURNS HIGHER THAN THOSE ALLOWED BY REGULATORS?

A. Yes. CA Exhibit-10 shows the calculation of the overall cost of capital and the earned return for a holding company with one subsidiary, under two different scenarios. Page 1 of CA Exhibit-10 shows the calculation of the overall cost of capital and the earned return for a holding company with no debt capital. Page 2 of CA Exhibit-10 shows the same calculations except that some of the debt capacity created by the utility ratepayers has been shifted to the parent company. That is, the total amount of debt used in the consolidated company (holding company and subsidiary) is the same as in the first scenario, however, in the second scenario, some of that debt is issued by the parent and resides on the parent’s balance sheet, not that of the subsidiary.

In both scenarios, the cost of equity/allowed ROE for the utility is 10%, the cost of debt is 5% and the assumed income tax rate is 35%. The consolidated capital structures (i.e., the combined capital structure of the parent and the utility subsidiary) are the same dollar amount in both instances, and the regulator sets utility rates for the subsidiary considering only the subsidiary capital structure. The example shows that the use of debt leverage at the parent company: 1) causes the cost of capital for utility ratepayers to
increase, 2) causes ratepayers to provide more income taxes in rates than the
parent company actually pays, and 3) causes the equity return actually earned
by the parent to be substantially higher than the return allowed the utility
subsidiary, i.e., the parent’s stockholders earn a return that exceeds the cost
of capital for a utility operation.

Q. CAN YOU EXPLAIN YOUR CA EXHIBIT-10 EXAMPLE IN MORE DETAIL?
A. Yes. Page 1 of CA Exhibit-10 shows our holding company with an all-equity
capital structure of $40. All of that $40 of parent company equity capital is
invested in the equity of the utility subsidiary, which has also issued $60 of
debt. The stand-alone utility subsidiary capital structure, then, consists of 40%
equity and 60% debt, and that capital supports a rate base of $100.\(^{19}\)
The arrow on page 1 of CA Exhibit-10 underscores the fact that all of the
parent company capital is invested in the equity of the utility subsidiary.
Combining the parent and subsidiary capital structures, the consolidated
capital structure for the holding company is also 40% equity and 60% debt,
because there is no parent debt in this first scenario.

With a 10% ROE, a 5% cost of debt and a 35% tax rate, the pre-tax
overall cost of capital in scenario 1 is 9.15%, which means that for a $100 rate
base, customers would have to provide $9.15 in rates to cover the utility’s cost

\(^{19}\) We assume here, as previously noted, that 60% is the maximum amount of debt that can be
supported by the utility’s revenue stream while maintaining an investment-grade credit rating.
of capital. [$100 Rate Base x 9.15% pre-tax overall return = $9.15] Page 1 of CA Exhibit-10 also shows that subtracting debt costs and taxes from that pre-tax overall return, the after-tax return available for the Holding Company is $4.00. That after-tax return divided by the $40 equity investment by the Holding Company means that the holding company’s earned return is 10.00%—the same as the return allowed the utility. In scenario 1, then, the realized ROE of the Holding Company is equivalent to that earned by the Utility and both are equivalent to the allowed return, which is based on the cost of equity capital—10.00%.

Q. HOW DO THE RESULTS OF YOUR EXAMPLE CHANGE WHEN SOME OF THE AVAILABLE DEBT CAPACITY IS REMOVED FROM THE UTILITY AND SHIFTED TO THE PARENT/HOLDING COMPANY LEVEL?

A. Page 2 of CA Exhibit-10 again shows a holding company and a subsidiary utility. However, only $45 of the debt resides at the utility level (instead of $60), and, $15 of debt has been issued by the parent or Holding Company. That is, in this scenario, some ($15) of the total debt capacity ($60) has been shifted to the parent. The parent has issued $40 of equity capital along with the $15 of debt and has total capital of $55 available to invest in the utility subsidiary. All of that capital is invested as equity in the utility subsidiary, again shown by the arrow on page 2 of CA Exhibit-10. That is, all of the Parent’s capital (debt and equity) invested in the Utility appears as equity
capital on the Utility’s books. Therefore, with $55 of equity and $45 of debt to support the $100 Utility rate base, the movement of debt capacity to the parent has caused the utility capital structure to shift to one that is much more equity-rich (55% equity and 45% debt) than was previously employed (40% equity and 60% debt).

These companies in the second scenario have identical operating risk to those in the first scenario, the consolidated capital structures are the same and, therefore, the capital costs are the same. However, the overall cost of capital used for ratemaking purposes in this second scenario is 10.71%. With a $100 rate base, ratepayers would be required to provide $10.71 of capital costs in rates in this situation, when, in the first (no parent debt) scenario, ratepayer’s capital costs were lower, at $9.15. Capital costs have increased for ratepayers, due to the higher common equity ratio and lower debt ratio at the subsidiary.

Also, included in the $10.71 pre-tax return that must be provided by ratepayers in this second (with-parent-debt) scenario, income taxes comprise $2.96. [$10.71 less $2.25 debt cost = $8.46 x 35% tax rate = $2.96]

However, after the additional parent-company debt costs are removed, the income taxes actually paid by the parent (the ultimate taxpayer) would be $2.70—less than the income taxes included in rates charged to ratepayers, as shown on page 2 of CA Exhibit-10. Due to the shifting of debt capacity to the parent company, the parent (the actual tax payer) has more tax-deductible
debt expense than does the utility subsidiary and, therefore, pays less in taxes that the taxes provided by ratepayers, which are calculated based on the utility’s lower debt load and lower amount of tax-deductible debt costs. Shifting debt capacity to the parent, therefore, also causes ratepayers to contribute higher income taxes in rates—taxes that the parent, ultimately, will not pay.  

Finally, as shown on page 2 of CA Exhibit-10, the after-tax return that flows to the parent holding company after all interest costs and taxes have been paid is $5.01. That return, when divided by the parent’s $40 equity investment produces a return on equity for the parent company of 12.53%—far above the 10% ROE allowed the utility, which is based on the cost of equity capital for similar-risk utility operations.

Q. ARE THE RESULTS SHOWN IN YOUR CA EXHIBIT-10 PERTINENT TO THE PROPOSED TRANSACTION?

A. Yes. In CA Exhibit-10, where parent company debt is only 25% of total debt ($15/$60 = 25%), shifting that amount of debt capacity from the utility balance sheet to the parent company balance sheet causes the ROE earned at the parent level to be much higher than the utility’s actual cost of capital.

As noted previously, Moody’s estimates that NEE’s parent-company debt

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20 In order to address this issue, some regulatory jurisdictions (West Virginia, for example) have a “consolidated tax savings” adjustment, whereby the regulated ratepayer is charged an allocated portion of the taxes actually paid by the parent company, not the statutory amount that appears to be owed by the regulated subsidiary.
comprises about 40% of total debt—a much larger proportion than that shown in the example in CA Exhibit-10, and much more leverage impacting utility returns.

CA Exhibit-10 also shows that when the consolidated capital structure contains less equity than that of the regulated utility the overall cost of capital to the utility ratepayer increases compared to the no-parent-debt scenario. The consolidated capital structure in the second (with-debt) scenario was 40% equity while the utility capital structure contains 55% equity. Those capital structure ratios are similar to the manner in which NEE and FPL are now capitalized and are

Finally, in the case where the parent company issues debt, because the cost of that additional parent-level debt must be removed from operating income before the parent’s taxes are calculated, the utility ratepayers will pay more income taxes in rates than the parent company will actually pay. The results shown in CA Exhibit-10 indicate that the use of additional debt leverage at the parent company level is designed to be beneficial to the parent company and its equity investors and is not undertaken to benefit ratepayers, who are denied the benefits of lower utility rates that would otherwise result from the use of more lower-cost debt capital at the utility subsidiary level.
Q. IS NEXTERA ENERGY STRUCTURED LIKE THE HOLDING COMPANY AND UTILITY COMPANY IN YOUR EXAMPLE?

A. NextEra’s corporate structure is very complex—an issue discussed in the next section of my testimony—far more complex than the simple example I present to show the impact of parent leverage on utility ratepayers. Nevertheless, the principles described are the same, and the concern regarding NEE’s use of debt at the parent level and remains.

Although the details of NEE’s corporate structure are complex, in the most general terms, the company is comprised of a utility (FPL) and a large grouping of unregulated companies which operate under NextEra Energy Capital Holdings (NEECH). As noted above, FPL is capitalized with about 55% common equity while the consolidated capital structure of NEE shows about 40% common equity. Algebraically, then, NEECH, the only other major subsidiary of NEE, must be capitalized with significant amounts of debt and lower amounts of equity capital.

The Company’s response to CA-IR-60 confirms that the “deemed” capital structure of NEECH (the holding company for all of NEE’s unregulated operations and some of its regulated transmission operations) is 70% debt and 30% equity. That is the capital structure used to calculate interest.

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21 NEECH’s capital structure is “deemed” because that capital structure is not published in S.E.C. documents or any reports issued by NEE. NEECH’s capital structure, then, can only be estimated.
expense allocated to NEECH and it is the capital structure for unregulated operations that “NextEra Energy has determined as being the current appropriate capital structure for NextEra Energy’s non-regulated businesses.”

Q, WHAT IS THE RESULT OF NEE’S ACTUAL CAPITAL STRUCTURE ON UTILITY RATEPAYERS IN FLORIDA, AND IN HAWAII IF THE PROPOSED TRANSACTION IS APPROVED?

A. NEE is capitalizing its lower-risk regulated utility operations (FPL) with higher-than-average common equity ratios (relatively expensive capital structures) while capitalizing its riskier, unregulated operations with much lower amounts of common equity and higher amounts of low-cost debt capital (relatively inexpensive capital structures). In this way, NEE is raising capital cost for regulated ratepayers while holding down capital costs for its unregulated operations by using much more debt to fund those operations.

All of this unregulated company financing is constructed so that the equity ratio of NEE’s consolidated capital structure remains at about 40%, which, along with some amount of project-related debt financing, is sufficient

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22 Applicant’s response to CA-IR-60.

23 “Project-related debt” is long-term financing that is secured by the cash flow generated by the project rather than the general revenues of the holding company, and, is “non-recourse” to NEE. That is, if the project goes bankrupt, NEE will not be responsible for those debt obligations. For that reason, may or may not be included in the credit rating consideration of the holding company.
to maintain an investment-grade credit rating. However because FPL is
capitalized with substantial amounts of expensive common equity, NEE's
financial engineering requires regulated ratepayers to shoulder some of the
operating risks of its unregulated operations through capital costs that are
higher than they need to be.

The [REDACTED] is proposed for the
HECO Companies if the proposed Transaction is approved and implemented.
Ratepayers in Hawaii would pay higher rates based on an [REDACTED] capital
structure, while the financial benefits of debt leverage would accrue for the
sole benefit of NEE shareholders.

Q. DOES USING HIGH EQUITY RATIOS TO CAPITALIZE LOW-RISK
OPERATIONS AND LOW EQUITY RATIOS TO CAPITALIZE HIGH-RISK
OPERATIONS MINIMIZE CAPITAL COSTS?
A. No. Because common equity, on a pre-tax basis, is more than three times as
costly as debt capital, traditional finance theory calls for capitalizing lower-risk
operations with more debt and less equity in order to minimize financing costs.
Lower-risk operations are lower-risk because they have more reliable income
streams. A more reliable income stream allows the use of more low-cost debt
capital than would be the case if the income stream were more uncertain
(more volatile). The use of more low-cost debt capital (and less equity) works
to minimize the capital cost of lower-risk operations like regulated utilities.
When the risk of the enterprise or project is high (the income stream is volatile) a cost-minimization strategy would call for the use of less debt and more equity, not the other way around. That is because, even though the use of more common equity in the financial mix raises the current overall cost of capital, it reduces the probability of default and, overall, is more cost-effective in the long run as opposed to the use of debt to finance an unstable income stream and the increased probability of default. Unregulated industrial companies, for example, have average common equity ratios that are substantially greater than those employed in the utility industry.²⁴

This cost-minimization strategy is fundamental financial capital structure theory. The fundamental goal of a financial manager is to minimize the cost of capital. In order to do that, low-risk operations should be capitalized with more debt and less equity than higher-risk operations, which should be capitalized with lower debt and higher amounts of common equity.

NEE’s financial managers are also pursuing lower costs, but only for their unregulated operations. They are shifting higher equity capital costs to regulated ratepayers by setting utility rates with a much higher-than-average common equity ratio, which, in turn, supplies the financial strength to support the additional parent company leverage for the unregulated operations. That is, the additional capital cost and taxes provided by ratepayers supports

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²⁴ The Value Line Industrial Composite (an index of 900 industrial, retail and transportation companies) had an average common equity ratio of 60%-65% in 2005-2009 period (Value Line Selection & Opinion, March, 2011).
the parent’s ability to maintain an investment-grade bond rating while capitalizing its unregulated operations with substantial amounts of debt.

Q. WHAT REASON DOES NEE PROVIDE FOR FINANCING ITS UNREGULATED OPERATIONS WITH LESS EQUITY THAN IT FINANCES ITS UTILITY OPERATIONS?

A. In response to CA-IR-87, NEE indicates that it capitalizes its unregulated operations with 30% common equity “to limit the amount of ongoing equity exposure in businesses that are generally viewed as having a higher business risk.” Here, NEE indicates that it is capitalizing its riskier unregulated operations with smaller amounts of common equity to protect its equity investors from potential loss (the chance of which is increased due to the higher level of debt funding) by minimizing the amount equity capital investment in those riskier operations.

This strategy could be reasonable on a stand-alone basis (i.e., if NEECH were a stand-alone company), provided the unregulated operations could actually sustain a 70% debt load. It is problematic, however, when used in tandem with an over-capitalized utility operation (a utility operation with a higher-than-average common equity ratio) because it represents financial cross-subsidization of NEE’s unregulated operations by the utility ratepayers.
That is, the regulated ratepayers of FPL (and potentially HECO) are asked to pay capital costs in rates that are higher than they need to be and, in so doing, are providing financial support for the unregulated side of NEE’s operations by keeping the parent company consolidated capitalization at an investment-grade level. Through this arrangement NEE is shifting capital costs from its under-capitalized unregulated operations onto its regulated ratepayers. If HECO joins the NEE “family” of companies, which will amount to the financial cross-subsidization of NEE’s unregulated operations by HECO ratepayers.

In summary, the use of debt at the parent company level by NEE and is problematic for several reasons. The use of a portion of the debt capacity created by the revenue stream of a regulated utility by the parent company leads to higher capital costs for the lower-risk regulated entity, lower capital costs for the higher-risk unregulated firms, the inclusion of income tax expense in rates that the parent does not pay, the opportunity for the parent to earn returns that exceed the cost of capital for utility operations, and financial cross-subsidization of the parent’s unregulated operations by the utility’s regulated ratepayers.
B. COMPLEXITY/TRANSPARENCY.

Q. WHY ARE COMPLEXITY AND TRANSPARENCY IMPORTANT CONCERNS IN CONSIDERING THE FINANCIAL ASPECTS OF THE PROPOSED MERGER?

A. In order to be able to properly regulate the activities of a utility operation, i.e., to assess the accuracy of the costs of the many types of operations that comprise the provision of utility service, to evaluate the return necessary to attract capital in order to build the plant necessary to serve the public needs, and to evaluate the efficiency of utility management in providing economically efficient service, a regulatory body requires access to detailed information about the utility’s operations. The purpose of that thorough review, of course, is to account for the interests of investors, who supply the capital necessary to build utility plant, and the interests of the ratepayers, who provide the rates to cover all the utility’s prudently incurred costs. Both parties (investors and ratepayers) ultimately have the congruent interest of fostering a utility that provides cost-effective service over the long term. The regulatory body, through its oversight and rate-setting ability, effectuates that end and must have access to the appropriate data in order to do so.

As the complexity of the operation increases, it becomes more difficult for a regulatory body, with limited resources, to provide the type of overview necessary to thoroughly evaluate the economic efficiency (cost-effectiveness) of the rates the utility is charging its customers. That is especially true when
some portion of the utility’s operations are determined through a holding company—a corporate entity that owns the utility operation but is not subject to rate review by the regulator. Although important decisions regarding the operation of the utility are determined at the holding company level, outside the utility corporation proper, the regulators’ oversight responsibility does not change nor does the information necessary to adequately regulate the utility. The ability to access that necessary information, however, can change with increased corporate complexity.

The HECO Companies—HECO, MECO and HELCO—are a relatively complex operation that generates and delivers electricity to Hawaii’s ratepayers. Those companies are all regulated by the HPUC and, for many years, operated without a holding company. When a holding company for HECO was formed in order to diversify operations, this Commission required continued access to data necessary to assess the operations of HECO, and some of those data were related to the non-utility operations owned by HEI. Those requirements were codified in what is known now as the 1982 Agreement, which is an example of a regulatory body attempting to ensure that it maintains access to data and information that could impact the operating and/or financial health of the regulated utility that is its prime focus.

As the corporate operation becomes more complex, through the addition of one or more parent company levels, the transparency of the financial and accounting processes that ultimately affects utility rates dwindles.
That is, it becomes more difficult to “see” all the variables that might impact the utility’s financial or operational well-being.

When HECO was a stand-alone utility, it was no simple organization, but tracking its accounting and financial operations was a relatively transparent process. Adding a holding company (HEI), with more corporate layers and unregulated operations that could impact the financial well-being of HECO increased organizational and informational complexity and, to some degree, reduced the transparency that existed when the Company was a stand-alone utility and, as noted, gave rise to the 1982 Agreement to assist in assuring HPUC control over its regulated utility responsibilities.

Q. WOULD THE CORPORATE COMPLEXITY ASSOCIATED WITH HECO INCREASE IF THE PROPOSED TRANSACTION IS APPROVED?

A. Yes. NextEra is a dramatically more complex corporate entity than is HEI. Moreover, the manner in which NEE’s corporate hierarchy is constructed reduces transparency, especially where the financing of its riskier, unregulated operations is concerned. Therefore, following approval of the pending transaction, it would be much more difficult for this Commission to assess, in the same manner that it now does, the operating and financial influences on HECO and its rates.
As noted in the discussion of parent company leverage, above, the true nature of the degree to which NEE elects to substitute debt capital for equity capital in its HEH/HECO investment is not knowable by the HPUC. Therefore, the effective capital mix used to finance the utility operations in Hawaii will not be known and the actual cost of capital cannot be identified if the proposed transaction is approved. That is because some of the will occur at another corporate entity (NEECH), which does not publish financial information. Applicant’s Exhibit 17 is a “Post-Merger Organizational Chart” that shows HECO, its subsidiaries (MECO and HELCO) and HECO’s projected parent HEH as part of the NEE organization. The Applicant’s depiction of the new corporate structure is very generalized, showing just four corporate entities other than HECO as subsidiaries to NEE. The diagram also makes HECO appear to be of equivalent size to NEE’s operations. This is not an accurate representation of the nature of the complexity of the NEE organization.

In response to CA-IR-61, NEE supplied a complete listing of the corporations that comprise NEE, showing all of the subsidiaries included within all of its corporate sub-groups. The data was not presented in a box chart like in Applicant’s Exhibit 17, as there were too many corporations for such a chart to be feasible. The data, which were deemed “Confidential & Restricted”
by NEE, were provided in paragraph form, with NEE listed first and justified farthest to the left. The data response contains 23 to 25 corporations on each page and the response is 41 pages long. According to CA-IR-61, Attachment 1, NEE is comprised of approximately corporations, and about of them are held within NextEra Energy Resources, which holds all of NEE’s unregulated operations.

Q. ISN’T IT REASONABLE TO BELIEVE THAT SOME OF THOSE MANY CORPORATIONS ARE SMALL, OR FINANCED WITH NON-RECOourse DEBT, AND UNLIKELY TO HAVE ANY FINANCIAL IMPACT ON NEE OR HECO?

A. Yes, some are likely to be land-holding companies or single-purpose entities (e.g., windmills) or smaller independent power projects or other relatively small operations, but which ones—and how they (and the subsidiaries that are not small) are interconnected financially is not knowable because that information is not made public. It is reasonable to believe that the extreme complexity of that corporate structure surrounding NEE’s unregulated operations on the mainland reduces the transparency of the operational and its financial impact

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CA-IR-61: “This information is confidential as disclosure of the names and ownership structure of certain entities could harm the company’s ability to develop or acquire assets, such as assembling land parcels for renewable energy or transmission projects. Moreover, the information is “Restricted” from disclosure to some of the intervenors due to their dual interests in the renewable energy market…”
on NEE, and ultimately on HECO in Hawaii. Also, two other factors exacerbate the complexity/transparency problems with NEE.

Q. WHAT ARE THOSE FACTORS?

A. First, NEE wants to restrict this Commission’s review of NEE operations unless there is a direct link between a particular subsidiary of NEE and HECO. If, for example, FPL engineers provide consulting services to HECO regarding operational issues, NEE will allow the Commission access to FPL's records to assess the accuracy of the affiliate charge. However, if a NEE nuclear unit were to experience a Fukushima-type melt-down event, and Price-Anderson protections did not cover all the damages, the Commission would be prohibited from investigating any potential financial impact on HECO as a result because that nuclear unit had no operational relationship with HECO.

As HECO witness Sekimura noted, I believe correctly, in response to CA-IR-91, “there may be situations in which upstream NextEra subsidiary activities could impact their credit ratings which in turn could affect the credit ratings of Hawaiian Electric.” For that reason, the increased complexity of the NEE organization is problematic for HECO.

Second, quite aside from the complex nature of NEE’s unregulated operations, the ultimate parent (NEE) has structured its financial reporting to reduce transparency with regard to the manner in which those unregulated operations are financed. The capital structure, balance sheet, income
statement and cash flow statement of NEECH, the financing arm of its subsidiary, NextEra Energy Resources (NEER), the corporation that has subsidiaries and owns all of NEE’s unregulated operations are not reported to the public.

As Moody’s noted in its December 2014 credit rating report on NEECH,

While it is reasonable to believe that, at some internal operational level, NEECH and NEER have financial statements—otherwise, how could NEE’s financial managers assess the collective risks and returns of the enterprises held in those two corporate entities and cost-effectively “manage” those operations? Also, NEECH is “the beneficiary of a full and unconditional guarantee of NextEra Energy.” (CA-IR-57) However, NEE elects not to disclose the financial statements of its unregulated operations to the S.E.C. or to the investing public. In my view, that lack of transparency regarding the manner in which NEE capitalizes its riskiest operations should be a concern for this Commission when considering the proposed merger of HECO with NEE. If NEE does not disclose the financial statements of its unregulated
operations, how can this Commission expect to assess the impact on HECO of any financial risks realized at NEECH?

Q. ARE THERE OTHER ASPECTS OF THE PROPOSED TRANSACTION THAT, IN YOUR VIEW, INDICATE A LACK OF TRANSPARENCY ON BEHALF OF THE APPLICANTS?

A. Yes, two. First, while this is a small point in the sweep of this proceeding, I believe the Applicant’s election to label credit rating reports related to NEE and its subsidiaries as “Confidential” demonstrates a lack of transparency. Credit rating reports are published documents available to the general public for a subscription from an investor service. Moody’s, for bond investors, is like Value Line for equity investors—both are widely published and considered to be representative of public opinion in the investment community. Neither should be kept from the public in a regulatory proceeding through a claim of confidentiality.

Second, there is a more important issue that also demonstrates a lack of transparency by NEE. At the same time that NEE has been pursuing a merger with HECO, it has also been considering acquiring a much larger regulated company, Oncor Energy (Oncor). Oncor is the regulated electric distribution utility subsidiary of Energy Future Holdings, an electric holding company that is facing bankruptcy due to a leveraged-buyout acquisition financed with too much parent-level debt. In response to interrogatory
DOD-IR-4, inquiring about the status of NEE’s $18 billion bid for Oncor,

NEE stated:

NextEra Energy, Inc. has submitted a bid for Oncor. Reportedly, other entities have done so as well. Under the process approved by the Bankruptcy Judge, Energy Future Holdings is expected to select a “stalking horse” bidder from among competing alternatives and submit that to the court for approval, after which there will be a competitive auction to determine whether another bidder has a better offer.

There has been no discussion of any active bid by NEE for any other company by the Applicants in their filing in this proceeding. While it is clear that NEE believes they have the financial wherewithal to manage acquiring HECO at the same time it acquires a company more than three times larger (or they would not be pursuing the acquisition), it is not clear that there would be no ramifications with regard to the financial impact of simultaneous acquisitions on NEE. Such an additional acquisition would certainly also add to the corporate complexity at NEE, which should be of concern to this Commission. Yet, there is no mention by the Applicants of the concurrent pending bid for Oncor and the only information we have is gleaned through information requests. This provides additional reasons for concern regarding the willingness of NEE to reveal the nature of its financial status with the stakeholders in Hawaii.
IV. FINANCIAL SAFEGUARDS.

Q. WHAT ARE THE SAFEGUARDS PROMISED BY THE APPLICANTS THAT WILL, IN THEIR VIEW, PROVIDE SUFFICIENT FINANCIAL PROTECTIONS FOR HECO IF THE MERGER PROCEEDS?

A. The financial safeguards promised by the Applicants are discussed primarily by HECO witness Sekimura and NEE witness Reed. At pages 14 and 15 of Ms. Sekimura’s Direct Testimony (Applicant’s Exhibit-28), she presents the commitments made by the Applicants (in addition to those they wish to retain in the 1982 Agreement) designed to ensure that the proposed transaction is in the public interest with respect to the financial arrangements that may affect the HECO Companies, and will not diminish the Commission’s authority with respect to capitalization and financial matters. Those conditions, which are not also already in the 1982 Agreement, are as follows:

- HEH will not make loans to NEE or any of its subsidiaries without Commission approval;
- HEH will not assume obligations on behalf of NEE or its subsidiaries;
- NEE will not pledge any HEH assets as backing for securities that NEE or its subsidiaries may issue;
- HECO Companies will maintain their own credit rating.
Q. DO THE PROMISED SAFEGUARDS ACCOMPLISH THE TASK OF SUPPORTING THE PUBLIC INTEREST OR PREVENTING DIMINUTION OF THE COMMISSION’S AUTHORITY OVER CAPITALIZATION AND FINANCING MATTERS FOR THE HECO COMPANIES?

A. In my view, they do not. First, neither HEH nor any of the HECO Companies has to “assume obligations,” “pledge assets” or “make loans” to NEE or its subsidiaries in order for NEE or its subsidiaries to issue debt secured by the revenue/income stream of the HECO Companies. As shown in the previous portion of this testimony, Long-term debt does not have to be secured by hard assets as in a mortgage bond or by any specific pledge of security. Long-term debt can be secured by the income stream of the operations—a debenture is such an instrument. Therefore, NEE can issue substantial amounts of debt that is secured by the regulated revenue and income stream generated by the HECO Companies. Once it owns the assets, NEE does not require any action of this Commission or guarantee by HECO in order to issue debt. Therefore, the pledge that HECO will not make loans to NEE or will not secure NEE loans in no way inhibits the ability of NEE to issue debt that is secured by the regulated income stream generated by HECO.
Second, upon completion of the proposed transaction, due to the difficulty of accessing the financial data of the entity that would, the ability of the Commission to have “authority” over the manner in which the HECO Companies are effectively capitalized will be considerably diminished—with or without the Applicant's promised safeguards. Again, that is because. Moreover, any HECO-related will only be a portion of the company-wide NEE capital acquisition program and analyzing the amounts of capital applicable to HECO, particularly, in the years following approval of the proposed transaction would not be practicable.26

Q. ARE THERE ANY COMMITMENTS THAT THE APPLICANTS CAN MAKE THAT WILL ENABLE THIS COMMISSION TO RETAIN AUTHORITY OVER HECO WITH RESPECT TO CAPITALIZATION AND FINANCIAL MATTERS?

A. I am not aware of any commitment that would enable this Commission to know, with precision following the approval of the proposed transaction, how the assets of HECO are effectively capitalized. As we have already seen (CA Exhibit-9), the capital structure and common equity percentage that

26 As noted previously, we have the opportunity to understand the
appears on HEH/HECO’s books of account will be managed by NEE to be what they believe it needs to be for rate setting purposes (assuming the Commission relies only on subsidiary capital structures), while, at some other entity, additional [Redacted]. I am unaware of any regulatory mechanism to prevent that behavior. Nevertheless, there are two factors to note.

First, the Commission has the ability to set utility rates on a capital structure different from that which appears on the Company’s books of account, i.e., a hypothetical capital structure. As we see in CA Exhibit-9, the common equity ratio that is projected to appear on the HECO Companies’ balance sheet is approximately [Redacted] of total capital. But we also know that a significant portion of that amount of [Redacted]. Instead of attempting to analyze which debt dollar goes where, it would be much simpler from a ratemaking standpoint to recognize, 1) that the capital mix supporting the HECO assets contains less common equity than appears on the HECO balance sheet, and 2) the average common equity ratio used by utility holding companies is 47%. Therefore, setting HECO rates with an industry-average amount of common equity would be a reasonable ratemaking option that recognizes, at least to some degree, the manner in which [Redacted] and affords ratepayers some of the savings garnered from the use of more low-cost debt and the imputation of lower taxes.
Another option for the Commission, of course, would be to claim all of the debt cost savings for ratepayers by setting rates for HECO using NEE’s consolidated capital structure (40% equity/60% debt). It is important to recall that, as we see in CA Exhibit-9, the effective capital structure of HECO by 2020, considering both incremental transaction-related debt issuances and equity reductions, is projected to fall below 40%. Therefore, NEE management believes that the income stream generated by its HECO investment is able to support a debt load comprising slightly more than 60% of total capital. In that light, the use of NEE’s consolidated capital structure for ratemaking purposes is within reason. In my view either of those options (industry-average or parent company consolidated capital structure) would better serve ratepayers than would an attempt to retain authority over effective HECO capitalization, which I believe would ultimately be ineffective.

Second, while I am unaware of any commitment that would allow the Commission to analyze or control how NEE elects to effectively capitalize its HECO investment, there are means through which the Hawaii utility operations of the HECO Companies can be protected from a financial crisis at NEE, just as Portland General was protected from the collapse of ENRON. Those type of financial protections for a regulated subsidiary are called “ring fencing.” Although, Mr. Reed characterizes the financial commitments discussed above as “ring-fencing” and indicated that no further ring-fencing measures were necessary for this transaction (Applicant’s Exhibit-33, pp. 45, 59), I disagree.
This Commission will not be able to discern how HEH/HECO is financed if the transaction is allowed to proceed and, therefore, if approval is ultimately determined to be reasonable, additional financial protections should be required. I will discuss those requirements subsequently.

Q. WHAT ARE YOUR COMMENTS ON THE APPLICANT'S REQUESTED CHANGES TO THE 1982 AGREEMENT THAT ACCOMPANIED THE CREATION OF HECO's INITIAL HOLDING COMPANY, HEI?

A. Most of the requested changes in the 1982 Agreement (Applicant's Exhibit-31) are name changes, from HEI ("Industries") to NEE ("NextEra"), which are not problematic. However, the requested changes to Conditions 1 and 3 change the Commission's ability to examine any books and records of the parent (then HEI) to the ability to examine only the books and records of those entities within NEE which have direct service charges to HEH/HECO.

Condition 2 of the 1982 Agreement as presented by the Applicants changes the Commission's ability to require "any employee" of the holding company to appear before the Commission to a Condition in which "an" employee or other representative would appear before the Commission as necessary to fulfill the Commission's statutory responsibilities to the utility. Here, the Applicants appear to request that they be able to restrict the Commission's investigation by limiting the issues of inquiry to only those that affect the utility and by self-selecting the employee or representative to
respond to the questions asked. That is, under the original 1982 Agreement, the Commission could require that Ms. Lau testify to explain a holding company issue, and she would be required to appear. Under the Applicant’s suggested change to Condition 3, the Commission could request that Mr. Robo appear at hearing, but the testifying agent would be appointed by the Company and that agent would be authorized to discuss only utility-related matters.

Also, the original Condition 15 in the 1982 agreement required the holding company to maintain a complete copy of its books and records in Hawaii. The Condition 15 suggested by the Applicants requires only the utility to maintain a complete copy of its books and records in Hawaii. With this change of condition, the Applicants are making access to the parent company’s books and records more difficult for the Commission.

As discussed previously in this testimony, NEE subsidiaries that do not have any direct engagement with HEH/HECO and, thus, would not create any direct “service charge,” such as NEECH, can have a profound impact on the Hawaii operations of the HECO Companies. Therefore, limiting the Commission’s review of NEE operations to only those companies that have a direct “billable” relationship with HECO restricts the Commission’s ability to fully investigate factors that may impact the Hawaii utility’s operations. As noted in the testimony of CA witness Carver, the Applicant’s requested changes to the 1982 Agreement restricting the Commission’s ability to review
the operations of the ultimate parent company, NEE, and its other subsidiaries, should be rejected.

Q. ARE THERE OTHER SPECIFIC CHANGES IN THE 1982 AGREEMENT CALLED FOR BY THE APPLICANTS, WHICH YOU BELIEVE ARE INAPPROPRIATE?

A. Yes. There are conditions in the 1982 Agreement that relate specifically to financial issues. Conditions 8 through 11 of the 1982 Agreement address specifics related to equity and debt issuances. The Applicant’s changes to those conditions are only name changes. I also believe those conditions are reasonable, continue to be helpful and should be retained if the proposed transaction is to be approved.

1982 Agreement condition 8 calls for HECO to continue to issue its own long term debt. That appears to be the intent of the Applicants. The only change I would make to condition 8 is to remove the phrase “as in the pre-corporate-restructuring period,” which appears not to be pertinent to the current situation.

Condition 9 prohibits the Utility from loaning funds directly to its parent without approval by the Commission. The Applicants agree to this condition, changing only the names.
Condition 10 requires that the Utility not pay more than 80% of its earnings in dividends when the equity ratio of the Utility falls below 35%. This is a reasonable condition designed to support the financial health of the utility when it is marginal (a low equity ratio of 35%) and prohibit the parent from withdrawing more in dividends that the Utility actually earned. The Applicants have no suggested changes to this condition.

Condition 11 prohibits the Utility from redeeming its common stock without Commission permission. This condition helps to maintain Commission control over the financial position of the utility under its purview. The Applicants have no modification for Condition 11.

Condition 16 requires that the common stock of the Utility not be sold or otherwise divested by the parent without Commission approval. The Applicants request deletion of this condition because, according to Ms. Sekimura at page 32 of her Direct Testimony (Applicants Exhibit-28), Commission approval prior to a sale of assets is required by statute, and the condition in the 1982 Agreement is unnecessary. However, if Condition 16 is duplicative, I see no detriment to any party in leaving it in the conditions set out in the 1982 Agreement in order that the Commission’s prior directives regarding holding companies remain intact and the holding company governing conditions are collected in one place (the 1982 Agreement). Therefore, I recommend that Condition 16 of the 1982 Agreement be retained as written (except for the appropriate corporate name changes).
Q. THE APPLICANTS HAVE COMMITTED TO ESTABLISHING A LOCAL ADVISORY BOARD, WHICH MR. GLEASON CHARACTERIZES AS A COMMITMENT TO LOCAL GOVERNANCE. WILL THE ADVISORY BOARD, AS ENVISIONED BY THE APPLICANTS, HAVE DECISION-MAKING AUTHORITY?

A. No. The Applicants make clear that the advisory board is just that—advisory; it is not a decision-making entity within HEH or NEE. The advisory board is designed to "provide input on matters of local and community interest." (Applicants Exhibit-1, p. 17)

When asked in FOL-IR-62 if the Commission required the continuation of an independent HEH Board of Directors, whether or not that would influence NEE’s position on the merger, the Applicants indicated very clearly that it would influence their position. The Applicants responded further that the creation of a Hawaii-based board of directors that could actually vote on issues pertinent to the HECO Companies would “likely constitute a Burdensome Condition under the Merger Agreement.” (FOL-IR-62, p. 3)

In other words, the NEE management in Juno Beach wants complete decision-making capability for the HECO Companies and anything less appears to be unacceptable.

In my experience it is not unusual for subsidiaries of utility holding companies to have actual decision-making boards of directors; in fact, it is common. It is often the case that the CEO and other officers of the holding
company also sit on the boards of the subsidiaries and, thereby exert considerable control in concert with their position in the holding company. However, the other (non-holding company) members of the subsidiary board of directors bring “local” knowledge about operations or community issues to which the holding company officers may not be privy. In other words, it is not necessarily true, as the Applicant’s claim, that the creation of an actual voting board in a subsidiary operation in Hawaii would “limit the effectiveness” of NEE’s ability to manage its investment in the HECO Companies. To the contrary, especially if local (Hawaii) participation were a part of the board mix, all the benefits touted by Mr. Gleason would be retained and improve the effectiveness of the manner in which a “new” HECO would operate. An independent HEH board of directors might also mean that Mr. Robo or his charge would have to travel to Honolulu a few times a year, or appear at the meeting through a videoconference, but it is not clear that his ability to manage NEE’s HEH/HECO investment would be hindered by that requirement.

It is telling in my view, however, that NEE management feels so strongly about the existence of any other decision-making authority in Hawaii that they indicate a willingness to walk away from the proposed transaction if the Commission requires that HEH have its own board of directors. Clearly, NEE wishes to retain complete control of the HECO Companies assets and anything less (i.e., the existence of a subsidiary board of directors)
amounts to a “Burdensome Condition,” which would give them leave to exit the transaction. If NEE management wants Hawaii’s input into their HECO decisions, then it is reasonable that they would let a local HEH board of directors (populated to some degree by Hawaii citizens) vote on those decisions instead of merely “advising” the decision-makers in Juno Beach about their preferences.

V. COMMISSION QUESTIONS.

Q. GIVEN YOUR REVIEW OF FINANCIAL MATTERS IN THE PROPOSED TRANSACTION, HOW DO YOU BELIEVE THEY IMPACT THE ANSWERS TO THE COMMISSION’S QUESTIONS REGARDING THE TRANSACTIONS MERITS?

A. With regard to the first question posed by the Commission, whether the transaction as proposed is in the public interest, from my review of the financial aspects of the transaction, the answer is that the transaction is not in the public interest. As discussed above, while it is certainly possible that there could be some financial benefits associated with the transaction (financing costs, rate case moratorium) it appears that those benefits are not quantifiable with a degree of certainty. Moreover, if ratepayer benefits are gained as a result of the transaction’s approval, they are likely to be less than those claimed by the Applicants and, therefore, do not represent significant benefits.
As to the Commission’s Question 1d regarding whether or not the corporate restructuring proposed is reasonable, my review indicates that it is not. Although the transaction is touted as one financed with common equity, the Applicant’s [REDACTED]. The proposed financing and corporate restructuring are not reasonable, in my view.

The Commission asks in subpart “f” of Question 1 whether adequate safeguards exist to protect the HECO Companies’ ratepayers from any business and financial risks associated with the operations of NEE and/or any of its affiliates. The conditions offered by the Applicants regarding the prohibition of HECO lending monies to NEE or any of its subsidiaries, or HECO assets being used as security for debt issued by NEE or its subsidiaries do not provide the safeguards set out by the Commission. As noted in the discussion above, NEE does not need to pledge HECO assets to secure debt
issued at a corporate level above HECO; it has nearly equivalent security through its ownership of those HECO assets and the stability of HECO’s income stream. There are no safeguards to prevent the stability of HEH/HECO revenues from supporting additional leverage above the HEH level.

Moreover, the Applicant’s offered conditions were related to the prevention of HECO’s election to support debt above its corporate level; there was no offering by the Applicants to prevent access to HECO assets by NEE in the event of financial distress at NEE or any of its other subsidiaries. Certainly without any active board of directors, if NEE finds itself in bankruptcy, it could also force HECO into bankruptcy and utilize HECO assets along with its other regulated and unregulated assets to satisfy any debtor claims that it might face. Therefore, as currently structured there are not adequate safeguards to protect HECO Companies’ ratepayers from “any business and financial risks associated with the operations of NextEra and/or any of its affiliates.”

Finally on this point of adequate safeguards, the Applicants, by amending the 1982 Agreement, have elected to limit the Commission’s ability to access the books and records of all parent company operations to only those entities that have billable exchanges with the HECO Companies. This adjustment of the Commission’s current capability works to limit its ability to review the books and records of any NEE subsidiary that does not offer
services to HECO but which is causing financial stress to NEE that impacts HECO. Therefore, the Applicant’s desire to limit the Commission’s investigative reach into parent company subsidiaries diminishes financial protections that now exist for the HECO Companies.

Q. HOW DO YOU RESPOND TO THE COMMISSION’S SECOND, “FIT, WILLING AND ABLE” QUESTION?

A. It appears that the Applicants are willing and able to undertake the proposed transaction from a financial viewpoint, however, I am not convinced that they are willing and able to do so in order to provide electric service “at the lowest reasonable cost,” as requested by the Commission. That is because the Applicants seek to set rates for HECO’s Hawaii ratepayers with a higher-than-industry-average [redacted] ratio while [redacted]. If the Applicant’s goal were to provide the lowest reasonable capital cost, then they would use the [redacted]. Therefore, from a financial/cost of capital viewpoint, the transaction as proposed will not result in more affordable rates for the customers of the HECO Companies.

Also, while on the subject of rate affordability, it is worth noting that when the Applicants use the term “lower rates” for HECO, they are not
referring to Hawaii electric rates that are lower than they are now. They are referring to rates that they believe will be lower than might otherwise have been the case with HECO as a stand-alone company. (CA-IR-104)

Subpart "d" of the Commission’s second question asks whether the financial soundness of HECO will be improved by completion of the proposed transaction. My review of the credit rating agency reports and the offer of one debt provider to issue conditional debt with a lower cost rate contingent on completion of the transaction indicate that the answer to that question is unclear, and certainly not as clear as purported to be by the Applicants. As discussed in more detail above, that debt offer, while affording some debt cost savings if consummated, does not appear to be an arms-length transaction that can be assumed to be the prevalent market-based opinion of the impact of the proposed transaction on the cost rate for HECO’s debt. Also, the proposed transaction brings with it NEE’s investment in unregulated energy trading and merchant generation operations, which carry greater investment risk than a regulated electric utility; and, without any specific financial protections from parent-level risks, the transaction would bring risks to bear on the HECO Companies that they do not now have.
Q. THE COMMISSION’S QUESTION FOUR ASKS WHETHER THE “FINANCIAL SIZE” OF THE HECO COMPANIES RELATIVE TO NEE WOULD REDUCE THE HPUC’s REGULATORY CONTROL. AFTER YOUR REVIEW, HOW WOULD YOU ANSWER THAT QUESTION?

A. Although the Commission will continue to set rates for the HECO Companies as it has in the past, in my opinion the proposed transaction will reduce the HPUC’s regulatory control over HECO. Also, while it is true that the HECO Companies will be a relatively small part of the NEE conglomerate of companies, I don’t believe that is the fundamental reason why regulatory control will be diminished. Rather, the Commission’s regulatory control will be reduced due to the complexity of the corporate hierarchy in which HECO will become involved if this transaction is approved and the lack of transparency that goes along with it. The Applicants want to limit the Commission’s investigative reach into the NEE organization (by adjusting the 1982 Agreement), eliminate local control of HECO by having only an “advisory” board of directors, and propose no protections for the HECO Companies in the event of financial hardship at NEE, all of which work to diminish the ability of the Commission to fully understand the operational details of the relationship between HECO and its parent/sister companies. Absent a full understanding of how HECO is governed and operated, the Commission is prohibited in exercising its traditionally thorough regulatory control. In addition, the manner in which NEE elects to undertake the financial business of its unregulated
operations (i.e., not making that information publicly available) makes it very difficult if not impossible for the Commission to know how HECO’s regulatory assets are actually capitalized—another way in which the proposed transaction limits the regulatory control of HECO by the HPUC.27

Q. SHOULD THE COMMISSION APPROVE THE PROPOSED MERGER TRANSACTION AS PRESENTED BY NEE AND HECO?

A. No. For the reasons set out above and discussed in more detail in my testimony, I believe the merger transaction between NEE and HECO as proposed is not in the public interest.

Q. THE COMMISSION ALSO ASKS, IN ITS QUESTIONS SET OUT FOR INVESTIGATING THE PROPOSED TRANSACTION, WHETHER THERE ARE ADDITIONAL CONDITIONS TO ENSURE THAT THE PROPOSED TRANSACTION IS NOT DETRIMENTAL TO THE HECO COMPANIES’ RATEPAYERS. DO YOU HAVE SUGGESTIONS IN THAT REGARD?

A. Yes. If the Commission determines, after a review of all the evidence related to this transaction, that the proposed transaction is in the public interest and elects to proceed with it, I recommend that the transaction proceed under additional conditions. Those conditions address two primary areas:

27 These issues related to the limitations of the Commission’s regulatory control are also pertinent to the Commission’s Question 3, which examines the proposed Transaction’s effects on its regulatory authority in light of the fact that ultimate control of the HECO Companies will reside remotely in Florida, not Hawaii.
1) additional ring fencing, and 2) a rate reduction to ensure ratepayers savings. Those conditions are discussed in the next section of my testimony.

VI. ADDITIONAL CONDITIONS.

A. RING-FENCING.

Q. YOU MENTIONED THAT RING FENCING IS ONE OF YOUR ADDITIONAL CONDITIONS. WHAT IS RING FENCING?

A. Ring fencing is a term given to a set of techniques or guidelines that, when employed together, will isolate the credit risks of a subsidiary from the credit risks of the parent company or other affiliates of the parent company. In this instance, ring fencing is designed to prevent financial risks that occur at the parent company (NEE), or its other subsidiaries, which have substantial unregulated assets that are weakly capitalized, from affecting the financial health of the regulated subsidiary to be acquired (the HECO Companies). Adequate ring fencing will have the beneficial effect of protecting the regulated ratepayers from potential financial risks that could occur at the parent level and that protection will also help to support the subsidiary’s credit rating.
Q. HAVE THE APPLICANTS OFFERED TO IMPLEMENT SOME ASPECTS OF RING FENCING?
A. Yes. As I noted in my previous discussion, the Applicants have offered conditions that are part of a series ring fencing guidelines. The Applicants have committed to the following conditions:

- The parent company of HECO will be domiciled in Hawaii;
- HECO will maintain its own credit ratings by at least two rating agencies;
- HECO will maintain its own books and records, and keep their debt separate and apart from NEE and its other subsidiaries;
- The HECO Companies will not make loans to NEE or any of its subsidiaries, nor assume any obligations of same;
- NEE will not pledge any of the assets of the HECO Companies as backing for any securities that NEE or its subsidiaries may issue;
- The HPUC will maintain authority over the issuance of HECO securities; and
- NEE will restrict payment of dividends by HECO if the consolidated common equity ratio of the HECO
companies falls below 35% of permanent
capitalization (i.e., excluding long-term debt).

Q. DO YOU RECOMMEND THAT THE APPLICANT’S RING FENCING
MEASURES BE MAINTAINED?
A. Yes. However, while those commitments work to ensure that HECO will not
voluntarily commit assets as security for NEE debt, there is no guarantee that
NEE will not issue debt based on its ownership of those assets and the
revenue/income stream created by those regulated assets. Therefore, those
safeguards will not prevent NEE from issuing additional debt secured by the
HECO Companies’ regulated revenue stream. Also, while the offered
commitments limit, to some degree, dividend payments to the parent if the
financial health of the HECO Companies deteriorates (i.e., if the consolidated
equity ratio declines below 35%), those protections could be stronger.
There are other mechanisms through which the parent company can access
subsidiary cash, e.g. short-term debt money pools, which are not addressed.

As noted previously, the Applicants intend for the holding company
between NEE and the HECO Companies to be operated without a board of
directors, limiting local control. Finally, the offered ring fencing conditions do
not address bankruptcy protections for the HECO Companies in the event of
financial stress at the parent level. This latter part, in my view, is the most
significant omission from the ring fencing mechanisms offered by
the Applicants.

Q. WHAT ADDITIONAL RING FENCING MEASURES WOULD YOU
RECOMMEND IF THE COMMISSION DETERMINES THAT THE
PROPOSED TRANSACTION SHOULD BE APPROVED?

A. As noted above, the most significant omission from the Applicants’ ring fencing
proposals is any protection for the HECO Companies from financial distress
that may occur in the NEE organization. If the transaction proceeds and the
ultimate parent company, NEE, enters bankruptcy, there are measures that
can be taken to ensure that NEE will not be able to also move its subsidiary,
HECO, into bankruptcy and, thereby, have access to its assets to satisfy its
(NEE’s) creditors.

In order to successfully insulate a regulated subsidiary from financial
difficulty existing at a parent company level, an intermediate corporate entity is
necessary. When such an entity is created specifically for the purpose of
providing insulation it is called a “special (or single) purpose entity,” or SPE.
That corporate entity has a board of directors and on that board is one
independent director (i.e., a person not affiliated with either the parent or the
subsidiary), and, most importantly, that independent director has sole
discretion over whether or not the regulated subsidiary is able to be filed into
bankruptcy. That is, in order to be forced into bankruptcy all board members,
including the independent director, would have to agree. If all but the independent director agree, the subsidiary cannot be forced into bankruptcy.

While that condition is helpful in protecting against parent company financial difficulties, the subsidiary is provided additional support by a “non-consolidation opinion” from the parent holding company. A non-consolidation opinion from the parent, indicating that the parent will not seek consolidation of assets in the event of bankruptcy, reduces the likelihood that a bankruptcy court would grant substantive consolidation of the regulated subsidiary’s assets with those of the parent.28

Together, the independent director and a non-consolidation opinion from the parent can support the financial health of the subsidiary in light of financial stress at the parent. For example, in a leveraged buy-out of Puget Energy by Macquarie (an Australian bank) in 2008, the Washington Utilities and Transportation Commission (WUTC) required both an independent director and a non-consolidating opinion as conditions for the acquisition.29 As a result, the leveraged parent company initially had a below-investment-grade bond rating (“BB”), while the utility subsidiary was able to maintain an investment grade credit rating (currently “BBB”). In other words, the independent director and the non-consolidating opinion from the

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29 WUTC Order 08 in Docket U-072375, Approving and Adopting Settlement Stipulation; Authorizing Transaction Subject to Conditions; December 30, 2008.
parent successfully insulated the regulated subsidiary from the financial risks of the parent.

In addition, the Applicants in the Puget transaction also agreed to local representation on the board of directors. In that transaction there were two companies below the parent holding company (Puget Holdings). They were, 1) Puget Energy, and 2) Puget Sound Energy. “Local” directors—directors domiciled in Washington—were required to sit on both boards.

Under Commitment 41, at least three directors at PSE and two at Puget Energy and Puget Holdings will be Washington residents. [footnote omitted] Joint Applicants argue that “these local directors and managers provide additional assurance to the community and PSE’s customers that local concerns will be considered at both the PSE and Puget Holdings board level. [footnote omitted]” [footnote omitted] (WUTC Order 08, Docket U-072375, p. 99)

Given that in prior acquisitions, the parties have agreed to utilize “local” directors as well as the fact that the Applicants in this proceeding understand the importance of local “advice,” it seems reasonable to require that at least four members of any post-merger board of directors for HECO are from Hawaii.
Q. YOU NOTED INITIALLY THAT A "SINGLE PURPOSE ENTITY" NEEDS TO BE CREATED BETWEEN THE REGULATED SUBSIDIARY AND THE PARENT COMPANY. IS THAT NECESSARY IN THIS CASE?

A. It does not appear so. The currently planned holding company for the HECO Companies, Hawaii Electric Holdings (HEH), will be a corporate entity between NEE and the HECO Companies and could function as a vehicle for ring-fencing. Moreover, the Applicants’ indicate that HEH does not intend to issue debt. While another entity between HEH and the HECO Companies could be created, and it would not be burdensome to do so if it becomes necessary, it appears unnecessary because the additional ring-fencing measures can be implemented through HEH.

Q. HOW WOULD THE APPLICANTS IMPLEMENT THE ADDITIONAL RING-FENCING MEASURES YOU SUGGEST?

A. First, as noted, a plan already exists for a holding company to be formed between the HECO Companies and NEE. That corporate entity will be Hawaiian Electric Holdings. Second, HEH should have a voting board of directors, with at least four individuals from Hawaii on that board. Third, there should also be one independent director on the board of HEH. That director would have no affiliation with either HECO or NEE and, without the affirmative vote of that independent director, the HECO Companies cannot be forced into bankruptcy. Fourth, NEE should submit a non-consolidating opinion regarding
the involuntary bankruptcy of the HECO Companies by NEE following completion of the proposed transaction.

While no corporate agreements or arrangements are without flaw, those measures, in my view, would sufficiently insulate the HECO Companies from financial duress at the parent company, NEE level. That insulation (ring-fencing) would help to prevent NEE, NEECH or NEER financial risks from affecting Hawaii ratepayers.

Q. ARE THERE OTHER CONDITIONS YOU WOULD RECOMMEND IN ORDER TO LIMIT THE SUPPORT OF NEE OPERATIONS THAT COULD BE HARMFUL TO HECO COMPANY OPERATIONS?

A. Yes. In similar fashion to the Applicants’ offer to limit the ability of HECO to provide direct security or otherwise pledge assets to NEE for the purpose of issuing debt, I believe it is reasonable to require that the HECO Companies not participate in NEE short-term debt money pool operations. A “money pool” operation, in general terms, is a corporate-wide cash management arrangement in which operating subsidiaries of a corporate parent add to or withdraw from cash accounts, which are also linked with short-term borrowing (bank lines of credit, commercial paper, etc.). Essentially, all subsidiaries lend or borrow from or lend to the cash/short-term debt “pool” as necessary.
Such arrangements are touted as being more cost-efficient because they are larger than would be a subsidiary-only cash management/short-term debt arrangement and they may, indeed, garner small cost benefits. However, in the current economic environment with very low short-term capital costs, any such differences would be relatively small. Offsetting any cost advantage, the concern with money pool arrangements is that such an arrangement allows parent company access to subsidiary cash.

If the Commission is going to limit dividend payments to the parent company to prevent excessive cash being withdrawn from the regulated utility operations, it should also limit that availability with short-term money pools. If this transaction is to be approved by the Commission, it should also require the HECO Companies to maintain their current short-term debt and cash management operations and avoid corporate money pool operations. Therefore, my final additional “ring-fencing” condition is to prohibit the use by HEH or the HECO Companies of NEE money pool operations.
Q. CAN YOU SUMMARIZE YOUR ADDITIONAL RING-FENCING RECOMMENDATIONS?

A. Yes. If the Commission elects to approve the proposed transaction, I recommend the following additional ring-fencing measures be implemented:

- A voting board of directors should be installed at Hawaiian Electric Holdings (HEH);
- Four of those directors on the HEH board should be from Hawaii;
- One of the members of the HEH board should be an independent director, affiliated with neither NEE nor HECO and, without the approval of that one independent director along with all of the other HEH board of directors, the HECO Companies cannot be moved into bankruptcy;
- Following the close of the transaction, NEE should submit a non-consolidating legal opinion, confirming that it will not attempt to consolidated HECO assets with NEE assets in the event of either financial stress or bankruptcy proceedings at the parent company; and
- The HECO Companies should be prohibited from participating in NEE corporate money pool operations.
B. RATE REDUCTION PLAN.

Q. WHAT IS THE REASON FOR THE CONSUMER ADVOCATE’S RATE REDUCTION RECOMMENDATION?

A. As I noted previously in my testimony and as discussed in the testimony of CA witness Brosch, the capital cost savings and rate savings promised Hawaii ratepayers by the Applicants are not certain, are based on broad assumptions that may not prove to be reliable and, if realized, appear likely to be less than the amounts promised. One way to ensure that Hawaii ratepayers get definite and quantifiable benefits from the proposed transaction (if it moves forward) is to lower rates. With regard to financial issues, the HECO Companies rates can be lowered by setting the cost of equity capital near the current cost of common equity capital and by using a ratemaking capitalization that 1) is similar to the average used in the electric industry, and 2) is more aligned with the manner in which NEE expects to effectively capitalize its HECO investment.

Q. PLEASE EXPLAIN IN MORE DETAIL THE COST OF CAPITAL AND CAPITAL STRUCTURE YOU RECOMMEND FOR USE IN A RATE REDUCTION PLAN.

A. The current cost of equity capital is well below the HECO Companies’ currently allowed returns (except for MECO, which is operating on a 9% return due to an imposed penalty). My own recent cost of capital testimony
presented before the Federal Energy Regulatory Commission (FERC) in Docket No. EL 14-12-002, a complaint case against the Midcontinent Independent System Operator (MISO) regarding one issue—the current cost of equity capital for electric utilities.\(^{30}\) My initial cost of equity testimony in that proceeding, filed in February of 2015 indicated that the cost of equity capital for integrated electric utilities was 8.85%. My most recent update of that testimony, filed in late July, indicates a current cost of equity for fully-integrated utility operations in the U.S. of 8.75%. That current level of equity capital costs, based on FERC’s mandated two-stage DCF model and the current market data of all publicly-traded electric utilities in the U.S., is below the currently-allowed ROE for the HECO companies.\(^{31}\) Therefore, if quantifiable, certain rate relief for the HECO Companies’ ratepayers is a goal of this proposed transaction, an immediate reduction in the Companies’ capital costs going forward would be a straightforward means to achieve that end. For purposes of a rate reduction plan, a going-forward cost of equity capital of 9.0%, slightly above the current cost of equity capital would be reasonable.

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31 In FERC’s recent Opinion 531 (Docket No. EL11-66-001), that commission codified the type of DCF model it would utilize in determining the cost of equity capital in regulated electric rate proceedings. The FERC’s new DCF model is a two-stage DCF. The dividend yield is the actual six month historical dividend yield based on monthly high and low stock prices for each company in the sample group. The sample group is the universe of U.S. electric utilities followed by Value Line and the DCF formula is \(k=D(1+0.5g)/P+g\), where “\(g\)” is calculated using IBES projected earnings (2/3 weighting) and long-term GPD growth (1/2 weighting).
Q. IS IT TRUE THAT THE FERC ELECTRIC PROCEEDINGS YOU DESCRIBE INVOLVE TRANSMISSION COMPANIES THAT DO NOT HAVE GENERATION ASSETS AND ARE, THUS, LESS RISKY THAN FULLY-INTEGRATED ELECTRIC COMPANIES LIKE HECO?

A. Yes. However, the equity cost estimate derived using the FERC DCF model is based on the market data of all publicly-traded electric companies in the U.S., which are, in the main, fully-integrated electric utility operations with generation. In addition, many of those publicly-traded companies also have unregulated operations (like NEE, for example) which would tend to increase their operating risk profile and the resultant cost of equity capital above that of a pure-play electric utility operation like the HECO Companies. Therefore, even though the current FERC DCF model provides an equity cost estimate that overstates the equity cost of transmission utilities (a point I raise in my cited FERC testimony), because that FERC DCF result is based primarily on the market data of integrated electric utilities, it is appropriate to use as an estimate of the current cost of equity for the HECO Companies.
Q. SHOULD THE HECO COMPANIES’ RATEMAKING CAPITAL STRUCTURE ALSO BE ADJUSTED IN ORDER TO CREATE SAVINGS FOR RATEPAYERS WHILE RETAINING FINANCIAL STRENGTH FOR THE COMPANIES?

A. Yes. As noted in the discussion of subsidiary and parent company capital structures previously in my testimony, NEE is of the opinion that the regulated revenue stream of the HECO Companies can support more debt capital than the amount that is included in the Companies’ book value capital structure. Therefore, a reduction in the HECO Companies’ ratemaking capital structure is reasonable in order to provide direct rate savings to ratepayers and will, according to NEE’s assessment of HECO’s financial position using an average level of common equity, not be problematic from a financial standpoint.

In addition, the June 2015 edition of AUS Utility Reports (p. 10) indicates that the average common equity ratio of the electric utility industry is 47% of total capital. For a rate reduction plan, I believe an industry-average capital structure provides substantial rate savings (containing less common equity (47%) than the HECO Companies’ recent ratemaking capitalization (approximately 56%)), while safeguarding the HECO Companies financial position using an average level of common equity. As noted previously, the average credit rating of the electric industry with a common equity ratio of 47% is between the highest “BBB” rating and the lowest “A” rating (“BBB+/A-”). Therefore, a 47%, while it does not capture all of the cost
benefits of the additional debt NEE intends to apply to the HECO Companies, that common equity ratio is financially conservative, equal to the equity ratio used on average in the electric industry and will provide significant rate savings as well as support for the Company’s financial position.

VII. CONCLUSION.

Q. CAN YOU SUMMARIZE YOUR COST OF CAPITAL RECOMMENDATIONS FOR THE PROPOSED RATE PLAN TO PROVIDE SUBSTANTIAL, QUANTIFIABLE BENEFITS FOR HECO’S HAWAII RATEPAYERS?

A. Yes. The HECO Companies’ cost of equity capital should be re-set at 9.0% (no change for MECO) and a ratemaking capital structure containing 47% common equity and 53% debt should be used to determine the overall ratemaking rate of return. Those two factors will assist in providing a better balance of the benefits of the proposed transaction between the stockholders of the HECO Companies and the Companies’ ratepayers in Hawaii. Those cost of equity and capital structure recommendations also meet the Hope and Bluefield criteria of providing the regulated utility a return that will attract investor capital and will support the utility’s financial position in a manner that is economically efficient.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.
Q. PLEASE STATE YOUR NAME, OCCUPATION AND ADDRESS.

A. My name is Stephen G. Hill. I am self-employed as a financial consultant, and principal of Hill Associates, a consulting firm specializing in financial and economic issues in regulated industries. My business address is P. O. Box 587, Hurricane, West Virginia, 25526 (e-mail: hillassociates@gmail.com).

Q. BRIEFLY, WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. After graduating with a Bachelor of Science degree in Chemical Engineering from Auburn University in Auburn, Alabama, in 1971, I was awarded a scholarship to attend Tulane Graduate School of Business Administration at Tulane University in New Orleans, Louisiana. In 1973, I received a Master's Degree in Business Administration from Tulane.

In 1975 I worked as a Compliance Engineer for the West Virginia Air Pollution Control Commission, where I was responsible for ensuring the compliance of the chemical plants in West Virginia with the requirements set out in the 1971 Clean Air Act.

In 1982 I joined the Consumer Advocate Division of the West Virginia Public Service Commission as a rate of return analyst, providing expert testimony on utility financial issues and engineering issues, when necessary. While employed by the State of West Virginia, I applied for and was awarded the professional designation of "Certified Rate of Return Analyst" by the Society of Utility and Regulatory Financial Analysts.
That professional designation is based upon education, experience and the successful completion of a comprehensive examination. In recent years I have been a member of the Board of Directors of that national organization, and am currently its Vice President.

In 1989 I ceased work for the West Virginia Consumer Advocate Division and started my own utility financial consulting firm, Hill Associates. Since that time, I have been providing expert witness testimony regarding utility financial issues, the cost of capital, capital structure and mergers and acquisitions to public utility commissions, consumer advocates, attorneys general and utility companies in the United States.


Q. HAVE YOU TESTIFIED BEFORE THIS OR OTHER REGULATORY COMMISSIONS?

A. Yes, I have testified before this Commission and, over the past 30 years, I have testified on cost of capital, corporate finance and capital market
issues in more than 300 regulatory proceedings before the following regulatory bodies: the West Virginia Public Service Commission, the Pennsylvania Public Utilities Commission, the Oklahoma State Corporation Commission, the Public Utilities Commission of the State of California, the Texas Public Utilities Commission, the Maryland Public Service Commission, the Public Utilities Commission of the State of Minnesota, the Ohio Public Utilities Commission, the Insurance Commissioner of the State of Texas, the North Carolina Insurance Commissioner, the Rhode Island Public Utilities Commission, the City Council of Austin, Texas, the Texas Railroad Commission, the Arizona Corporation Commission, the Missouri Public Service Commission, the South Carolina Public Service Commission, the New Mexico Corporation Commission, the Kentucky Public Service Commission, the Massachusetts Department of Public Utilities, the State of Washington Utilities and Transportation Commission, the Alabama Public Service Commission, the Georgia Public Service Commission, the Public Service Commission of Utah, the Illinois Commerce Commission, the Kansas Corporation Commission, the Indiana Utility Regulatory Commission, the Washington Utilities and Transportation Commission, the Montana Public Service Commission, the Public Service Commission of Wisconsin, the Vermont Public Service Board, and the Federal Energy Regulatory Commission. I have also testified before the West Virginia Air Pollution Control Commission regarding appropriate pollution control technology
and its financial impact on the company under review and have been an
advisor to the Arizona Corporation Commission on matters of utility
finance.

A list of cases in which I have testified follows, including the
jurisdiction in which the testimony was submitted, the part for whom the
testimony was prepared, the case number, and the subject matter of the
testimony.

STEPHEN G. HILL
EXPERT TESTIMONY

WEST VIRGINIA

Testimony on behalf of: Consumer Advocate Division of the WV Public Service
Commission.

1. Case No. 80-039-G-42T - Holden Division, Southern Public Service
   Company; cost of capital / capital structure.

2. Case No. 80-040-G-42T - Logan Division, Southern Public Service
   Company; cost of capital / capital structure.

3. Case No. 80-041-G-42T - Man Division, Southern Public Service
   Company; cost of capital / capital structure.

4. Case No. 82-207-W-42T - Huntington Water Corporation; cost of
   capital / capital structure.

5. Case No. 82-162-E-42T - Appalachian Power Company; cost of
   capital / capital structure.

6. Case No. 82-334-E-42T - Wheeling Electric Company; cost of
   capital / capital structure.

7. Case No. 82-380-G-42T - Columbia Gas of West Virginia; cost of
   capital / capital structure / equity cost penalty.
8. Case No. 82-391-E-42T - Virginia Electric Power Company; cost of capital / capital structure.

9. Case No. 82-580-E-GI - Potomac Edision Electric Company; "show cause" hearing; cost of capital / capital structure.

10. Case No. 82-561-W-42T - West Virginia Water Company; cost of capital / capital structure.

11. Case No. 82-615-G-42T - Equitable Gas Company; cost of capital / capital structure.


23. Case No. 83-648-G-SC - Columbia Gas of West Virginia / Allegheny and Western Energy Corporation (special hearing to investigate a buy-out/merger of Columbia by A&W); financial integrity of purchasing company / potential ratepayer impact.


25. Case No. 84-008-W-42T - West Virginia Water Company; cost of capital / capital structure / double leverage.


28. Case No. 84-250-T-42T - West Virginia Telephone Company; cost of capital / capital structure / double leverage.


30. Case No. 84-7338-G-42T - Hope Gas, Incorporated; cost of capital / capital structure.

31. Case No. 84-875-E-42T - Potomac Edison Electric Company; cost of capital / capital structure.

32. Case No. 84-747-T-42T - Chesapeake and Potomac Telephone Company of West Virginia; cost of capital / capital structure.

33. Case No. 84-861-G-42T - Consumer's Gas Company; cost of capital structure.


35. Case No. 85-289-G-42T - Penzoil Company; cost of capital / capital structure.


37. Case No. 85-222-T-42T - Continental Telephone Company of West Virginia; cost of capital / capital structure / double leverage.
38. Case No. 85-405-G-30C - Mountaineer Gas Company; investor attitudes toward company's gas supplier and owner-Allegheny and Western Energy / affiliated transactions.


41. Case No. 86-008-G-42T - Southern Public Service Company; cost of capital / capital structure.

42. Case No. 86-524-E-SC - Monongahela Power Company ("show cause" proceeding); cost of capital / capital structure.

43. Case No. 86-212-W-42T - West Virginia Water Company; cost of capital / capital structure.

44. Case No. 86-341-W-42T - Huntington Water Corporation; cost of capital / capital structure.


47. Case No. 86-780-T-42T - General Telephone Company of the South; cost of capital / capital structure / rural telephone company operating risk.


51. Case Nos. 89-439 and 87-434-G-30C - Hope Gas, Inc.; ability of Company to refund purchased gas over collections.
52. Case No. 89-206-T-42T - Contel of West Virginia; cost of capital / capital structure.

53. Case No. 89-481-G-42T - Equitable Gas Company; cost of capital / capital structure.


55. Case No. 89-640-G-42T - Mountaineer Gas Company; cost of capital / capital structure.


57. Case No. 90-522-T-42T - GTE South; Telephone utility operating risk / ratemaking capital structure / cost of capital.

58. Case No. 90-504 -E-42T - Monongahela Power Company; capital structure, cost of capital, flotation cost issues.

59. Case No. 90-888-G-42T - Equitable Gas Company; capital structure, cost of capital, inflation adjustment.

60. Case No. 91-025 -G-42T - Hope Gas, Inc.; capital structure, earnings volatility analysis, cost of capital, flotation cost issues.

61. Case No. UT-09-0871 – Frontier Communications/Verizon merger; Financial Issues related to merger.

ALABAMA

Testimony on behalf of: the American Association of Retired Persons (AARP).


63. Docket Nos. 18117 and 18416 – Alabama Power Company; cost of capital / capital structure / use of market-value capitalization in ratemaking.

64. Docket Nos. 18046 and 18328 – Alabama Gas Corporation; cost of capital / capital structure / rate stabilization mechanism.
ARIZONA


67. Docket No. U-1345--90-007 - Arizona Public Service Company; cost of capital / capital structure / electric utility dividend policy / recommended dividend policy for APS / electric utility industry diversification.


CALIFORNIA


86. Application Nos. 92-05-010 through 015 - Annual Cost of Capital Proceeding; cost of equity capital.
87. Application Nos. 07-05-003 through 008 - Annual Cost of Capital Proceeding; cost of equity capital.


CONNECTICUT

Testimony on behalf of the Office of Consumer Counsel.


DISTRICT OF COLUMBIA

Testimony on behalf of: DC Peoples’ Counsel.

91. Formal Case No. 916 - Washington Gas Light - review the application to issue securities / projected financial statements / recommended alternative financing plan.

GEORGIA

Testimony on behalf of the Governor’s Office of Consumer Utility Counsel.


95. Docket No. 18638-U – Atlanta Gas Light – Testimony on capital structure and the cost of equity capital.


HAWAII

Testimony on behalf of Department of Commerce; the County of Kauai, Department of Defense.

98. Docket No. 7585 - GTE Hawaiian Telephone - Testimony addressed the financial and cost of capital impacts of a surcharge designed to recover weather-related damages.


100. Docket No. 94-0097 - Citizens Utilities Kauai Electric Division - risk/return requirements within a regulatory framework regarding natural disasters.


102. Docket No. 95-0051 - Proceeding to Examine the Establishment of a Self-Insured property Damage Reserve for Public Utilities in the State of Hawaii - risk/return requirements within a regulatory framework regarding natural disasters.

103. Docket No. 04-0104 – Purchase of Verizon Hawaii by the Carlyle Group (merger); developed position on financial requirements for Consumer Advocate.


ILLINOIS

Testimony on behalf of: the City of Chicago and the Illinois Attorney General.

111. Docket No. 91-0586 - The Peoples Gas Light and Coke Company; capital structure / projected capital structure / cost of equity capital / focus on analysts’ projected growth rates.


113. Docket No. 95-0032 - The Peoples Gas Light and Coke Company; capital structure / projected capital structure / cost of equity capital.

114. Docket No. 95-0031 - North Shore Gas; capital structure / projected capital structure / cost of equity capital.

INDIANA

Testimony on behalf of: Office of Utility Consumer Counselor.

115. Cause No. 38880 - Indiana-American Water Company; cost of capital / capital structure.

116. Cause No. 39641 - Indiana Cities Water Corporation; cost of capital / fair value rate base.
KANSAS

Testimony on behalf of the Citizen’s Utilities Ratepayer Board.


118. Docket No. 01-WSRE-436-RTS – Western Resources – capital structure / cost of equity / capital structure implications of spin-off of unregulated operations.


KENTUCKY

Testimony on behalf of the Office of Attorney General.


LOUISIANA

Testimony on behalf of: Louisiana Public Service Commission Staff.


MAINE

Testimony on behalf of: Public Advocate.

126. Docket No. 84-104 - Continental Telephone Company of Maine; cost of capital / capital structure / double leverage.


129. Docket No. 89-68 - Central Maine Power; cost of capital / capital structure / flotation and market pressure cost issues.


132. Docket No. 90-076 - Central Maine Power; cost of capital / capital structure / flotation and market pressure cost issues.

133. Docket No. 90-085 - Central Maine Power Company; decoupling risk/cost of capital.

134. Docket No. 93-005 and 93-145 - Consumers Maine Water Company; cost of capital impacts of merger, cost of equity, capital structure (testimony on behalf of municipal and industrial intervenors as well as Maine Consumer Advocate).


137. Special Project for Maine Public Advocate – Gas distribution cost of capital, merger risk.


MARYLAND

Testimony on behalf of: Maryland Peoples’ Counsel.

146. Case No. 8119 - Maryland Natural Gas Company; cost of capital / capital structure (current and pro-forma).

147. Case No. 8191 - Maryland Natural Gas Company; cost of capital / capital structure (current and hypothetical) / earnings stability.

148. Case No. 8469 - Potomac Edison Company; capital structure, cost of capital, flotation cost issues, purchased power issues.
149. Case No. 8725 - Baltimore Gas & Electric Company and Potomac Electric Company merger application - cost of capital / capital structure for individual and combined companies.


152. Case No. 8795 – Delmarva Power & Light Company (Connectiv) – Electric Restructuring, cost of equity capital for integrated electrics, T&D, merchant power plants, capital structure and regulatory policy issues.


156. Case No. 8829 – Baltimore Gas and Electric Company / Gas Division – cost of capital, capital structure.


163. Case No. 9221 – Baltimore Gas and Electric Company – Return to be included in cash working capital allowance of standard offer service.

164. Case Nos. 9226, 9232 – Delmarva Power & Light, Potomac Electric Power – Return to be included in cash working capital allowance of standard offer service.

165. Case No. 9221(Remand) – Baltimore Gas and Electric Company – Return to be included in cash working capital allowance of standard offer service.

**MASSACHUSETTS**

Testimony on behalf of: Attorney General of Massachusetts.


**MINNESOTA**

Testimony on behalf of: Minnesota Department of Public Service.


171. Docket No. ER-97-394 – Missouri Public Service (UtiliCorp), cost of capital, capital structure (divisional cost of capital issues).


175. Docket No. ER-2008-0318 – Ameren-UE, cost of capital, capital structure, overall cost of capital.

176. Docket No. ER-2010-0036—Ameren-UE; Cost of equity capital.


MONTANA

Testimony on Behalf of the Montana Consumer Counsel.

179. Docket No. D95.7.90, Montana-Dakota Utilities Company; capital structure / embedded cost of debt refinancing costs / cost of equity capital.


181. Docket No. D96.7.123, Great Falls Gas Company, capital structure, cost of capital, relative risk.


NEW MEXICO

Testimony on behalf of the State Corporation Commission Staff.

188. Docket No. 92-291-TC, GTE Southwest, capital structure/ operating risk/ cost of equity capital / competitive risk.

189. Case No. 3008 US WEST Communications (before the State Public Regulation Commission), capital structure/ operating risk/ cost of equity capital / competitive risk.
NEW HAMPSHIRE

Testimony on behalf of the Office of Consumer Advocate.

190. Docket No. DT02-110, Verizon New Hampshire; cost of common equity and capital structure in both a TELRIC and traditional rate base rate of return cases.

191. Docket No. DE 04-177; Public Service Company of New Hampshire; cost of equity capital of integrated generation operations.

192. Docket No. DE-06-028; Public Service Company of New Hampshire, cost of equity capital, capital structure.

NORTH CAROLINA

Testimony on behalf of the North Carolina Department of Insurance.


OHIO

Testimony on behalf of: Consumers’ Counsel.


OKLAHOMA

Testimony on behalf of the Oklahoma Corporation Commission; Attorney General of Oklahoma.

201. Cause No. PUD 001190 - Oklahoma Natural Gas Company - cost of capital/capital structure.


203. Cause No. PUD 940000477 - Oklahoma Natural Gas Company - cost of capital/capital structure.

204. Cause No. PUD 990000166 – Oklahoma Natural Gas Company – cost of capital/capital structure.

Testimony on behalf of: Office of Public Advocate.


RHODE ISLAND

Testimony on behalf of: Rhode Island Division of Public Utilities.

SOUTH CAROLINA

Testimony on behalf of: Division of Consumer Advocacy.

231. Docket No. 91-141-G - Piedmont Natural Gas Company; cost of capital / capital structure / use of short-term debt as permanent capital / operating risk analysis.

TEXAS

Testimony on behalf of: Texas Attorney General, Austin Ratepayers Association, Office of Public Insurance Counsel, Office of Public Utility Counsel, Allied Coalition of Cities.

232. Docket No. 5220 - Southwest Bell Telephone Company; cost of capital / capital structure / double leverage.

233. Docket No. 1 - City of Austin Electric Utility; cost of capital / debt service coverage ratio / municipal bond rating parameters / appropriate treatment of nuclear investment.


254. GUD Docket Nos. 10170 and 10174 – Atmos Energy, West Texas and Mid-Texas Divisions – capital structure / cost of equity / overall cost of capital.

**UTAH**

Testimony on behalf of: The Committee of Consumer Services.


**VERMONT**

Testimony on behalf of: Vermont Department of Public Service.

257. Docket No. 5282 - Green Mountain Power Company; cost of capital / capital structure / relative risk.


262. Docket No. 5724 - Central Vermont Public Service - capital structure / historical operating risk / cost of equity capital.


**VIRGINIA**

Testimony on behalf of the Division of Consumer Council, Office of the Attorney General / Department of Defense.

266. SCC Case No. INS940101 – Workers Compensation Benchmark Rate Proceeding - Cost of capital and relative risk issues in assigned risk workers compensation insurance.

267. Case No. PUC950019 - GTE South, Incorporated - capital structure / re-engineering adjustment to equity capital / cost of equity capital.

268. SCC Case No. INS960191 - Workers Compensation Benchmark Rate Proceeding - Cost of equity capital, capital structure, investment return.

269. Case No. PUE 960227 – Virginia Natural Gas – cost of capital / capital structure.


**WASHINGTON**

Testimony on behalf of: Attorney General's Office, and Washington Utilities and Transportation Commission Staff.


275. Docket No. UE-921262-Puget Sound Power & Light; cost of capital, capital structure, impact of decoupling on risk and return, purchased power risk.


278. Docket No. UE-991832, Pacificorp, capital structure/ cost of equity capital.

279. Docket Nos. UE-991606 and UE-991607 – Avista Corporation, capital structure, operating risk/ cost of equity capital.

280. Docket No. UG-011570/1-Puget Sound Power & Light; Interim/Emergency Rate Case/ financial need / bond rating impact of purchased power losses.

281. Docket No. UG-031885 – Northwest Natural Gas; capital structure / cost of common equity capital.

282. Docket No. UE-032065 – Pacificorp; capital structure / cost of common equity capital.


284. Docket No. UE-050684 – Pacificorp; cost of common equity / capital structure / overall cost of capital.


292. Docket No. UT-090842—Frontier Communications/Verizon merger; Financial Issues related to merger.

293. Dockets UE-121697 and UG-121705 – Puget Sound Energy – testimony regarding the change in the cost of equity capital since the Company’s 2011 rate proceeding and the impact of decoupling on the cost of equity capital.


WISCONSIN

Testimony on behalf of: Wisconsin Citizens’ Utilities Board.


302. Docket No. 6690-UR-122, Wisconsin Public Service Corporation, cost of capital / capital structure / decoupling risks and return impact / the use of market-value capital structures in utility ratemaking

EASTERN CARIBBEAN TELECOMMUNICATIONS AUTHORITY (ECTEL)

Testimony on behalf of: ECTEL.

303. (No Docket Number) Initial Rate Determination of Cable & Wireless local exchange telecommunications operations – capital structure / relative risk / cost of equity / risk premium for investing in Easter Caribbean / overall cost of capital.

FEDERAL COMMUNICATIONS COMMISSION

Testimony on behalf of: Consumer Advocate Division of the WV Public Service Commission.

304. Docket No. 89 - 624 – Re-prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers; statement in response to initial submission of telephone companies.

FEDERAL ENERGY REGULATORY COMMISSION

Testimony on behalf of: Consumer Advocate Division of the WV Public Service Commission, Maryland Peoples’ Counsel, Pennsylvania Office of Consumer Advocate, Joint Consumer Advocates in Midwest (MISO Complaint).


306. Docket No. 86-37 - Allegheny Generating Company (complaint case); cost of capital / capital structure.

308. Docket No. 87-61-000 - Eastern Shore Natural Gas Company; cost of capital / capital structure.

309. Docket No. EL-89-17 and 18 - San Diego Gas and Electric Company v. Alamito Company; Arizona Corporation Commission v. Alamito Company (complaint case), testimony on financial history of Alamito Company, regulation as marketplace surrogate, "sharing" gain on sale leaseback as generic policy, institutional investor responsibility.


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**Additional Transaction-related Debt and Reduced Equity**

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<td>43.21%</td>
<td>56.79%</td>
<td>100.00%</td>
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<td>2019</td>
<td></td>
<td>$2,295.64</td>
<td>$2,158.19</td>
<td>$6,406.65</td>
<td>43.43%</td>
<td>56.57%</td>
<td>100.00%</td>
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<td>2020</td>
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<td>$2,483.67</td>
<td>$2,343.60</td>
<td>$6,943.00</td>
<td>43.52%</td>
<td>56.48%</td>
<td>100.00%</td>
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*Calculation of reduced common equity*
HECO - NEXTERA ENERGY MERGER APPLICATION

IMPACT OF PARENT COMPANY LEVERAGE

CASE I - NO DEBT AT HOLDING COMPANY

<table>
<thead>
<tr>
<th>STAND ALONE HOLDING COMPANY</th>
<th>STAND ALONE REGULATED SUBSIDIARY</th>
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<tbody>
<tr>
<td>Capital $</td>
<td>%</td>
</tr>
<tr>
<td>EQUITY</td>
<td>$40</td>
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<tr>
<td>DEBT</td>
<td>$0</td>
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<tr>
<td>TOTAL</td>
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Consolidated Capital Structure

<table>
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<tr>
<th>Capital Amount</th>
<th>Percent</th>
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<tr>
<td>Equity</td>
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<tr>
<td>Debt</td>
<td>$60</td>
</tr>
<tr>
<td>Total</td>
<td>$100</td>
</tr>
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</table>

Pre-tax Overall Return = 10.25% x $100 Rate Base = $9.15
Weighted Utility Debt Cost = 3.00% x $100 Rate Base = ($3.00)
Pre-tax Overall Return from Utility to HoldCo = $6.15
Less Taxes @ 35% ($2.15)
After-tax Return for HoldCo Common Equity = $4.00
Equity Return/Equity Amount = $4.00/$40 = 10.00%

HoldCo Return = Utility Return = 10.0%
HECO - NEXTERA ENERGY MERGER APPLICATION

IMPACT OF PARENT COMPANY LEVERAGE

CASE II - DEBT AT HOLDING COMPANY

<table>
<thead>
<tr>
<th>STAND ALONE HOLDING COMPANY</th>
<th>STAND ALONE REGULATED SUBSIDIARY</th>
</tr>
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<tbody>
<tr>
<td>Capital $</td>
<td>%</td>
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<tr>
<td>EQUITY $40</td>
<td>73%</td>
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<tr>
<td>DEBT $15</td>
<td>27%</td>
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<tr>
<td>TOTAL $55</td>
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Consolidated Capital Structure

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<tr>
<th>Capital</th>
<th>Amount</th>
<th>Percent</th>
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</thead>
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<tr>
<td>Equity</td>
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<td>40%</td>
</tr>
<tr>
<td>Debt</td>
<td>$60</td>
<td>60%</td>
</tr>
<tr>
<td>Total</td>
<td>$100</td>
<td>100%</td>
</tr>
</tbody>
</table>

Pre-tax Overall Return = 11.42% x $100 Rate Base = $10.71
Weighted Utility Debt Cost = 2.25% x $100 Rate Base = ($2.25)
Pre-tax Overall Return from Utility to HoldCo = $8.46
HoldCo Debt Cost = $15 x 5% = ($0.75)
Pre-tax Overall Return for HoldCo Common Equity = $7.71
Less Taxes @ 35% = ($2.70)
After-tax Return for HoldCo Common Equity = $5.01
Equity Return/Equity Amount = $5.01/$40 = 12.53%

HoldCo Return (12.53%) > Utility Return (10%)
DIRECT TESTIMONY AND EXHIBITS

OF

MICHAEL L. BROSCH

ON BEHALF OF
THE DIVISION OF CONSUMER ADVOCACY

SUBJECT: Projected Transaction-enabled Cost Savings, Proposed Rate Plan Benefits, Other Accounting and Ratemaking Concerns, Consumer Advocate Ratemaking Conditions
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DIRECT TESTIMONY OF MICHAEL L. BROSCH

I. INTRODUCTION AND SUMMARY.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael L. Brosch. My business address is P.O. Box 481934, Kansas City, Missouri 64148.

Q. WHAT IS YOUR PRESENT OCCUPATION?

A. I am a principal and the President of Utilitech, Inc. The firm’s business and my responsibilities are primarily related to special services work for utility regulatory clients, including rate case reviews, alternative regulation plans, cost of service analyses, jurisdictional and class cost allocations, financial studies, rate design analyses, utility merger and reorganization studies and regulatory investigations of utility operations and ratemaking issues.

Q. WILL YOU SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE IN THE FIELD OF UTILITY REGULATION?

A. I have prepared CA Exhibit-12 for this purpose.
Q. HAVE YOU PREVIOUSLY PARTICIPATED IN REGULATORY ENGAGEMENTS BEFORE THE HAWAII PUBLIC UTILITIES COMMISSION ("COMMISSION")?

A. Yes. I submitted written direct testimony on behalf of the Hawaii Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate" or "CA") in many prior rate case proceedings involving all of the largest Hawaii utility companies, including:


- GTE Hawaiian Telephone Company (now Hawaiian Telcom) Docket No. 94-0298.

- The Gas Company Docket Nos. 00-0309 and 2008-0081.

In addition to these rate case engagements, I assisted the Consumer Advocate in the following:

• Analysis and Statement of Position preparation in Docket No. 03-0051 involving the subsequent sale of The Gas Company by Citizens Communications Company to K-1 USA Ventures, Inc.

• Analysis and Statement of Position preparation in the most recent sale of The Gas Company to Macquarie Infrastructure Company in Docket No. 05-0242.

• Analysis and Statement of Position preparation regarding the sale of the Kauai Electric Division by Citizens in Docket Nos. 00-0352 and 02-0060.

• Analysis and Statement of Position preparation in the sale of Verizon Hawaii to entities controlled by the Carlyle Group in Docket No. 04-0140.


• Analysis and testimony in the HECO Community Benefits proceeding, Docket No. 05-0146.

• Analysis and development of the Joint Statement of Position between the Consumer Advocate and the Hawaiian Electric Companies regarding Decoupling matters in Docket No. 2008-0274.¹

¹ The “HECO Companies” or “Hawaiian Electric Companies” refer to HECO, HELCO, and MECO.

• Analysis and development of the Consumer Advocate’s Statements of Position in all annual decoupling tariff transmittal filings of the Hawaiian Electric Companies, to date.

• Analysis and development of the Joint Statement of Position between the Consumer Advocate and Kauai Island Utility Cooperative (“KIUC”) regarding the Renewable Integration Cost Adjustment (“RICA”) Mechanism now under consideration by the Commission in Docket No. 2014-0016.

Q. WHAT IS YOUR UNDERSTANDING OF THE PURPOSE OF THIS DOCKET?

A. Docket No. 2015-0022 was established by the Commission for consideration of the Application for Approval of a Proposed Change of Control and Related Matters that was filed jointly by the Hawaiian Electric Companies and NextEra Energy, Inc. (“NextEra,” “NextEra Energy,” or “NEE”) on January 29, 2015. I will refer to NextEra and the Hawaiian Electric Companies together as the “Applicants” throughout this testimony and the Proposed Change of Control as the “Transaction”. The Commission, through its Order Nos. 32695 and 32739, has identified the Standards of Review applicable to the Transaction, has granted intervenor status to numerous “Parties,” has established procedural
scheduling and provisions and has defined a list of issues to be addressed by Applicants, the Consumer Advocate and the Parties. In accordance with the requirements of Order No. 32739, the Applicants submitted their Direct Testimonies and supporting exhibits on April 13, 2015. My testimony and the testimony and exhibits of other Consumer Advocate witnesses are submitted at this time, to address the issues defined by the Commission in its Order No. 32739 and in the Applicants’ Direct Testimony and exhibits.

Q. HAVE YOU PREVIOUSLY PARTICIPATED IN REGULATORY ENGAGEMENTS INVOLVING THE REVIEW AND APPROVAL OF UTILITY MERGER TRANSACTIONS IN STATES OTHER THAN HAWAII?

A. Yes. I previously sponsored testimony in connection with utility acquisitions, mergers, divestitures and other restructuring transactions in the states of Arizona, Illinois, Iowa, Kansas, Nevada, Oklahoma and Utah.²

Q. ON WHOSE BEHALF ARE YOU NOW APPEARING?

A. I am testifying on behalf of the Consumer Advocate in this proceeding.

² See listing of previous testimony contained in CA-Exhibit-12 at pages 2 through 8.
Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony presents and explains the Consumer Advocate’s position with respect to the Applicants’:

- Projected Transaction-enabled cost savings,
- Proposed Rate Plan Benefits,
- Other Accounting and Ratemaking issues, and
- Proposed Ratemaking Conditions.

In these four issue areas, my testimony is offered in response to the evidence of the Applicants and is intended to assist the Commission in determining whether the Transaction should be approved, based upon a determination whether, on a combined basis, Applicants are sufficiently fit, willing and able to properly provide safe, adequate and reliable electric service at the lowest reasonable cost and whether the proposed Transaction is consistent with the public interest.
Q. WHICH OF THE ISSUES IDENTIFIED IN ORDER NO. 32739 ARE YOU ADDRESSING IN TESTIMONY?

A. My testimony is intended to address, from a regulatory accounting and ratemaking perspective, the following issues listed by the Commission in Order No. 32739:

<table>
<thead>
<tr>
<th>Issue Number</th>
<th>Issue Description</th>
<th>Ratemaking Perspective Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Whether the Proposed Transaction is in the public interest.</td>
<td>No</td>
</tr>
<tr>
<td>1a</td>
<td>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.</td>
<td>No</td>
</tr>
<tr>
<td>1b</td>
<td>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.</td>
<td>No</td>
</tr>
<tr>
<td>2</td>
<td>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.</td>
<td>Not at lowest reasonable cost.</td>
</tr>
</tbody>
</table>

As more fully described by Consumer Advocate witness Mr. Dean Nishina, other Consumer Advocate witnesses are addressing the issues identified by the Commission with regard to utility service quality, societal and cultural concerns, affiliated interest concerns, clean energy transformational concerns and the other issues identified in the Commission Order No. 32739.
<table>
<thead>
<tr>
<th></th>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>2a</td>
<td>Whether the Proposed Transaction, if approved, will result in more affordable electric rates for the customers of the HECO Companies.</td>
<td>No</td>
</tr>
<tr>
<td>6</td>
<td>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?</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Q. CAN YOU SUMMARIZE WHY YOU HAVE RESPONDED “NO” TO ISSUES 1, 1A, 1B, 2, and 2A IN THIS TABLE?

A. My review and testimony is focused upon the revenue requirement and ratemaking issues that are raised by the proposed Transaction and the related Application. From this perspective, my testimony observes that Applicants' witnesses have explained NextEra's significant financial and operational capabilities and NextEra's keen interest in identifying and exploiting opportunities for business integration, the application of operational expertise and the achievement of cost savings, after merging with the Hawaiian Electric Companies. At this time, however, Applicants offer little detail regarding specifically how the planned business integration would occur, what actual cost savings may ultimately be achieved and what costs and risks will be involved in completing business integration efforts to achieve such cost savings. Instead, highly speculative broad-scale estimates of potential net savings are offered by Applicants' witnesses.
Compounding this uncertainty surrounding estimated future net cost savings that may be achieved by the Hawaiian Electric Companies, the proposed rate case moratorium offered by Applicants, which is the only proposed mechanism designed to facilitate ratepayer participation in the expected net savings, is fatally flawed because it:

- Initially provided no significant, quantifiable benefits to ratepayers, due to Applicants’ proposed decoupling Rate Adjustment Mechanism concession being constrained by the RAM Cap that was approved in the Commission’s Order No. 32735, and now, after modifications made to recognize the RAM Cap, provides “fixed dollar reductions” equaling $60 million that are inadequately small ratepayer benefits.\(^4\)

- Locks in the previously approved return on equity (“ROE”), common equity ratios, and overstated cost of debt rates that were approved in past Commission rate case orders and that should be updated before any rate case moratorium is commenced.

- Includes unenforceable moratorium conditions, exposing ratepayers to early rate cases and the risk of potential recovery of business integration costs exceeding benefits.

- Requires the acceleration of RAM revenue recognition, at potentially significant cost to ratepayers,

- May be withdrawn if the Hawaiian Electric Companies’ proposed Standards and Guidelines for Eligibility of Projects for Cost Recovery through the RAM above the RAM Cap is not approved to provide interim recovery of capital investments made above the RAM Cap,\(^5\) and

\(^4\) In Applicants’ responses to CA-IR-96 and CA-IR-350, NextEra has now proposed “fixed dollar reductions in the RAM Revenue Adjustment portion of the RAM filings, equaling $60 million across four years.”

\(^5\) Applicants’ response to CA-IR-351. The Consumer Advocate filed comments in opposition to this expanded RAM above the RAM Cap proposed in Docket No. 2013-0141 on June 30, 2015.
• Therefore, provides insufficient and potentially negative value for ratepayers.

For these reasons, I have concluded that the proposed Transaction and Applicants' proposed accounting and ratemaking treatment of the Transaction are not in the public interest, do not satisfy the best interest of the State and communities served by the Hawaiian Electric Companies and will not provide significant, quantifiable benefits to the HECO Companies' ratepayers in either the short or the long term. With respect to Issues 2 and 2a, my testimony explains why, from a ratemaking perspective, Applicants have not demonstrated they 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 or that the Proposed Transaction, if approved, will result in more affordable electric rates for the customers of the HECO Companies.
Q. WHY DO YOU RESPOND “YES” ON ISSUE NUMBER 6, REGARDING WHETHER 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?

A. In the event the Commission or the Applicants desire guidance in ways the Consumer Advocate believes that the proposed Transaction and the regulatory treatment of the Transaction could be improved, to make it more consistent with the Commission’s public interest and fit/willing/able review standards, the Consumer Advocate is offering certain “Conditions” that are summarized in Mr. Nishina’s testimony. In the final section of this testimony, I am sponsoring several of these conditions, including an alternative rate case moratorium arrangement ("Rate Plan") for consideration by the Commission and Applicants.

Q. HOW IS THE BALANCE OF YOUR TESTIMONY ORGANIZED?

A. My testimony is arranged in topical sections, as outlined in the index presented above.
II. PROJECTED TRANSACTION-ENABLED COST SAVINGS.

Q. DO THE APPLICANTS CONTEND THAT THE PROPOSED TRANSACTION WILL YIELD MEASURABLE COST SAVINGS THAT WILL BENEFIT THE HAWAIIAN ELECTRIC COMPANIES’ RATEPAYERS?

A. Yes. According to Applicants' witness Mr. Reed, the proposed Transaction, “…offers clear, immediate and quantifiable benefits to the Hawaiian Electric Companies’ customers.” The claimed Transaction benefits are presented by Mr. Reed in two forms. He first states, “[t]he Applicants have committed to a base rate moratorium of at least four years and to suspending for this four-year period the rate increases that would otherwise occur pursuant to the operations and maintenance expense rate adjustment of the decoupling Rate Adjustment Mechanism (“O&M RAM”). As discussed later in my testimony, these commitments alone will provide an estimated $60 million in customer savings.”⁶ Beyond these “customer savings,” Mr. Reed also states that “merger savings are expected to be achieved during the base rate moratorium and after the base rate moratorium.”⁷

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⁶ Applicants Exhibit-33, page 7.
⁷ Applicants Exhibit-33, page 7.
Q. IS THERE A DIFFERENCE BETWEEN “CUSTOMER” SAVINGS FROM THE RATEMAKING COMMITMENTS DESCRIBED BY APPLICANTS, COMPARED TO UTILITY COST SAVINGS THAT COULD BE REALIZED BY THE HAWAIIAN ELECTRIC COMPANIES IF THEY MERGE WITH NEXTERA?

A. Yes. Customer savings and utility cost savings may be conceptually related, but are actually quite distinct. Customer savings typically arise from regulatory commitments or conditions and represent foregone revenues for the utility that reduce future utility earnings if not offset by Transaction-enabled cost savings that are realized by the utility. On the other hand, Transaction-enabled cost savings may be realized by the utilities, which tend to increase future utility earnings, but only to the extent such savings are not being credited to customers through regulatory commitments or conditions that reduce utility revenues. It is reasonable to think of Transaction-enabled cost savings as first benefiting the utility and its shareholders, with such benefits to shareholders then reduced by the portion of any benefits that are affirmatively passed through to the utility’s customers.

As a point of reference, the Applicants’ witnesses refer to several categories of potential future cost savings and then recommend a rate case moratorium of at least four years, along with removal of O&M RAM adjustments from the RAM mechanism during this moratorium period. Applicants Exhibit-15 is a one-page “Base Rate Moratorium Qualifications”
summary that is relied upon by Mr. Oshima in his explanation of why the Proposed Transaction would be in the best interests of the State’s economy and the communities served by the HECO Companies.  

Similarly, Mr. Gleason explains that NextEra commits that for at least four years following the closing of the Proposed Change in Control, the HECO Companies will not submit any applications for base rate increases, which he concludes will yield, “…an estimated $60 million in customer savings” because of a further commitment to forego Rate Adjustment Mechanism expense increases during that moratorium period.  

Q. HAVING DISTINGUISHED BETWEEN CUSTOMER AND UTILITY COST SAVINGS BENEFITS, DOES THIS SECTION OF YOUR TESTIMONY ADDRESS THE APPLICANTS’ PROPOSED RATE CASE MORATORIUM AND O&M RAM CONCESSIONS THAT ARE SAID BY APPLICANTS TO PRODUCE “CUSTOMER” SAVINGS?

A. No. I will respond to the Company’s proposed regulatory commitments and recommended moratorium rate plan benefits in a later section of my testimony. In this section, I will focus upon the claimed cost savings that are estimated to be realizable by the Hawaiian Electric Companies from the proposed Transaction.

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8 Applicants Exhibit-1, page 14.

Q. HAVE THE APPLICANTS PREPARED A SINGLE, DETAILED ESTIMATE OF
THE COST SAVINGS THAT MAY BE ACHIEVABLE IF THE TRANSACTION
IS APPROVED AND CONSUMMATED?

A. No. An early cost savings estimate was prepared by NextEra to evaluate,
within a financial model, the expected financial impact of the Proposed
Transaction, before somewhat more detailed cost savings estimates were later
prepared and sponsored by Mr. Reed. I understand that these early NextEra
savings estimates were relied upon to guide NextEra in its financial analysis of
the Proposed Transaction and to support its efforts in negotiating and finalizing
the financial terms of the Agreement and Plan of Merger.¹⁰

Then, Mr. Reed was retained by the Applicants, following the execution
of the Proposed Transaction, and he prepared a series of broader estimates of
potential cost savings that are based upon comparisons to other utility merger
taxtion cost savings studies and limited scope analyses that are explained
in his testimony.

¹⁰ Applicants' response to CA-IR-128. In its initial response to CA-IR-128, NextEra states, after
objecting, that its financial modeling, “…was assembled on a confidential basis and at
considerable expense of time and money by NextEra Energy for its sole use in seeking to
evaluate and acquire the Hawaiian Electric Companies through the acquisition of the
outstanding shares of Hawaiian Electric Industries, Inc. (“HEI”).”
Even Mr. Reed’s savings estimates are preliminary and incomplete. Applicants’ response to Consumer Advocate CA-IR-303 states:

Complete estimates of annual costs to achieve merger savings, annual expense savings and annual capital cost savings in each available year after closing have not yet been developed. As reflected in the testimony of Eric Gleason, the integration planning process is just getting underway, and the most specific opportunities for cost savings enabled by the merger likely will not be identified until the companies begin operating together.\(^{11}\)

It is not unusual for utility merger savings estimates to remain highly uncertain until management and operational integration of the businesses is carefully analyzed and decisions are made across functional areas to make changes in policies, processes, automated systems and organizational structures that create the opportunity for specific benefits to be achieved.

Q. **BEFORE THE FINAL MERGER AGREEMENT AND PLAN OF MERGER\(^{12}\)** WAS EXECUTED, WHAT LEVEL OF COST SAVINGS WAS INITIALLY ESTIMATED TO BE ACHIEVABLE BY NEXTERA IN EVALUATING THE OPPORTUNITY TO MERGE WITH HAWAIIAN ELECTRIC?

A. A financial forecasting model was prepared and relied upon by NextEra to evaluate and quantify the financial results expected to be achieved upon merging with the Hawaiian Electric Companies. An Excel version of the

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\(^{11}\) Applicants’ supplemental response to CA-IR-303(a) dated July 20, 2015.

\(^{12}\) See Applicants Exhibit 13.
NextEra confidential financial model was provided in Applicants' response to CA-IR-128. In that model, NextEra assumed that certain non-fuel Operations and Maintenance ("O&M") expense savings could be achieved after acquisition and integration of the Hawaiian Electric Companies. The basis for such assumed cost savings was explained in the confidential response to CA-IR-129 which stated:

NextEra Energy understands this question to be asking about cost savings or other financial benefits assumed to be enabled by the Agreement and Plan of Merger from the financial perspective of NextEra Energy and not from the perspective of the customers of the Hawaiian Electric Companies. NextEra Energy has not performed an analysis to quantify each element of cost savings or other financial benefit that was assumed to be enabled by the Agreement and Plan of Merger. NextEra Energy assumed non-fuel O&M cost savings relative to an assumed level of O&M on a stand-alone basis of [REDACTED] for the first three full years of ownership of the Hawaiian Electric Companies, with savings continuing at the [REDACTED] beyond year three. These high-level savings assumptions are based largely upon the relative cost positions of the two companies, with Florida Power & Light Company ["FPL") being best-in-class in O&M per kWh and the Hawaiian Electric Companies having a fourth quartile ranking on this metric.

The response to CA-IR-335 further explained NextEra’s, “...financial model assumed only non-fuel O&M savings and did not estimate any potential capital savings. As such, a reconciliation between the savings estimates in the financial model and each element of savings developed by Mr. Reed would not be a meaningful comparison.”
Q. IF THE PERCENTAGES INITIALLY USED BY NEXTERA TO ESTIMATE EXPECTED TRANSACTION-ENABLED COST SAVINGS WITHIN ITS FINANCIAL MODEL WERE APPLIED TO THE STAND-ALONE O&M OF THE HAWAIIAN ELECTRIC COMPANIES IN CALENDAR 2014, WHAT AMOUNTS OF ANNUAL COST SAVINGS WOULD BE EXPECTED?

A. In 2014, the Hawaiian Electric Companies reported non-fuel “Other operation and maintenance expense” in their U.S. Securities and Exchange Commission (“SEC”) Form 10K of $410.6 million. Applying the O&M net savings percentages used in NextEra’s initial financial modeling to this level of stand-alone would yield expected annual net expense savings of **[redacted]** in the first post-acquisition year, **[redacted]** in year two and **[redacted]** in each year thereafter.\(^\text{14}\)

\(^\text{13}\) HEI and HECO, Combined SEC Form 10-K for calendar 2014, page 122. Mr. Reed also refers to a “confirmed 2014 level of non-fuel O&M of approximately $410 million” at page 32 of Applicants Exhibit-33.

\(^\text{14}\) Derived by applying the confidential percentages from CA-IR-129 quoted above to the $410.6 million in 2014 total non-fuel O&M expense, without compounding the expense reduction percentages from year to year.
Q. SHIFTING TO THE ESTIMATES THAT WERE LATER PREPARED BY MR. REED AND INCLUDED IN HIS TESTIMONY, PLEASE OUTLINE THE COST SAVINGS THAT THE APPLICANTS NOW CONTEND ARE ENABLED BY THE PROPOSED TRANSACTION.

A. In Mr. Reed’s Direct Testimony, cost savings are estimated to be enabled by the Transaction within three broad categories: 1) construction program capital expenditure savings, 2) debt cost (interest) savings, and 3) non-fuel O&M savings. With respect to the first category, Mr. Reed claims a “massive long-term savings opportunity” exists through expected savings in capital expenditures, based upon the work of a “NextEra Project review team” that “…has concluded that project-level savings of 10% of currently planned costs are reasonable to expect.” He explains in testimony his consultations with members of NextEra’s “Integrated Supply Chain (“ISC”), Engineering & Construction (“E&C”) and Treasury groups” that involved an “executive level review” of several projects he lists in testimony to support his 10 percent cost reduction expectation.

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15 Applicants Exhibit-33, pages 21 and 24.
16 Id. pages 22-24.
Mr. Reed also identifies certain benefits from “access to lower cost debt” that “are highly likely to be produced by the Proposed Transaction” that would be additive to the aforementioned project-level savings.\textsuperscript{17} He also states his expectation for “savings in the area of fuel expenses” based upon NextEra’s “significant expertise in fuel procurement and management” and NEE’s “extensive relationships with a broad cross section of fuel supply vendors” and he indicates that, “[u]pon approval of the Proposed Transaction, NextEra and the Hawaiian Electric Companies will begin formulating specific plans to identify and pursue areas of savings and other efficiencies with regard to fuel procurement.”\textsuperscript{18}

Mr. Reed further states, “I expect the merger will produce savings in the range of 10 percent of non-fuel O&M costs of the Hawaiian Electric Companies after a five to ten year ramp-up period relative to what non-fuel O&M costs would have been absent the Proposed Transaction.”\textsuperscript{19} Mr. Reed elaborates on this O&M savings estimate through what he calls his “analysis of quick hit opportunities” that are explained in some detail later in his testimony.\textsuperscript{20} In this category, the projected O&M savings are significantly

\footnotesize{\textsuperscript{17} Id. page 26. \\
\textsuperscript{18} Id. page 36. \\
\textsuperscript{19} Id. page 21. \\
\textsuperscript{20} Id. pages 34-36.}
lower than NextEra’s initial estimates, described above, that were included in pre-Transaction financial modeling.

Finally, Mr. Reed discusses “other benefits associated with the Proposed Transaction that cannot be quantified at this time” including “access to the world class expertise that exists at NextEra.”

Q. DOES MR. REED COMPILE ANY SUMMARY OF HIS ESTIMATED COST SAVINGS WITHIN HIS TESTIMONY OR WITHIN ANY EXHIBITS TO HIS TESTIMONY?

A. No. However, in response to Consumer Advocate information requests, a summary of Mr. Reed’s cost savings estimates has been provided and revised since Mr. Reed’s testimony was prepared. Estimated cost savings were most recently summarized in Applicants’ July 20, 2015 supplemental response to CA-IR-303, and include:

- Average 10% savings on capital programs following integration of the supply chain, construction management and engineering processes. Assuming overall Hawaiian Electric Companies’ Power Supply Improvement Plan (“PSIP”) investment in future years aggregating up to $8 billion, these claimed savings could ultimately reach $800 million if achieved.

- Debt cost savings, starting at approximately $0.2 million in year 1 and ramping to $2.4 million by year 5, with additional savings possible over time from refinancing existing debt. As debt costs decline, Allowance Funds Used During Construction (“AFUDC”) rates applied to construction costs would also be reduced.

21 Id. pages 36-38.
Non-fuel O&M savings of approximately $100 million over the first five years, including insurance cost savings, external audit fee savings, Information Management ("IT") software license and maintenance cost savings, estimated 5% cost savings in procurement costs within five years, yielding an estimated 10% total annual steady state non-fuel O&M savings within four years.

Fuel cost savings of $10 to $20 million utilizing NextEra’s expertise in fuel procurement and management as well as fuel vendor relationships. Generation modernization activities in 2021 are expected to yield another $15 to $20 million per year in fuel cost savings through the use of combined cycle gas turbines, presumably enabled by access to NextEra’s generation fleet modernization experience.

Offsetting these estimated savings would be any costs incurred to integrate business operations, provide consultative services, negotiate improved vendor pricing, consolidated information technology processes and adopt new business policies and procedures required to achieve targeted savings. As noted above, the Applicants have provided no detailed estimates of these integration costs.23

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22 Applicants’ response to CA-IR-303, Supplement dated 7/20/2015, pages 33 through 38. Additional “savings” are claimed from a four-year general base rate case moratorium, but these amounts represent foregone revenues, rather than any actual cost savings, except for avoided rate case expenses during the moratorium period.

23 In Applicants’ Supplemental Response to CA-IR-303 dated July 9, 2015, “Costs to Achieve” are characterized as, “While no comprehensive analysis has been performed, based on experience in other mergers, Concentric [Navigant Consulting ("Concentric")] has estimated costs to achieve merger savings average approximately 25% of total savings when measured over the entirety of the merger savings ramp up period (e.g., $10 million of costs for $40 million of savings).” See also Applicants’ response to CA-IR 356 for additional discussion of “Costs to Achieve.”
Q. ARE THE APPLICANTS' ESTIMATES OF EXPECTED COST SAVINGS, NET OF BUSINESS INTEGRATION COSTS, DETAILED ENOUGH TO CONCLUDE THAT ANNUAL SAVINGS WILL, IN FACT, EXCEED INTEGRATION COSTS IN EACH YEAR AFTER THE PROPOSED TRANSACTION IS CONSUMMATED?

A. No. The Applicants' cost savings estimates are not detailed, are not broken down by year, and have not been netted against the costs that must be incurred to achieve such savings. Mr. Reed's cost savings estimates are much more general and judgment-based. According to Mr. Reed's testimony:

"[a]t the request of NextEra, our firm has been engaged in conducting a first-phase identification and quantification of merger savings opportunities for the post-merger companies. Our review to date has focused on 'quick hit' opportunities for cost reductions in three distinct areas: 1) capital expenditures; 2) non-fuel O&M costs; and 3) debt costs." Mr. Reed's cost savings estimates and the expected integration costs required to achieve such savings are not compiled within annual summaries, net of integration costs, anywhere in his testimony. Because of the absence of any summarized data, the Consumer Advocate submitted CA-IR-303 asking for, “the most detailed available estimates of annual costs to achieve merger savings, annual expense savings, and annual capital cost savings in each available year after closing the proposed Change in Control, in as much detail as possible.” In its

24 Applicants Exhibit 33, page 19.
supplemental response to this request, Applicants provided an extensive narrative of the ongoing work done collectively related to "consent approvals required under the Merger Agreement or a consulting agreement" that include Smart Grid, Information Management work on Enterprise Resource Planning/Enterprise Asset Management ("ERP/EAM") implementation integration, Independent Power Producers ("IPP") contract modification and facilities acquisition options and several fuel, Liquefied Natural Gas ("LNG") and Energy Cost Adjustment Clause ("ECAC") incentive projects where a potential for future cost savings has been identified.  

Aside from these project-related collaborative efforts, Mr. Reed’s testimony clearly indicates that "NextEra and the Hawaiian Electric Companies have not yet focused extensively on where and how the companies will be able to realize savings in non-fuel O&M costs, or prepared a detailed estimate of such savings."  

Q. WOULD IT BE FAIR TO CHARACTERIZE THE APPLICANTS’ ESTIMATES OF EXPECTED NET MERGER COST SAVINGS AS LARGELY SPECULATIVE AND SUBJECT TO SIGNIFICANT FUTURE REVISION?  

A. Yes. Throughout Mr. Reed’s testimony the preliminary and inherently imprecise nature of his merger savings estimates are apparent. For example, Mr. Reed’s estimated potential savings in future Hawaiian Electric capital

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25 Applicants’ Response to CA-IR-303, supplement 7/20/2015, pages 2-29.  
expenditures are quantified as, “10% of currently planned costs” and the support for this quantification is revealed in the related explanatory narrative stating, “NextEra’s review team has estimated that the generic composition of the savings it expects to achieve is 3% from design optimization, 3% from improved supply chain pricing, 2% from the incorporation of lessons learned and best practices from across the NextEra fleet, and 2% from enhanced construction management.”\textsuperscript{27}

With respect to his estimated non-fuel O&M expense savings, similarly general characterizations are offered by Mr. Reed from what he refers to as “two distinct analyses, one related to industry averages for non-fuel O&M savings in recent utility mergers” from which he concludes that, “recent transactions have a central tendency in the range of 15% of the acquired company’s non-fuel O&M” but that for the HECO Companies, “[t]hese data suggest that the near-term (i.e., 4 year) savings that could be achieved in the Proposed Transaction are less than 10% of the Hawaiian Electric Companies’ non-fuel O&M costs…..[of] up to $40 million per year of savings.”\textsuperscript{28} Mr. Reed describes his second approach to O&M savings estimation as an “early-state savings estimate for this Proposed Transaction” that he later refers to as an “analysis of quick hit opportunities” from which he concludes, “[b]ased on my

\textsuperscript{27} Applicants Exhibit-33, pages 24-25.  
\textsuperscript{28} Id. pages 30-32.
initial review, it is reasonable to expect at least $100 million [of] merger savings over the 5 year study period."

Q. WHAT HAVE YOU CONCLUDED WITH RESPECT TO THE APPLICANTS' EXPECTED COST SAVINGS THAT MAY RESULT FROM THE PROPOSED TRANSACTION?

A. I believe that the potential cost savings enabled by the Transaction, initially estimated by NextEra and later re-estimated by Mr. Reed, are highly speculative at this time because of the limited amount of detailed analysis that has been completed to create an understanding of precisely how the NextEra business organization can most efficiently be integrated with the Hawaiian Electric Companies. There has been no analysis to date determining the scope and specific elements of needed integration work, a schedule to complete such work, the costs that would be incurred in each element of such integration efforts, or any detailed quantification of eventual cost savings that may be achievable within each business process area upon completion of all integration efforts.

29 Id. pages 30-31 and page 34.
Q. WHAT IS NEXTERA’S PLAN FOR COMMENCING DETAILED INTEGRATION WORK?

A. According to Applicants’ supplemental response to CA-IR-298 dated July 9, 2015, NextEra Energy recently retained Boston Consulting Group as its integration consultant on June 10, 2015, and has brought on board additional NextEra Energy and Hawaiian Electric team members to establish a core Integration Management Office (“IMO”), established guiding principles and a preliminary team structure, and commenced culture assessment planning and planning for the first executive steering committee. Thus, detailed analysis of integration issues and options and the planning process for business integration is only now beginning.

It is impossible to specifically identify and accurately quantify the scope of activities and specific cost/benefit results to be expected from the proposed Transaction and the integration of the businesses until more work has been completed. The limited progress with respect to Applicants’ integration work and the status of these efforts has been the subject of information requests that discuss “legal and practical constraints” on NextEra’s ability to develop plans and projects in coordination with the Hawaiian Electric Companies prior to the transaction’s consummation. In its recent response to CA-IR-360, Applicants characterized the merger integration planning process as “...just

See, for example, Applicants’ responses to CA-IR-171, CA-IR-176, OP-IR-7, OP-IR-128 and DBEDT-IR-124.
now kicking off and it is not known at this time what services will be provided
to the Hawaiian Electric Companies from FPL, or if those services can be
provided with the existing support structure.”

Q. HAVE ANY THIRD PARTY ANALYSTS PUBLISHED COMMENTS
REGARDING THE EXPECTED COST SAVINGS SYNERGIES THAT MAY
RESULT FROM THE PROPOSED TRANSACTION?

A. Yes. In response to PUC-IR-32, Applicants provided an Attachment
containing financial analysts’ reports, including a Deutsche Bank Markets
Research “Breaking News” document described the announced Transaction
between NEE and Hawaiian Electric (“HE” in the document) and stated,
“Synergies not the key driver. Meaningful O&M synergies are unlikely, in our
view given the geographic distance between the two utilities and NEE already
having committed to no involuntary workforce reductions keeping HE’s HQ in
Hawaii. That said, NEE expects the deal to be neutral to EPS in the first full
year after close and accretive in Y2 and thereafter based on growth in HE’s
rate base.”

31 Applicants response to PUC-IR-32, Attachment 1, supplement June 15, 2015, page 570.
Q. ARE THE COST SAVINGS ESTIMATES THAT HAVE BEEN SUBMITTED BY THE APPLICANTS SO SPECULATIVE THAT THEY SHOULD BE COMPLETELY DISCOUNTED BY THE COMMISSION IN ITS EVALUATION OF PUBLIC INTEREST BENEFITS THAT MAY RESULT FROM THE PROPOSED TRANSACTION?

A. No. But Applicants’ broad gauge estimates of potential cost savings cannot be relied upon to conclude that the Proposed Transaction is clearly consistent with the public interest. I agree with Applicants that there is an opportunity to achieve significant post-Transaction cost savings through careful comparative analysis by NextEra and the Hawaiian Electric Companies of each entity’s business processes and procedures, vendor/contractor arrangements, potentially shared automated systems, proven effective business practices and other business intelligence, followed by careful change management and the systematic integration of common corporate support functions. However, it is far from certain that significant net cost savings at estimated levels will actually be achieved. If the Transaction is approved by the Commission, Applicants should be expected to evaluate the costs and risks associated with each of the individually significant business integration issues, to ensure that expected cost savings justify the incurrence of such costs and risks. On the

32 This responsibility has been acknowledged in Applicants response to CA-IR-360(b) which states, “It will be important to evaluate the net impact of all corporate service costs for the Hawaiian Electric Companies whether source from affiliates, contractors, consultants or internal labor to determine the ultimate benefits delivered to the Hawaiian Electric Companies customers.”
other hand, as noted earlier in this testimony, there is a meaningful difference between realized cost savings for the utility and realized cost savings that are translated into tangible benefits for utility customers. While the projected net savings that may accrue to the Hawaiian Electric Companies from the proposed Transaction are highly uncertain, they are potentially quite beneficial if and when they materialize and should be expected to improve upon the high cost and high utility rate environment that has burdened ratepayers in this State for many years.

Q. WHAT CAN THE COMMISSION DO TO ENSURE THAT REGULATORY APPROVAL OF THE PROPOSED TRANSACTION, BASED UPON ACCEPTANCE OF APPLICANTS’ SPECULATIVE ESTIMATES OF FUTURE NET COST SAVINGS OPPORTUNITIES, WOULD TRULY BE CONSISTENT WITH THE PUBLIC INTEREST?

A. The best way for the Commission to “firm up" the inherently uncertain estimates of cost savings that may result from the proposed Transaction is to condition regulatory approval of the Transaction upon the implementation of a “Rate Plan" that ensures that significant positive benefits will actually flow to ratepayers. In the next section of testimony, I will present and explain the Consumer Advocate’s recommended “Rate Plan" that is designed to accomplish two goals:
Acceptance and reliance upon Applicants’ submitted estimates of Transaction-enabled net cost savings, within an enforceable base rate case moratorium period that maintains the existing regulatory framework and various Commission-approved rate adjustment mechanisms, and

- Updating of the utilities’ allowed cost of equity and equity ratios, at the inception of an enforceable base rate case moratorium, to ensure ratepayer participate in the currently low interest rate environment and the financial leverage and lower capital cost benefits expected to be realized during the moratorium.

The Consumer Advocate’s recommended Rate Plan is explained in greater detail in the following section of my testimony.

### III. PROPOSED RATE PLAN BENEFITS.

#### A. APPLICANTS’ RATE PLAN.

Q. HAVE THE APPLICANTS RECOGNIZED THE NEED FOR CHANGES TO THE EXISTING REGULATORY FRAMEWORK IF THE PROPOSED TRANSACTION IS APPROVED AND CONSUMMATED?

A. Yes. A four-year rate moratorium is proposed, that is subject to multiple conditions as described in Applicants Exhibit-15. Mr. Oshima refers to this proposal stating, “Highlights of the Application include a commitment to not file a request for a general base rate increase for at least four years
post-transaction close and approximately $60 million in quantified customer
savings, both subject to approval of certain conditions as explained in the
testimony of Eric Gleason [in] Applicants Exhibit-7."33 I will discuss the details
of Applicants’ rate case moratorium proposal in more detail later in this section
of my testimony.

Q. AS A PRELIMINARY MATTER, WILL RATEPAYERS RECEIVE ALL OF THE
$60 MILLION IN “QUANTIFIED CUSTOMER SAVINGS” THAT MR. OSHIMA
REFERENCES IN HIS TESTIMONY?

A. Ratepayer realization of all of the claimed amount of ratepayer savings was
not certain from the Applicants’ filed testimony. Language within Applicants
Exhibit-15 indicates the Applicants would, “…forego recovery of the
incremental base expenses through the O&M RAM mechanism for at
least 4 years.” However, the “O&M RAM mechanism” was made subject to an
overall RAM Cap calculation in the Commission’s Order No. 32735 in Docket
No. 2013-0141. The new RAM Cap encompasses all elements of the RAM.
Thus, the Cap could serve to limit future O&M RAM increases even without
Applicants’ new offer to forego such increases.

However, in a supplemental response to CA-IR-96, the Applicants
provided an Attachment 1 that illustrates a method through which “O&M RAM
Savings per merger application” amounts could be hard input after the RAM

33 Applicants Exhibit-1, page 14.
Cap is applied, in fixed amounts that ensure this cumulative “savings” is realized by ratepayers. Later, in response to CA-IR-350, Applicants confirmed their intent to now revise their Exhibit 15 O&M RAM provision, as shown in the CA-IR-96 Attachment 1 schedules, in order to “agree to fixed dollar reductions in the RAM Revenue Adjustment portion of the RAM filings, equaling $60 million across four years…”

Q. TURNING TO THE APPLICANTS’ PROPOSED MORATORIUM ON BASE RATE CASES, IS IT OBVIOUS THAT THIS PROPOSAL WOULD BENEFIT RATEPAYERS?

A. No. The actual value of any rate case moratorium is a function of the reasonableness of the present rates at the inception of any moratorium as well as all of the other terms and conditions effective during the moratorium that impact rates actually charged to customers.

B. A RATE CASE MORATORIUM IS NEEDED.

Q. DO YOU AGREE WITH APPLICANTS THAT IT IS IMPORTANT TO STABILIZE UTILITY RATES AND AVOID TRADITIONAL RATE CASES IN THE YEARS IMMEDIATELY AFTER A CHANGE IN CONTROL?

A. Yes. A change in control event exposes the utility to significant organizational change, potentially large one-time restructuring efforts and costs and increased uncertainty with respect to forecasted expense and investment
levels in any particular test year. After the proposed Transaction is consummated, senior management and corporate support functions that currently reside within Hawaiian Electric Company and HEI, for which costs are currently allocated among the Hawaiian Electric Companies and American Savings Bank ("ASB"), would be replaced in ways yet to be determined, using some mix of Hawaiian Electric, NextEra and Florida Power & Light senior management and corporate support functionality.\(^{34}\) Additionally, NextEra has indicated an intent to achieve future cost savings by applying its expertise and business methods to utility operations in Hawaii. As an example, Mr. Gleason states, “NextEra Energy brings world-class engineering, procurement and construction capabilities to major capital projects, driving down their cost, and thereby depreciation expense.”\(^{35}\) When asked about how these capabilities are planned to be deployed, NextEra responded that no plans or decisions have been made, but that, “NextEra Energy anticipated being able to ‘plug in’ Florida based resources to support the locally-based Hawaiian Electric Companies’ team on major projects.”\(^{36}\)

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\(^{34}\) In response to CA-IR-28, NextEra indicated that it has not created a detailed department-by-department organizational chart and the response to DBEDT-IR-124 states, “NextEra Energy has not evaluated or determined yet a date for the creation of such a chart.”

\(^{35}\) Applicants Exhibit 7, page 18.

\(^{36}\) See NextEra Supplemental Response to CA-IR-171 dated July 6, 2015.
Q. **IS IT REASONABLE TO EXPECT BUSINESS INTEGRATION ACTIVITIES TO EXTEND OVER MANY MONTHS AFTER THE PROPOSED TRANSACTION IS CONSUMMATED?**

A. Yes. Mr. Gleason states, “Joining NextEra will provide the Hawaiian Electric Companies with access to the technologies, best practices and expertise of an industry leader, all under the direction of local management. While the integration planning process is just getting underway, most specific opportunities for cost savings enabled by the merger likely will not be identified until the companies begin operating together.”

After explaining his expectations for expected benefits to Hawaii customers and communities at pages 14 to 18 of his testimony, Mr. Gleason observes, “While the existence of these potential benefits is clear, we recognize that the magnitude and timing are less clear. This has led us to propose tangible cost reductions for customers over the medium term, as discussed below in Issue 1.b.”

He repeats this conclusion at page 26 and states, “That said, we appreciate the Commission’s desire to quantify benefits, so to bridge this gap we have done two things. First, John Reed from Concentric has estimated the magnitude and timing of some of the potential cost savings we have identified (Applicants Exhibit-33). Second, let me here emphasize NextEra Energy’s commitment to provide customers the benefit of a four-year base rate

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37 Applicants Exhibit-7, page 16.

38 Id. Page 18.
moratorium.” For his part, Mr. Reed indicates that, “In the case of the
Proposed Transaction, while I have no doubt that significant merger savings
will be achieved during and after the rate moratorium period, it is reasonable to
expect that this integration process will occur at a slower pace than many
deals that are driven by the need to achieve more immediate and aggressive
reductions in headcount and compensation.”39

Q. WOULD IT BE POSSIBLE TO EFFICIENTLY PROCESS A TRADITIONAL
RATE CASE DURING APPLICANTS’ PROPOSED FOUR YEAR BASE RATE
CASE MORATORIUM AND BEFORE NEXTERA’S PLANNED BUSINESS
INTEGRATION ACTIVITIES ARE COMPLETED?

A. No. It would be extremely difficult for the Hawaiian Electric Companies to
attempt development of the types of detailed expense and investment
forecasts that must be developed and defended within rate case proceedings,
at the same time an extensive process of planning and implementing business
integration activities is underway. Since a forecasted test year is used in
Hawaii, the utilities would be required to adopt and be able to defend
forecasting assumptions about future business activities and costs that are in
transition and inherently uncertain. At the same time, a conceptual approach
for the ratemaking treatment of business integration costs would be required,
reasonably balancing any request for rate recovery of such costs against the

39 Applicants Exhibit-33, page 20.
inclusion of offsetting and uncertain cost savings intended to be achieved as a result of such costs.

In turn, it would be very difficult for the Consumer Advocate and the Commission to gain comfort with the reasonableness of test year forecasting assumptions that may be adopted by the utilities in the midst of business restructuring activities, when historical costs may no longer serve as a reasonable basis for comparison to forecasted costs. Any revenue requirement determined for a utility test year falling soon after the Proposed Transaction is closed is likely to be burdened with complex and controversial issues arising from the uncertainties caused by business integration decisions and activities.

Finally, any rate case occurring within a few years of a change in control could, either intentionally or inadvertently, include within the revenue requirement potentially significant one-time costs arising from the transition to new ownership and the integration of business processes and organizations.
Q. HAS THE COMMISSION IMPOSED CONDITIONS IN PRIOR CHANGE OF
CONTROL DOCKETS INVOLVING HAWAII UTILITIES THAT WERE
DESIGNED TO PRECLUDE RATE RECOVERY OF MERGER
INTEGRATION COSTS?

A. Yes. In previous Hawaii change in control proceedings, the one-time costs
associated with utility merger and acquisition integration activities were
referred to as “transition” costs. In Docket No. 02-0060 involving KIUC, the
Commission’s Decision and Order approved a Stipulation that included the
following conditions:

Applicants acknowledge the commission's policy to not allow
accounting deferral or recovery from utility customers of transaction
and transition costs arising from utility merger and acquisition
transactions. In accordance with this policy, KIUC will not seek rate
recovery of any transaction or transition costs or amortization of
such costs in future rate proceedings.40

In approving the merger transaction conveying Verizon Hawaii Inc.’s business
and assets into Hawaiian Telcom, the Commission’s Decision and Order
approved a combination of rate case moratorium and non-recovery of
transition cost conditions that had the effect of shielding ratepayers from any
rate recovery of post-merger transition costs:

1. Hawaiian Telcom commits to not submit any application for a
general utility rate increase that would utilize a prospective
test year earlier than calendar year 2009, unless the
Commission finds that a compelling financial need justifies
the waiver of this condition. Before any consideration shall
be given to any general rate increase case using a test year

40 Docket No. 02-0060, Decision and Order No. 19658, September 17, 2002, page 29.
earlier than calendar year 2009, Carlyle, as ultimate owner of Hawaiian Telcom, shall make an additional equity capital investment in Paradise HoldCo or Hawaiian Telcom equal to the amount of the annual revenue increase proposed by Hawaiian Telcom in that general rate increase application. In addition to the equity infusion, Hawaiian Telcom will not object to the imputation of 67% of its affiliate's revenues from local directory operations as part of Hawaiian Telcom's test year annual revenue requirement in any general rate increase case utilizing a test year earlier than calendar year 2009. In any rate case using a test period 2009 or any subsequent test period, Hawaiian Telcom, the Consumer Advocate and all other parties may present other positions on the treatment of imputed directory revenues during such cases. Notwithstanding the above, events such as acts of God (i.e., major uninsured storm losses and other events of force majeure) or damage sustained as a result of a terrorist attack would not be subject to this Condition No. 1. [footnote omitted]

3. None of the transaction and transition costs incurred by the "Buyer" and "Seller" (as those terms are defined in the "Agreement" described in Section II below) (see Exhibit 1 of the Application) shall be deferred as a regulatory asset for future recovery from ratepayers. In the event transaction or transition costs are recorded as assets on the books of Hawaiian Telcom, the amortization of such assets shall be completed by December 31, 2008, for ratemaking purposes. [footnote omitted].

Again, in the latest change in control involving The Gas Company (dba Hawaii Gas), the Commission's Decision and Order adopted conditions that included a rate case moratorium and non-recovery of transaction and transition costs:

Docket No. 04-0140, Decision and Order No. 21696, March 16, 2005, pages 29-31, 48, and 56.
1. None of the transaction and transition costs incurred by the Buyer and Seller shall be deferred as a regulatory asset for future recovery from ratepayers.

2. [Hawaii Gas] commits to not submitting any Application for a general utility rate increase that would utilize a prospective test year earlier than calendar 2009, unless the [Commission] finds that a compelling financial need justifies the waiver of this condition.42

Q. WHY DO MERGER INTEGRATION COSTS REPRESENT AN IMPORTANT CONCERN FOR THE COMMISSION IN REVIEWING THIS TRANSACTION?

A. As was the case in these prior Hawaii transactions, during the proposed integration of the Hawaiian Electric Companies with NextEra, one-time costs are likely to be incurred for additional consulting services (beyond Boston Consulting’s initial engagement) and significant incremental costs may ultimately be incurred for integration of automated information technology systems, finance and reporting processes and systems, human resources, treasury and other corporate support functions. Mr. Gleason’s testimony emphasizes NextEra’s financial strengths, capital project execution skills, operating cost effectiveness, renewable energy acumen and recent experience in modernizing utility generation and distributions facilities, indicating plans for these capabilities to be deployed in Hawaii, making it clear that significant reorganization and change to existing policies, procedures,

organizations and cost structure are anticipated. Because of the scope of
the promised integration, Applicants will undoubtedly incur significant travel
and meeting costs, and may later determine it reasonable to offer some
employees incentives for retention, voluntary resignation or relocation, adding
to the one-time costs of integration.

Q. WOULD A RATE CASE MORATORIUM HELP TO REDUCE THE RISK THAT
ANY ONE-TIME COSTS OR INEFFICIENCES CAUSED BY BUSINESS
INTEGRATION ACTIVITIES DO NOT ADVERSELY IMPACT CUSTOMER
RATES?

A. Yes. A primary reason for imposing a rate case moratorium is avoiding the
complexities of isolating and removing unusual and one-time transition costs
while dealing with the uncertainties of accurately forecasting normal, ongoing
expense and investment levels before a steady-state operating environment
has been established for the post-Transaction enterprise. A secondary benefit
is the avoidance of the management distraction and cost associated with
processing rate cases in this complex and changing business environment.

C. APPLICANTS’ RATE PLAN IS UNACCEPTABLE.

Q. IT WOULD APPEAR THAT YOU AGREE WITH THE APPLICANTS THAT SOME FORM OF RATE CASE MORATORIUM IS APPROPRIATE IF THE PROPOSED TRANSACTION IS APPROVED BY THE COMMISSION. ARE THE TERMS OFFERED BY APPLICANTS FOR A RATE CASE MORATORIUM ACCEPTABLE?

A. No. The “Base Rate Moratorium Qualifications” set forth in Applicants Exhibit-15 are unacceptable for several reasons, including:

- The offered Moratorium would “not apply” and would become unenforceable in the event any vaguely defined “financial distress” condition occurs, such as the incurrence of an “extraordinary expense” or if any “circumstances otherwise arise that create a compelling financial need.”

- A condition that there be “no material change in the current formulation of the decoupling mechanisms” even though such a change has already occurred through the Commission Order No. 32735, as noted in footnote 1 of Applicants Exhibit-15.

- A condition that a list of eight other ratemaking mechanisms remain “in effect, as currently authorized” including the Renewable Energy Infrastructure Program (“REIP”) and the ECAC, which are currently under review and could be revised at any time within Docket No. 2013-0141.

- A condition that each of the utilities be “authorized to record revenues collected through the RAM Provision starting January 1 of each year of the stay-out period” which would increase recorded utility revenues above currently authorized and expose ratepayers to potentially higher costs in the event any accrued but uncollected RAM revenues existed at the time of a next rate case.
A condition that rejection or significant limitation of the Hawaiian Electric Companies’ newly proposed Standards and Guidelines for Eligibility of Projects for Cost Recovery through the RAM above the RAM Cap may cause modification or withdrawal of the base rate moratorium,\(^{44}\) and

- A condition that would allow rate changes if “authorized by legislation during the stay out period.”

Collectively, the “Qualifications” attached to the Applicants’ offered base rate case moratorium cause it to have either already been violated by Order No. 32735, or likely to be violated when and if the Commission makes any further changes to the RAM, REIP, the Hawaiian Electric Companies’ proposed RAM above the Cap mechanism, or ECAC within Docket No. 2013-0141 or if any instance of financial distress is experienced. The provision allowing rate changes if authorized by future legislation adds more uncertainty. Additionally, the required acceleration of RAM accruals for all three utilities would produce higher recorded revenues, beyond what is presently authorized, which is inconsistent with the concept of not changing the utilities’ revenue requirement during a rate case moratorium.

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\(^{44}\) See Applicants’ response to CA-IR-351(a). In response to CA-IR-355, Attachment 1, Applicants have now added a new condition to their base rate case moratorium proposal within Footnote 1 that would require Commission approval of the Hawaiian Electric Companies pending “above the RAM Cap” cost recovery proposal in Docket No. 2013-0141 that has been opposed by the Consumer Advocate, and no changes to the ECAC in that docket that would “severely restrict the Companies’ ability to timely recover fuel and purchased power costs...”
Q. ACCORDING TO MR. REED, THE PROPOSED TRANSACTION WILL PRODUCE BENEFITS THAT, “…BEGIN WITH A MORATORIUM FOR AT LEAST FOUR YEARS FOREGOING THE OPPORTUNITY TO FILE A REQUEST FOR A GENERAL BASE RATE INCREASE, WHICH IS A SUBSTANTIAL BENEFIT IN AND OF ITSELF.”\(^{45}\) DO YOU AGREE?

A. No. There has been no showing that a rate case moratorium, freezing currently effective base rate levels, would benefit ratepayers at all. Mr. Reed’s claim that a moratorium is beneficial to ratepayers presumes, with no supporting analysis, that present rate levels are not excessive today and will not become excessive throughout at least four future years, even after realization of the significant costs savings that he has estimated will be enabled by the proposed Transaction.

Q. HAVE YOU OBSERVED ANY EVIDENCE SUGGESTING THAT PRESENT RATE LEVELS MAY, IN FACT, BE EXCESSIVE AND SHOULD FIRST BE REDUCED, PRIOR TO COMMENCING A MULTI-YEAR RATE CASE MORATORIUM?

A. Yes. Twice in the annual decoupling filings with the Commission over the past three years, HECO and then MECO submitted calculations showing they earned in excess of their authorized return on equity in the prior calendar year,

\(^{45}\) Applicants Exhibit-33, page 17.
resulting in earnings sharing credits to ratepayers. Additionally, the decoupling regime approved by the Commission in Docket No. 2008-0274 contemplated triennial rate case filings, to effect a periodic updating of O&M expenses, the components of rate base not captured by the Rate Base RAM, and the capital structure and debt/equity cost rates. However, the Companies' last two rate case filings, submitted by HECO and MECO, respectively, were accompanied by letters that indicated no rate change was actually being sought by the utilities from such filings, implying an understanding by the utilities that their present rate and revenues levels were acceptable. Without complete processing of the last two rate case filings, the input values for RAM calculations, including O&M expenses and the cost of capital used in annual RAM calculations, have not been updated in some time and may be overstating reasonable levels of recoverable cost.  

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46 See Tariff Transmittal Nos. 13-03 (HECO) and 15-05 (MECO), Schedule H.

Q. ARE THERE KNOWN PROBLEMS WITH THE PRESENT RATE LEVELS OF THE HAWAIIAN ELECTRIC COMPANIES THAT SHOULD BE REMEDIED BEFORE ANY MULTI-YEAR RATE CASE MORATORIUM IS IMPLEMENTED?

A. Yes. One concern is with the dated and apparently excessive ten percent authorized ROE levels for HECO and HELCO, which were established using test years 2011 and 2010 in Docket Nos. 2010-0080 and 2009-0164, respectively. Since the test years used in these prior rate cases, the general trend in long term risk-free interest rates has been downward, as indicated by this chart showing weekly average percentage yields on 30-year treasury bonds:

![Weekly Average 30-YR Treasury Bond Yield](https://research.stlouisfed.org/fred2/series/DGS30/downloaddata)
An updating of the ROE is needed to consider the effect of the recently lower interest rate environment that was not considered when the ROE was last established for HECO and HELCO. As a point of reference, the most recent general rate case for any of the HECO Companies was for MECO and employed a 2012 test year. With respect to ROE, the Commission's Decision and Order No. 31288 found:

At this time, while forecasts may indicate an increase in interest rates in the future, as argued by MECO, it is undisputed that the financial market conditions have changed since the Parties first submitted their respective analyses regarding ROE. Given the updated analysis discussed above, the commission finds it reasonable to adjust the Parties' stipulated ROE 50 basis points downward to appropriately reflect updated economic and financial market conditions of the 2012 Test Year. Thus, a 9.50% ROE would have been acceptable but for MECO's inability to address certain apparent system inefficiencies, which are discussed in the section below. The commission notes that this level of return reflects MECO's low proportion of purchase power agreement fixed obligations as compared to the other HECO Companies, and MECO's almost 57% common equity ratio.48 [footnotes omitted]

The common equity ratios within the capital structures last approved by the Commission for all three utilities are also excessive, given NextEra's planned future financing plans and much lower consolidated equity ratios, as more fully explained in the testimony of Mr. Stephen Hill. Additionally, HECO and HELCO have issued new debt since their last rate case orders were issued,

reducing their cost of long term debt, but these debt cost reductions have not been captured for the benefit of ratepayers in the absence of rate cases.49

Q. HAVE APPLICANTS PROPOSED ANY UPDATING OF THE COSTS OF CAPITAL EMBEDDED IN PRESENT BASE RATES OR THAT ARE USED IN ANNUAL DECOUPLING RAM CALCULATIONS, AT THE INCEPTION OF THE PROPOSED RATE MORATORIUM PERIOD?

A. No.

Q. UNDER THE APPLICANTS’ PROPOSED RATE PLAN AND MORATORIUM, WHAT HAPPENS TO CUSTOMERS’ RATE LEVELS AT THE END OF YEAR FOUR?

A. The annual customer rate credits that are proposed by Applicants would increase to $24 million across the three utilities by year four, but would terminate in year five. This termination would cause an immediate rate increase at that time of $24 million. Such an outcome is clearly unreasonable given Applicants’ testimony that significant Transaction-enabled merger savings will have accumulated by then and will be ongoing. Consider, for example, Mr. Reed’s testimony that “[m]erger related savings typically accrue over time and often require a period of five to ten years to reach ‘steady

49 The Rate Base RAM calculation relies upon the cost of capital findings from each utility’s most recent base rate case order. The Earnings Sharing calculations within RAM utilize an updated cost of debt from the prior calendar year, but retain the ROE authorized within the most recent base rate case.
state. With this in mind, the expiration of Applicants’ proposed rate credits in year five would be occurring about when integration work is being completed and “steady state” savings are being harvested by the utilities.

Q. HAVE APPLICANTS MADE ANY REVISIONS TO THE CLAIMED VALUE OF THE RATE MORATORIUM PLAN THEY OFFER?

A. Yes. In a supplemental response to CA-IR-303 dated July 20, 2015, Applicants appear to have only recently discovered an additional $132 million of previously hidden value attributable to their offered rate moratorium, that is now captioned, “Four Year General Base Rate Moratorium” on Line 1 of Attachment 1 to this supplemental response. Applicants seek to add this new “rate case avoidance” value to the previously claimed $60 million value that now appears on line 2 of this document. Page 31 of this supplemental response adds language describing these new values that purports to estimate the outcome of future assumed rate cases for HECO in 2017, MECO in 2018 and HELCO in both 2016 and 2019, presuming rate case outcomes with cumulative rate increases totaling $132 million that would occur in all of those years, but for the moratorium. According to page 31, this new value associated with the foregone rate cases, “[a]ssumes that O&M cost increases (in excess of inflationary increases captured by O&M portion of the RAM Cap) equal those approved in the span of the last two completed rate cases for

50 Applicants Exhibit-33, page 20.
each utility.” In other words, the $132 million assumes the historical change in utility O&M from previous rates cases will accurately predict future O&M growth that would be allowed by the Commission in future rate cases.

Q. WHAT IS WRONG WITH APPLICANTS’ MORE EXPANSIVE NEW FOREGONE RATE CASE REVENUE ESTIMATES?

A. In a word, “everything.” There has been no showing that the utilities’ future O&M would, in fact, grow at the rate of historical growth in Commission-approved O&M values from past rate cases. In fact, Applicants’ evidence all points to an opposite conclusion, that future O&M is likely to be lower and/or grow less rapidly than historical O&M levels because of the Proposed Transaction. The recent actions taken by HECO and MECO, in filing rate case applications and then not asking for the revenue increases supported therein, also undermines the credibility of any assumption that large future rate increases would suddenly be needed. In response to CA-IR-353, Applicants admit that, “The O&M expenses approved in future rate case[s] will likely not grow at the exact same rate as the change in O&M expenses approved in the last two fully completed rate cases for each of the Companies”
as assumed in developing the newly claimed $132 million in foregone rate case value.\footnote{Applicants' response to CA-IR-354, Attachment 1, provides Adjusted O&M values for each of the three utilities for the past nine years. This data reveals rapid growth in O&M through 2010, with very minor O&M growth thereafter. Total Adjusted Non-fuel O&M across all three utilities grew by only 1.6 percent in 2013 (over 2012 levels) and by 1.9% in 2014 (over 2013 levels). These O&M expense growth rates imply adequate recovery of O&M is occurring through the GDPPI capped RAM and that Mr. Reed’s extrapolation of much older trends in O&M to project future expenses is unreasonable.}

My testimony and the testimony of Mr. Hill support a conclusion that new rate cases would likely reduce revenues, so as to capture the currently lower costs of debt and equity capital, rather than increase rates as speculated in the supplemental response to CA-IR-303. Finally, the discovery of an additional $132 million in ratepayer benefits, resulting from foregone future rate case increases, strains the credibility of Applicants’ other estimates. Adding $132 million of foregone revenues, without changing Applicants’ rate plan, exceeds the entirety of Mr. Reed's claimed O&M savings of, “…$100 million over the next five years,” causing one to wonder how such a large new revenue reduction could now be affordable and why alleged savings of only $60 million were previously viewed as a reasonable share of Transaction-enabled savings for ratepayers in Applicants’ direct testimony.
D. THE CONSUMER ADVOCATE'S PROPOSED RATE PLAN.

Q. IF THE COMMISSION APPROVES THE PROPOSED TRANSACTION, HAVE YOU FORMULATED AN ALTERNATIVE RATE PLAN THAT SHOULD BE EMPLOYED, IN PLACE OF THE APPLICANTS’ PROPOSAL, TO ENSURE SIGNIFICANT PUBLIC INTEREST RATEMAKING BENEFITS WOULD RESULT FROM THE TRANSACTION?

A. Yes. If the Transaction is approved by the Commission, I recommend that presently effective base rate levels for each of the three Hawaiian Electric Companies be permanently reduced, across all rate schedules, by 0.7 cents per kWh ($0.007) effective at the date the proposed Transaction is consummated. This level of “up-front” rate reduction would impact annual revenues across the three utilities by about $62 million annually, reducing a typical residential customer bill by about $4.20 per month. These up-front rate reductions would update the cost of equity and equity ratios underlying the Companies’ existing base rates and then account for a conservative estimate of the potential Transaction-enabled cost savings sponsored by Mr. Reed, less an allowance for integration costs, for the first four years after consummation of the Transaction.

52 The calculations supporting the proposed revenue change, per kWh change and average customer impact are set forth in CA Exhibit-13 and assume kWh volumes last used to revise Revenue Balancing Account (“RBA”) rates for each utility and average residential customer usage of 600 kWh per month.
After base rates are reduced, during the 48 months immediately following consummation of the Transaction, the utilities would be precluded from seeking an increase in base rates in the absence of an event or circumstance that creates a compelling financial need for an earlier rate change. The proposed rate case moratorium would not preclude revenue-neutral rate changes that may be approved by the Commission during this period. Other rate adjustment mechanisms would remain in effect during this moratorium period, in the form approved by the Commission.

This approach “locks in” more current capital cost assumptions for the utilities as well as a fixed amount of expected net cost savings from the Transaction, so as to ensure that consummation of the Proposed Transaction will yield tangible public interest benefits in the form of more affordable electric rates for all of Hawaiian Electric’s ratepayers.

Importantly, the use of permanent base rate changes in the Consumer Advocate’s rate plan eliminates the problem of expiring rate credits that is a key feature of the Applicants’ rate plan. The opportunity for Transaction-enabled costs savings does not expire after four years and the changes planned to be made by Applicants to harvest such savings will not be reversed after four years. It makes no sense to raise rates by $24 million as proposed by Applicants if the benefits from the proposed Transaction are long-lived.
Q. WHAT ARE THE COMPONENT PARTS OF THE $62 MILLION IN ANNUAL  
BASE RATE REVENUE REDUCTIONS YOU PROPOSE?  

A. The Consumer Advocate’s recommended Rate Plan revenue adjustment has  
three component parts, with the following approximate values when applied  
across all three utilities:

<table>
<thead>
<tr>
<th>Revenue Adjustment Basis</th>
<th>Annual Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Updated Cost of Debt Capital</td>
<td>$ 5.7 million</td>
</tr>
<tr>
<td>Revised ROE at 9% with 47% Equity</td>
<td>$46.6 million</td>
</tr>
<tr>
<td>Net Anticipated O&amp;M Cost Savings</td>
<td>$10.1 million</td>
</tr>
<tr>
<td>Annual Revenue Impact</td>
<td>$62.4 million</td>
</tr>
</tbody>
</table>

When accumulated throughout an assumed minimum four-year  
moratorium period, the cumulative value of this base rate and revenue  
reduction would be approximately $250 million at present annual kWh sales  
volumes. If base rates remain unchanged after the four year moratorium  
period, the embedded savings would continue to benefit ratepayers until a  
“next” rate case occurs for each utility.
Q. WHY SHOULD THE COST OF DEBT BE UPDATED AT THE INCEPTION OF ANY LONG TERM BASE RATE MORATORIUM?

A. As noted previously, cost of capital updating was initially intended to occur in triennial rate cases as a condition of the Commission’s decoupling orders. However, there have been no recent rate case proceedings where the Companies’ ability to refinance its long term debt at reduced cost rates could be considered. Before commencing a moratorium that would delay any updating of capital costs for at least another four years, ratepayers should be allowed to participate in the benefits of the currently low interest rate environment that has allowed the Hawaiian Electric Companies to reduce their debt costs.

Q. HOW DID YOU QUANTIFY THE HAWAIIAN ELECTRIC COMPANIES’ UPDATED COST OF DEBT AND THE REVENUE REDUCTION NEEDED TO ACCOUNT FOR LOWER DEBT COSTS?

A. Each of the utilities submits an annual decoupling filing that contains an Earnings Sharing Calculation on Schedule H. Updated cost rates reflective of the prior calendar year actual cost of debt are included in Schedule H and supported in a corresponding WP-H-004 analysis of capitalization and capital costs. I relied upon the Companies’ calculations for calendar 2014 from these

submissions to quantify the updated cost rates for long-term debt, short-term debt and hybrid securities for each utility. Schedule D of the annual decoupling filings utilizes “PUC Approved Capital Structure & Costs” to determine the Rate Base RAM – Return on Investment each year. Therefore, to calculate the annual revenue requirement impact of updating debt cost rates, I applied the adjusted and unadjusted overall pretax earnings requirement, from Schedule H versus Schedule D, to each utility’s submitted 2015 RAM Average Rate Base from the most recent decoupling filings, to determine the annual revenue requirement impact of debt cost rate updating.  

Q. WAS A SIMILAR CALCULATION PROCESS USED TO QUANTIFY THE IMPACT OF ADJUSTING THE ALLOWED RETURN ON EQUITY TO NINE PERCENT FOR EACH UTILITY AND TO REVISE THE COMMON EQUITY RATIO TO 47 PERCENT?  

A. Yes. After debt cost rates were updated, another iteration of the same calculation was performed to determine the approximate revenue requirement impact of the reduced return on rate base needed with revised equity cost and equity ratio inputs. Mr. Hill supports the Consumer Advocate’s utilization of

54 These calculations can be observed in CA Exhibit-13 at pages 2 through 4.  
55 Id.
these inputs as part of the recommended Rate Plan if the proposed
Transaction is approved by the Commission.

Q. EARLIER IN THIS TESTIMONY, YOU REFERENCED THE FINANCIAL
MODELING PERFORMED BY NEXTERA PRIOR TO AGREEING TO
ACQUIRE THE HAWAIIAN ELECTRIC COMPANIES. HOW DOES YOUR
PROPOSED $62 MILLION IN ANNUAL BASE RATE REDUCTIONS
COMPARE TO THE TRANSACTION-ENABLED EXPENSE SAVINGS
INITIALLY ESTIMATED BY NEXTERA IN THOSE FORECASTS?

A. An annual revenue reduction of $62 million appears quite reasonable in
relation to NextEra’s initial estimates of expected expense savings that could
be achieved by the Hawaiian Electric Companies in a post-merger
environment.\textsuperscript{56}

\textsuperscript{56} See confidential values calculated at page 18 of this testimony.
Q. MR. REED’S TESTIMONY AT PAGE 31 CONTAINS TABLE 1: ESTIMATED SYNERGY SAVINGS FROM OTHER UTILITY MERGER TRANSACTIONS WHICH HE CONCLUDES SHOWS A “CENTRAL TENDENCY IN THE RANGE OF 15% OF THE ACQUIRED COMPANY’S O&M.” HOW DOES AN ANNUAL RATE REDUCTION OF $62 MILLION COMPARE TO THIS CONCLUSION?

A. Compared to calendar 2014 reported O&M expense of $410 million across the Hawaiian Electric Companies, a $62 million revenue reduction, when reduced by avoided revenue taxes at 8.9 percent of this amount, represents about 14 percent of the Companies’ recorded non-fuel O&M expenses. While most of the Consumer Advocate’s Rate Plan reductions are actually attributable to reduced capital cost inputs, the overall revenue impact of the proposed rate reduction is comparable to Mr. Reed’s calculated “central tendency” value with regard to O&M expense savings alone. This comparison shows that achievement of total net O&M cost savings by the Hawaiian Electric Companies near Mr. Reed’s “central tendency” value, would allow the utilities to “earn back” all of the rate reductions proposed by the Consumer Advocate through O&M savings alone, yielding returns on equity at or above authorized levels.

57 Applicants Exhibit-33, page 31.

58 $62 million, less revenue taxes of 8.885% of this value or $5.5 million, yields an expense equivalent value of $56.5 million, which is 13.8 percent of the Hawaiian Electric Companies’ reported 2014 total non-fuel O&M expense of $410 million.
Q. YOU HAVE EXPLAINED WHY PRESENT BASE RATE REVENUES OF THE
HAWAIIAN ELECTRIC COMPANIES SHOULD BE REDUCED, WITH MOST
OF THE REDUCTION ARISING FROM UPDATING CAPITAL COST RATES
AND THE EQUITY RATIO USED TO DETERMINE BASE RATE REVENUE
REQUIREMENTS. WHY HAVE YOU INCLUDED ONLY $10.1 MILLION OF
ASSUMED NON-FUEL O&M EXPENSE REDUCTIONS IN THIS
PROPOSAL?

A. The $10.1 million represents only the more detailed O&M savings that
Mr. Reed has estimated within his testimony for; 1) avoided rate case
expenses, 2) assumed savings in insurance expenses, 3) reduced audit
fees, 4) savings in information technology expenses, and 5) supply chain
procurement costs, reduced by an allowance for assumed integration costs
estimated at 25 percent of the estimated O&M savings. At $10.1 million, this
level of estimated annual non-fuel O&M savings used to reduce base rates is
a modest share of the “up to $40 million per year of savings” that Mr. Reed
ultimately concludes is achievable from “near-term potential savings.”

Again, this conservative approach may allow Applicants to earn back much of

59 These estimates are based upon Applicants’ initial and supplemental responses to CA-IR-303
and CA-IR-304. Average insurance savings, audit fee savings, IT software license savings
were derived from Applicants’ Supplement, dated 7/20/2015, to CA-IR-303 at page 36.
Supply Chain procurement savings reflect gradual ramping to the “Estimated 5% savings”
reference at CA-IR-303, page 37. Costs to achieve merger savings at 25% of saving also
based on CA-IR-303, page 37.

60 Applicants Exhibit-33, page 32.
the revenue reduction implemented under the Consumer Advocate’s proposed
Rate Plan during the moratorium period.

Q. SHOULD THE MORATORIUM PERIOD YOU PROPOSE BE TERMINATED
IF THE COMMISSION ORDERS CHANGES TO THE UTILITIES’ VARIOUS
RATE ADJUSTMENT TARIFFS, SUCH AS THE RAM, THE REIP
SURCHARGE OR THE ECAC, AS A RESULT OF ONGOING COMMISSION
REVIEW WITHIN DOCKET NO. 2013-0141 OR OTHER PROCEEDINGS?

A. No. It is essential that any rate moratorium be durable and enforceable to
avoid exposing ratepayers to the uncertainties surrounding Applicants’ cost
savings estimates, and the risks arising from integration activities and costs
that may be encountered during the moratorium, and that would produce
overstated revenue requirements in any “early” rate cases occurring soon after
Transaction consummation. Clearly, the public interest “value” attributed to
base rate case moratorium that is relied upon by the Commission in this
proceeding, could be quickly and massively eroded if that moratorium were not
enforceable under all reasonably foreseeable circumstances.
Q. HOW CAN THE COMMISSION, IF APPROVAL OF THE PROPOSED TRANSACTION IS CONDITIONED UPON A RATE CASE MORATORIUM, HELP TO ENSURE THAT THE MORATORIUM IS HONORED BY THE APPLICANTS?

A. I recommend that a penalty be applied in the event the Proposed Transaction is approved, subject to a rate case moratorium, and that moratorium is not honored. Specifically, I recommend that an ROE penalty be imposed within any premature rate case occurring within the ordered moratorium period, reducing the otherwise reasonable ROE by 100 basis points (1.0%) so as to encourage compliance with any approved moratorium.

Q. WHY DOES THE RATE PLAN YOU DESCRIBE NOT PROVIDE FOR ACCELERATED ACCOUNTING RECOGNITION OF RAM RATE CHANGES EACH YEAR, AS PROPOSED IN THE APPLICANTS’ RATE PLAN?61

A. This advance accrual of RAM revenues, before RAM revenues are chargeable to ratepayers each June 1, creates an additional regulatory asset on the utilities’ books. These accruals serve to increase the reported revenues and income of the utilities, while representing an obligation for ratepayers to pay higher rates than may otherwise be justified after a subsequent rate case order. This accounting was disputed by the Consumer Advocate in Hawaiian

61 Applicants Exhibit-15 indicates a condition requiring “each of the Hawaiian Electric Companies being authorized to record revenues collected through the RAM Provision starting January 1 of each year of the stay out period…”
Electric’s initial decoupling rate adjustment and rejected by the Commission at that time, but was later accepted on a temporary basis and for only HECO, as part of the settlement to avoid prudence audits and to limit regulatory disallowances arising from Campbell Industrial Park CT-1 and Customer Information System cost over-run issues. Further expansion of RAM accrual accounting would create negative value for ratepayers, if granted as part of the Applicants’ proposed rate case moratorium.

Q. DOES THE CONSUMER ADVOCATE’S PROPOSED RATE PLAN SEEK TO OBLIGATE THE COMMISSION TO ACCEPT THE HAWAIIAN ELECTRIC COMPANIES’ PROPOSED STANDARDS AND GUIDELINES THAT WOULD PERMIT RECOVERY OF FUTURE PROJECT COSTS THROUGH THE RAM AND ABOVE THE RAM CAP?

A. No. This is another difference between Applicants’ proposal and the Consumer Advocate’s proposal. In a supplemental response to CA-IR-118, Applicants state, “[p]rovided the Commission allows for adequate interim cost

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62 See Stipulated Settlement Agreement filed January 28, 2013, in Docket No. 2008-0083 and approved in Order No. 31126, dated March 19, 2013. The RAM Accrual granted in this settlement was limited to the years 2014, 2015 and 2016 and applies only to HECO.

63 In its response to CA-IR-348, Attachment 1, Applicants prepared estimates of the annual revenue value of RAM increase accrual accounting. In those examples, GDPPI is assumed to increase at only 1.1% per year, and the revenue value of RAM acceleration is estimated to be worth about $6 million per year across all three utilities. If GDPPI increases by more than 1.1%, the value of Applicants’ proposed acceleration of RAM revenues would be higher. This response also confirms that “Applicants do not intend to waive the right to recover any accrued but uncollected RAM revenues in the event that a rate case occurs prior to the expiration of the accrued amounts.”
recovery above the Revenue Adjustment Mechanism ("RAM") Cap for approved projects as contemplated in Order No. 32735, the Commission's decision is not expected to represent a Company Material Change that would cause the Applicants to withdraw or modify its proposed base rate moratorium." The Consumer Advocate has objected to this "above the RAM Cap" proposal and does not believe that Transaction approval or the needed Rate Plan if the Transaction is approved should be contingent upon Commission approval of this excessive and poorly defined new regulatory mechanism.64

Q. DOES THE CONSUMER ADVOCATE’S PROPOSED RATE PLAN REQUIRE THAT THE COMMISSION MAKE NO CHANGES TO THE ECAC OR TO THE OTHER COST RECOVERY MECHANISMS THAT ARE PRESENTLY IN EFFECT FOR THE BENEFIT OF THE HAWAIIAN ELECTRIC COMPANIES?

A. No.

64 See Consumer Advocate letter dated June 30, 2015, in Docket No. 2013-0141 indicating agreement upon a Joint Proposed Modified REIP Framework and related Standards and Guidelines, but urging rejection of the Hawaiian Electric Companies additional proposed mechanism for “through the RAM and above the RAM Cap” rate recoveries.
Q. HAVE YOU DEVELOPED REGULATORY CONDITIONS THAT DEFINE THE
RATE PLAN THAT IS PROPOSED BY THE CONSUMER ADVOCATE, AND
THAT SHOULD BE ADOPTED IN ANY ORDER OF THE COMMISSION
APPROVING THE PROPOSED TRANSACTION?

A. Yes. The four conditions providing for implementation of the
Consumer Advocate’s recommended Rate Plan are as follows:

1. To ensure significant tangible public interest benefits to Hawaiian
Electric Companies’ ratepayers, HECO, HELCO, and MECO shall file
tariffs reducing each of the non-fuel base energy charge rates to each
customer class by $0.007 (seven tenths of one cent) per kWh, to be
effective upon consummation of the proposed Change in Control, with
corresponding prospective downward adjustment to the target revenues
of each utility for Revenue Balancing Account purposes. This condition
is expected to reduce annual revenues of the HECO Companies
by $62.4 million at currently estimated sales volumes.

2. The Hawaiian Electric Companies shall not submit an application
seeking a base rate/revenue increase prior to the date 48 months
subsequent to the date of closing of the proposed Change in Control.
This condition shall not preclude requests for base revenue reduction
filings or revenue-neutral tariff modifications during this moratorium
period. If circumstances arise that create a compelling financial need
for a base rate/revenue increase that violates this rate case moratorium
period, the base revenue increase shown to be justified under such
circumstances shall be revised downward to reflect a rate of return on
common equity penalty reduction of 100 basis points (1.0 percent) from
the otherwise appropriate common equity return levels.

3. The decoupling mechanism last approved by the Commission in Order
No. 32735 issued March 31, 2015 in Docket No. 2013-0141, shall
remain in effect during the rate case moratorium period described in the
immediately preceding condition, subject to any changes ordered by
Commission from time to time.
The Rate Base RAM – Return on Investment within the Rate Adjustment Mechanism filings submitted by each of the Hawaiian Electric Companies, for all periods after closing of the proposed Change in Control and until a next general rate case order, shall be revised to reflect an approved return on Common Equity of 9.0 percent and a Common Equity ratio of 47 percent (with corresponding upward adjustment to the long term debt capital ratio). The same return on Common Equity and Common Equity Ratio assumptions should be utilized in AFUDC rate determination calculations for all periods after closing of the proposed Change in Control and until a next general rate case order.

IV. OTHER ACCOUNTING AND RATEMAKING ISSUES.

A. TRANSACTION RELATED COSTS.

Q. IN THE PREVIOUS SECTION OF YOUR TESTIMONY, YOU IDENTIFIED CONDITIONS TO DEAL WITH MERGER-RELATED COSTS THAT WERE IMPOSED BY THE COMMISSION, IN APPROVAL OF PRIOR MERGERS INVOLVING HAWAII GAS AND HAWAII TELCOM. ARE COMPARABLE CONDITIONS NEEDED FOR THE PROPOSED TRANSACTION?

A. Yes. Conditions were imposed by the Commission, as quoted above, to preclude any deferred accounting or cost recovery from ratepayers of the transaction and transition costs incurred by either the buyer or the seller in the previous mergers involving Hawaiian Telcom and Hawaii Gas. These conditions were imposed, even though both Hawaiian Telcom and
Hawaii Gas had committed to a base rate case moratorium condition similar to
the moratorium under consideration for use in this Proposed Transaction.65

Q. HAVE THE APPLICANTS IN THIS DOCKET PROPOSED RATE RECOVERY
OF ANY MERGER TRANSACTION COSTS?

A. No. In Applicants’ response to CA-IR-136, supplemented July 16, 2015,
Attachment 2 sets forth, “a table of the Applicants’ treatment of transaction
costs, transition/integration costs, costs to achieve savings and transformation
costs, and examples of the types of expenses that would be included in each
category.” Attachment 2 defines “Transaction Costs” as the costs incurred to
develop or consummate the Proposed Transaction, including investment
banking, legal, consulting and other fees, including change in control
payments or other executive compensation. The Applicants’ proposed
treatment for these costs is stated as, “NextEra Energy commits that it will not
seek to recover through rates any acquisition premium, transaction or
transition cost arising from the Proposed Change of Control.”

65 Hawaiian Telcom committed, in Docket No. 04-0140, to not submit any application for a
general utility rate increase using a test year earlier than 2009. Hawaii Gas (then The Gas
Company, LLC) also committed to not submitting an Application for a general utility rate
increase using a test year earlier than 2009 in Docket No. 05-0242.
Q. HAVE THE APPLICANTS IN THIS DOCKET PROPOSED RATE RECOVERY OF ANY MERGER TRANSITION COSTS?

A. This is less clear. Mr. Gleason states, “NextEra Energy commits that it will not seek to recover through rates any acquisition premium, transaction, or transition costs arising from the Proposed Change of Control.”

However, when asked for more specifics about this commitment, Applicants now propose to isolate three different categories of transition costs and then commit to “not seek to recover through rates” only the first of these three categories:

- “Transition costs, which include costs necessary to integrate the two companies and transition between ownership, such as relocation fees.”

- “Costs incurred to integrate or optimize processes, tools and/or technology to further improve operational efficiencies and lower costs” are intended to be treated as “recoverable by HECO and NextEra Energy regulated utility subsidiaries.”

- “Transformation” costs incurred to support the Clean Energy Transformation of the Hawaiian Electric Companies, as defined in their PSIP and DGIP (Distributed Generation Interconnection Plan) filings.

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66 Applicants Exhibit-7, page 46.
would be treated as “potentially recoverable” and if billed by NEE affiliates, would be “tracked in separate sub-projects.”

The preliminary status of integration planning makes it difficult to analyze the nature and scope of potential future costs in these three categories. Additionally, the definitional boundaries offered by Applicants are vague, where rate recovery determination would require a judgment about whether specific costs were “necessary” to integrate the two companies, in contrast to activities and costs that “further improve operational efficiencies and lower costs.” For example, in information request DOD-IR-86, Applicants were asked to explain when and how any future severance costs would be treated and the Applicants’ response stated, “…to the extent severance costs, if any, are costs associated with the transaction such costs will be recorded on the books of NEE Acquisition Sub I and will not be charged to the Hawaiian Electric Companies. However, to the extent severance costs are incurred to achieve productivity improvements that may be available as a result of the merger, rather than to consummate the merger, such costs will generally be recorded as an expense by the applicable company that recognizes the resulting future cost savings.”

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67 Applicants response to CA-IR-136, Supplement 7/16/2015, Attachment 2.
Q. IS APPLICANTS’ PROPOSED DIFFERENTIATION BETWEEN “TRANSITION” VERSUS “INTEGRATION/OPTIMIZATION” ACTIVITIES AND COSTS A MEANINGFUL AND USEFUL DISTINCTION?

A. No. Applicants insertion of a “necessary” qualifier in defining “transition” costs is inherently problematic and would likely result in most business integration costs being classified as “costs to achieve merger savings” that would then be deemed recoverable in rates, rather than “transition” costs that have routinely been disallowed in past Hawaii merger transactions.

Q. WITH RESPECT TO SO-CALLED “COSTS TO ACHIEVE MERGER SAVINGS”, WHAT COMMITMENTS ARE MADE BY APPLICANTS REGARDING COST RECOVERY?

A. If all of Applicants’ conditions attached to its proposed base rate case moratorium are approved, NextEra, “…commits that it will not seek recovery of O&M expense costs to achieve merger synergies during the general base rate moratorium.” With regard to any “costs to achieve that are incurred during the general base rate moratorium and that are capitalized, such as plant, software development costs, and other multi-year assets, will be allowed recovery as specified in Order No. 32735…during the general base rate moratorium, and
for the unamortized/undepreciated portion of these investments after the base rate moratorium.”

Q. WILL THE APPLICANTS’ PROPOSED RATE MORATORIUM ENSURE THAT ANY RECORDED INTEGRATION COSTS ARE NOT RECOVERED FROM RATEPAYERS?

A. No. As noted above, because of the conditions set forth in Applicants Exhibit 15, the Applicants’ proposed base rate case moratorium is unenforceable and of no clear benefit to ratepayers. The proposed moratorium cannot be relied upon to protect ratepayers from recovery of potentially large business integration charges on the books of the Hawaiian Electric Companies, which costs may exceed any resulting cost savings in the year incurred and potentially thereafter. Another concern arises from the RAM earnings sharing provision that provides decoupling rate credits whenever actual earnings in the prior year exceed Commission-authorized return levels. Annual utility operating income used to determine earnings sharing would be influenced by any recorded costs and may be distorted by large business integration expenses in the years immediately following consummation of the Proposed Transaction.

68 Applicants’ response to CA-IR-356.
Q. WOULD THE ADOPTION OF THE CONSUMER ADVOCATE’S MORE ENFORCEABLE BASE RATE CASE MORATORIUM PROPOSAL ELIMINATE THESE CONCERNS?

A. Not completely. First, the Consumer Advocate’s proposed moratorium would not be enforceable if circumstances arise in the future that create a compelling financial need for a base rate increase during the moratorium period. Additionally, the RAM earnings sharing calculations that would occur throughout the moratorium period could be significantly impacted by recorded business integration expenses on the utilities’ books, using the Applicants’ permissive accounting that would include “costs incurred to integrate or optimize” operations in determining annual earnings and achieved ROE.

Q. SHOULD THE COMMISSION REQUIRE ANY SPECIFIC ACCOUNTING TREATMENT FOR APPLICANTS’ INCURRED MERGER TRANSACTION AND TRANSITION COSTS, INCLUDING THOSE COSTS CHARACTERIZED AS INCURRED TO INTEGRATE OR OPTIMIZE TOOLS AND/OR TECHNOLOGY TO FURTHER IMPROVE OPERATIONAL EFFICIENCIES AND LOWER COSTS?

A. Yes. All of these types of costs, whether allocated or charged to Hawaiian Electric by NextEra Energy, Inc., FPL or other NextEra affiliates, or when incurred directly by the Hawaiian Electric utilities, should be charged to non-operating (below-the-line) expense accounts, so as to not influence
reported utility operating income or RAM shareable earnings. I have included
in the final section of my testimony a proposed Condition to implement this
recommendation. This accounting condition would avoid the challenges of
parsing definitions and classifying different types of integration costs according
to relative necessity or the potential of certain activities and costs to create
future cost savings, while ensuring no inadvertent rate recovery of costs that
have historically been treated as not recoverable from ratepayers.

Q. HAVE YOU PREPARED A RECOMMENDED CONDITION THAT WOULD
HELP TO INSURE THAT TRANSACTION AND TRANSITION COSTS ARE
NOT CHARGED, DIRECTLY OR INDIRECTLY, TO RATEPAYERS?

A. Yes. The condition needed to provide assurance of non-recovery of such
costs is:

• All costs directly incurred by, or allocated to the Hawaiian Electric Companies, as a result of the proposed Change in Control, including transaction-related fees and expenses to seek and receive shareholder and regulatory approvals, shareholder litigation costs, business integration and transition expenses and other costs to achieve merger savings shall be recorded in non-operating expense accounts that are not reflected in utility operating income accounts and such recorded costs shall be excluded from any base rate increase requests and in determining annual utility earnings for Earning Sharing calculations within the decoupling mechanism.
Q. REFERRING BACK TO MR. GLEASON’S TESTIMONY, DO APPLICANTS MAKE ANY COMMITMENT REGARDING ACQUISITION PREMIUM COST RECOVERY?

A. Yes. Mr. Gleason states, “NextEra Energy acknowledges the Commission’s general policy against recovery from utility customers of acquisition premium amounts arising from utility merger and acquisition transactions. In accordance with this policy, NextEra Energy agrees that under its control, the Hawaiian Electric Companies will not seek rate recovery of any goodwill amortization, acquisition premium costs, or goodwill impairment charges incurred as a result of the Proposed Change of Control.”

Q. PLEASE EXPLAIN THE ACQUISITION PREMIUM AND GOODWILL AMORTIZATION CONCERN THAT IS REFERENCED BY MR. GLEASON.

A. Utility service rates are established to provide a reasonable opportunity to earn a return on the original cost of investments made in utility plant in service, net of accumulated depreciation and other includable rate base assets and liabilities. In addition, utility rates provide for the recovery of depreciation on the original cost of utility plant in service. In instances where either the utility’s assets, or going concern business containing such assets, have been conveyed to another entity in a change of control proceeding, the value of

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69 Applicants Exhibit-7, page 46.
consideration paid to acquire the business or the utility’s assets often exceeds the original cost of the investments, which is recorded on the utility’s books. In these instances, the additional value paid for the acquired enterprise or its assets is often recorded on the consolidated public financial statements as an intangible asset called “goodwill.” The corresponding asset label for this extra value on the regulated utility books is “Electric plant acquisition adjustment”. In order to be sure that utility ratepayers continue to pay rates based only on the original cost of assets built or acquired to serve them, it is essential that “goodwill” and “acquisition adjustment” costs not be recoverable through rates. If such recovery was permitted, simply conveying utility property at higher market valuations would create an opportunity for ever higher utility rates, through the rate recovery of goodwill or acquisition premium valuation adjustments resulting from the transaction.

70 Goodwill is an intangible asset that arises when a buyer acquires an existing business and pays more than the fair market value of the acquired net assets. The goodwill represents the excess of the purchase consideration paid over the fair market value of the assets and liabilities being acquired. Under GAAP accounting pursuant to ASC 350 / FAS 142, goodwill recorded by public companies is no longer amortized, but is instead evaluated every year by management to determine if a downward impairment valuation adjustment is required. If the fair market value of the acquired net assets goes below historical cost (what goodwill was purchased for), an impairment must be recorded to reduce goodwill to its fair market value.

71 The Federal Energy Regulatory Commission (“FERC”) Uniform System of Accounts (18 CFR §1.101) defines Account 114 Electric plant acquisition adjustments as: A. This account shall include the difference between: (1) the cost to the accounting utility of electric plant acquired as an operating unit or system by purchase, merger, consolidation, liquidation, or otherwise, and (2) the original cost, estimated, if not known, of such property, less the amount or amounts credited by the accounting utility at the time of acquisition to accumulated provisions for depreciation and amortization and contributions in aid of construction with respect to such property.
Q. SHOULD THE APPLICANTS’ COMMITMENT IN TESTIMONY TO NOT SEEK
RECOVERY OF GOODWILL OR ACQUISITION PREMIUM COSTS BE
FORMALIZED IN A REGULATORY CONDITION, IF THE PROPOSED
TRANSACTION IS APPROVED BY THE COMMISSION?

A. Yes. There should be no ambiguity concerning the fact that the original cost
basis of the utility plant of the Hawaiian Electric Companies will not be
increased by the Transaction and no rate recovery shall occur for
consideration paid by NextEra in excess of original cost in any future rate
proceedings. I have included the following proposed condition to address this
matter:

- No costs arising from any Acquisition Premium or Goodwill
amortization, impairment or related charge to expense or
income shall be directly incurred by, allocated to, or recorded
on the books of the Hawaiian Electric Companies as a result
of the proposed Change in Control.

Q. ARE THERE OTHER RATEMAKING POLICIES OF THIS COMMISSION,
BEYOND THE NON-RECOVERY OF MERGER TRANSACTION,
TRANSITION AND ACQUISITION PREMIUM COSTS, THAT ARE RAISED
BY THE PROPOSED TRANSACTION?

A. Yes. There are several additional regulatory accounting and ratemaking
issues that merit consideration. These other policy matters include:

- Incentive Compensation Costs associated with variable compensation
plans established for the benefit of utility employees and affiliated
company employees.
• Income Tax Net Operating Loss Carryforward Deferred Tax Assets that are recorded when taxable income is persistently negative, such that income tax losses cannot be immediately monetized under IRS loss carryback rules.

• Corporate Aviation costs that have not been incurred historically by the Hawaiian Electric Companies, but are routinely incurred by and charged among NextEra affiliated entities.

• NextEra Executive Compensation costs that have not been incurred historically by the Hawaiian Electric Companies and that may become allocable to the Hawaii utilities through management fee or other affiliate cost assignment or allocation regimes.

• NextEra Captive Insurance Affiliate costs that have not been incurred historically by the Hawaiian Electric Companies and that may become allocable or chargeable to the Hawaii utilities through new insurance premium charges from Palms Insurance Company, Ltd., NextEra’s wholly owned captive insurance company domiciled in the Cayman Islands.

The Commission should consider the potentially negative impact upon Hawaiian Electric Companies’ ratepayers that could result from the Proposed Transaction in connection with each of these policy matters.
B. INCENTIVE COMPENSATION.

Q. HAVE THE HAWAIIAN ELECTRIC COMPANIES SOUGHT, IN THEIR PAST RATE CASE APPLICATIONS, ANY RECOVERY THROUGH RATES OF INCENTIVE COMPENSATION EXPENSE FOR EMPLOYEES OF HEI OR ANY OF THE HAWAIIAN ELECTRIC COMPANIES' EMPLOYEES?

A. No. In deference to long-standing Commission policy not allowing recovery of such costs, the Hawaiian Electric Companies do not include incentive compensation expenses within their rate case applications or test year expense forecasts. Additionally, when calculating each utility’s achieved return on equity for purposes of RAM earnings sharing, the recorded expenses associated with incentive compensation are removed so as to not understate shareable earnings and return on equity. A summary of the HEI and Hawaiian Electric utilities’ incentive compensation amounts recently payable, by plan and entity, was provided in Applicants’ response to CA-IR-338.

Q. DO FPL AND THE OTHER NEXTERA COMPANIES ALSO PROVIDE INCENTIVE COMPENSATION TO EMPLOYEES, IN AMOUNTS THAT MAY BEALLOCATED TO THE HAWAIIAN ELECTRIC COMPANIES IF THE PROPOSED TRANSACTION IS CONSUMMATED?

A. Yes. However, according to Applicants’ response to HBWS-IR-40, “NextEra Energy does not intend to allocate incentive compensation costs to the Hawaiian Electric Companies in the interim before the next rate case.
No decisions have been made with respect to what may be requested in a future rate case, but the Commission would have the opportunity to review and approve these amounts if they are included.\textsuperscript{72} In other words, after any rate moratorium is completed or terminated due to compelling financial need, ratepayers may face the additional cost and risk of proposed rate recovery of incentive compensation costs that were not historically requested by the Hawaiian Electric Companies under HEI control.

Q. WOULD THE PURSUIT OF RATE RECOVERY FOR INCENTIVE COMPENSATION COSTS, AFTER THE PROPOSED TRANSACTION IS CONSUMMATED, REPRESENT SPECIFIC FINANCIAL HARM TO HAWAIIAN ELECTRIC RATEPAYERS BECAUSE SUCH RECOVERY WOULD RESULT IN HIGHER UTILITY RATES?

A. Yes. Out of concern regarding the incremental cost to ratepayers of the potential change in regulatory policy regarding incentive compensation costs under NextEra ownership and control, a regulatory condition is proposed in the next section of my testimony that seeks to preclude future rate increases to effect rate recovery of incentive compensation costs.

\textsuperscript{72} In Applicants’ response to CA-IR-338, part (d), only a similarly worded “interim before the next rate case” commitment is offered, after acknowledging that “the Commission has historically denied cost recovery for incentive compensation costs.”
Q. HAVE YOU DEVELOPED A CONDITION THAT WOULD BE EFFECTIVE IN PREVENTING THE DIRECT OR INDIRECT RATE RECOVERY OF INCENTIVE COMPENSATION COSTS THAT HAVE NOT HISTORICALLY BEEN RECOVERED FROM HAWAII RATEPAYERS?

A. Yes. The following recommended condition is for this purpose:

- No costs arising from incentive compensation payable to any employee of NextEra or any NextEra subsidiary or affiliated entity, or of the Hawaiian Electric Companies shall be charged or allocated to any Operating Expense accounts or to any Plant in Service accounts of the Hawaiian Electric Companies.

C. NET OPERATING LOSS TAX BENEFITS.

Q. WHAT ARE NET OPERATING TAX LOSSES AND WHY DO THEY MATTER IN THE REGULATION OF PUBLIC UTILITIES?

A. Electric utilities are capital intensive businesses that invest heavily in new utility plant assets each year. These investments create significant federal income tax deductions for bonus and accelerated tax depreciation as well as for costs that can be expensed as “repairs” for tax purposes that are capitalized on the books. When these income tax deductions grow large enough to cause the utility to have negative taxable income, a “net operating loss” is created on the income tax return that is eligible for limited carryback and carryforward to other tax years where such losses can be “utilized” to reduce the amount of income taxes actually payable to the government. Generally, tax operating losses can be carried back for two years and forward
for up to 20 years as an offset to positive taxable income in those years. The Hawaiian Electric Companies have experienced income tax losses so large that the losses exceeded the two year carryback, if analyzed on a utility-only basis, creating large balances of Net Operating Loss (“NOL”) carryforward deferred tax assets on the books of the Hawaiian Electric Companies.

In rate cases and annual decoupling RAM filings, the deferred tax assets may be included rate base, increasing the utility’s revenue requirement to reflect the delay in utilization of the losses to yield cash income tax savings. The rate base inclusion of NOL deferred tax asset balances was raised as an issue in recent decoupling filings, but was resolved informally with the Hawaiian Electric Companies agreeing to not require rate base treatment of such balances. The Consumer Advocate has disputed the need for any rate base inclusion of the utilities’ NOL balances because, on a consolidated HEI income tax return basis of accounting, there were no NOL carryforwards that required a return from ratepayers.

Q. WOULD THE PROPOSED TRANSACTION HAVE A DETRIMENTAL IMPACT ON THE HAWAIIAN ELECTRIC COMPANIES’ HISTORICAL ABILITY TO REALIZE THE FINANCIAL BENEFIT OF INCOME TAX LOSSES?

A. Yes. Under present ownership, the cumulative federal NOL tax benefits produced by the Hawaiian Electric Companies as of December 31, 2014, have
been realized by the inclusion of such losses within HECO, Inc.’s HEI’s consolidated federal income tax return. If not for this consolidation benefit, the deferred tax asset balances of HECO and MECO would have increased the rate base of these utilities by $40 million and $12 million, respectively, at that date. Under present HEI ownership, the consolidated group has the ability to accelerate the realization of the utilities’ tax losses by offsetting those losses against ASB’s federal taxable income.

In contrast, under NextEra ownership, and after the planned spin-off of ASB, the Hawaiian Electric Companies would be included in the consolidated Federal income tax return of NextEra and NextEra Energy expects to treat the Hawaiian Electric Companies on a stand-alone basis in regards to any tax allocation agreement. As a consequence, the tax loss accelerated realization for the utilities, as now accomplished through affiliation with HEI and ASB, would be lost and utility revenue requirements would be higher prospectively.

73 Applicants’ response to CA-IR-337.
74 Applicants’ response to CA-IR-301.
75 Applicants’ response to CA-IR-302. See also Applicants’ response to CA-IR-373.
76 While there have been no rate cases in which the Commission was able to consider the accelerated realization of utility tax losses through the submission of a consolidated HEI Federal income tax return where ASB taxable income was offset by HECO and MECO tax losses, the deferred tax assets associated with the utilities’ NOLs were removed from rate base by agreement between the Hawaiian Electric Companies and the Consumer Advocate and have not increased utility revenue requirement through the decoupling RAM mechanism, to date.
Q. HAVE YOU PREPARED A REGULATORY CONDITION THAT COULD SERVE TO PREVENT THE NEGATIVE RATEPAYER IMPACT THAT MAY RESULT IF THE CONSOLIDATED FEDERAL INCOME TAX RETURN “SHELTER” FOR UTILITY TAX LOSSES IS NO LONGER ENABLED BECAUSE OF THE PROPOSED TRANSACTION?

A. Yes. The ratemaking condition is proposed to preserve the past elimination of utility tax loss NOL deferred tax asset amounts in determining rate base within future electric rate cases and RAM calculations is:

- No deferred tax assets recorded by the Hawaiian Electric Companies that arise from income tax net operating loss carryforwards, federal tax credit carryforwards or alternative minimum tax carryforwards shall be included in the rate base of the Hawaiian Electric Companies within either future base rate case filings or Rate Base Return on Investment decoupling filings that are submitted by the Hawaiian Electric Companies.

D. CORPORATE AVIATION COSTS.

Q. PLEASE EXPLAIN THE CONCERN RAISED BY CORPORATE AVIATION COSTS THAT ARE INCURRED BY NEXTERA.

A. An obvious concern raised by the proposed NextEra ownership and control of the Hawaiian Electric Companies is the large geographic distance between most of NextEra’s management and employees, who are domiciled in Florida, and Hawaiian Electric’s operations that are approximately 4,800 miles distant. Internet and telephonic communications would, no doubt, be the primary future modes of communications to support post-merger management, but the need
for face to face meetings is likely to add significant new transportation costs into the expenses reported by the utilities that are potentially included in their future rates. As noted above, Applicants have provided no estimates of their expected costs to achieve full integration of operations, much less any vision of how the integrated businesses may rely upon air transportation.

NextEra presents information about its three corporate jet aircraft in its response to CA-IR-371, but objected and declined to provide the requested distribution of total 2014 flight operations costs among NextEra Energy entities by FERC account in part (d) of that response. In part (f), that requested a statement of expectations for utilization of corporate aircraft for travel to/from Hawaii if the proposed Change in Control is consummated, the response given is, “this has not yet been determined.”

The Consumer Advocate is concerned that significant new charges to the Hawaiian Electric Companies may result from future use of NextEra’s aviation fleet for travel to and from Hawaii, adding significant new costs that may be sought for recovery from ratepayers. These new costs would have a detrimental impact upon ratepayers, to the extent not moderated by ratemaking adjustments and/or offset by tangible benefits for each flight taken and charged.
Q. HAVE YOU PROPOSED A REGULATORY CONDITION TO ADDRESS THIS CONCERN IN THE NEXT SECTION OF YOUR TESTIMONY?

A. Yes. The following condition is proposed for that purpose:

- No costs associated with aviation assets owned or leased and/or operated by NextEra, or any entity affiliated with NextEra, shall be charged or allocated to, or recorded to any Operating Expense accounts or to any Plant in Service accounts of the Hawaiian Electric Companies.

E. NEXTERA SENIOR EXECUTIVE MANAGEMENT COSTS.

Q. WHAT IS THE NATURE OF THE CONCERN REGARDING POTENTIAL ASSIGNMENT OR ALLOCATION OF NEXTERA’S SENIOR EXECUTIVE MANAGEMENT COSTS TO THE HAWAIIAN ELECTRIC COMPANIES?

A. NextEra is a broadly diversified parent/holding company and the Proposed Transaction would, if consummated, add the Hawaiian Electric Companies as a relatively small part of a much larger and more complex consolidated business enterprise. NextEra’s top five “Named Executive Officers” (“NEOs”), for SEC reporting purposes, are highly compensated based upon their responsibilities for the financial performance of the consolidated business. The ratemaking concern is that compensation costs for NextEra’s NEOs should be treated as ownership and portfolio management costs properly retained by the parent organization, rather than being allocated to the Hawaiian Electric Companies, because such costs are not necessary for the ongoing operations of the electric utilities in Hawaii. If an allocation of NextEra’s senior executive management costs occurs simply because of NextEra’s
acquisition of the utilities after consummation of the Proposed Transaction, these incremental costs may represent a public interest detriment caused by the Transaction.

Q. HOW MUCH WERE NEXTERA’S TOP FIVE NAMED EXECUTIVES COMPENSATED IN 2014?

A. The following data has been extracted from “Summary Compensation Table” 1a appearing within NextEra’s Schedule 14A Proxy Statement filed with the SEC on March 31, 2015, the total compensation to NextEra’s NEOs in 2014:

<table>
<thead>
<tr>
<th>NEO Name</th>
<th>Positions</th>
<th>2014 Salary</th>
<th>Stock &amp; Options</th>
<th>Non-equity Incentives</th>
<th>Other Compensation</th>
<th>Total Compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>James L Robo</td>
<td>Chairman, CEO of NEE; Chairman FPL</td>
<td>$1,215,000</td>
<td>$7,481,805</td>
<td>$2,780,528</td>
<td>$705,963</td>
<td>$12,183,296</td>
</tr>
<tr>
<td>Moray P Dewhurst</td>
<td>Vice Chairman and CFO, Exec. VP, Finance of NextEra Energy; Exec VP Finance and CFO of FPL</td>
<td>$703,100</td>
<td>$4,680,284</td>
<td>$979,400</td>
<td>$370,176</td>
<td>$6,732,960</td>
</tr>
<tr>
<td>Manoochehr K Nazar</td>
<td>President, Nuclear Division and CNO of NextEra Energy and FPL</td>
<td>$808,300</td>
<td>$2,086,282</td>
<td>$1,126,000</td>
<td>$419,372</td>
<td>$4,439,954</td>
</tr>
<tr>
<td>Armando Pimentel, Jr.</td>
<td>President and CEO of NextEra Energy Resources</td>
<td>$745,900</td>
<td>$1,930,093</td>
<td>$1,039,000</td>
<td>$357,181</td>
<td>$4,072,174</td>
</tr>
<tr>
<td>Charles E. Sieving</td>
<td>Exec VP and General Counsel of NextEra Energy and Exec VP of FPL</td>
<td>$689,000</td>
<td>$1,253,906</td>
<td>$685,600</td>
<td>$271,773</td>
<td>$2,900,279</td>
</tr>
</tbody>
</table>


According to this disclosure, the total compensation for the NEOs was $30.3 million in 2014. While it is unlikely that all of these positions would represent compensation costs chargeable to the Hawaiian Electric Companies prospectively, unless and until the Commission has an opportunity to carefully examine the nature and value of any services provided by the NEO’s in a next
formal rate case, the costs of these executives should not be allocated or otherwise charged into the operating expenses of the utilities in Hawaii.

Q. ARE YOU AWARE OF ANY OTHER ELECTRIC UTILITIES, WHO ARE PART OF LARGE HOLDING COMPANY STRUCTURES, AND THAT ROUTINELY REMOVE THE COSTS OF SENIOR EXECUTIVE MANAGEMENT COMPENSATION IN THE DETERMINATION OF UTILITY REVENUE REQUIREMENTS?

A. Yes. In the annual rate adjustment filings of Commonwealth Edison Company, the largest electric utility in Illinois, the utility makes a self-disallowance adjustment for “Executive Compensation Exclusions” that represent the Commonwealth Edison allocated share of salaries, incentives, share-based compensation and perquisites for thirteen Exelon executive management positions.77

77 See ComEd Exhibit 2.04, page 38 of 559 from the pending formula rate proceedings of Commonwealth Edison Company in ICC Docket No. 15-0287.
Q. HAVE YOU PREPARED A CONDITION, FOR CONSIDERATION BY THE COMMISSION, IN THE EVENT THE PROPOSED TRANSACTION IS AUTHORIZED, THAT ADDRESSES NEXTERA’S EXECUTIVE MANAGEMENT COMPENSATION COSTS?

A. Yes. The following condition is proposed for that purpose:

- No costs for compensation of NextEra’s most highly compensated “Named Executive Officers”, for purposes of financial reporting, shall be assigned or allocated to any Operating Expense or Plant in Service accounts of the Hawaiian Electric Companies.

F. CAPTIVE INSURANCE AFFILIATE COSTS.

Q. PLEASE EXPLAIN THE REGULATORY CONCERN ASSOCIATED WITH NEXTERA’S CAYMAN ISLANDS CAPTIVE INSURANCE SUBSIDIARY, PALMS INSURANCE COMPANY, LTD.

A. The regulatory concern is that Applicants may decide, after the Proposed Transaction is consummated, that NextEra’s captive insurance company should provide insurance services to the Hawaiian Electric Companies at pricing that is unreasonable, negatively impacting reported utility financial results that may be used in calculating revenue requirements or earnings sharing in annual decoupling filings.

In response to CA-IR-346(a), Applicants state the following regarding NextEra’s captive insurance subsidiary:

Palms is a single parent captive insurer wholly owned by NextEra Energy Capital Holdings, Inc., which in turn is wholly owned by NextEra Energy, Inc. (“NEE”). Palms provides property and casualty insurance only to NEE and its affiliates. Palms presently
insures the following: NEE Renewables Builders All Risk (quota share with commercial insurers), Florida Power & Light Company (“FPL”) Employee and Contractor Workers’ Compensation (FPL’s self-insured retention), FPL Fleet Auto Liability (FPL’s self-insured retention), FPL Construction Builders All Risk for Port Everglades Energy Center (quota share with commercial insurers), and NextEra Energy Resources, LLC Property (deductible buy-down).

Part (d) of the same response notes that insurance is provided to the FPL regulated utility business for a self-insured retention layer of risks associated with worker’s compensation and fleet automobile liability and for Construction Builders All Risk coverage in a quota share at FPL’s Port Everglades Energy Center. The premiums charged to FPL by this affiliated company are said to be calculated, “…considering historical losses and related expenses, projecting expected losses and expenses utilizing actuarial studies, and reflecting market conditions. In the case of quota share programs, pricing is established by the commercial insurers taking into considerations losses, expenses and market conditions.”

Q. HAVE CAPTIVE INSURANCE AFFILIATES OF PUBLIC UTILITIES PROVEN TO BE CONTROVERSIAL IN RATE PROCEEDINGS?

A. Yes. I personally sponsored a ratemaking adjustment in a 1996 rate case involving GTE Hawaiian Telephone Company’s captive insurance affiliate, in a
rate case that was ultimately settled before the Commission. More recently, I have addressed Atmos Energy Corporation’s Bermuda captive insurance affiliate in multiple gas rate cases involving Atmos gas utility operations.

Q. DOES NEXTERA INTEND TO ESTABLISH INSURANCE COVERAGE ARRANGEMENTS WITH THE HAWAIIAN ELECTRIC COMPANIES, IF THE PROPOSED TRANSACTION IS CONSUMMATED?

A. This is not presently known. Part (c) of Applicants’ response to CA-IR-346 states, “[a]n analysis of the provision of products or services by Palms to the Hawaiian Electric Companies has not been conducted at this time.”

Q. HAVE YOU PREPARED A REGULATORY CONDITION FOR CONSIDERATION BY THE COMMISSION WITH RESPECT TO NEW AFFILIATED COMPANY INSURANCE ARRANGEMENTS?

A. Yes. The following condition is proposed to address this concern:

- No costs for insurance services or coverage from any NextEra Energy affiliated company shall be assigned or allocated to any Operating Expense or Plant in Service accounts of the Hawaiian Electric Companies.

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78 See Docket No. 94-0298, CA-T-5 Brosch testimony pages 99-105 regarding GTE Hawaiian Tel Insurance Company affiliate transactions and the required ratemaking adjustment.
V. SUMMARY OF RATEMAKING CONDITIONS.

Q. HAVE YOU COMPILED A COMPLETE LISTING OF THE ACCOUNTING AND RATEMAKING CONDITIONS THAT ARE SUPPORTED IN YOUR TESTIMONY?

A. Yes. The following list of conditions is proposed for utilization in this docket, in the event the Commission determines that the Proposed Transaction should be approved:

Ratemaking Conditions:

1. To ensure significant tangible public interest benefits to Hawaiian Electric Companies' ratepayers, HECO, HELCO and MECO shall file tariffs reducing each of the non-fuel base energy charge rates to each customer class by $0.007 (seven tenths of one cent) per kWh, to be effective upon consummation of the proposed Change in Control, with corresponding prospective downward adjustment to the target revenues of each utility for Revenue Balancing Account purposes. This condition is expected to reduce annual revenues of the HECO Companies by $62.4 million at currently estimated sales volumes.

2. The Hawaiian Electric Companies shall not submit an application seeking a base rate/revenue increase prior to the date 48 months subsequent to the date of closing of the proposed Change in Control. This condition shall not preclude requests for base revenue reduction filings or revenue-neutral tariff modifications during this moratorium period. If circumstances arise that create a compelling financial need for a base rate/revenue increase that violates this rate case moratorium period, the base revenue increase shown to be justified under such circumstances shall be revised downward to reflect a rate of return on common equity penalty reduction of 100 basis points (1.0 percent) from the otherwise appropriate common equity return levels.

3. The decoupling mechanism last approved by the Commission in Order No. 32735 issued March 31, 2015 in Docket No. 2013-0141, shall remain in effect during the rate case moratorium period described in the immediately preceding condition, subject to any changes ordered by Commission from time to time.
4. The Rate Base RAM – Return on Investment within the Rate Adjustment Mechanism filings submitted by each of the Hawaiian Electric Companies, for all periods after closing of the proposed Change in Control and until a next general rate case order, shall be revised to reflect an approved return on Common Equity of 9.0 percent and a Common Equity ratio of 47 percent (with corresponding upward adjustment to the long term debt capital ratio). The same return on Common Equity and Common Equity Ratio assumptions should be utilized in AFUDC rate determination calculations for all periods after closing of the proposed Change in Control and until a next general rate case order.

5. All costs directly incurred by, or allocated to the Hawaiian Electric Companies, as a result of the proposed Change in Control, including transaction-related fees and expenses to seek and receive shareholder and regulatory approvals, shareholder litigation costs, business integration and transition expenses and other costs to achieve merger savings shall be recorded in non-operating expense accounts that are not reflected in utility operating income accounts and such recorded costs shall be excluded from any base rate increase requests and in determining annual utility earnings for Earning Sharing calculations within the decoupling mechanism.

6. No costs arising from any Acquisition Premium or Goodwill amortization, impairment or related charge to expense or income shall be directly incurred by, allocated to, or recorded on the books of the Hawaiian Electric Companies as a result of the proposed Change in Control.

7. No costs arising from incentive compensation payable to any employee of NextEra Energy or any NextEra subsidiary or affiliated entity, or of the Hawaiian Electric Companies shall be charged or allocated to any Operating Expense accounts or to any Plant in Service accounts of the Hawaiian Electric Companies.

8. No deferred tax assets recorded by the Hawaiian Electric Companies that arise from income tax net operating loss carryforwards, federal tax credit carryforwards or alternative minimum tax carryforwards shall be included in the rate base of the Hawaiian Electric Companies within either future base rate case filings or Rate Base Return on Investment decoupling filings that are submitted by the Hawaiian Electric Companies.
9. No costs associated with aviation assets owned or leased and/or operated by NextEra Energy, or any entity affiliated with NextEra Energy, shall be charged or allocated to, or recorded to any Operating Expense accounts or to any Plant in Service accounts of the Hawaiian Electric Companies.

10. No costs for compensation of NextEra Energy most highly compensated “Named Executive Officers”, for purposes of financial reporting, shall be assigned or allocated to any Operating Expense or Plant in Service accounts of the Hawaiian Electric Companies.

11. No costs for insurance services or coverage from any NextEra Energy affiliated company shall be assigned or allocated to any Operating Expense or Plant in Service accounts of the Hawaiian Electric Companies.

Q. IN YOUR OPINION, IF ALL OF THESE CONDITIONS WERE ACCEPTED BY THE APPLICANTS, WOULD THE PROPOSED TRANSACTION BE CONSISTENT WITH THE PUBLIC INTEREST FROM A RATEMAKING PERSPECTIVE?

A. I understand that there are many other concerns with the Proposed Transaction that are addressed in the testimonies of other Consumer Advocate witnesses. However, with regard to the specific concerns addressed in my testimony, the proposed conditions in this listing serve to adequately mitigate my stated concerns with respect to ratemaking issues.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes. It does.
Michael L. Brosch
Utilitech, Inc. – President
Bachelor of Business Administration (Accounting)
University of Missouri-Kansas City (1978)
Certified Public Accountant Examination (1979)

GENERAL

Mr. Brosch serves as the director of regulatory projects for the firm and is responsible for the planning, supervision and conduct of firm engagements. His academic background is in business administration and accounting and he holds CPA certificates in Kansas and Missouri. Expertise is concentrated within regulatory policy, financial and accounting areas with an emphasis in revenue requirements, business reorganization, cost allocations, rate design and alternative regulation.

EXPERIENCE

Mr. Brosch has supervised and conducted the preparation of rate case exhibits and testimony in support of revenue requirements and regulatory policy issues involving more than 100 electric, gas, telephone, water, and sewer proceeding across the United States. Responsible for virtually all facets of revenue requirement determination, cost of service allocations and tariff implementation in addition to involvement in numerous utility merger, alternative regulation and other special project investigations.

Industry restructuring analysis for gas utility rate unbundling, electric deregulation, competitive bidding and strategic planning, with testimony on regulatory processes, asset identification and classification, revenue requirement and unbundled rate designs and class cost of service studies.

Analyzed and presented testimony regarding income tax related issues within ratemaking proceedings involving interpretation of relevant IRS code provisions and regulatory restrictions.

Has substantial experience in the application of lead-lag study concepts and methodologies in determination of working capital investment to be included in rate base.
Conducted alternative regulation analyses for clients in Arizona, California, Hawaii, Illinois, Texas and Oklahoma, focused upon challenges introduced by cost-based regulation, incentive effects available through alternative regulation and balancing of risks, opportunities and benefits among stakeholders. Analyses included targeted rate adjustment clauses, regulatory deferral accounting mechanisms, revenue/price cap arrangements and formula rate adjustment programs, including advisory work in the design of such plans as well as analyses and administration of alternative regulation plans after implementation. Analyzed and developed alternative regulation plans for electric and gas utilities in multiple states. Participated in the development, implementation and administration of decoupling and formula rate adjustment mechanisms. Advised and assisted in legislative advocacy regarding electric and gas infrastructure rate adjustment mechanisms.

Mr. Brosch managed the detailed regulatory review of utility mergers and acquisitions, diversification studies and holding company formation issues in energy and telecommunications transactions in multiple states. Sponsored testimony regarding merger synergies, merger accounting and tax implications, regulatory planning and price path strategies. Traditional horizontal utility mergers as well as leveraged buyouts of utility properties by private equity investors have been addressed in several states.

**WORK HISTORY**

1985 - Present

**President** - Utilitech, Inc.
Regulatory project management and advisory/consulting services on behalf of industry and governmental agencies.

1983 - 1985:

**Project manager** - Lubow McKay Stevens and Lewis.
Responsible for supervision and conduct of utility regulatory projects on behalf of industry and regulatory agency clients.

1982 - 1983:

**Regulatory consultant** - Troupe Kehoe Whiteaker and Kent.
Responsible for management of rate case activities involving analysis of utility operations and results, preparation of expert testimony and exhibits, and issue development including research and legal briefs. Also involved in numerous special projects including financial analysis and utility systems planning. Taught firm's professional education course on "utility income taxation - ratemaking and accounting considerations" in 1982.
Supervised and conducted rate case investigations of utilities subject to PSC jurisdiction in response to applications for tariff changes. Responsibilities included development of staff policy on ratemaking issues, planning and evaluating work of outside consultants, and the production of comprehensive testimony and exhibits in support of rate case positions taken.

**OTHER QUALIFICATIONS**

Bachelor of Business Administration - Accounting, 1978
University of Missouri - Kansas City

Member American Institute of Certified Public Accountants
Missouri Society of Certified Public Accountants
Kansas Society of Certified Public Accountants

Attended Iowa State Regulatory Conference 1981, 1985
Regulated Industries Symposium 1979, 1980
Michigan State Regulatory Conference 1981
United States Telephone Association Round Table 1984
NARUC/NASUCA Annual Meeting 1988, Speaker
NARUC/NASUCA Annual Meeting 2000, Speaker
NASUCA Regional Consumer Protection Meeting 2007, Speaker

Instructor INFOCAST Ratemaking Courses
Arizona Staff Training
Hawaii Staff Training
<table>
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<th>Utility Company</th>
<th>State</th>
<th>Tribunal</th>
<th>Case Number</th>
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<td>REVENUE REQUIREMENT - CAPITAL COST UPDATING:</td>
<td>PRETAX ANNUAL RETURN IMPACT— 2015 AVERAGE RATE BASE</td>
<td>INPUTS FROM S. HILL</td>
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<td>Source: Pages 2 through 4 by utility</td>
<td>Source: Pages 2 through 4 by utility</td>
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<td>UPDATE DEBT COST RATES</td>
<td>HECO</td>
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<td>MECO</td>
<td>TOTAL</td>
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<td></td>
<td>$ (4,657) $</td>
<td>$ (1,109) $</td>
<td>$ 50</td>
<td>$ (5,716) $</td>
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<td>2</td>
<td>REVISE EQUITY RATIO &amp; ROE</td>
<td>HECO</td>
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<td>MECO</td>
<td>TOTAL</td>
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<td></td>
<td>(34,925) $</td>
<td>(6,992)</td>
<td>$ (4,712)</td>
<td>(46,629) $</td>
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<td>3</td>
<td>Pre-Tax ROI on 2015 Average Rate Base (RAM Filings)</td>
<td>HECO</td>
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<td>MECO</td>
<td>TOTAL</td>
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<td></td>
<td>(39,581) $</td>
<td>(8,101)</td>
<td>(4,663)</td>
<td>(52,345) $</td>
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<th>2</th>
<th>3</th>
<th>4</th>
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<td>UPDATE DEBT COST RATES</td>
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<td>$ (5,716) $</td>
<td>$ (5,716) $</td>
<td>$ (5,716) $</td>
<td>$ (22,865) $</td>
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<td>REVISE EQUITY RATIO &amp; ROE</td>
<td>(46,629) $</td>
<td>(46,629) $</td>
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<td>Pre-Tax ROI on 2015 Average Rate Base (RAM Filings)</td>
<td>(52,345) $</td>
<td>(52,345) $</td>
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<td>(52,345) $</td>
<td>(209,381) $</td>
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<td>Rate Case Expense (Initial CA-IR-303, Att. 1)</td>
<td>$ (1,172) $</td>
<td>$ (1,172) $</td>
<td>$ (1,172) $</td>
<td>$ (1,172) $</td>
<td>$ (4,688) $</td>
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<td>Insurance (CA-IR-304, Att.1, line 3)</td>
<td>(2,900) $</td>
<td>(2,987) $</td>
<td>(3,077) $</td>
<td>(3,230) $</td>
<td>(12,194) $</td>
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<tr>
<td>Professional Services (CA-IR-303 Supp 7/20, page 36)</td>
<td>-</td>
<td>-</td>
<td>(300) $</td>
<td>(300) $</td>
<td>(600) $</td>
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<td>Supply Chain Savings - See Note 1.</td>
<td>(2,542) $</td>
<td>(5,084) $</td>
<td>(7,626) $</td>
<td>(10,168) $</td>
<td>(25,420) $</td>
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<td>Information Technology (CA-IR-304, Att.1, line 2)</td>
<td>(1,273) $</td>
<td>(1,273) $</td>
<td>(1,273) $</td>
<td>(1,273) $</td>
<td>(5,092) $</td>
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<td>Less: Cost to Achieve at 25% of lines 8-11</td>
<td>1,679 $</td>
<td>2,336 $</td>
<td>3,069 $</td>
<td>3,743 $</td>
<td>10,827 $</td>
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<tr>
<td>Subtotal</td>
<td>(6,208) $</td>
<td>(8,180) $</td>
<td>(10,379) $</td>
<td>(12,400) $</td>
<td>(37,168) $</td>
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<td>Revenue Tax Factor (1/(1-8.885%))</td>
<td>1.0975</td>
<td>1.0975</td>
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<td>Subtotal Rate Adjustments for Projected Merger Savings</td>
<td>(6,814) $</td>
<td>(8,978) $</td>
<td>(11,391) $</td>
<td>(13,609) $</td>
<td>(40,791) $</td>
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<tr>
<td>TOTAL ANNUAL RATE/REVENUE ADJUSTMENT</td>
<td>$ (59,159) $</td>
<td>$ (61,323) $</td>
<td>$ (63,736) $</td>
<td>$ (65,955) $</td>
<td>$ (250,172) $</td>
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| Amount per KWH (Combined 2015 GWH forecast used)   | $ (0.0066) $ | $ (0.0068) $ | $ (0.0071) $ | $ (0.0074) $ | $ (0.0070) $ |
| MONTHLY CUSTOMER BILL AT 600 KWH                   | $ (3.96) $ | $ (4.11) $ | $ (4.27) $ | $ (4.42) $ | $ (4.20) $ |

Note 1: Supply Chain Savings based on IR-303 Supp 7/20 p.37 "5% savings in procurement costs within the first five years of merger" and quantified at 1% in year one ratably increasing to 4% in year 4, applied to 62% of $410M in 2014 annual non-fuel O&M. See HECO decoupling Schedule C1 for inputs from Dkt 2010-0080 where the non-labor portion of O&M was $161 million of total O&M of $258 million, or 62%.

Note 2: Combined Sales Forecast from "Company 5/21/15 Filing" in Statement of Position and Revised RBA Adjustment letter 5/21/2015, Attachment 1A
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DIRECT TESTIMONY AND EXHIBITS

OF

STEVEN C. CARVER

ON BEHALF OF
THE DIVISION OF CONSUMER ADVOCACY

SUBJECT: AFFILIATE TRANSACTIONS AND SAFEGUARDS,
CROSS-SUBSIDIZATION COST ALLOCATION GUIDELINES,
REGULATORY OVERSIGHT, MERGER CONDITIONS
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DIRECT TESTIMONY OF STEVEN C. CARVER

I. INTRODUCTION.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.
A. My name is Steven C. Carver. My business address is P.O. Box 481934, Kansas City, Missouri 64148.

Q. WHAT IS YOUR PRESENT OCCUPATION?
A. I am a principal in the firm Utilitech, Inc., which specializes in providing consulting services for clients who actively participate in the process surrounding the regulation of public utility companies. Our work includes the review of utility rate applications, as well as the performance of special investigations and analyses related to utility operations, cost allocation and ratemaking issues.

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?
A. On December 3, 2014, an Agreement and Plan of Merger ("Agreement") was executed for purposes of transferring control of the HECO Companies\(^1\) from Hawaiian Electric Industries, Inc. ("HEI") to "Hawaiian Electric Holdings," a wholly owned subsidiary of NextEra Energy, Inc. ("NextEra Energy" or "NEE") (collectively, the "Applicants"). On January 29, 2015, the Applicants filed an

\(^{1}\) The “HECO Companies” refers to Hawaiian Electric Company, Inc. ("HECO"), Hawaii Electric Light Company, Inc. ("HELCO") and Maui Electric Company, Limited ("MECO").
application ("Application") with the Public Utilities Commission of the State of Hawaii ("Commission" or "HPUC") seeking approval of the proposed change of control. On April 13, 2015, the joint Applicants filed direct testimony and related exhibits supporting the proposed change of control. The Commission opened Docket No. 2015-0022 to review and address this merger/acquisition request.

Utilitech was retained by the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy (hereinafter "Consumer Advocate" or "CA") to review and respond to the change of control filing and to prepare direct testimony regarding the issues identified during the course of our review. Consequently, I am appearing on behalf of the Consumer Advocate.

Q. PLEASE SUMMARIZE THE PURPOSE OF YOUR TESTIMONY.
A. My responsibilities in this docket encompass partial sponsorship of the Consumer Advocate’s positions and recommendations, from an accounting and regulatory perspective, associated with Issues 1.e., 1.f., 2, 3, 4, 5 and 6 as set forth in the Commission’s Order No. 32739, which are as follows:

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2 Docket No. 2015-0022, In the Matter of the Application of HAWAIIAN ELECTRIC COMPANY, INC., HAWAI'I ELECTRIC LIGHT COMPANY, INC., MAUI ELECTRIC COMPANY, LIMITED, and NEXTERA ENERGY, INC., For Approval of the Proposed Change of Control and Related Matters.
<table>
<thead>
<tr>
<th>Issue No.</th>
<th>Issue Description</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.e.</td>
<td>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.</td>
<td>No</td>
</tr>
<tr>
<td>1.f.</td>
<td>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.</td>
<td>No</td>
</tr>
<tr>
<td>2</td>
<td>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.</td>
<td>Not necessarily at lowest reasonable cost</td>
</tr>
<tr>
<td>3</td>
<td>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.</td>
<td>Probably</td>
</tr>
<tr>
<td>4</td>
<td>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.</td>
<td>Probably</td>
</tr>
<tr>
<td>5</td>
<td>Whether NextEra, FPL, or any other affiliate has been subject to compliance or enforcement orders issued by any regulatory agency or court.</td>
<td>Yes</td>
</tr>
<tr>
<td>6</td>
<td>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.</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Additional aspects of the pending application are being addressed by other Consumer Advocate witnesses, including Mr. Dean Nishina (CA Exhibit-1), Mr. Michael Brosch (CA Exhibit-11), Mr. Stephen Hill (CA Exhibit-7), Mr. Maximilian Chang (CA Exhibit-20) and Mr. Ian Chan Hodges (CA Exhibit-5).
II. EDUCATION AND EXPERIENCE.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I graduated from State Fair Community College, where I received an Associate of Arts Degree with an emphasis in Accounting. I also graduated from Central Missouri State University (now University of Central Missouri) with a Bachelor of Science Degree in Business Administration, majoring in Accounting.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE IN THE FIELD OF UTILITY REGULATION.

A. My entire professional career has been associated with the regulation of public utilities. From 1977 to 1987, I was employed by the Missouri Public Service Commission (“MoPSC”) in various professional auditing positions, including a promotion by the Missouri Commissioners to the position of Chief Accountant in April 1983. Since my employment with Utilitech in June 1987, I have been associated with various regulatory projects on behalf of clients in multiple State jurisdictions (Arizona, California, Florida, Hawaii, Kansas, Illinois, Iowa, Indiana, Mississippi, Missouri, Nevada, New Mexico, New York, Oklahoma, Pennsylvania, Texas, Utah, Washington, West Virginia and Wyoming) and have conducted revenue requirement and special studies involving various regulated industries (i.e., electric, gas, telephone, water and steam heat). Additional information regarding my professional experience and qualifications are summarized in CA Exhibit-17.
Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION IN PROCEEDINGS THAT INVOLVED THE HECO COMPANIES?

A. Yes. I have been involved in and presented revenue requirement recommendations in multiple rate cases involving the HECO Companies: five HECO rate cases (Docket Nos. 7700, 04-0113, 2006-0386, 2008-0083, and 2010-0080), three HELCO rate cases (Docket Nos. 99-0207, 05-0315 and 2009-0164), and three MECO rate cases (Docket Nos. 2006-0387, 2009-0163 and 2011-0092) on behalf of the Consumer Advocate.

In addition, I have prepared testimony in several other Hawaii regulatory proceedings, including: Kauai Electric Division of Citizens Communications Company (Docket Nos. 94-0097 and 94-0308 Consolidated); GTE Hawaiian Telephone Company, Inc. (Docket Nos. 94-0298 and 95-0194 Consolidated); The Gas Company (“TGC”) (Docket Nos. 00-0309 and 2008-0081); as well as a self-insured property damage reserve generic proceeding (Docket No. 95-0051), in which the HECO Companies participated and a HELCO purchased power agreement (Docket No. 98-0013).

Further, I have assisted the Consumer Advocate in its analysis of the acquisition of The Gas Company by Citizens Utilities Company from Broken Hill Proprietary Company, Ltd. (Docket No. 97-0035) and the subsequent acquisition of The Gas Company, a Division of Citizens Communications Company by K-1 USA Ventures, Inc. (Docket No. 03-0051), as well as the analysis of the sale
Finally, also on behalf of the Consumer Advocate, I participated along with Mr. Brosch in two decoupling proceedings (Docket Nos. 2008-0274 and 2013-0141) including oral testimony at panel hearings. I also assisted the Consumer Advocate in the review and evaluation of HECO Companies’ annual sales decoupling revenue balancing account (“RBA”) and the related revenue adjustment mechanism (“RAM”) filings, since initial implementation in 2011-2012.

III. CROSS-SUBSIDIZATION AND AFFILIATE TRANSACTIONS.

Q. COMMISSION ORDER NO. 32739 (“ORDER 32739”) POSED A SERIES OF ISSUES TO BE ADDRESSED IN PREFILED TESTIMONY. WHICH OF THOSE ISSUES DIRECTLY RELATE TO CROSS-SUBSIDIZATION AND AFFILIATE TRANSACTION CONCERNS?

A. This section of my testimony addresses the following issues identified by the Commission:

1. Whether the Proposed Transaction is in the public interest.
   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.
   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.
A. AFFILIATE TRANSACTIONS.

Q. HOW DO YOU RESPOND?

A. Absent additional conditions and requirements imposed on the Applicants prior to consummation of the merger, the Applicants’ proposed merger terms and conditions contain insufficient safeguards to protect against cross-subsidization and to safeguard HECO Companies’ ratepayers from affiliate transactions.³

In direct testimony, Applicant witness Mr. Eric Gleason reaches the opposite conclusion, including the following points:⁴

- First and foremost, NextEra Energy already is very experienced and successful in ensuring that all of its affiliate relationships are appropriately managed consistent with legal requirements and do not result in cross subsidization.

- Importantly, the Commission itself also has full legal authority to prevent inappropriate transactions with affiliates of Hawai‘i utilities pursuant to Section 269-19.5, Hawai‘i Revised Statutes.

- The Commission’s ability to audit the books and records of the Hawaiian Electric Companies is not impacted.

- On the matter of affiliate relations, the Applicants are requesting confirmation from the Commission that upon consummation of the Proposed Change of Control, the Thomas Report, which was adopted by the Commission in Docket No. 7591, will no longer be applicable.

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³ The context of Mr. Carver’s discussion of affiliate transactions and safeguards excludes competitive RFP process arrangements, which is discussed by Mr. Chang.

⁴ Applicants Exhibit-7, Gleason Direct at 39-42.
Similarly, Applicants are requesting certain modifications to “The 1982 Agreement” as it relates to the holding of the common stock of the Hawaiian Electric Companies. However, no modifications to the safeguards preventing cross subsidization between affiliates are being requested.

NextEra Energy does not currently have any plans to create any new non-utility subsidiaries under Hawaiian Electric Holdings or the Hawaiian Electric Companies or to expand upon the scope of products and services historically offered by the Hawaiian Electric Companies or any NextEra Energy subsidiaries within Hawaii.

Adequate safeguards exist to protect the Hawaiian Electric Companies’ ratepayers from any business and financial risks associated with the operations of NextEra Energy and/or any of its affiliates.

Mr. Gleason also lists a series of financing and capitalization matters as further assurance that the Proposed Change of Control is reasonable and in the public interest.5

Q. HOW DO YOU REACH THE OPPOSITE CONCLUSION FROM MR. GLEASON?

A. Basically, Mr. Gleason is suggesting that, as NEE has done this before and is an experienced operator, the Commission should just trust that the safeguards proposed by NEE are sufficient. I disagree.

5 Applicants Exhibit-7, Gleason Direct at 42.
When contemplating such a significant change in control as proposed by the Applicants, it is incumbent on the Commission and the Consumer Advocate to anticipate possible situations in which regulatory oversight is required to address activities, events or actions that do not occur as planned. If unexpected situations or actual activities and responsibilities vary from pre-merger affairs, questions might arise as to whether the Commission established sufficient guidelines and conditions prior to approving the change in control to enable the timely collection of necessary information in future regulatory proceedings.

Q. WHAT FACTORS HAVE THE APPLICANTS RELIED UPON TO CONCLUDE THAT ADEQUATE SAFEGUARDS ALREADY EXIST TO ADDRESS CROSS-SUBSIDY CONCERNS AND PROTECT AGAINST ABUSIVE AFFILIATE TRANSACTIONS?

A. In response to CA-IR-110, the Applicants have indicated that the Florida Power & Light Company’s (“FPL”) Cost Allocation Manual (“CAM”) “describes the policies, practices and processes for fees billed by FPL to all affiliates, and, therefore, would be applicable to the Hawaiian Electric Companies.” In response to CA-IR-239(b), the Applicants list a series of commitments to provide “assurances that the Proposed Change of Control and NextEra Energy’s other activities will not result in any material adverse impacts to the Hawaiian Electric Companies.” In response to CA-IR-72, which cited to Applicants Exhibit-7, pages 39 and 44,
the Applicants provided references to and copies of regulations and NEE’s written policies and procedures that protect against cross-subsidization.

In response to multiple information requests, the Applicants have cited to the CAM maintained by FPL pursuant to requirements of the Federal Energy Regulatory Commission ("FERC") and the Florida Public Service Commission ("FPSC") as being based on “well established methodologies that are used to charge affiliates for services provided.” The fact that “state regulators have repeatedly reviewed FPL’s policies and procedures and determined that these existing safeguards prevent cross subsidization” is useful information but does not resolve the fact that this Commission is charged with ensuring that the rates and charges for electric service in the State of Hawaii are just and reasonable. The Commission should not rely on periodic work done by other regulators to conclude that the costs underlying the corporate services performed by affiliate FPL for the NextEra family of companies, including the HECO Companies post-merger, are properly quantified and included in Hawaii electric rates.

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6 See Applicants’ responses to CA-IR-72, CA-IR-124 and KLMA-IR-24, for example.

7 Applicants Exhibit-33, Mr. John J. Reed at 49.

8 Id.

9 See Applicants’ responses to CA-IR-222, CA-IR-321(d) and CA-IR-364.
Q. WHAT DO YOU RECOMMEND?

A. In the event that the proposed change in control is approved, I recommend that the Commission adopt a series of affiliate-related merger conditions designed to protect the customers of the HECO Companies from cross-subsidizing other NEE affiliates (whether regulated or unregulated). Those conditions include:

1. In all future transactions between the Hawaiian Electric Companies and
   1) NextEra Energy or 2) NextEra Energy affiliates, other than FPL;
   transactions involving the transfer of goods or services shall be priced asymmetrically to the benefit of the Hawaiian Electric Companies and their ratepayers. Asymmetric pricings means that the Hawaiian Electric Companies always pay the lesser of cost-based or market-based prices, whenever purchasing goods or services from an affiliated entity (other than FPL), and that Hawaiian Electric Companies always receive the higher of cost-based or market based prices whenever selling goods or services to such affiliates. Transactions between the HECO Companies and FPL, both regulated entities, will be at cost.

2. Within 90 days after the closing of the proposed Change in Control, the HECO Companies shall provide the Consumer Advocate a draft Hawaii specific CAM, containing detailed affiliate transaction policies, practices and guidelines (including, asymmetrical pricing for transactions between regulated and unregulated affiliates, direct charging of corporate costs when possible, apportionment of common or shared costs using direct measures of cost causation when identifiable, and allocation of shared services costs using general allocation techniques as necessary among all benefiting affiliated entities) designed to protect against cross-subsidization of NEE affiliates by the HECO Companies. Representatives of the HECO Companies and the Consumer Advocate shall collaboratively review, discuss and revise the draft CAM with the objective of filing a joint CAM recommendation for consideration and approval by the Commission. Pending Commission approval, NEE will apply the FPL CAM methodologies and approaches for all transactions between NEE affiliates and the HECO Companies.
4. Following the proposed Change in Control, NEE and FPL shall cooperatively provide information requested by the Commission and the Consumer Advocate supporting the need for and basis of corporate and shared services costs directly charged and/or allocated to the HECO Companies. The information shall include, but not be limited to: detailed overhead loading factor development and application; source documentation and calculations supporting the development of allocation factors based on direct measures of cost causation or general allocation factors (e.g., Massachusetts Formula); sufficiently detailed data to allow for testing, analysis and verification of corporate and shared services costs allocated to the HECO Companies, including quantification support for alternative allocation factor applications; access to studies and detailed support underlying any rent compensation calculations used in affiliate overhead loading rate charges or for purposes of allocating FPL or NEE affiliate-owned office space to affiliates via corporate or shared services allocations; information explaining the basis for the inclusion or exclusion of other NEE affiliates from the allocation of specific corporate costs or shared services cost pools; and accounting, financial and operational data necessary to test and analyze the basis for and reasonableness of including or excluding the HECO Companies or other NEE affiliates from participation in the allocation of corporate or shared services costs.

5. The HECO Companies shall file a report annually with the Commission and the Consumer Advocate disclosing the nature of the transactions and the annual value of those activities between each HECO Company and each NEE affiliate.10

Q. COULD YOU PROVIDE ANY EXAMPLES OF THE POTENTIAL CONCERNS THAT THE CONSUMER ADVOCATE IS SEEKING TO MITIGATE WITH THESE AFFILIATE CONDITIONS?

A. Over time, the Commission should expect ongoing changes and events to occur at the NEE or FPL level that will directly or indirectly impact the work requirements, shared services cost levels, and/or allocation factors that drive

10 Affiliate Condition 5 is discussed in the Thomas Report section herein.
charges to the HECO Companies in a post-merger environment. It is imperative that conditions be implemented, as part of any Commission authorization of the proposed change in control, to ensure that: (a) all required information can be readily and timely obtained for review and analysis in future regulatory engagements; (b) the Consumer Advocate and the Commission will have access to the information necessary to determine the need for and reasonableness of the NEE/FPL costs directly charged or allocated to the HECO Companies; (c) barriers to accessing substantive information related to future changes and events are minimized so that the reasonableness of NEE/FPL costs or the allocation factor impact applied to those costs that drive charges to the HECO Companies can be tested, reviewed and verified in a timely manner; and (d) the shared services costs allocated from FPL and other NEE affiliates to the HECO Companies are not excessive or burdensome relative to similar pre-merger cost levels.

In general terms, these changes and events could involve NEE decisions to acquire or divest additional regulated or nonregulated lines of business, reorganize the corporate hierarchy of NEE/FPL, further consolidation of shared services into existing or new corporate entities, or the push-down of currently centralized support functions to the local entity level with multiple changes in cost allocations between NEE affiliates.

While there is no certainty that NEE will undertake any or all of these types of changes or events, the Consumer Advocate and the Commission must
take reasonable steps to ensure the availability of required information regardless of future developments along these or other lines.

Q. WHY DO YOU BELIEVE THAT NEE MAY ACQUIRE OR DIVEST ADDITIONAL REGULATED OR NONREGULATED LINES OF BUSINESS OVER TIME?

A. In response to CA-IR-61, the Applicants provided a confidential Attachment 1 listing the principal subsidiaries of NEE, including FPL, comprising the corporate portfolio. This confidential listing spans 41 pages and provides NEE’s ownership interest in each entity. In response to CA-IR-340, NEE provided confidential Attachment 1, representing a two page chronological listing of organizations acquired over the past ten years. Further, Applicants response to OP-IR-31 stated that NextEra Energy “has more than 900 subsidiaries of varying size, and regularly acquires or sells subsidiaries.”

In addition to the pending merger with the HECO Companies, NEE confirmed it had been assessing a potential acquisition of Energy Future Holdings’ (“EFH”) interest in Oncor’s distribution business in Texas. A June 10, 2015 news story on the Bloomberg Business Network estimated the transaction at approximately $18 billion. NEE’s assessment began in April 2014, but the Delaware Bankruptcy Court approved EFH’s proposal to cancel the auction process in June 2015 to pursue a proposal to transfer its interest in
Oncor to a group of creditors. Since that time, NEE has not engaged with EFH in any material respect.\textsuperscript{11}

The key take-away is not whether interest in the Oncor transaction might one day be renewed. Rather, the Commission should not be surprised if NEE remains active in the acquisition market, given NEE’s history of acquisitions and the fact that the Oncor transaction (reportedly valued at about four times the proposed HECO Companies transaction) could have proceeded on a parallel track.

Q. WHAT TYPES OF QUESTIONS MIGHT NEED TO BE ADDRESSED WITH REGARD TO POSSIBLE FUTURE CHANGES AND EVENTS?

A. Questions should be expected to arise as to whether future acquisitions, divestments, reorganizations or restructurings will result in increased cost responsibility, benefits or savings that could be expected to impact the HECO Companies. Changes in recorded and forecasted labor and non-labor costs, whether direct charged or allocated to the HECO Companies, should be expected, including revisions to underlying allocation factors and overhead loading rates.

Neither the Consumer Advocate nor the Commission should find it necessary to attempt independent quantification or estimation of the impact of

\textsuperscript{11} See NEE response to CA-IR-332.
such changes or events on the HECO Companies cost of service with limited
access to data. Even though current or future NEE affiliates may be unregulated,
the financial and operational data of those unregulated affiliates may be germane
and relevant to the Hawaii regulated operations because the unregulated
affiliates may contribute to the incurrence of additional allocable costs or
unregulated affiliate data must be reviewed for possible incorporation into the
shared services allocation process or loading rate development.

If information requests are submitted by the Consumer Advocate or the
Commission seeking copies of pre-existing reports or the compilation of other
necessary data, the process of obtaining the requested data should not require
the filing of motions to compel and relevance hearings before the Commission.
Similarly, the identification of existing reports or report writing capabilities should
not be the subject of a game of “hide and seek” where multiple rounds of
discovery are required to obtain needed data simply because exact names of
reports, report writing routines or data field codes are unknown to the
Commission or the Consumer Advocate. While I am not suggesting that NEE or
FPL would intentionally engage in such gamesmanship to delay production of
data, the time to minimize that process is now, not after the change in control is
approved.
Q. HAS PRODUCTION OF NONUTILITY AFFILIATE INFORMATION BEEN EXPLORED IN DISCOVERY?

A. Yes. CA-IR-311 was submitted in an effort to determine Applicants’ willingness to commit to the production of nonutility affiliate financial or operational data should the Commission or the Consumer Advocate request such information to assess whether direct costs were properly assigned or common costs (i.e., shared services costs) were properly allocated to the HECO Companies. After objecting to this information request, the Applicants referred to and quoted from the response to PUC-IR-174 discussing NextEra Energy’s position “that the Commission should have access to the books and records of NextEra Energy and its subsidiaries (including FPL, NextEra Energy Hawai’i, NextEra Energy Transmission, and NextEra Energy Resources, as applicable) that provide services chargeable to the Hawaiian Electric Companies, to the extent necessary for the Commission to fulfill its statutory responsibilities over the Hawaiian Electric Companies.” It remains unclear whether Applicants will willingly produce affiliate data required to review, test and possibly modify allocation factor inputs as to whether all benefiting NEE subsidiaries have been adequately considered in direct measure or general allocation factor development. As stated previously, NextEra Energy “has more than 900 subsidiaries of varying size, and regularly acquires or sells subsidiaries.” Whether the data NextEra committed to produce relative to FPL, NextEra Energy Hawai’i, NextEra Energy Transmission, and
NextEra Energy Resources will be sufficient for Hawaii regulatory purposes will only be determinable if future regulatory disputes arise.

If the Consumer Advocate and the Commission were denied access to necessary data, it would likely be impossible to evaluate any historical trends or variations in total costs (i.e., both direct charged and subject to allocation) incurred by NEE/FPL or to test/verify that the claimed allocation factors or loading rates were properly developed and applied in determining actual monthly charges or forecasts of charges to the HECO Companies O&M and capital accounts. With respect to affiliate transaction information, the Commission should not tolerate or otherwise allow a regulated utility to simply deny access to necessary NEE/FPL affiliate data and how costs are or will be direct charged or allocated between benefiting affiliates.

The presentation of data (e.g., organized by function, by service request or code, identification of applicable allocation factor code or loading rates, etc.) in a useful format (i.e., spreadsheet files rather than image or PDF file formats) is critically important to the time-sensitive review, verification and analysis process that occurs in a general rate case. Manual sorting of PDF reports and data input to create needed spreadsheet files is counter-productive and should be avoided.
Q. WHY IS VERIFIABILITY IMPORTANT?

A. In the normal course of business, NEE/FPL and the HECO Companies should strive for regulatory transparency of all direct and allocable charges incurred to support Hawaii operations, particularly since these charges result from transactions between affiliated entities. Although the Commission does not have specific affiliate transaction rules, Hawaii statutes (see HRS § 269-19.5 Relations with an affiliated interest; definition, contracts with affiliates filed and subject to commission action) recognize that affiliate transactions are not at arm's length or between unrelated parties. HRS § 269-19.5(b) encourages utility procurement of services by relying on competitive practices or, in the case of affiliate transactions, requires the utility to be prepared to “show by clear and convincing evidence to be in furtherance of the interests of the public.”

Consequently, it is reasonable to expect additional regulatory review and evaluation of related-party transactions – particularly, when acquisition or divestment transactions may materially impact the allocation and apportionment of an affiliate’s common or shared services costs. It is only through such a review and evaluation process that affiliate costs can be examined and verified to ensure that NEE/FPL affiliate costs are not mischarged to the HECO Companies and its Hawaii ratepayers, whether intentionally or unintentionally.
Q. IN YOUR OPINION, DO THESE AFFILIATE-RELATED MERGER CONDITIONS REQUIRE THE COMMISSION TO ESTABLISH A RULEMAKING PROCEEDING TO ADDRESS SUCH AFFILIATE MATTERS?

A. I am not an attorney so I am unable to comment on any legal requirements that might be involved. But, as a practical matter and from a regulatory perspective, I do not believe that there is a compelling need for a formal rulemaking proceeding. In my opinion, HRS § 269-19.5 provides fairly clear authority for the Commission to regulate affiliate transactions.¹²

I previously referenced the FPL CAM, which has been cited by the Applicants as addressing concerns the Commission might have with regard to cross-subsidization issues.¹³ For the Commission’s information, the affiliate transaction rule of the FPSC referenced in the FPL CAM and the comparable Public Utility Commission of Texas rule are included as Attachments 3 and 5, respectively, to Applicants’ response to CA-IR-72. As further support for affiliate transaction principals, particularly asymmetrical pricing, see the FERC cross-subsidization restrictions included as Attachment 2 to Applicants’ response.

¹² Mr. Nishina does, however, raise the question whether the development of affiliated transaction rules might expedite various proceedings instead of dealing with affiliate issues on a “one-off” case-by-case basis. See CA Exhibit-1.

¹³ See Applicants’ response to KLMA-IR-24, Attachment 1, page 3.
to CA-IR-72 and also refer to the Missouri Public Service Commission affiliate transaction rule provided as CA Exhibit-18\textsuperscript{14} for informational purposes.

The Commission should also be aware that, in the Stipulation in Lieu of Hearing filed on September 21, 2001, in Docket No. 00-0309, TGC and the Consumer Advocate agreed to the preparation, review and filing of a cost allocation manual to specifically address policies and issues raised by the Consumer Advocate regarding TGC’s utility and nonutility operations and cost apportionment.

Q. IF, FOLLOWING AN APPROVED CHANGE IN CONTROL, NEE/FPL PRODUCE AMOUNTS ALLOCATED TO THE HECO COMPANIES AND THE ALLOCATION FACTORS APPLIED TO DETERMINE THOSE ALLOCATED AMOUNTS, WHY DO YOU BELIEVE IT WOULD BE INSUFFICIENT TO SIMPLY “BACK-INTO” THE TOTAL NEE/FPL AMOUNTS FOR VERIFICATION PURPOSES?

A. There is no question that, if “A times B equals C,” one can mathematically determine “A by dividing C by B.” However, the testing, evaluation and verification process can be improperly frustrated by an affiliated entity’s refusal to provide “A” (in this scenario data underlying total NEE/FPL costs subject to allocation or the underlying transaction support) or “B” (other affiliate data

necessary to analyze the propriety of allocation factor and loading rate
development) and in turn thwart any meaningful assessment by interested
parties. Mistakes do happen and differences of opinion can arise, but credible
and useful data must be produced particularly in the context of affiliate
transaction cost recovery matters in a general rate case. Complete disclosure of
all NEE/FPL affiliate costs, allocations factors, loading rates and direct
assignments is necessary for effective regulatory oversight.

B. PENSION/OPEB CONDITIONS.

Q. WITH REGARD TO COMMISSION ISSUES 1.E. AND 1.F., DO YOU HAVE ANY
ADDITIONAL CONDITIONS OR ISSUES THAT SHOULD BE CONSIDERED BY
THE COMMISSION?

A. Yes. There are two remaining matters that merit discussion. The first relates to
Applicants Exhibit-15, Base Rate Moratorium Qualifications, which subjects the
moratorium commitment to the continuation of various other tariff and tracker
conditions, including Condition 8 relating to the Pension and Other Than Pension
Employee Benefits (“OPEB”) tracking mechanism. The Consumer Advocate
certainly understands the Applicants desire to retain the pension and OPEB
tracking mechanisms. However, the genesis of those mechanisms resulted from
negotiated settlements between the Consumer Advocate and each of the
HECO Companies that were approved as reasonable by the Commission. The
ultimate decision on whether these tracking mechanisms are retained, modified
or terminated lies with the Commission. Regardless of the future of those tracking mechanisms and in order to ensure the continued equity and balance of these employee benefit programs, it is critical that:

(a) NEE maintain the HECO Companies’ pension and OPEB plans and trusts on a stand-alone basis in substantially the current form;

(b) NEE not transfer, spin off or commingle any of the HECO Companies’ pension/OPEB assets with any comparable assets of NEE affiliates;

(c) NEE file an application with the Commission formally seeking approval to transfer, spin off or commingle any HECO Companies’ pension/OPEB assets with comparable assets of other NEE affiliates, should it desire to do so at some future date; and

(d) NEE file an application with the Commission formally seeking approval prior to materially altering the HECO Companies’ pension/OPEB plans or transferring HECO Companies’ employees to the NEE pension/retirement plans, should it desire to do so at some future date.

These conditions should not be onerous or unduly burdensome for the Applicants. In response to CA-IR-339, the Applicants stated that there are “no current plans to merge the Hawaiian Electric Companies’ pension and post-retirement plans with those of NextEra Energy” and that the “Hawaiian Electric Companies and NextEra Energy will be able to maintain independent pension and post-retirement benefit plans for as long as desired.” In addition, Applicants’ response to CA-IR-367 repeated the “no current plans” language but was not prepared or willing to commit to these types of conditions, without further review.
Although the response to CA-IR-367 indicated that NEE would seek approval on any planned actions “that are required to be approved” by the Commission, the above conditions are necessary to ensure Applicants understand that Commission approval is required.

C. CODE OF CONDUCT.

Q. WHAT IS THE SECOND REMAINING MATTER THAT MERITS DISCUSSION IN THIS SECTION OF YOUR TESTIMONY?

A. The direct testimony of Applicants’ witnesses Gleason and Reed generally discuss NEE’s standards of conduct regarding competitive power generation or transmission markets. While the competitive energy supply and RFP process is discussed by Consumer Advocate witness Chang, the Consumer Advocate has not undertaken an exhaustive evaluation of the competitive market in Hawaii or the potential impact that NEE may have on that market post-merger. Such an evaluation is extremely complex and beyond the resources available in the current docket.

However, Applicants have responded to various discovery requests, explained the standards or codes of conduct under which it operates and provided copies of related materials. Mr. Gleason offers that “[t]he Proposed

\[15\] See Applicants’ responses to CA-IR-72, CA-IR-134, CA-IR-174, CA-IR-223, CA-IR-345, AES-IR-14, COM-IR-5, OP-IR-137 and SunEdison-IR-23.
Change of Control, in and of itself, will not diminish competition in Hawaii’s various energy markets.” Further, NEE represents that the participation of its subsidiaries in Hawaii’s competitive power generation or transmission markets would be subject to the applicable rules and regulations of the Commission and strict affiliate standards of conduct. Mr. Reed contends that approval of the Proposed Transaction will not have a negative impact on competition and states:

The fact is that competition should simply be fair...It is entirely appropriate for the Commission to protect the competitive process, ensuring that all competitors are treated equally and fairly. That is what the Commission established in the Framework for Competitive Bidding. [footnote omitted] That is what robust affiliate standards of conduct, and the Commission’s review of affiliate transactions, does.

In response to CA-IR-72, the Applicants provided eighteen attachments including required standards of conduct, cross-subsidization restrictions, affiliate transaction rules, related NEE written policies and procedures as well as employee training requirements. This response also states, in part:

NextEra Energy has a comprehensive compliance approach to ensure that employees are well informed, knowledgeable and trained regarding all applicable rules and regulations and associated policies and procedures (including cross subsidization, inappropriate sharing of information, reasonable compensation for transfers of tangible and intangible assets and all other affiliate transaction matters).

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16 Applicants Exhibit-7, at 6-7.
17 Applicants Exhibit-33, at 51-52 and 66.
NextEra Energy uses various methods of distribution to train and educate applicable employees with the Code, Compliance Plan and LST Compliance Plan and to deliver NextEra Energy’s compliance program goals.

Additionally, CRO manages the Code, FERC and PUCT training programs by developing and/or keeping training materials current, identifying the required participants for each type of training needed, providing training in both classroom and electronic forms as applicable, ensuring all employees requiring training complete the training within required timeframes, and providing ad hoc training as needed for current events. Applicable employees are required to be trained on a regular basis.

In response to CA-IR-134 which seeks information about new policies and procedures that are planned to be implemented if the merger is completed, Applicants state, in part:

Under the Hawaiian Electric Companies’ Code of Conduct, there are requirements related to the protection of non-public confidential information (Sections 3, 7, 8, and 9), shared employees (Section 6), the separation of certain employees (Sections 2 and 4) and the creation of organization charts for certain employee teams (Section 5). These are requirements that NextEra Energy is very familiar with in the context of the codes of conduct and standards of conducts that NextEra Energy must comply with as provided in response to CA-IR-72. As is also provided in CA-IR-72, NextEra Energy has implemented compliance plans, including training, on these types of compliance requirements. Given NextEra Energy’s experience on very similar compliance requirements as those presented in the Hawaiian Electric Companies’ Code of Conduct, upon approval of the proposed change of control, NextEra Energy views the implementation of any necessary additional compliance policies and procedures to address Hawai’i compliance requirements as an extension of its already comprehensive approach to compliance. [Emphasis Added]
CA-IR-345 requested information regarding the Lone Star Transmission Code of Conduct and subpart (c) inquired whether those provisions should be made applicable to the HECO Companies if the proposed change of control is approved. Applicants' response to subpart (c) follows:

The standards of conduct for the sharing of personnel, information, and other intangible assets for NEE’s entities are dependent upon the jurisdiction. The PUCT [Public Utility Commission of Texas] has provided the regulatory code of conduct applicable to this situation. Similarly, the Federal Energy Regulatory Commission (“FERC”) has provided regulatory standards of conduct and affiliate restrictions applicable to its jurisdictional boundaries governing the same situations. The FERC and the PUCT do not have jurisdiction over Hawai‘i; therefore, these entities’ regulations and NextEra Energy's FERC and PUCT Compliance Plan and LST Compliance Plan will not be applicable to the Hawaiian Electric Companies, if the Proposed Change of Control is approved by the Commission. The documents referenced in parts a and b above are internal documents designed to meet the requirements of those regulatory confines. However, FPL will likely provide corporate shared services to HECO post merger. Since FPL is regulated by FERC and the FPSC, those regulatory requirements (coupled with the requirement to provide consistency in its affiliate billings so as to ensure no cross subsidization) will necessitate the application of the same compliance practices to billings from FPL to HECO just as it does across the current NEE enterprise.

That being said, the NextEra Energy, Inc. Code of Business Conduct & Ethics (“Code”) should be made applicable to the Hawaiian Electric Companies, if the Proposed Change of Control is approved by the Commission. The Code is applicable to all non-bargaining employees and sets forth requirements to help NextEra Energy maintain the accountability and integrity required by our work. In addition, the Code of Conduct adopted by the Commission on July 15, 2007 will continue to remain in effect.

Please see also the response to CA-IR-134, supplemented on July 7, 2015, for a more detailed explanation.

[Emphasis Added]
In response to OP-IR-54, the Applicants discuss employee training, certification and other forms of communication surrounding NEE “compliance culture” in the context of Commission issue 5, Enforcement and Compliance Orders.

As evidenced by the above information, NEE has developed a number of policies, training processes and codes of conduct for multiple purposes across its numerous affiliates. What code of conduct will actually be applied to the HECO Companies, if the change of control is approved, remains uncertain.

Q. DOES THE CONSUMER ADVOCATE HAVE EXPLICIT RECOMMENDATIONS AT THIS TIME REGARDING CODES OR STANDARDS OF CONDUCT?

A. No. The design and implementation of proper codes of conduct are important from a regulatory perspective, particularly when transactions with unregulated affiliates are involved. As noted in the responses to various Consumer Advocate and other party information requests referenced above, there are multiple standards and training requirements in place as a result of NEE affiliate regulation in Florida, Texas and by FERC. While the Consumer Advocate is not suggesting that specific codes of conduct applicable to NEE’s Hawaii operations post-merger should be determined by other regulatory jurisdictions, the Consumer Advocate recognizes that comprehensive codes or standards applicable to Hawaii cannot be developed and implemented in a streamlined timeline embodied by the pending proceeding.
Although the Consumer Advocate has not presented an explicit code of conduct framework, the Commission should consider whether to establish a proceeding and direct NEE and the HECO Companies, post-merger, to address the current HECO Companies’ code of conduct and recommend modifications thereto for consideration and comment by the Consumer Advocate and approval by the Commission in the proper forum. Pending implementation of Hawaii-specific codes of conduct, NEE should be held accountable to its own claimed training and code standards in a post-merger environment, but no less stringent than the current HECO Companies’ code of conduct. The Consumer Advocate would be supportive of Commission action to develop such standards relating to specific areas of concern under a reasonable timeline.

IV. LOWEST REASONABLE COST.

Q. WHICH ISSUE IDENTIFIED IN ORDER NO. 32739 IS ADDRESSED IN THIS TESTIMONY SECTION?

A. This section of my testimony addresses a portion of general Issue 2:

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.

Beginning at page 45, Mr. Gleason explains that NEE shares the HECO Companies’ “vision of lower customer bills, and fully expects the change
of control to result in cost savings for customers” and refers to FPL’s success in reducing rates in Florida.  

Q. DOES THE CONSUMER ADVOCATE SHARE A VISION OF LOWER COSTS OF SERVING UTILITY CUSTOMERS IN HAWAII BEING TRANSLATED INTO LOWER UTILITY RATES?

A. Absolutely. While the success of reducing rates in Florida is laudable, there is no certainty or guarantee that granting the requested change in control will produce a similar result in Hawaii.

Mr. Gleason also discusses NEE as an industry leader in producing clean and renewable electric energy, employing about 14,000 people that deliver electricity in the U.S. and Canada. As one of NEE’s principal subsidiaries, FPL serves over 4.7 million homes, more than 9 million people, in the State of Florida. NEE’s subsidiaries own and operate over 44 gigawatts of electric generating capacity across 27 states and Canada, approximately 8,500 circuit miles of high-voltage transmission, 68,000 miles of distribution lines and 800 substations. Since 2003, Mr. Gleason states that FPL and NextEra Energy Resources have completed over 101 major capital projects totaling about $27 billion.

________________________________________

18 Applicants Exhibit-7 at 45.
19 Applicants Exhibit-7 at 7-8.
From an accounting and regulatory perspective, my testimony addresses the Consumer Advocate’s concern with the potential that such a large organization might result in higher direct costs and shared services costs being allocated from FPL and/or affiliates relative to the costs that the HECO Companies have been or would be charged by HEI or self-provisioned by HECO for comparable services.

Q. DOES NEXTERA ENERGY OR ANY OF ITS SUBSIDIARIES CHARGE AN ASSET MANAGEMENT FEE OR ANY OTHER CHARGE FOR OPERATIONAL OR ADMINISTRATIVE GOVERNANCE SERVICES TO ENTITIES THAT ARE CONTROLLED BY NEXTERA ENERGY?

A. Yes. As explained by Applicants in response to CA-IR-125, traditional corporate services are performed by FPL for the NEE family of companies:

These traditional corporate services are recurring and are therefore provided and billed to FPL affiliates through its affiliate management fee ("AMF"). The AMF is not an assessment or management overhead charge; instead, it is comprised of discrete services aggregated into like cost pools which are then billed out to the benefiting companies on the basis of a variety of billing factors dependent upon the service being provided. It is important to note that many of the services billed through the AMF, and particularly those billed using the Massachusetts Formula, are not related linearly to the entities being served. Therefore, efficiencies increase as more entities are served by a relatively fixed cost of service. The policy, practice, and process for the fees billed by FPL to affiliates are described in detail in FPL’s Cost Allocation Manual ("CAM"). Please refer to the response to KLMA-IR-24, Attachment 1 for the CAM.
The following table represents a summary of the allocated shared services\textsuperscript{20} amounts charged and collected by FPL by entity for 2012 thru 2014, as provided in response to CA-IR-125:\textsuperscript{21}

<table>
<thead>
<tr>
<th>AFFILIATE MANAGEMENT FEE</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>NextEra Energy Resources, LLC</td>
<td>$65,884,644</td>
<td>$72,577,499</td>
<td>$67,388,411</td>
</tr>
<tr>
<td>FPL FiberNet, LLC</td>
<td>$2,525,255</td>
<td>$2,771,283</td>
<td>$2,883,680</td>
</tr>
<tr>
<td>FPL Energy Services, Inc.</td>
<td>$1,325,036</td>
<td>$1,385,406</td>
<td>$1,249,272</td>
</tr>
<tr>
<td>NextEra Energy, Inc.</td>
<td>$274,455</td>
<td>$414,244</td>
<td>$301,212</td>
</tr>
<tr>
<td>New Hampshire Transmission, LLC</td>
<td>$82,120</td>
<td>$94,300</td>
<td>$79,681</td>
</tr>
<tr>
<td>Lone Star Transmission, LLC</td>
<td>$292,975</td>
<td>$840,059</td>
<td>$918,343</td>
</tr>
<tr>
<td>NextEra Energy Transmission, LLC</td>
<td>$119,671</td>
<td>$231,601</td>
<td>$292,239</td>
</tr>
<tr>
<td>NextEra Energy FiberNet, LLC</td>
<td>$97,684</td>
<td>$217,905</td>
<td>$174,447</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$70,601,820</strong></td>
<td><strong>$78,512,296</strong></td>
<td><strong>$73,285,286</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>SERVICE FEE</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>NextEra Energy Resources</td>
<td>$14,891,644</td>
<td>$14,765,598</td>
<td>$15,552,203</td>
</tr>
</tbody>
</table>

While NEE and the HECO Companies have not yet developed an integration plan, NEE’s response to CA-IR-125 identified a number of potential services provided by FPL for the NEE enterprise that comprise nondiscretionary,

\textsuperscript{20} As discussed in the FPL CAM per Attachment 1 to Applicants’ response to KLMA-IR-24, FPL costs are apportioned among entities based on three cost characteristics: costs are directly assigned when identifiable to a specific activity; costs are assigned to activities and apportioned based on direct measures of cost causation; or shared costs are allocated via the Affiliate Management Fee using specific drivers or a general allocator (i.e., the Massachusetts Formula).

\textsuperscript{21} In addition to the AMF, FPL utilizes a Service Fee to charge NextEra Energy Resources (“NEER”) for shared support related to the Nuclear fleet operations. The amounts billed for 2012 thru 2014 are shown in the chart. The nuclear service fee would not be billed to the Hawaiian Electric Companies. [See Applicants’ response to CA-IR-125.] According to Attachment 1 to the Applicants’ response to CA-IR-252, the AMF amounts exclude the shared services costs allocated to and retained by FPL. For 2014, the AMF charges including FPL allocations was $243.4 million.
governance and compliance activities likely to be provided to the HECO Companies post-closing, including:

- governance provided by NEE’s senior and corporate executive team members and Board of Directors (who provide oversight and strategic direction to all of NEE’s affiliates);
- certain corporate finance support functions, such as corporate tax planning and compliance;
- Securities and Exchange Commission reporting;
- federal regulatory and legal compliance; and
- investor relations.

According to the response to CA-IR-125, the specific services and amounts to be billed to the HECO Companies for such services are not known at this time and are dependent on the ultimate cost of the service and the relative results of the cost drivers used to bill those aggregate corporate services.

Q. WHAT TYPES OF ALLOCATION METHODS ARE APPLIED BY FPL TO APPORTION SHARED SERVICES AMF COSTS BETWEEN BENEFITING AFFILIATED ENTITIES?

A. As discussed in the FPL CAM, shared services costs that cannot be directly assigned are apportioned between regulated and non-regulated activities and
entities via the AMF using two general allocation methods.\textsuperscript{22} If identifiable, shared services costs are allocated using specific drivers as the allocation basis (e.g., relative distribution of payroll, megawatts, headcounts, square footage, workstations, etc.). When specific drivers are not available, FPL uses a general allocation method commonly identified as the Massachusetts Formula which employs a simple average of Payroll, Revenues and average Gross Property Plant and Equipment to distribute common costs between benefiting entities.

Q. WHAT IS THE APPROXIMATE PERCENTAGE OF THE AFFILIATE MANAGEMENT FEE ALLOCATED BY FPL TO THE VARIOUS NEE ENTITIES BASED ON SPECIFIC DRIVERS VERSUS THE GENERAL ALLOCATOR?

A. In 2014, the breakdown of FPL’s AMF shared services allocation was about 38% Massachusetts Formula and 62% specific cost drivers.\textsuperscript{23}

\textsuperscript{22} See Attachment 1 to the Applicants’ response to KLMA-IR-24 for the 2015 FPL Cost Allocation Manual.

\textsuperscript{23} See Applicants’ response to CA-IR-315(f).
Q. THE ABOVE TABLE OF AMF FEES PROVIDED IN RESPONSE TO CA-IR-125 SHOWS ABOUT $73.3 MILLION ALLOCATED BY FPL IN 2014. IF THE HECO COMPANIES HAD BEEN “PRO FORMED” INTO THE AMF ALLOCATION PROCESS FOR 2014, HAVE THE APPLICANTS PROVIDED AN ESTIMATE OF THE COSTS THAT MIGHT HAVE BEEN ALLOCATED TO THE HECO COMPANIES IN 2014?

A. No. The Consumer Advocate made several unsuccessful attempts to obtain a ballpark quantification of the shared services costs that might be allocated to the HECO Companies by FPL.

- CA-IR-125 asked, in part, for an explanation and quantification of any AMF fees that would be charged to the HECO Companies in a post-merger environment. In response, the Applicants observed:

  The specific services and amounts to be billed to the Companies for such services are not known at this time and would be dependent on the ultimate cost of the service and the relative results of the cost drivers used to bill those aggregate corporate services.

- CA-IR-323(b) and (c) sought an explanation whether NEE reasonably anticipated that the inclusion of Hawaiian Electric Holdings in cost pool sharing would reduce the FPL costs otherwise allocable to the now-current (i.e., pre-merger) NEE affiliates. And, if so, requested NEE’s best preliminary estimate of the annual cost savings to the now-current NEE affiliates. The response stated:
The integration planning for the merger is in its early stages, and as such, Applicants are not able to identify every service that will be provided to the Hawaiian Electric Companies by NextEra Energy and its subsidiaries. As the various functional teams engage and decisions are made regarding integration, NextEra Energy and the Hawaiian Electric Companies will analyze and evaluate what services are deemed prudent and necessary or that would otherwise benefit the Hawaiian Electric Companies. However, if all else remains equal and to the extent the cost pool does not change, but additional operating businesses are served, the costs retained by Florida Power & Light Company and allocable to the now current affiliates may be reduced as they would be spread over a broader base.

- CA-IR-360 was submitted to assess the likelihood that NEE affiliates would experience a reduction in AMF charges if the merger is consummated. According to that response, if FPL: 1) provides comprehensive services to the HECO Companies as it does for other affiliates, 2) can do so without incurring additional costs, and 3) cost driver inputs remain the same, Applicants stated that “it is likely that the NextEra Affiliates that receive…[AMF] allocations would experience a reduction in AMF charges as that is the mathematical outcome of having relatively fixed costs to serve an expanding enterprise.” However, the Applicants observed that merger integration planning has recently commenced and it is unknown what services and how services will be provided to the HECO Companies.

In 2014, the total AMF pool of shared services allocated costs was about $243.4 million, of which $170.1 million was allocated to FPL and $73.3 million
was allocated and billed to other FPL affiliates. As previously indicated, the 2014 AMF costs were primarily allocated using specific drivers (62%) with the balance using the Massachusetts Formula (38%). However, if the total AMF pool of costs remained unchanged at $243.4 million and the HECO Companies were pro formed to receive a composite allocation of 7.0% (i.e., based on a combination of specific drivers and Massachusetts Formula inputs), the HECO Companies would receive an allocation of FPL shared service costs of about $17 million (i.e., 7.0% times $243.4 million) resulting in reduced allocations to the other FPL affiliates.

Q. WAS THE 7.0% ALLOCATION FACTOR DERIVED FROM SOME SPECIFIC CALCULATION?

A. No. The 7.0% allocation factor was simply used as a marker to estimate the relative impact of possible amounts allocable from FPL post-merge.

Q. HOW DOES THE 7.0% ALLOCATION FACTOR COMPARE TO THE HECO COMPANIES’ RELATIVE PERCENTAGE OF TOTAL NEE OPERATIONS, USING GENERAL ALLOCATORS AS AN INDICATION OF RELATIVE SIZE?

A. Using publicly available information for 2014 and excluding American Savings Bank, NEE estimated that the HECO Companies’ “approximate share of NextEra

See Attachment 1 of Applicants’ response to CA-IR-252.
Energy’s total (a) revenues would have been 15%, (b) assets would have been 7%, and (c) net income would have been 5%.” Even though the Massachusetts Formula is based on an average of Payroll, Revenues and average Gross Property Plant and Equipment, this information suggests that that the assumed 7.0% allocation factor used to derive the $17 million estimate of FPL shared services costs potentially allocable to the HECO Companies may be conservatively low.

Since OP-IR-1 sought the HECO Companies’ relative share of NEE total revenues, assets and net income, CA-IR-359 was submitted seeking information to allow a more direct comparison of the HECO Companies’ relative share of NEE for each of the three elements of the Massachusetts Formula. According to Applicants’ response to CA-IR-359, the HECO Companies’ portion of the 2014 Massachusetts Formula is approximately: 15% for payroll, 15% for revenue and 7% for gross property, plant and equipment. A simple average of these three factors would produce a Massachusetts Formula allocation to the HECO Companies of about 12.3%. Applying this factor to the $243.4 million total AMF pool of costs would produce about $30 million of potentially allocable costs from FPL post-merger to the HECO Companies.

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25 See Applicants’ response to OP-IR-1.
Q. DO YOU HAVE AN OPINION AS TO WHY THE RESPONSE TO OP-IR-1 AND CA-IR-359 INDICATE THAT THE HECO COMPANIES’ APPROXIMATE SHARE OF NEXTERA ENERGY’S 2014 TOTAL REVENUES WOULD HAVE BEEN 15%, BUT THE COMPARABLE SHARE FOR ASSETS AND NET INCOME WERE MUCH LOWER AT 7% and 5%, RESPECTIVELY?

A. While I have not seen any documentation supporting the Applicants’ calculation of the percentages supplied in response to OP-IR-1, the confidential supporting documentation provided in response to CA-IR-359 produced a comparable result based on gross revenues. Because Hawaii is a high fuel cost environment, such a result (i.e., relative revenue share higher than some other relative values) might be expected. For this reason, I believe that it would be reasonable for the Commission and Consumer Advocate to carefully consider whether the Massachusetts Formula’s reliance on gross, rather than net, revenues is appropriate for general allocation purposes post-merger.

Q. REFERING TO THE ASSUMED 7.0% AND 12.3% ALLOCATION FACTORS, HOW WOULD THE CALCULATED $17-30 MILLION RANGE OF FPL SHARED SERVICES COSTS POTENTIALLY ALLOCABLE TO THE HECO COMPANIES COMPARE TO RECENT AMOUNTS BILLED TO THE HECO COMPANIES FROM HEI?

A. At the present time, it is not possible to match the scope of shared services that might have been provided by FPL associated with the $17-30 million range of
calculated amounts with the scope of services historically provided by HEI and
billed to the HECO Companies or self-provisioned by HECO and cross-billed to
HELCO and MECO. In a supplemental (6/25/2015) response to CA-IR-128, the
Applicants provided an Attachment 7 with page 2 summarizing the following HEI
Intercompany Billings:

<table>
<thead>
<tr>
<th></th>
<th>2013 Actual</th>
<th>2014 Budget</th>
<th>2015 Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>HECO</td>
<td>$4,696</td>
<td>$4,777</td>
<td>$4,924</td>
</tr>
<tr>
<td>HELCO</td>
<td>760</td>
<td>759</td>
<td>898</td>
</tr>
<tr>
<td>MECO</td>
<td>745</td>
<td>723</td>
<td>836</td>
</tr>
<tr>
<td>Total</td>
<td>$6,201</td>
<td>$6,259</td>
<td>$6,658</td>
</tr>
</tbody>
</table>

In Applicants’ response to CA-IR-110, Attachment 1 provided similar data
showing HEI billings to the HECO Companies for 2014:

<table>
<thead>
<tr>
<th></th>
<th>2014 Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>HECO</td>
<td>$5,252</td>
</tr>
<tr>
<td>HELCO</td>
<td>764</td>
</tr>
<tr>
<td>MECO</td>
<td>781</td>
</tr>
<tr>
<td>Total</td>
<td>$6,797</td>
</tr>
</tbody>
</table>

However, the response to CA-IR-358(b) states that the HEI data supplied as
CA-IR-128, Attachment 7, page 2 includes both allocated and direct charge
amounts.26 Further, CA-IR-110 Attachment 1 also showed 2014 HECO billings

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26 See Attachment 1 of CA-IR-358 for a breakdown of the HEI charges per CA-IR-128, Attachment 7, page 2 between direct allocated and direct charge amounts.
to HEI ($2.3 million), HELCO ($21.2 million) and MECO ($18.1 million) - illustrating the difficulty in comparing potential shared services costs allocable from FPL with historical HEI costs. Nevertheless, the difficulty of making such a comparison does not diminish the concern that the HECO Companies could potentially incur greater shared services charges post-merger from combination of FPL allocated costs and some degree of continued self-provisioning of necessary administrative services.

Q. IS THIS CONCERN THE BASIS FOR THE CONSUMER ADVOCATE’S RECOMMENDED AFFILIATE CONDITION 3, REQUIRING GENERAL RATE CASE TESTIMONY RECONCILING POST-MERGER SHARED SERVICES COSTS WITH PRE-MERGER ESCALATED LEVELS AND EARNINGS SHARING LIMITS FOR RBA/RAM FILING PURPOSES?

A. Yes. The Applicants have not provided any information satisfying the Consumer Advocate’s concern that the HECO Companies could see higher shared services costs post-merger. To help ensure that any costs charged to the HECO Companies by FPL or other NEE affiliates are reasonable relative to historical pre-merger cost levels, the Consumer Advocate proposes two related conditions:

3. In all general rate cases following the proposed Change in Control, the respective filing of each of the HECO Companies shall include direct testimony and exhibits explaining and quantifying all affiliate transactions of each type. Additionally, testimony shall include information needed to explain and reconcile the proposed amount of test year shared services
costs charged or allocated by FPL or any other NextEra affiliate in comparison to the actual costs charged/allocated to the HECO Companies by HEI or self-provisioned by the HECO Companies in calendar year 2014, escalated by GDPPI thereafter.

In a post-merger environment, the Commission will never know precisely what shared services costs the HECO Companies might have incurred absent the merger. However, the Applicants should be able to determine the shared services costs incurred directly or billed from HEI and/or HECO in 2014 and then apply GDPPI escalation rates to develop a baseline for comparison to comparable shared services costs included in the next rate case test year.

Since the Applicants have referred to and relied on expected economies resulting from the merger to support the requested change in control, it is only reasonable for the Commission to direct the HECO Companies to perform this comparison and reconcile any material variances in future rate cases as a merger condition. In fact, the response to part (b) of CA-IR-310 states:

While the necessary integration work to determine costs to be directly charged or allocated to the Hawaiian Electric Companies will not be completed until after the transaction closes, Applicants understand that the costs allocated and charged to the Hawaiian Electric Companies will need to be shown to be reasonable and cost-beneficial for customers of the Hawaiian Electric Companies in order to be eligible for rate recovery. In determining whether and what types of costs will be charged or allocated, Applicants will apply this test to help ensure that any amounts can satisfy the applicable tests.

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27 See, for example, Applicants Exhibit-7 at 16-18, 25-27 and 45-46; Applicants Exhibit-33 at 16-20; and Applicants’ responses to CA-IR-64, and CA-IR-310.
I concur. These conditions recommended by the Consumer Advocate will memorialize this requirement for future regulatory purposes. Requiring the HECO Companies to perform this reconciliation will assist the Commission and the Consumer Advocate in future rate cases in determining whether the post-merger shared services costs are reasonable in setting electric rates.

Q. WHAT ASSURANCES HAVE THE APPLICANTS PROVIDED THAT FUTURE FPL COSTS, WHETHER DIRECT CHARGED OR ALLOCATED, BILLABLE TO THE HECO COMPANIES POST-MERGER WILL NOT MATERIALLY EXCEED HISTORICAL LEVELS?

A. None. While CA-IR-358(d) was more narrowly written to only apply to HEI Intercompany Billing amounts, rather than also include costs self-provisioned by HECO and cross-billed to HEI, HELCO and MECO, the Applicants were unable to provide any assurances:

The merger integration planning process is just now kicking off and Applicants have not yet identified what affiliate relationships and transactions are expected to occur post-merger. Therefore, NextEra Energy is not able to provide assurances regarding any future Florida Power & Light Company ("FPL") costs that may be charged to the Hawaiian Electric Companies. The extent to which the affiliate charges to the Hawaiian Electric Companies from FPL/NextEra Energy exceed those currently billed to the Hawaiian Electric Companies from HEI is not an indicator of the Hawaiian Electric Companies' customer merger impact. Instead it will be important to evaluate the net impact of all corporate service costs for the Hawaiian Electric Companies whether sourced from affiliates, contractors, consultants or internal labor to determine the ultimate benefits delivered to the Hawaiian Electric Companies’ customers.
Q. YOU ALSO SUPPORT THE CONSUMER ADVOCATE’S RECOMMENDED AFFILIATE CONDITION 6 THAT THE EARNING SHARING CALCULATIONS WITHIN THE RBA/RAM DECOUPLING MECHANISM BE ADJUSTED TO LIMIT THE AMOUNT OF SHARED SERVICES COSTS CHARGED OR ALLOCATED BY FPL OR ANY OTHER NEXTERA AFFILIATE TO NO MORE THAN THE ACTUAL COSTS CHARGED/ALLOCATED TO THE HECO COMPANIES BY HEI IN CALENDAR YEAR 2014, ESCALATED BY GDPPI. CORRECT?

A. Yes. This Consumer Advocate proposed condition reads:

6. In determining annual utility earnings for Earning Sharing calculations within the decoupling mechanism in all periods prior to the completion of each utility’s next general rate case, the amount of shared services costs charged or allocated by FPL or any other NextEra Affiliate shall not exceed the actual costs charged/allocated to the HECO Companies by HEI or self-provisioned by the HECO Companies in calendar year 2014, escalated by GDPPI thereafter.
As noted previously, the Applicants have discussed expected cost reductions realizable from the proposed change in control. The Applicants have yet to provide any details regarding the scope of shared services and related costs FPL and its affiliates are likely to provide to the HECO Companies’ much less the expected costs thereof. Therefore, it is important that, if those economies or savings are not realized in the post-merger provision of shared services, the HECO Companies’ customers do not effectively pay for those higher costs indirectly through lower achieved earnings and side-step the purpose of the earnings sharing component of the RBA/RAM mechanism. This is particularly important since the Commission and the Consumer Advocate will not be positioned to conduct any meaningful review of the FPL affiliate shared services scope and cost until the next following general rate case for each of the HECO Companies.

Consequently, the proposed shared services cost limitation for RBA/RAM purposes will help protect customers of the HECO Companies from indirectly paying for potentially escalating shared services costs prior to the next round of rate cases where the reasonableness of such costs can be reviewed and evaluated.

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28 See Applicants’ responses to CA-IR-299, CA-IR-310, CA-IR-320, CA-IR-322 and CA-IR-323.
V. REGULATORY AUTHORITY.

Q. WHICH ISSUES IDENTIFIED IN ORDER NO. 32739 ARE ADDRESSedin THIS TESTIMONY SECTION?

A. This section of my testimony addresses a portion of Issues 3 and 4:

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.

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.

With regard to Issue 3, Mr. Gleason answers “No” and explains that the “proposed change of control involves a transfer of the Hawaiian Electric Companies’ upstream ownership interests and does not involve a sale of any of the Hawaiian Electric Companies’ assets or a transfer of any of the Hawaiian Electric Companies’ own ownership interests” and that HECO, HELCO and MECO “will each continue to remain in existence and continue to operate under their respective tariffs and operating authority (i.e., each entity’s respective Franchise).”

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29 Applicants Exhibit-7 at 52.
Further, Mr. Gleason states:

NextEra Energy commits and agrees that the Commission’s jurisdiction with respect to the Hawaiian Electric Companies will not be diminished as a result of the Proposed Change of Control. To this end, NextEra Energy and the Hawaiian Electric Companies commit and agree that upon and subsequent to the Proposed Change of Control, the Hawaiian Electric Companies will continue to abide by and comply with all Commission decisions, orders, and rules applicable to the Hawaiian Electric Companies, as authorized by law.30

Q. HOW DO YOU RESPOND?

A. It is impossible to know now, with absolute certainty, the extent to which the Commission’s regulatory authority could be diminished over transactions between the HECO Companies and the much larger, geographically diverse NextEra Energy and its affiliates headquartered thousands of miles away from Hawaii.31 My answer is that the Commission’s regulatory authority will “probably” be diminished without additional conditions beyond those offered by the Applicants.

30 Id. at 53.

31 The distance between NEE’s headquarters in Juno Beach, FL and Honolulu, HI is over 4,800 miles.
As discussed previously herein, I believe it is critical that the Commission and the Consumer Advocate have a clear and unequivocal accounting and regulatory understanding of post-merger affiliate transactions and have full access to all information required for regulatory review and oversight. The Consumer Advocate’s recommendations regarding a Hawaii-specific Cost Allocation Manual and access to affiliate financial records will be beneficial in ensuring that the Commission retains regulatory authority over affiliate transactions, assuming the merger is approved.

While discussing Commission Issue 3, Mr. Gleason also refers to the testimonies of Applicant witnesses Tayne Sekimura (Applicants Exhibit-28) and John Reed (Applicants Exhibit-33) regarding modifications to the 1982 Agreement and termination of the applicability of the Thomas Report. The Consumer Advocate does not necessarily agree with the Applicants’ proposed recommendations, which I will discuss in response to Commission Issue 6 in a later testimony section.

In his direct testimony, CA witness Mr. Hill discusses NEE’s proposal to establish a local advisory board and presents the Consumer Advocate’s recommendation that Hawaiian Electric Holdings, LLC (“HEH”) have its own independent local board of directors with decision-making authority, including Hawaii citizenry. I agree that Mr. Hill’s board of director recommendation will aid the Commission in retaining regulatory authority over the HECO Companies post-merger.
Q. WHAT IS YOUR RESPONSE TO COMMISSION ISSUE 4?

A. I agree with Mr. Hill that financial size alone is not the problem. Rather, it is the expected complexity of the family of NEE affiliates and what appears to be the Applicants’ desire to limit the ability of the Commission to review and explore affiliate transactions and activities (i.e., reduced transparency). Although the Applicants have stated repeatedly that the intention is to expand the Commission’s authority over affiliate transactions, the rationale for the proposed modifications to the 1982 Agreement would imply otherwise.

The modifications also reflect that the Commission may need information above the HEI/Hawaiian Electric Holdings level in order to fulfill its statutory responsibilities in regulating and overseeing the Hawaiian Electric Companies. As such, the modifications reflect expanding the Conditions to include NextEra Energy becoming subject to requests for information necessary to fulfill the statutory responsibilities of the Commission with respect to the Hawaiian Electric Companies, with the limitation that the information is sought from entities that provide services chargeable to the Hawaiian Electric Companies. [Emphasis Added]

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32 See, for example, Applicants Exhibit-28, at 28-29, Applicants Exhibit-31, Applicants’ responses to CA-IR-113, CA-IR-239, CA-IR-312 and FOL-IR-29.

33 See Applicants Exhibit-28, at 28-29.
The sought after limitation underscored above could effectively handicap the Commission’s access to needed information by restricting financial information and business activities of other NEE entities simply because those entities do not provide chargeable services – even though those very same entities could directly impact the cost or allocation of FPL shared services to the HECO Companies post-merger. Such a restriction is unacceptable and could result in a diminution of the Commission’s regulatory control.

VI. COMPLIANCE AND ENFORCEMENT.

Q. WHAT ORDER NO. 32739 ISSUE IS ADDRESSED IN THIS TESTIMONY SECTION?

A. This section of my testimony addresses a portion of Issue 5:

5. Whether NextEra, FPL, or any other affiliate has been subject to compliance or enforcement orders issued by any regulatory agency or court.

Mr. Gleason explains that NEE is in a “highly regulated business” and “subject to audits, investigations, notices of violation and compliance orders.” 34 A summary of various enforcement and compliance order information was provided in Applicants Exhibit-18. In response to various information requests issued in this proceeding, NEE provided additional materials and/or internet links associated

34 See Applicants Exhibit-7 at 55-56.
with numerous enforcement/compliance matters addressed in Applicants Exhibit-18.\textsuperscript{35} While the Consumer Advocate’s review of this voluminous material continues, there were three items identified in discovery that should be brought to the Commission’s attention.

Q. PLEASE DISCUSS THE FIRST ITEM.

A. Applicants’ response to CA-IR-222 provided additional information regarding a FPSC Staff audit report related to transactions between FPL and unregulated affiliate FPL Energy Services ("FPLES").\textsuperscript{36} The audit raised concerns about FPL’s policies and practices related to customers calling in to the utility. According to the audit report, a FPL customer service representative would initially receive and handle customer calls to establish electric service. Customers were then transferred to FPLES representative to receive a service order confirmation number without FPL initially disclosing that the second representative worked for an unregulated affiliate. Although the affiliate representative did indicate that they worked for FPLES, the customer was not apparently provided any new information about the specific utility service serving as the initial purpose of the call. The audit report also questioned whether

\textsuperscript{35} While not necessarily all-inclusive, see Applicants’ responses to CA-IR-194, CA-IR-195, CA-IR-196, CA-IR-222, CA-IR-223, CA-IR-224, CA-IR-225, CA-IR-226 and OP-IR-54

\textsuperscript{36} See Applicants’ response to CA-IR-222, Attachment 1, Staff Audit Report, Audit Findings 1 and 2, attached to a memorandum dated October 11, 2010.
FPLES may have obtained and retained confidential customer information, but was assured by FPLES that was not the case. In order to resolve the audit report findings, FPL agreed to revise the script used by FPL service representatives to “clearly define the services being provided by FPL versus the services being offered by FPLES.”

Q. PLEASE DISCUSS THE SECOND ITEM.

A. Applicants’ response to CA-IR-225 discusses a January 2010 press release in which FPL announced suspension of activities on major infrastructure projects representing “approximately $10 billion of capital investment” due in part to a denial of requested rate increases by the FPSC. The press release cited the “negative decision…as further evidence of a deteriorating regulatory and business environment.” Following responses to FPSC Staff discovery regarding this suspension and “an in-depth analysis, FPL determined that it was appropriate to move ahead with a $2 billion investment to modernize its Riviera Beach and Cape Canaveral power plants, which were completed in 2013 and 2014, respectively, ahead of original schedules and under budget.”

37 Applicants’ response to CA-IR-222.

38 Per Applicants’ response to CA-IR-225, the press release, which explains the circumstances in greater detail, could be read at: http://newsroom.fpl.com/index.php?section=31517&item=101548
In April 2010, FPL issued a press release entitled, “FPL to Move Forward with Plant Modernizations that Will Deliver Customer Benefits in the Decades Ahead While Reducing Staffing Levels to Keep Costs in Line in the Current Economy.” The decision to move forward with the projects included an announcement that the FPL would also reduce staffing levels, “primarily due to the difficult economy and a dramatic reduction in new housing construction that reduced the need for positions to support that activity.”

Q. PLEASE DISCUSS THE THIRD ITEM.

A. Applicants’ response to CA-IR-226 describes a September 2010 motion filed “seeking to disqualify former Commissioner Skop from participating in all hearings, deliberations, decision-making, or acting in any other capacity, on all active dockets and matters involving FPL” until the expiration of his term on January 1, 2011. The Applicants’ response stated:

FPL maintained that that Commission Skop could not render impartial rulings in FPL matters pending before the FPSC. The motion clearly demonstrated that a reasonably prudent person in FPL’s position would fear that he or she would not receive a fair and impartial hearing from Commissioner Skop.

39 Applicants’ response to CA-IR-225 also indicated that the press release could be read at: http://newsroom.fpl.com/index.php?s=31517&item=101539.
Following a denial of FPL’s motion by the FPSC, FPL’s appeal of that ruling to the First District Court of Appeal, the court’s issuance of an order for the FPSC to “show cause why the writ of prohibition should not be issued” and briefs filed by FPL and FPSC, the appeal served as a stay of all FPL matters before the Commission on which Commissioner Skop participated. The FPSC was unable to rule on a settlement in a pending FPL rate case as a result of the stay.

In December 2010, the court granted a motion filed by the FPSC to relinquish jurisdiction over the rate case settlement which the FPSC approved on December 14, 2010.40

Q. DO YOU BELIEVE THAT THESE MATTERS ARE IMPORTANT FOR THE COMMISSION TO CONSIDER IN THE CONTEXT OF AFFILIATE TRANSACTIONS?

A. Yes. Since affiliate transactions are often between regulated and unregulated operations, the best interests of regulated customers may not necessarily be a common goal or objective. Without having conducted independent analyses or been involved in any of these three matters, I am unable to directly comment on whether FPL acted properly or over-reacted to the situation. However, regulatory vigilance and attention to affiliate relationships is important, even though these

40 See Applicants’ response to CA-IR-226, including Attachment 1 consisting of 720 pages and multiple links to motions/orders.
particular situations may not directly apply to a post-merger Hawaii environment, if the change of control motion is approved. Nevertheless, I do believe that appropriate affiliate transaction rules and merger conditions as proposed by the Consumer Advocate are in the best long-term interests of the HECO Companies’ customers, the Applicants, the Commission and the Consumer Advocate.

VII. OTHER CONDITIONS.

Q. PLEASE IDENTIFY THE ORDER NO. 32739 ISSUE YOU ADDRESS IN THIS TESTIMONY SECTION.

A. This section of my testimony addresses a portion of Issue 6:

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.

Regarding Issue 6, Ms. Sekimura explains the Applicants’ proposed modifications to the 1982 Agreement and why the Thomas Report and its recommendations should no longer apply to the Hawaiian Electric Companies and their new parent, Hawaiian Electric Holdings, upon consummation of the proposed Change in Control.\(^{41}\) I will not restate the various conditions recommended in prior sections of my testimony, instead focusing on the 1982 Agreement and the Thomas Report.

\(^{41}\) See Applicants Exhibit-28, at 28-33.
A. 1982 AGREEMENT.

Q. WHAT IS THE 1982 AGREEMENT?

A. In Docket No. 4337, the Commission approved HEI owning all of the issued and outstanding common stock of Hawaiian Electric and approved Conditions for the Merger and Corporate Restructuring of Hawaiian Electric Company, Inc. dated September 23, 1982 (the “1982 Agreement”). Condition 16 of the 1982 Agreement provides that “acquisition of Hawaiian Electric Industries, Inc., by a third party, whether by purchase, merger, consolidation, or otherwise, shall require prior written approval of the Commission.” The 1982 Agreement contained 24 specific conditions. The Applicants are currently seeking the Commission’s approval of the pending change of control pursuant to Condition 16.

Q. ARE ANY SPECIFIC CHANGES PROPOSED BY THE APPLICANTS TO THE 1982 AGREEMENT?

A. Yes. The Applicants are requesting specific modifications to the 1982 Agreement which are delineated in Applicants Exhibit-31, showing both the original condition language and the Applicants’ proposed revisions.43

42 See Applicants Exhibit-30 for the Commission order and the 1982 Agreement.  
43 The Applicants’ proposed modifications to the 1982 agreement were also set forth in Exhibit-8 of the original application filed in the pending docket.
Q. DO YOU AGREE WITH THE APPLICANTS’ REQUESTED MODIFICATIONS?

A. Some, but not all. Many of the modifications relate to corporate name changes and a few ministerial revisions. However, some of the proposed modifications are more substantive. CA Exhibit-19, Consumer Advocate Proposed Modifications to the 1982 Agreement Conditions, is intended to build upon Applicants Exhibit-31 by adding a column showing the Consumer Advocate’s incremental changes to the Applicants Exhibit-31. Mr. Hill will discuss the Consumer Advocate’s recommendations regarding the Applicants’ position on Conditions 8-11 and 16. I will discuss the differences between the Applicants and the Consumer Advocate on the remaining Conditions to the 1982 Agreement.44

- **Condition 1**: Applicants propose to insert a reference to the “Utility Corporation” and expand the condition to include NextEra Energy but to limit that expansion to “entities that provide services chargeable to the Hawaiian Electric Companies.” The insertion of “Utility Corporation” is unnecessary as that term and application are already addressed in Condition 3, unless the Applicants had more far reaching intentions with that change alone would imply. With respect to the “services chargeable” limitation, the importance of access to NEE affiliate data is broader than

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44 Name changes and other ministerial differences are not discussed herein, unless substantive. There are no differences between the Applicants and the Consumer Advocate on Conditions 4, 6, 7, 12, 17, 18, 20-24.
direct transaction information as addressed in the earlier affiliate transaction discussion.

In response to CA-IR-113(a), Applicants further explain the basis for its proposed modifications would “also allow for the regulatory review of costs that are allocated directly or indirectly to the Hawaiian Electric Companies (as such costs would be for services chargeable to the Hawaiian Electric Companies).” Further, Applicants indicate that the proposed revisions “were made to actually expand the scope of the Commission’s review.” And that, “the Commission may need information above the HEI/Hawaiian Electric Holdings level in order to fulfill its statutory responsibilities in regulating and overseeing the Hawaiian Electric Companies.” This response also stated: “NextEra Energy is agreeable to make it clear that it is willing to expand the scope of the existing requirement imposed in Condition No. 1 of the 1982 Agreement to cover all NextEra entities that provide services chargeable to the Hawaiian Electric Companies.”

The Consumer Advocate agrees that all changes to the conditions of the 1982 Agreement should not narrow the ability of the Commission (and the Consumer Advocate) to fulfill statutory obligations. However, the Consumer Advocate believes that its proposed modifications to Condition 3, discussed below, will ensure the availability of the affiliate
transaction data that may be required for regulatory and ratemaking purposes.

- **Condition 2:** Applicants propose to change the phrase “when requested in writing or in open hearing, shall voluntarily have *any* employee…” as contained in the original 1982 Agreement to “when requested in writing or in open hearing, shall voluntarily have *an* employee…” In response to CA-IR-114(a), NEE expressed concern that the word “any” could be used to compel “every single employee…[or] dozens or hundreds of NextEra Energy employees” to appear and testify before the Commission. However, after objecting to CA-IR-312(b), NEE indicated that “Applicants have no such evidence” that the Commission has unreasonably demanded that every single employee or dozens or hundreds of employees of the HECO Companies appear to testify.\(^{45}\)

- **Condition 3:** Similar to Condition 1, Applicants propose to insert additional references to the “Utility Corporation” and restrict the condition regarding NextEra entities “that provide services chargeable to the Utility Corporation.” The Consumer Advocate would insert the phrases “or impact shared services costs allocable” and “and/or other NextEra

\(^{45}\) The response to CA-IR-114 also indicated that the “Applicants would be willing to work with the Consumer Advocate to reach an agreement on appropriate revisions to this condition…” To date, there have been no discussions between the Applicants and the Consumer Advocate on this condition.
affiliates, as necessary” to recognize that affiliate data needs are likely to arise that go beyond direct transactions, as noted in the discussion of Condition 1 above.

In response to CA-IR-115, the Applicants explained Condition 3 appeared to be overly broad and go beyond the Commission’s statutory authority. After objecting to CA-IR-312(c), NEE indicated that “Applicants have no such information” that the Commission has exceeded its statutory authority because of that language or that the HECO Companies have found that language to be unduly burdensome.

- **Condition 5**: Similar to Conditions 1 and 3, the Consumer Advocate would insert the phrase “and each affiliate of NextEra” recognizing that some affiliate transaction and cost allocation reviews will require information from affiliated entities other than NextEra.

- **Condition 13**: Applicants propose to delete Condition 13, claiming it is ambiguous, unclear and already addressed by existing statutory provisions. Further, Applicants contend that Condition 13 could result in undue burden to obtain prior Commission approval to transfer utility property that is already retired or no longer in use. The Consumer Advocate does not believe that the Applicants have made a sufficient showing that Condition 13 has been administratively unworkable since 1982. Further, it is a bit alarming that NextEra may seek to repurpose assets previously used for utility service for monetary
gain that the HECO Companies had been unable to achieve independently, possibly without adequate compensation. Consequently, the Consumer Advocate has only proposed to insert references to “NextEra” in the original language.

- **Condition 14**: The only proposed Consumer Advocate change to the Applicants’ language is to insert the phrase “and regulatory accounting requirements” to recognize that the Commission could direct certain regulatory accounting that varies from general accepted accounting principles.

- **Condition 15**: The only proposed Consumer Advocate change to the Applicants’ language is to insert the phrase “and provide access to the required books and records of NextEra affiliates.” This addition recognizes the fact that certain affiliate data may be required and that sufficient resources may not be available for the Commission or the Consumer Advocate to feasibly send personnel to Juno Beach or some other mainland destination to review books and records or other supporting documentation. Due to the ability to produce electronic files at otherwise remote locations, this requirement should not be a burdensome revision.
Condition 19: The Consumer Advocate proposes to update the language to provide current context, which appears to have been the original intent in the 1982 Agreement.

B. THOMAS REPORT.

Q. PLEASE BRIEFLY IDENTIFY THE THOMAS REPORT, AS DISCUSSED BY THE APPLICANTS IN THIS PROCEEDING.

A. The Thomas Report was a product of Docket No. 7591 – a proceeding opened by the Commission at HECO’s request involving an independent consultant retained by the Commission.

The purpose of the review is to determine whether the HEI—HECO relationship, HEI’s diversified activities, and HEI’s policies, operations, and practices have resulted in or are having any negative effects on HECO and its electric utility subsidiaries, the Hawaii Electric Light Company, Inc. (HELCO) and Maui Electric Company, Ltd. (MECO).

As part of that proceeding, the Commission contracted Dennis Thomas and Associates to perform a review of HEI’s diversification history. In January 1995, the Thomas Report concluded that HEI and HECO were in basic compliance with


47 Docket No. 7591, Order No. 12155 at 2.
Conditions of the merger and that ratepayers had not been materially harmed by HECO’s diversification.\textsuperscript{48}

However, the Thomas Report also made several recommendations advising that HECO should: (1) improve communications with the commission on the potential risks or conflicts with each diversification venture; (2) provide the commission with meaningful information on an ongoing basis; (3) increase the independence of the HECO board of directors; (4) provide for greater separation between the operations of HEI and HECO; (5) resolve reliability problems; and (6) improve communications with Wall Street investors.

In the early 1990s, the Commission recognized community concerns regarding the effect that HEI’s numerous nonutility subsidiaries and activities were having on the HECO Companies, which served as the catalyst for the review proceeding and the Thomas Report. The Thomas Report made several recommendations that were intended to safeguard the HECO Companies from negative impacts that could have arisen from HEI’s then non-utility operations or investments. The Thomas Report was adopted by the Commission in its entirety.\textsuperscript{49}

In Order No. 15225, the Commission also adopted a Department of Defense’s recommendation:

\textsuperscript{48} Docket No. 7591, Order No. 15225, at 3.

\textsuperscript{49} See Section VII of the Application, at 44 and Applicants Exhibit-28, at 33-34.
In any proceeding involving the establishment of rates for HECO, HELCO, or MECO, the utility should be required to present a comprehensive analysis of the impact that the holding company structure and investments in non-utility subsidiaries have on the cost of capital to the utility. The utility must also present an analysis designed to remove such effects from the cost of capital to the utility.\(^{50}\)

The Applicants contend the circumstances that gave rise to the Thomas Report are materially different than the circumstances that exist today. “HEI does not engage in nearly the same level of diversification activities as it did at the time of Docket No. 7591 over twenty years ago”, American Savings Bank will be spun-off as a separate, independent entity and no longer affiliated with the HECO Companies. And, NEE has no current plans to create any new non-utility subsidiaries under Hawaiian Electric Holdings or the HECO Companies.\(^{51}\)

To the extent NextEra Energy desires to form any new non-utility subsidiaries under Hawaiian Electric Holdings or the Hawaiian Electric Companies at any point in the future, NextEra Energy would seek Commission approval prior to doing so.\(^{52}\)

Applicants contend that the Thomas Report and the recommendations adopted by the Commission are or will no longer be applicable upon consummation of the Proposed Change of Control.\(^{53}\) As a result, Applicants have requested that the

\(^{50}\) Docket No. 7591, Order No. 15225, at 5-6.

\(^{51}\) See Section VII of the Application at 45 and Applicants Exhibit-28, at 35.

\(^{52}\) \textit{Id.}

\(^{53}\) \textit{Id.}
Commission confirm that upon consummation of the Proposed Change of Control, the Thomas Report (including all of the recommendations set forth therein) will no longer be applicable and should no longer apply to the HECO Companies and their new parent, Hawaiian Electric Holdings, upon consummation of the proposed Change in Control.

Q. DO YOU HAVE ANY COMMENTS REGARDING THE APPLICANTS’ PROPOSAL TO TERMINATE THE APPLICABILITY OF THE THOMAS REPORT POST-MERGER?

A. In its introductory section, the Thomas Report summarized specific matters of concern with regard to HEI’s diversification activities:

With the public interest standards as backdrop, Chapter 4 of this report takes up the significant particular occurrences illustrating the effects of HEI’s diversification on the quality of the utilities’ service, the fairness of utilities’ rates, and the harms or benefits to utilities of affiliation with the nonutility companies. Chapter 4 is the longest chapter in this report, because it considers the particulars of eight of these “events of concern” in HEI’s diversification record. Those eight sections of that chapter deal with:

- the failure of the insurance company (HIG)
- the purchase of American Savings Bank (ASB)
- four significant power outages on Oahu since 1982
- the demise and sale of the wind power affiliate (HERS)

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54 See Section VII of the Application, at 45, Applicants Exhibit-7, at 40 and Applicants Exhibit-28, at 35.

• attempted land transactions between HECO and the developer affiliate Malama Pacific Corp. (MPC)
• regulatory treatment of intercompany allocations of shared services
• HECO’s bond rating downgrade after the failure of HIG
• contracts between utilities and Hawaiian Tug and Barge (HTB) for fuel hauling

Some of these events should be regarded as stories that have ended, but some are more in the nature of continuing processes than events, and raise issues which may need to be dealt with in the future.

In support of the request that the Thomas Report be no longer applicable upon approval of the change in control, Applicants have explained that:

• Hawaiian Electric Industries, Inc. (“HEI”) has divested the vast majority of its non-utility operations and investments, and the spin-off of the ownership of American Savings Holdings, Inc. to HEI investors will occur as part of the Proposed Change of Control. As such, any concerns about how diversification affects the regulated utility operations of the Hawaiian Electric Companies are no longer a critical issue.56

• The circumstances that gave rise to the Thomas Report are materially different than the circumstances that exist today. The current HEI corporate structure is fundamentally different than at the time of the report, and HEI does not engage in nearly the same level of diversification activities as it did at the time of Docket No. 7591 over twenty years ago. For example, the following entities were subsidiaries of HEI that engaged in a variety of non-utility or water carrier activities at the time of the report: HEI Investment Corp., Hawaiian Electric Renewable Systems, Malama Pacific Corp., Hawaiian Tug and Barge Corp./Young Brothers, Ltd., Hawaiian Insurance Group, and Pacific Energy Conservation Services, Inc. All of these entities are no longer subsidiaries

56 Applicants’ response to PUC-IR-91.
of HEI. Additionally, the bank (i.e., American Savings Holdings, Inc., including its subsidiary, American Savings Bank, F.S.B.) will be spun-off as a separate, independent entity in connection with and immediately prior to consummation of the Proposed Change of Control. Once the Bank Spin-Off occurs, the bank will be independent from and no longer affiliated with the Hawaiian Electric Companies. In other words, following consummation of the Proposed Change of Control, the bank will not be a subsidiary of Hawaiian Electric Holdings (the new parent company of the Hawaiian Electric Companies that will essentially take the place of HEI). Further, NextEra Energy does not currently have any plans to create any new non-utility subsidiaries under Hawaiian Electric Holdings or the Hawaiian Electric Companies.57

While NEE may not have any current plans to create new non-utility subsidiaries under HEH or the HECO Companies, what the future may hold in a post-merger environment is unknown as is the extent of shared services transactions and other business relationships that might evolve with the NEE affiliate family. While these statements about HEI having divested many of its non-utility operations and investments are accurate, the Commission and the Consumer Advocate should remain mindful of the fact that Docket No. 7591 was opened in 1993, about ten years after “HECO became a subsidiary of HEI as a result of the purchase of HECO’s outstanding common stock by HEI in 1982.” Assuming approval of the proposed change of control, it is critical that the Commission and the Consumer Advocate remain vigilant in monitoring and addressing potential

57 Applicants’ response to COM-IR-9.
cross-subsidy issues and anticompetitive activities particularly in light of NEE’s acquisition and divestiture history.

As indicated previously, NextEra Energy has committed to seek Commission approval prior to forming any new non-utility subsidiaries under Hawaiian Electric Holdings or the HECO Companies at any time in the future. 58

The Consumer Advocate recommends that this commitment be memorialized by retaining Condition 16 of the 1982 Agreement, which requires a Commission decision approving any future change in control. 59

In light of the importance of regulatory transparency involving affiliate transactions, the Consumer Advocate also recommends that the HECO Companies be required to file a report annually with the Commission and the Consumer Advocate disclosing the nature of the affiliate transactions and the annual value of those activities between each HECO Company and each NEE affiliate. 60

58 Section VII of the Application, at 45 and Applicants Exhibit-28, at 35.
59 Condition 16 of the 1982 Agreement is discussed by Mr. Hill.
60 This recommendation is presented by Consumer Advocate’s proposed Affiliate Condition 5.
VIII. CONCLUSION.

Q. HOW DO YOUR FINDINGS AND OPINIONS IMPACT WHETHER NEE IS FIT, WILLING AND ABLE TO PROVIDE SAFE, ADEQUATE AND RELIABLE ELECTRIC SERVICE AT THE LOWEST REASONABLE COST IN DETERMINING WHETHER THE PROPOSED TRANSACTION IS IN THE PUBLIC INTEREST?

A. The testimonies of other Consumer Advocate witnesses have addressed a variety of concerns with the Proposed Transaction in addition to those that I discuss herein. The conditions I propose serve to adequately mitigate my stated concerns with respect to affiliate transactions and regulatory issues.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.
Qualifications of Steven C. Carver

EMPLOYER: Utilitech, Inc.
Regulatory and Management Consultants

POSITION: Vice-President

ADDRESS: P.O. Box 481934
Kansas City, Missouri 64148

PRIOR EXPERIENCE:
6/87 - Present Utilitech, Inc.
4/83 - 6/87 Missouri Public Service Commission, Chief Accountant
10/79 - 4/83 Missouri Public Service Commission, Accounting Manager
6/77 - 10/79 Missouri Public Service Commission, Regulatory Auditor

EDUCATION:
Central Missouri State University
Bachelor of Science Degree in Business Administration
Accounting Major (1977)

State Fair Community College
Associate of Arts Degree - Emphasis in Accounting (1975)

OTHER QUALIFICATIONS:
Speaker - 1988 Missouri Public Service Commission Workshop
- 1990 Annual NASUCA/NARUC Convention (Orlando)
- 1996 Mid-Year NASUCA Meeting (Chicago)
Instructor - 1994 Hawaii Consumer Advocate Regulatory Training Program
- 1997 Hawaii Consumer Advocate Telecommunications Training Program
- 1999 Overview of Utility Regulation (Hawaii)
- 2000 Telecommunications: Overview of Regulation (Arizona)

PRIOR TESTIMONIES: (See listing on pages 5-10.)
**Education and Experience**

I graduated from State Fair Community College where I received an Associate of Arts Degree with an emphasis in Accounting. I also graduated from Central Missouri State University with a Bachelor of Science Degree in Business Administration, majoring in Accounting. Subsequent to the completion of formal education, my entire professional career has been dedicated to public utility investigations, regulatory analysis and consulting.

From 1977 to 1987, I was employed by the Missouri Public Service Commission in various professional auditing positions associated with the regulation of public utilities. In that capacity, I participated in and supervised various accounting compliance and rate case audits (including earnings reviews) of electric, gas, telephone utility, water/wastewater and steam utility companies and was responsible for the submission of expert testimony as a Staff witness.

In October 1979, I was promoted to the position of Accounting Manager of the Kansas City Office of the Commission Staff and assumed supervisory responsibilities for a staff of regulatory auditors, directing numerous rate case audits of large electric, gas and telephone utility companies operating in the State of Missouri. In April 1983, I was promoted by the Commission to the position of Chief Accountant and assumed overall management and policy responsibilities for the Accounting Department, providing guidance and assistance in the technical development of Staff issues in major rate cases and coordinating the general audit and administrative activities of the Department.
During 1986-1987, I was actively involved in a docket established by the Missouri Public Service Commission to investigate the revenue requirement impact of the Tax Reform Act of 1986 on Missouri utilities. In 1986, I prepared the comments of the Missouri Public Service Commission respecting the Proposed Amendment to FAS Statement No. 71 (relating to phase-in plans, plant abandonments, plant cost disallowances, etc.) as well as the Proposed Statement of Financial Accounting Standards for Accounting for Income Taxes. I actively participated in the discussions of a subcommittee responsible for drafting the comments of the National Association of Regulatory Utility Commissioners ("NARUC") on the Proposed Amendment to FAS Statement No. 71 and subsequently appeared before the Financial Accounting Standards Board with a Missouri Commissioner to present the positions of NARUC and the Missouri Commission.

In July of 1983 and in addition to my duties as Chief Accountant, I was appointed Project Manager of the Commission Staff's construction audits of two nuclear power plants owned by electric utilities regulated by the Missouri Public Service Commission. As Project Manager, I was involved in the staffing and coordination of the construction audits and in the development and preparation of the Staff's audit findings for presentation to the Commission. In this capacity, I coordinated and supervised a matrix organization of Staff accountants, engineers, attorneys and consultants.

Since commencing employment with Utilitech in June 1987, I have conducted revenue requirement and special studies involving various regulated industries (i.e., electric, gas, telephone, water and steam heating) and have been associated with regulatory projects on behalf of clients in twenty State regulatory jurisdictions.
Previous Expert Testimony

I have appeared as an expert witness before the Missouri Public Service Commission on behalf of various clients, including the Commission Staff. I have filed testimony before utility regulatory agencies in Arizona, California, Florida, Hawaii, Kansas, Indiana, Nevada, New Mexico, Missouri, Oklahoma, Pennsylvania, Texas, Utah, and Washington. My previous experience involving electric and gas company proceedings includes: PSI Energy, Union Electric (now Ameren Missouri), Kansas City Power & Light, Missouri Public Service/UtiliCorp United/Aquila (now Kansas City Power & Light Company), Public Service Company of Oklahoma, Oklahoma Gas and Electric, Hawaii Electric Light Company, Hawaiian Electric Company, Maui Electric Company, Sierra Pacific Power/ Nevada Power, Gas Service Company, Northern Indiana Public Service Company, Arkla (a Division of NORAM Energy), Oklahoma Natural Gas Company, Missouri Gas Energy, Arizona Public Service Company, Southwestern Public Service (Texas), Atmos Energy Corporation (Texas divisions) and The Gas Company (Hawaii). I have also sponsored testimony in telecommunications, water and steam heat proceedings in various regulatory jurisdictions.
## STEVEN C. CARVER

Summary of Previously Filed Testimony

1978 through 2015 (August)

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1978 through 2015 (August)

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# Rules of
Department of Economic Development
Division 240—Public Service Commission
Chapter 20—Electric Utilities

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Title 4—DEPARTMENT OF ECONOMIC DEVELOPMENT
Division 240—Public Service Commission
Chapter 20—Electric Utilities

4 CSR 240-20.010 Rate Schedules
(Rescinded April 30, 2003)

AUTHORITY: section 393.140, RSMo 1986.

4 CSR 240-20.015 Affiliate Transactions

PURPOSE: This rule is intended to prevent regulated utilities from subsidizing their non-regulated operations. In order to accomplish this objective, the rule sets forth financial standards, evidentiary standards and record-keeping requirements applicable to any Missouri Public Service Commission (commission) regulated electrical corporation whenever such corporation participates in transactions with any affiliated entity (except with regard to HVAC services as defined in section 386.754, RSMo Supp. 1998, by the General Assembly of Missouri). The rule and its effective enforcement will provide the public the assurance that their rates are not adversely impacted by the utilities’ non-regulated activities.

(1) Definitions.
(A) Affiliated entity means any person, including an individual, corporation, service company, corporate subsidiary, firm, partnership, incorporated or unincorporated association, political subdivision including a public utility district, city, town, county, or a combination of political subdivisions, which directly or indirectly, through one (1) or more intermediaries, controls, is controlled by, or is under common control with the regulated electrical corporation.

(B) Affiliate transaction means any transaction for the provision, purchase or sale of any information, asset, product or service, or portion of any product or service, between a regulated electrical corporation and an affiliated entity, and shall include all transactions carried out between any unregulated business operation of a regulated electrical corporation and the regulated business operations of a corporation. An affiliate transaction for the purposes of this rule excludes heating, ventilating and air conditioning (HVAC) services as defined in section 386.754 by the General Assembly of Missouri.

(C) Control (including the terms “controlling,” “controlled by,” and “common control”) means the possession, directly or indirectly, of the power to direct, or to cause the direction of the management or policies of an entity, whether such power is exercised through one (1) or more intermediary entities, or alone, or in conjunction with, or pursuant to an agreement with, one or more other entities, whether such power is exercised through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, affiliated entities, contract or any other direct or indirect means. The commission shall presume that the beneficial ownership of ten percent (10%) or more of voting securities or partnership interest of an entity constitutes control for purposes of this rule. This provision, however, shall not be construed to prohibit a regulated electrical corporation from rebutting the presumption that its ownership interest in an entity confers control.

(D) Corporate support means joint corporate oversight, governance, support systems and personnel, involving payroll, shareholder services, financial reporting, human resources, employee records, pension management, legal services, and research and development activities.

(E) Derivatives means a financial instrument, traded on or off an exchange, the price of which is directly dependent upon (i.e., “derived from”) the value of one or more underlying securities, equity indices, debt instruments, commodities, other derivative instruments, or any agreed-upon pricing index or arrangement (e.g., the movement over time of the Consumer Price Index or freight rates). Derivatives involve the trading of rights or obligations based on the underlying product, but do not directly transfer property. They are used to hedge risk or to exchange a floating rate of return for a fixed rate of return.

(F) Fully distributed cost (FDC) means a methodology that examines all costs of an enterprise in relation to all the goods and services that are produced. FDC requires recognition of all costs incurred directly or indirectly used to produce a good or service. Costs are assigned either through a direct or allocated approach. Costs that cannot be directly assigned or indirectly allocated (e.g., general and administrative) must also be included in the FDC calculation through a general allocation.

(G) Information means any data obtained by a regulated electrical corporation that is not obtainable by nonaffiliated entities or can only be obtained at a competitively prohibitive cost in either time or resources.

(H) Preferential service means information or treatment or actions by the regulated electrical corporation which places the affiliated entity at an unfair advantage over its competitors.

(I) Regulated electrical corporation means every electrical corporation as defined in section 386.020, RSMo, subject to commission regulation pursuant to Chapter 393, RSMo.

(J) Unfair advantage means an advantage that cannot be obtained by nonaffiliated entities or can only be obtained at a competitively prohibitive cost in either time or resources.

(K) Variance means an exemption granted by the commission from any applicable standard required pursuant to this rule.

(2) Standards.
(A) A regulated electrical corporation shall not provide a financial advantage to an affiliated entity. For the purposes of this rule, a regulated electrical corporation shall be deemed to provide a financial advantage to an affiliated entity if:

1. It compensates an affiliated entity for goods or services above the lesser of—

   A. The fair market price; or
   B. The fully distributed cost to the regulated electrical corporation to provide the goods or services for itself; or

2. It transfers information, assets, goods or services of any kind to an affiliated entity below the greater of—

   A. The fair market price; or
   B. The fully distributed cost to the regulated electrical corporation.

(B) Except as necessary to provide corporate support functions, the regulated electrical corporation shall conduct its business in such a way as not to provide any preferential service, information or treatment to an affiliated entity over another party at any time.

(C) Specific customer information shall be made available to affiliated or unaffiliated entities only upon consent of the customer or as otherwise provided by law or commission rules or orders. General or aggregated customer information shall be made available to affiliated or unaffiliated entities upon similar terms and conditions. The regulated electrical corporation may set reasonable charges for costs incurred in producing customer information. Customer information includes information provided to the regulated utility by affiliated or unaffiliated entities.
(D) The regulated electrical corporation shall not participate in any affiliated transactions which are not in compliance with this rule, except as otherwise provided in section (10) of this rule.

(E) If a customer requests information from the regulated electrical corporation about goods or services provided by an affiliated entity, the regulated electrical corporation may provide information about its affiliate but must inform the customer that regulated services are not tied to the use of an affiliate provider and that other service providers may be available. The regulated electrical corporation may provide reference to other service providers or to commercial listings, but is not required to do so. The regulated electrical corporation shall include in its annual Cost Allocation Manual (CAM), the criteria, guidelines and procedures it will follow to be in compliance with this rule.

(F) Marketing materials, information or advertisements by an affiliate entity that share an exact or similar name, logo or trademark of the regulated utility shall clearly display or announce that the affiliate entity is not regulated by the Missouri Public Service Commission.

(3) Evidentiary Standards for Affiliate Transactions

(A) When a regulated electrical corporation purchases information, assets, goods or services from an affiliated entity, the regulated electrical corporation shall either obtain competitive bids for such information, assets, goods or services or demonstrate why competitive bids were neither necessary nor appropriate.

(B) In transactions that involve either the purchase or receipt of information, assets, goods or services by a regulated electrical corporation from an affiliated entity, the regulated electrical corporation shall document both the fair market price of such information, assets, goods and services and the FDC to the regulated electrical corporation to produce the information, assets, goods or services for itself.

(C) In transactions that involve the provision of information, assets, goods or services to affiliated entities, the regulated electrical corporation must demonstrate that it—

1. Considered all costs incurred to complete the transaction;
2. Calculated the costs at times relevant to the transaction;
3. Allocated all joint and common costs appropriately; and
4. Adequately determined the fair market price of the information, assets, goods or services.

(D) In transactions involving the purchase of goods or services by the regulated electrical corporation from an affiliated entity, the regulated electrical corporation will use a commission-approved CAM which sets forth cost allocation, market valuation and internal cost methods. This CAM can use benchmarking practices that can constitute compliance with the market value requirements of this section if approved by the commission.

(4) Record Keeping Requirements.

(A) A regulated electrical corporation shall maintain books, accounts and records separate from those of its affiliates.

(B) Each regulated electrical corporation shall maintain the following information in a manually agreed-to electronic format (i.e., agreement between the staff, Office of the Public Counsel and the regulated electrical corporation) regarding affiliate transactions on a calendar year basis and shall provide such information to the commission staff and the Office of the Public Counsel on, or before, March 15 of the succeeding year:

1. A full and complete list of all affiliated entities as defined by this rule;
2. A full and complete list of all goods and services provided to or received from affiliated entities;
3. A full and complete list of all contracts entered with affiliated entities;
4. A full and complete list of all affiliate transactions undertaken with affiliated entities without a written contract together with a brief explanation of why there was no contract;
5. The amount of all affiliate transactions by affiliated entity and account charged; and
6. The basis used (e.g., fair market price, FDC, etc.) to record each type of affiliate transaction.

(C) In addition, each regulated electrical corporation shall maintain the following information regarding affiliate transactions on a calendar year basis:

1. Records identifying the basis used (e.g., fair market price, FDC, etc.) to record all affiliate transactions; and
2. Books of accounts and supporting records in sufficient detail to permit verification of compliance with this rule.

(5) Records of Affiliated Entities.

(A) Each regulated electrical corporation shall ensure that its parent and any other affiliated entities maintain books and records that include, at a minimum, the following information regarding affiliate transactions:

1. Documentation of the costs associated with affiliate transactions that are incurred by the parent or affiliated entity and charged to the regulated electrical corporation;
2. Documentation of the methods used to allocate and/or share costs between affiliated entities including other jurisdictions and/or corporate divisions;
3. Description of costs that are not subject to allocation to affiliate transactions and documentation supporting the nonassignment of these costs to affiliate transactions;
4. Descriptions of the types of services that corporate divisions and/or other centralized functions provided to any affiliated entity or division accessing the regulated electrical corporation's contracted services or facilities;
5. Names and job descriptions of the employees from the regulated electrical corporation that transferred to a nonregulated affiliated entity;
6. Evaluations of the effect on the reliability of services provided by the regulated electrical corporation resulting from the access to regulated contracts and/or facilities by affiliated entities;
7. Policies regarding the availability of customer information and the access to services available to nonregulated affiliated entities desiring use of the regulated electrical corporation's contracts and facilities; and
8. Descriptions of and supporting documentation related to any use of derivatives that may be related to the regulated electrical corporation's operation even though obtained by the parent or affiliated entity.

(6) Access to Records of Affiliated Entities.

(A) To the extent permitted by applicable law and pursuant to established commission discovery procedures, a regulated electrical corporation shall make available the books and records of its parent and any other affiliated entities when required in the application of this rule.

(B) The commission shall have the authority to—

1. Review, inspect and audit books, accounts and other records kept by a regulated electrical corporation or affiliated entity for the sole purpose of ensuring compliance with this rule and making findings available to the commission; and
2. Investigate the operations of a regulated electrical corporation or affiliated entity and their relationship to each other for the sole purpose of ensuring compliance with this rule.

(C) This rule does not modify existing legal standards regarding which party has the burden of proof in commission proceedings.
(7) Record Retention. 
    (A) Records required under this rule shall be maintained by each regulated electrical corporation for a period of not less than six (6) years.

(8) Enforcement. 
    (A) When enforcing these standards, or any order of the commission regarding these standards, the commission may apply any remedy available to the commission.

(9) The regulated electrical corporation shall train and advise its personnel as to the requirements and provisions of this rule as appropriate to ensure compliance.

(10) Variances. 
    (A) A variance from the standards in this rule may be obtained by compliance with paragraphs (10)(A)(1), or (10)(A)(2). The granting of a variance to one regulated electrical corporation does not constitute a waiver respecting or otherwise affect the required compliance of any other regulated electrical corporation to comply with the standards. The scope of a variance will be determined based on the facts and circumstances found in support of the application.

1. The regulated electrical corporation shall request a variance upon written application in accordance with commission procedures set out in 4 CSR 240-2.060(11); or

2. A regulated electrical corporation may engage in an affiliate transaction not in compliance with the standards set out in subsection (2)(A) of this rule, when to its best knowledge and belief, compliance with the standards would not be in the best interests of its regulated customers and it complies with the procedures required by subparagraphs (10)(A)(2)(A), and (10)(A)(2)(B) of this rule—

   A. All reports and record retention requirements for each affiliate transaction must be complied with; and

   B. Notice of the noncomplying affiliate transaction shall be filed with the secretary of the commission and the Office of the Public Counsel within ten (10) days of the occurrence of the non-complying affiliate transaction. The notice shall provide a detailed explanation of why the affiliate transaction should be exempted from the requirements of subsection (2)(A), and shall provide a detailed explanation of how the affiliate transaction was in the best interests of the regulated customers. Within thirty (30) days of the notice of the noncomplying affiliate transaction, any party shall have the right to request a hearing regarding the noncomplying affiliate transaction. The commission may grant or deny the request for hearing at that time. If the commission denies a request for hearing, the denial shall not in any way prejudice a party's ability to challenge the affiliate transaction at the time of the annual CAM filing. At the time of the filing of the regulated electrical corporation's annual CAM filing, the regulated electrical corporation shall provide to the secretary of the commission a listing of all non-complying affiliate transactions which occurred between the period of the last filing and the current filing. Any affiliate transaction submitted pursuant to this section shall remain interim, subject to disallowance, pending final commission determination on whether the noncomplying affiliate transaction resulted in the best interests of the regulated customers.

11. Nothing contained in this rule and no action by the commission under this rule shall be construed to approve or exempt any activity or arrangement that would violate the antitrust laws of the state of Missouri or of the United States or to limit the rights of any person or entity under those laws.


4 CSR 240-20.017 HVAC Services Affiliate Transactions

PURPOSE: This rule prescribes the requirements for HVAC services affiliated entities and regulated electric corporations when such electric corporations participate in affiliated transactions with an HVAC affiliated entity as set forth in sections 386.754, 386.756, 386.760, 386.762 and 386.764, RSMo by the General Assembly of the State of Missouri.

(1) Definitions.  
    (A) Affiliated entity means any entity not regulated by the Public Service Commission which is owned, controlled by or under common control with a utility and is engaged in HVAC services. 

    (B) Control (including the terms "controlling," "controlled by," and "common control") means the possession, directly or indirectly, of the power to direct, or to cause the direction of the management or policies of an entity, whether such power is exercised through (1) one or more intermediary entities, or alone, or in conjunction with, or pursuant to an agreement with, one (1) or more other entities, whether such power is exercised through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, affiliated entities, contract or any other direct or indirect means. The commission shall presume that the beneficial ownership of more than ten percent (10%) of voting securities or partnership interest of an entity confers control for purposes of this rule. This provision, however, shall not be construed to prohibit a regulated electric corporation from rebutting the presumption that its ownership interest in an entity confers control.

    (C) Fully distributed cost means a methodology that examines all costs of an enterprise in relation to all the goods and services that are produced. Fully distributed cost requires recognition of all costs incurred directly or indirectly used to produce a good or service. Costs are assigned either through a direct or allocated approach. Costs that cannot be directly assigned or indirectly allocated (e.g. general and administrative) must also be included in the fully distributed cost calculation through a general allocation.

    (D) HVAC services means the warranty, sale, lease, rental, installation, construction, modernization, retrofit, maintenance or repair of heating, ventilating and air conditioning (HVAC) equipment.

    (E) Regulated electric corporation means an electrical corporation as defined in section 386.020, RSMo, subject to commission regulation pursuant to Chapter 393, RSMo.

    (F) Utility contractor means a person, including an individual, corporation, firm, incorporated or unincorporated association or other business or legal entity, that contracts, whether in writing or not in writing, with a regulated electric corporation to engage in or assist any entity in engaging in HVAC services, but does not include employees of a regulated electric corporation.

(2) A regulated electric corporation may not engage in HVAC services, except by an affiliated entity, or as provided in section (8) or (9) of this rule.

(3) No affiliated entity or utility contractor may use any vehicles, service tools, instruments, employees, or any other regulated electric corporation assets, the cost of which are recoverable in the regulated rates for regulated electric corporation service, to engage in HVAC services unless the regulated electric corporation is compensated for the use of such assets at the fully distributed cost to the regulated electric corporation.
### Consumer Advocate Proposed Modifications to the 1982 Agreement Conditions

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<td>subsidiaries in which Hawaiian Electric Industries, Inc., or its subsidiaries have a</td>
<td>subsidiaries in which NextEra Energy Hawaiian Electric Industries, Inc., or its subsidiaries have a</td>
<td>assigns, including all subsidiaries in which NextEra Energy Hawaiian Electric</td>
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<td>hereinafter collectively called “Industries”, shall furnish to the Public Utilities</td>
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<td>information that is necessary to fulfill the statutory responsibilities of the</td>
<td>statutory responsibilities of the Commission. Industries shall also provide the same</td>
<td>Commission. The information requested of Industries by the Commission shall</td>
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<td>Commission. Industries shall also provide the same information requested by the</td>
<td>information requested by the Commission to the Public Utilities Division of Consumer Advocacy,</td>
<td>relate to information that is necessary to fulfill the statutory</td>
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<td>Commission to the Public Utilities Division, Department of Commerce and Consumer</td>
<td>Department of Commerce and Consumer Affairs, State of Hawai‘i (&quot;Consumer Advocate&quot;) herein. The</td>
<td>responsibilities of the Commission with respect to the “Utility Corporation”</td>
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<td></td>
<td>Affairs, State of Hawai‘i (&quot;Consumer Advocate&quot;) herein. The Consumer Advocate shall</td>
<td>Consumer Advocate shall utilize the procedures set forth in Section 269-54(d), Hawai‘i</td>
<td>(as that term is defined in Condition No. 3), and be sought from entities</td>
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<td>utilize the procedures set forth in Section 269-54(d), Hawai‘i Revised Statutes, when</td>
<td>Revised Statutes, when it requests such information from Industries.</td>
<td>within NextEra that provide services chargeable to the Utility Corporation.</td>
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<td>it requests such information from Industries.</td>
<td></td>
<td>NextEra Industries shall also provide the same information requested by and</td>
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<td>furnished to the Commission to the Public Utilities-Division of Consumer</td>
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<td>Advocacy, Department of Commerce and Consumer Affairs, State of Hawai‘i (&quot;Consumer</td>
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<td>information from NextEra Industries.</td>
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<td>2</td>
<td>Industries, when requested in writing or in open hearing, shall voluntarily have any</td>
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</tr>
<tr>
<td></td>
<td>employee, officer, director or agent of Industries appear before the Commission for</td>
<td>employee, officer, director, or agent or other representative of Industries appear before</td>
<td>voluntarily have any employee, officer, director, or agent or other</td>
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<tr>
<td></td>
<td>the purpose of testifying before the Commission.</td>
<td>the Commission for the purpose of testifying before the Commission, as necessary to fulfill</td>
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<td>representative of Industries appear before the Commission, as necessary to fulfill</td>
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CA EXHIBIT-19
DOCKET NO. 2015-0022
Page 1 of 10
**Consumer Advocate Proposed Modifications to the 1982 Agreement Conditions**

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<tr>
<td>3</td>
<td>The Commission shall have the right to investigate any matter, activity or transaction between Hawaiian Electric Company, Inc., and its subsidiaries, hereinafter collectively called “Utility Corporation”, and Industries. For purposes of investigation, the Commission shall have the right to enter the premises of Industries during normal working hours and to review any and all records, books or documents of every nature and kind which relate to the investigation or inquiry.</td>
<td>The Commission shall have the right to investigate any matter, activity or transaction between Hawaiian Electric Company, Inc., and its subsidiaries, hereinafter collectively called “Utility Corporation”, and any entities within NextEra Industries that provide services chargeable to the Utility Corporation, as may be necessary to fulfill the statutory responsibilities of the Commission with respect to the Utility Corporation. For purposes of investigation, the Commission shall have the right to enter the premises of Hawaiian Electric Holdings Industries during normal working hours and to review any and all records, books or documents of every nature and kind which relate to the investigation or inquiry.</td>
</tr>
<tr>
<td>4</td>
<td>Industries shall furnish to the Commission and the Consumer Advocate the following: (1) quarterly and annual financial statements in reasonable detail; (2) annual consolidated financial statements, in reasonable detail, certified by independent certified public accountants; and (3) consolidating statements involved in the preparation of the financial statements together with an explanation of the nature of intercompany transactions and the basis of any allocations made.</td>
<td>Hawaiian Electric Holdings Industries shall furnish to the Commission and the Consumer Advocate the following: (1) quarterly and annual financial statements in reasonable detail; (2) annual consolidated financial statements, in reasonable detail, certified by independent certified public accountants; and (3) consolidating statements involved in the preparation of the financial statements together with an explanation of the nature of intercompany transactions and the basis of any allocations made.</td>
</tr>
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<td>5</td>
<td>The Commission and the Consumer Advocate shall have the right to review any intercompany charges and allocations of common expenses between the Utility</td>
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## Consumer Advocate Proposed Modifications to the 1982 Agreement Conditions

<table>
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<tr>
<th>Corporation and Industries. Such allocations shall include, but not be limited to:</th>
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<th>Corporation and NextEra Industries Energy, Inc. and each affiliate of NextEra. Such allocations shall include, but not be limited to:</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Salaries of personnel who perform duties for the utility as well as an affiliate; and other related expenses such as payroll taxes, pension and group insurance costs, travel and reimbursable expenses.</td>
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<td>b) Common expenses for facilities, including rent, taxes, depreciation and insurance.</td>
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<td>c) Expenditures for outside services such as legal counsel, auditing, advertising and public relations.</td>
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<tr>
<td>d) Construction costs, including equipment and materials expended thereon.</td>
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</table>

Any intercompany charges and allocations not deemed proper for ratemaking and quality of service purposes may be disregarded by the Commission in determining allowable expenses, revenues, rate base and rate of return for the Utility Corporation.

Any plant or property carried on the books of the Utility Corporation shall be subject to review by the Commission for determination of its qualification as being "used or useful" in utility operation. The Commission may exclude from the rate base any assets determined to be non-utility in nature, so long as any related income and expenses are excluded from earnings in determining rate of return.

The Commission shall continue to have full authority over the Utility Corporation’s issuance of securities. Normally the Commission will not approve the issuance of

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The Commission shall continue to have full authority over the Utility Corporation’s issuance of securities. Normally the Commission will not approve the issuance of
any securities, which would result in long-term debt being more than 60%, or common equity being less than 35% of the Utility Corporation’s capitalization. For this purpose, short-term bank loans utilized for interim financing of capital projects shall not be included as part of capitalization. The capitalization ratio restrictions in this paragraph shall in no way be construed to mean that the Commission has relinquished its right to review at any time the Utility Corporation’s financial policies.

<table>
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<tr>
<th>8</th>
<th>The Utility Corporation shall obtain its own interim and long-term borrowing as in the pre-corporate-restructuring period. Any cash advances made to the Utility Corporation by Industries shall bear interest at a rate not higher than that currently being paid on the Utility Corporation’s principal bank borrowings.</th>
</tr>
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<tbody>
<tr>
<td>9</td>
<td>The Utility Corporation shall not loan directly or indirectly any funds to Industries without prior Commission approval. Any loans made hereunder shall be evidenced by a Note of Indebtedness specifying principal amount, interest rate and maturity date. Such loans shall bear interest at a rate not less than that paid by Industries on its principal bank loans.</td>
</tr>
<tr>
<td>10</td>
<td>The Utility Corporation shall not pay cash dividends to its stockholders in excess of 80% of its earnings available for payment of dividends in its current fiscal year and preceding five years less the amount of dividends paid by the Utility Corporation during such period when the Utility Corporation consolidated common equity is less than 35% of total capital. In the event of any securities, which would result in long-term debt being more than 60%, or common equity being less than 35% of the Utility Corporation’s capitalization. For this purpose, short-term bank loans utilized for interim financing of capital projects shall not be included as part of capitalization. The capitalization ratio restrictions in this paragraph shall in no way be construed to mean that the Commission has relinquished its right to review at any time the Utility Corporation’s financial policies.</td>
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The Utility Corporation shall not loan directly or indirectly any funds to NextEraIndustries without prior Commission approval. Any loans made hereunder shall be evidenced by a Note of Indebtedness specifying principal amount, interest rate and maturity date. Such loans shall bear interest at a rate not less than that paid by NextEraIndustries on its principal bank loans.

The Utility Corporation shall not pay cash dividends to its stockholders in excess of 80% of its earnings available for payment of dividends in its current fiscal year and preceding five years less the amount of dividends paid by the Utility Corporation during such period when the Utility Corporation consolidated common equity is less than 35% of total capital. In the event of
### Consumer Advocate Proposed Modifications to the 1982 Agreement Conditions

<table>
<thead>
<tr>
<th>Article</th>
<th>Proposed Modification</th>
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<tbody>
<tr>
<td>11</td>
<td>The Utility Corporation shall not redeem any of its common stock without prior approval of the Commission.</td>
</tr>
<tr>
<td>12</td>
<td>In any transactions with affiliates, the Utility Corporation and the affiliates shall deal fairly with each other, and where appropriate, NextEraIndustries shall retain and rely upon the advice of independent experts to assure such fairness.</td>
</tr>
<tr>
<td>13</td>
<td>The Utility Corporation shall not transfer any of its property which is or was in the rate base nor assume any liabilities of Industries, directly or indirectly, without the prior approval of the Commission. The determination of the transfer value and the accounting and ratemaking treatment thereof shall be determined by the Commission at the time of approval of such transfer.</td>
</tr>
<tr>
<td>14</td>
<td>The accounts, accounting methods and procedures of Industries shall be maintained in such manner that they will accurately reflect, under generally accepted accounting principles, the operations, assets and liabilities and the overall financial condition of the Utility.</td>
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## Consumer Advocate Proposed Modifications to the 1982 Agreement Conditions

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<td>15</td>
<td>Industries shall always maintain a complete set of their books of accounts and supporting records in the State of Hawai‘i.</td>
</tr>
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<td>16</td>
<td>Industries shall not sell or otherwise divest itself of any of the common stock of the Utility Corporation without the prior approval of the Commission. The acquisition of Hawaiian Electric Industries, Inc., by a third party, whether by purchase, merger, consolidation or otherwise, shall require prior written approval of the Commission.</td>
</tr>
<tr>
<td>17</td>
<td>In any of the foregoing matters, the information obtained by the Commission and its Staff and/or the Consumer Advocate and its Staff shall be considered as having been obtained for the sole purpose of properly exercising the Commission’s jurisdiction over the Utility Corporation. Information relating to the assets, liabilities, income and expenses of Hawaiian Electric Industries, Inc., except in cases where they are material or relevant in a proceeding before the Commission, or before the courts; said determination of materialness or relevance to be determined by the presiding body.</td>
</tr>
<tr>
<td>If at any time, the Commission finds that the Utility Corporation or Industries is not complying in good faith with the provisions of this order, the following procedures will be instituted:</td>
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<td>a) The Utility Corporation or Industries or both shall be notified in writing of the action, circumstance or condition which requires correction and the measures necessary to rectify the situation.</td>
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<td>b) Industries shall have a minimum of ten days, unless extended further by the Commission, in which to undertake the corrective measures.</td>
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<td>c) If Industries fails to undertake a correction of the breach of the Agreement, the Consumer Advocate may initiate a request for an order to show cause from the Commission or the Commission may institute a show cause proceeding.</td>
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<td>d) If Industries fails, after hearing and a decision rendered, to comply with the Commission's order to rectify the breach of this Agreement, the Commission may take appropriate action to assure compliance with this Agreement, including, without limitation, issuing an order requiring Industries (or its successor as parent company of the Utility Corporation) to divest itself of its ownership of the Utility Corporation’s common stock under terms and conditions which will take into consideration the best interests of the Utility Corporation’s customers, employees and stockholders.</td>
<td>d) If NextEraIndustries fails, after hearing and a decision rendered, to comply with the Commission's order to rectify the breach of this Agreement, the Commission may take appropriate action to assure compliance with this Agreement, including, without limitation, issuing an order requiring NextEraIndustries (or its successor as parent company of the Utility Corporation) to divest itself of its ownership of the Utility Corporation’s common stock under terms and conditions which will take into consideration the best interests of the Utility Corporation’s customers, employees and stockholders.</td>
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## Consumer Advocate Proposed Modifications to the 1982 Agreement Conditions

**Industries** represents that the proposed merger and corporate restructuring are designed for the following purposes:

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<tr>
<td><strong>a)</strong></td>
<td>To separate the operations now conducted by Hawaiian Electric Company, Inc. from future diversified activities which will be nonutility in nature. Such diversified activities, if conducted by the present corporation, either directly or through a subsidiary, could involve the Utility Corporation’s assets and credit. If undertaken by an affiliate, there would be no involvement of the utility, thus permitting the utility’s activities to be confined to an area more clearly delineated for regulation by the Commission.</td>
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<td><strong>b)</strong></td>
<td>To facilitate vertical integration which would be accomplished by entry into alternate energy business by non-regulated affiliates of the Utility Corporation which could supply energy to the Utility Corporation.</td>
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<td><strong>c)</strong></td>
<td>To provide a means of assisting the efforts to enhance commercialization of alternate energy technologies.</td>
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<td><strong>d)</strong></td>
<td>To allow greater flexibility in the financing of certain activities in the alternate energy and other fields because the restrictive covenants in various instruments under the first mortgage bonds and other securities of the Utility Corporation would not apply.</td>
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**NextEraIndustries** represents that the proposed merger and corporate restructuring are designed for the following purposes:

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<td><strong>a)</strong></td>
<td>The Agreement and Plan of Merger was entered into for the purpose of transferring control of the Hawaiian Electric Companies from Hawaiian Electric Industries, Inc. (&quot;HEI&quot;) to &quot;Hawaiian Electric Holdings,&quot; a wholly owned subsidiary of NextEra Energy. To separate the operations now conducted by Hawaiian Electric Company, Inc. from future diversified activities which will be nonutility in nature. Such diversified activities, if conducted by the present corporation, either directly or through a subsidiary, could involve the Utility Corporation’s assets and credit. If undertaken by an affiliate, there would be no involvement of the utility, thus permitting the utility’s activities to be confined to an area more clearly delineated for regulation by the Commission.</td>
</tr>
<tr>
<td><strong>b)</strong></td>
<td>The Proposed Change of Control is expected to improve the financial status of the Hawaiian Electric Companies, result in lower costs and customer savings, strengthen and accelerate the Hawaiian Electric Companies’ clean energy plans and transformation, and enhance the Hawaiian Electric Companies’ ability to continue providing safe and reliable service to their customers. To facilitate vertical integration which would be accomplished by entry into alternate energy business by non-regulated affiliates of the Utility Corporation.</td>
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<tr>
<td>20</td>
<td>In construing or interpreting this document, the construction or interpretation which most favors the regulation and control over the Utility Corporation shall be applied.</td>
</tr>
<tr>
<td>21</td>
<td>For good cause shown, the parties to this Agreement or the Consumer Advocate may request that this Agreement be amended in whole or in part, but this Agreement may not be amended without mutual consent of the parties to the Agreement.</td>
</tr>
<tr>
<td>22</td>
<td>Industries agrees that this Agreement shall be binding on its successors and assigns.</td>
</tr>
<tr>
<td>23</td>
<td>All papers to be served by either party regarding this Agreement shall utilize the procedures outlined in Section 2-3 of the Rules of Practice and Procedure of the Commission.</td>
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### Consumer Advocate Proposed Modifications to the 1982 Agreement Conditions

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<th>This Agreement shall be governed by the laws of the State of Hawai‘i and of the United States of America.</th>
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DIRECT TESTIMONY AND EXHIBITS

OF

MAXIMILIAN CHANG

ON BEHALF OF
THE DIVISION OF CONSUMER ADVOCACY

SUBJECT: RELIABILITY, CLEAN ENERGY, COMPETITION, AND MANAGEMENT AND PERFORMANCE
DIRECT TESTIMONY OF MAXIMILIAN CHANG

I. INTRODUCTION.

Q. PLEASE STATE YOUR NAME, POSITION, AND PLACE OF EMPLOYMENT.

A. My name is Maximilian Chang and I am a Principal Associate with Synapse Energy Economics, an energy consulting company located at 485 Massachusetts Avenue, Cambridge, Massachusetts.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS CASE?

A. I am testifying on behalf of the Department of Commerce and Consumer Affairs of the State of Hawaii, as represented by the Division of Consumer Advocacy (“Consumer Advocate”).

Q. PLEASE DESCRIBE SYNAPSE ENERGY ECONOMICS.

A. Synapse Energy Economics (“Synapse”) is a research and consulting firm specializing in energy and environmental issues, including: electric generation, transmission and distribution system reliability, market power, electricity market prices, stranded costs, efficiency, renewable energy, environmental quality, and nuclear power.
Q. PLEASE STATE YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGROUND.

A. My experience is summarized in my resume, which is attached as CA Exhibit-21. I am an environmental engineer and energy economics analyst who has analyzed energy industry issues for more than seven years. In my current position at Synapse, I focus on many aspects of the electric power industry, including assessment and implementation of energy efficiency and demand response alternatives, as well as economic and technical analysis of nuclear power, wholesale and retail electricity markets, and renewable resource alternatives. I have been an author and project coordinator for two biennial New England Avoided Energy Supply Component reports used by energy efficiency program administrators in the six New England states to evaluate energy efficiency programs. I have provided testimony on electric utility merger related matters in the District of Columbia, New Jersey, and Delaware.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to evaluate whether the proposed merger ("the Merger" or "Proposed Transaction") of NextEra Energy, Inc. ("NextEra") and Hawaiian Electric Companies¹ (collectively, "the Applicants," "the Joint

¹ Hawaiian Electric Companies ("HECO Companies") includes Hawaiian Electric Company, Inc. ("Hawaiian Electric" or "HECO"), Hawai’i Electric Light Company, Inc. ("Hawai’i Electric Light" or "HELCO"), and Maui Electric Company, Limited ("Maui Electric" or "MECO").
Applicants”) provides benefits to ratepayers in connection with the following issues identified by the Hawaii Public Utilities Commission (“the Commission”).

<table>
<thead>
<tr>
<th>Issue Number</th>
<th>Issue Description</th>
<th>Response</th>
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<tbody>
<tr>
<td>1(a)</td>
<td>Whether the approval of the Proposed Transaction would be in the best interests of the State’s economy and the communities served by the HECO Companies.</td>
<td>Inconclusive</td>
</tr>
<tr>
<td>1(c)</td>
<td>Whether the Proposed Transaction will impact the ability of the HECO Companies’ employees to provide safe, adequate, and reliable service at reasonable rates.</td>
<td>Inconclusive</td>
</tr>
<tr>
<td>1(f)</td>
<td>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.</td>
<td>Inconclusive</td>
</tr>
<tr>
<td>1(g)</td>
<td>Whether the Proposed Transaction, if approved, will enhance or detrimentally impact the state’s clean energy goals.</td>
<td>Inconclusive</td>
</tr>
<tr>
<td>1(h)</td>
<td>Whether the transfer, if approved, would potentially diminish competition in Hawaii’s various energy markets and, if so, what regulatory safeguards are required to mitigate such adverse impacts.</td>
<td>Yes</td>
</tr>
</tbody>
</table>

2 Docket No. 2015-0022, Order No. 32739, pp 8-10.
Q. WOULD YOU SUMMARIZE WHY YOU HAVE RESPONDED “INCONCLUSIVE” TO ISSUES 1(A), 1(C), 1(F), 1(G), AND 2(B) IN THIS TABLE?

A. My review and testimony is focused upon specific issues raised by the Commission and discussed in the Proposed Transaction and the related Application. My findings are summarized below.

For Issue 1(a), I find that the impact of the Proposed Transaction is at this point inconclusive since the Applicants do not provide specific commitments to benefit low-income customers. In addition, I find that the Applicants have claimed a benefit for future charitable contributions by committing to maintain the status quo. The Applicants have not discussed how they will ensure the spin-off of American Savings Bank (“ASB”) Hawaii or NextEra will maintain or increase charitable contributions in Hawaii.

For Issues 1(c) and 2(b), I find that the impact of the Proposed Transaction is at this point inconclusive whether or not it is in the public
interest because the Applicants have not provided any specific commitments
to improve reliability nor have they made any specific commitments to link
reliability improvements to specified budgets. For issue 1(c), I also find the
Applicants’ commitment of no involuntary workforce reductions for two years
does not address voluntary reductions in the HECO Companies workforce nor
does it address concerns about the HECO Companies aging workforce that
could impact performance in future years.

For issue 1(f), I find that the impact of the Proposed Transaction is
inconclusive because the Applicants have not provided specific assurances
through ring-fencing measures to protect Hawaii customers from possible
future decommissioning costs associated with NextEra’s nuclear generation
fleet.

For Issue 1(g), I find that the Applicants have touted NextEra’s clean
energy portfolio, however, almost all of Florida Power and Light’s (“FPL”)
renewable energy assets are outside of its FPL service territory. Thus, I find it
inconclusive whether NextEra will be able to enhance or detrimentally impact
the state’s clean energy goals since it is unclear how NextEra’s unregulated
affiliates with renewable energy experience will assist the HECO Companies.
Q. WOULD YOU SUMMARIZE WHY YOU HAVE RESPONDED “YES” TO ISSUES 1(H) AND (6) IN THE TABLE?

A. For Issue 1(h), I find that the Proposed Transaction could diminish competition in the competitive Request For Proposal (“RFP”) process in that potential bidders may be dissuaded from participating since NextEra would be both a potential bidder and the issuer of the RFP.

For Issue (6), I have provided a list of conditions at the end of my testimony that addresses the concerns that I have found in the issues that I have reviewed.

I understand that other witnesses sponsored by the Consumer Advocate will address other questions and/or other elements of the issues identified by the Commission.

II. ISSUE 1(A): CONCERNS ABOUT PROTECTIONS FOR LOW-INCOME CUSTOMERS.

Q. WHAT ARE YOUR FINDINGS AND CONCERNS REGARDING LOW-INCOME CUSTOMERS?

A. I find it problematic that the Applicants have not provided any commitments directly targeting low-income customers. While I acknowledge that the Applicants' commitment to maintain charitable contributions at current levels benefits charities and foundations, this commitment does not directly address low-income customers.
Q. WHAT ARE THE NEXTERA-HAWAIIAN ELECTRIC COMPANIES WILLING TO COMMIT TO ASSIST LOW-INCOME CUSTOMERS DIRECTLY?

A. The Applicants' exhibits do not mention low-income customers specifically, so I could not find anything in the Application that addresses concerns of low-income customers. That said, I do acknowledge that the Applicants' expectation to lower electric rates "for customers than would otherwise be the case" would benefit all ratepayers, including low-income ratepayers. Further, I agree with the Applicants' observation that high electric rates do impact disposable income, affecting ratepayers' ability to spend or save.

Q. HAVE YOU SEEN COMMITMENTS TO LOW-INCOME RATEPAYERS IN OTHER MERGER PROCEEDINGS?

A. Yes. The Maryland Public Service Commission's Order No. 86990 approving the Exelon Pepco Merger required that $6.3 million (20 percent) of the $31.5 million Customer Investment Fund be targeted towards low- to

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3 Applicants Exhibit-7 at 14:14-15.

4 Applicants Exhibit-7 at 14:16-17.
moderate-income energy efficiency programs. This condition is in addition to the $48.6 million rate credit ($100 per customer) for residential customers.

Q. WHAT ARE YOUR RECOMMENDATIONS FOR THE APPLICANTS TO ADDRESS LOW-INCOME RATEPAYERS?

A. I recommend that the Commission require that the Applicants develop specific programs to benefit low-income customers directly. The Commission may deem it necessary that the HECO Companies coordinate with other agencies to determine the most appropriate mechanism to benefit low-income customers to avoid duplication.

III. ISSUE 1(A): CONCERNS ABOUT THE APPLICANTS’ CHARITABLE CONTRIBUTIONS COMMITMENT.

Q. WHAT ARE YOUR FINDINGS REGARDING YOUR CONCERNS ABOUT CHARITABLE CONTRIBUTIONS?

A. I am concerned that the Applicants have claimed a benefit for its charitable contributions by maintaining the status quo of the Hawaiian Electric Industries’ (“HEI”) current contribution levels. While it is laudable that NextEra has committed to maintain charitable donations for the Hawaiian Electric Industries, this does not address the specific needs of low-income customers.


Companies at an amount equal to $2.2 million, this amount is merely what is being done currently Pre-Transaction.\textsuperscript{7} It only becomes an overall benefit to Hawaii when 1) one presumes that the ASB Hawaii spin-off will maintain some level of charitable contributions, that are unknown at this point, and 2) NextEra maintains its level of charitable contributions in Hawaii.

Q. PLEASE EXPLAIN THE APPLICANTS’ CHARITABLE CONTRIBUTIONS COMMITMENT.

A. The Applicants have indicated that they will maintain the HEI consolidated level of charitable giving of $2.2 million.\textsuperscript{8} This would include charitable contributions made by ASB Hawaii that would be spun off should the merger close.\textsuperscript{9} The Applicants note that the amount of the funding is in nominal dollars, and not in real dollar terms.\textsuperscript{10} Moreover, the Applicants have not indicated the duration of this commitment.\textsuperscript{11} In future years, the Applicants have not committed to specified spending levels beyond 2015.\textsuperscript{12} On one hand, the Applicants represent that the $2.2 million is a floor to their planned

\textsuperscript{7} Applicants Exhibit-1. April 13, 2015, at 15:4.
\textsuperscript{8} Applicants Exhibit-1. April 13, 2015, at 15:4.
\textsuperscript{9} Applicants Exhibit-1. April 13, 2015, at 15:5.
\textsuperscript{10} Applicants’ response to CA-IR-331.
\textsuperscript{11} Applicants’ response to DBEDT-IR-60.
\textsuperscript{12} Applicants’ response to DOD-IR-108.
giving and does not preclude them from increasing charitable contributions to
account for future inflation or for other reasons.\textsuperscript{13} On the other hand, the
Applicants also indicated in an earlier information request that they did not
foresee any increase in charitable contributions.\textsuperscript{14} This inconsistent set of
responses is indicative of the Application. Thus, it appears that the Applicants
are claiming a benefit of the Merger when they are just maintaining the status
quo.

Q. BESIDES THE ASSERTION IN APPLICANTS EXHIBIT-7, IS THERE ANY
ADDITIONAL INFORMATION ON NEXTERA’S CHARITABLE
CONTRIBUTIONS IN HAWAII?

A. Yes, NextEra has provided a total of $37,000 ($20,000 in 2014 and $17,000 in
2015 to date) in charitable giving and sponsorships in Hawaii.\textsuperscript{15} In contrast,
on Applicants Exhibit-7, page 23, Applicants contend that “Since 2010,
NextEra Energy and its subsidiaries and employees have contributed more
than $48 million in cash contributions and more than 180,000 hours. . . .”
It appears that NextEra has only recently participated in community building in
Hawaii through charitable contributions and at a very low level relative to the
NextEra’s overall cash contributions.

\textsuperscript{13} Applicants’ response to CA-IR-331.

\textsuperscript{14} Applicants’ response to CA-IR-177.

\textsuperscript{15} Applicants Exhibit-14, page 1 of 6.
Q. WHAT IS YOUR CONCERN IF THE APPLICANTS ARE MAINTAINING THE CONSOLIDATED HEI LEVEL OF CHARITABLE CONTRIBUTIONS IF THE MERGER IS APPROVED?

A. My concern is that the wording of the Applicants’ commitments for charitable contributions at best maintains the current aggregate level of HEI’s current charitable contributions within Hawaii. The Applicants assertion about increased aggregate levels of charitable giving occurs if 1) the ASB Hawaii spinoff maintains some level of charitable donations, which is unknown at this point, and 2) if NextEra maintains its levels of charitable contributions in Hawaii.

The Applicants have noted that this would result in more charitable giving if the ASB Hawaii spin-off continues to provide charitable giving.\(^{16}\) Even if this were the case, the Applicants’ maintenance of ASB Hawaii’s $1.3 million ($2,200,000 - $850,680\(^{17}\)) (the average of the Hawaiian Electric Companies charitable donations)) in charitable giving pales to the $599 million in shareholder premium based on the announced acquisition price and the trading value of HEI stock.\(^{18}\) Should the new ASB Hawaii or NextEra reduce its future charitable contributions, then the aggregate increase in the dollar amount of charitable contributions could be reduced in Hawaii.

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\(^{16}\) Applicants Exhibit-1, April 13, 2015, at 15:6.

\(^{17}\) Applicants’ response to DOD-IR-107.

\(^{18}\) See Applicants’ response to OP-IR-17, Attachment 1. The $599 million does not include the $0.50 dividend, nor the $8.00/share ASB Hawaii spinoff.
Q. WHAT ARE YOUR RECOMMENDATIONS REGARDING THE APPLICANTS’ CHARITABLE CONTRIBUTIONS COMMITMENT?

A. First, it should be made clear that charitable contributions are not recoverable from customers. I understand that the Consumer Advocate has consistently rejected attempts to recover charitable contributions from customers in past rate proceedings and the Commission has supported those efforts. Instead, charitable contributions should be a symbol of the regulated company’s (and its affiliates’) commitment to the community and desire to be a good corporate citizen. Thus, the Commission should require that NextEra maintain or increase its current charitable contributions in real dollar terms and that the Applicants ensure that, as part of the spinoff of ASB Hawaii, the new owner also maintains or increases the overall level of charitable contributions such that the aggregate level of charitable contributions in Hawaii exceeds the pre-transaction level.

IV. ISSUES 1(C) AND 2(B): CONCERNS ABOUT SERVICE QUALITY AND RELIABILITY.

Q. PLEASE SUMMARIZE YOUR CONCERNS REGARDING THE APPLICANTS’ PROPOSED RELIABILITY COMMITMENTS.

A. As I discuss below, my concern is that the Applicants’ reliability commitment is unknown at this time and is contingent upon the Commission’s approval of the merger. Furthermore, the Applicants do not intend to seek approval from the
Commission in establishing their reliability commitment. In effect, the Applicants are asking the Commission to trust their judgment. The Applicants have not provided the Commission sufficient information regarding their post-merger reliability goals or the associated costs of achieving these goals. Thus, it is unclear whether the Applicants are truly fit, willing, and able to improve the reliability performance of the Hawaiian Electric Companies.

8 Q. WHAT IS THE APPLICANTS’ PROPOSED RELIABILITY COMMITMENT FOR THE HAWAIIAN ELECTRIC COMPANIES?

9 A. As stated in the direct testimony of Mr. Gleason, NextEra has committed that upon approval of the merger:

10 NextEra Energy commits to making reasonable improvements in service reliability with reference to a baseline year (to be established post-closing of the Proposed Change of Control) using performance standards such as System Average Interruption Duration Index (“SAIDI”) and System Average Interruption Frequency Index (“SAIFI”).

11 This commitment does not establish a quantifiable level of reliability improvement, and it only offers suggested metrics such as SAIDI and SAIFI.

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Q. ARE LOWER VALUES FOR SYSTEM AVERAGE INTERRUPTION DURATION INDEX (“SAIDI”), SYSTEM AVERAGE INTERRUPTION FREQUENCY INDEX (“SAIFI”), AND CUSTOMER AVERAGE INTERRUPTION DURATION INDEX (“CAIDI”) A GOOD INDICATION OF RELIABILITY?

A. Yes. Lower SAIDI, CAIDI, and SAIFI values reflect shorter outage durations for the system (SAIDI) and for customers (CAIDI), and fewer system interruptions (SAIFI). Thus, a reported SAIDI value that is lower than a given commitment or requirement would mean better reliability. Conversely, a SAIDI value that is higher than a given commitment or requirement would mean worse reliability.

Q. ARE THERE CURRENT RELIABILITY REQUIREMENTS FOR THE HAWAIIAN ELECTRIC COMPANIES?

A. No. I am not aware of any currently required reliability performance targets for the Hawaiian Electric Companies. The issue of reliability requirements is, however, pending before the Commission in Docket No. 2013-0141 as part of the conventional performance incentive mechanisms discussed in Schedule B of Docket No. 2013-0141.

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20 Applicants’ response to HREA-IR-15.

21 Docket No. 2013-0141, Order No. 32735, Appendix A. See also Initial Briefs and Reply Briefs regarding Schedule B issues were filed by all parties, including the Consumer Advocate, on June 1, 2015 and June 15, 2015, respectively.
Q. DO THE APPLICANTS PROVIDE THE HISTORICAL RELIABILITY PERFORMANCE OF THE HAWAIIAN ELECTRIC COMPANIES IN THE APPLICATION TO PROVIDE SOME CONTEXT?

A. Not as part of the Application. In response to interrogatories, the Applicants provide the historical reliability performance for the Hawaiian Electric Companies and FPL. The Hawaiian Electric Companies have, however, been filing reliability performance reports with the Commission. In addition, as part of Docket No. 2013-0141, the Hawaiian Electric Companies have recently made some of its historical reliability performance available online.\(^\text{22}\) However, FPL and the Hawaiian Electric Companies use different methodologies to adjust, or normalize, their reliability indices.\(^\text{23}\) In follow-up interrogatories, the Applicants provide the reliability performance for both the Hawaiian Electric Companies and FPL under a common normalization methodology.\(^\text{24}\)


\(^{23}\) Applicants’ response to CA-IR-172.

\(^{24}\) Applicants’ response to CA-IR-324.
Q. HOW DOES THE RELIABILITY OF THE HAWAIIAN ELECTRIC COMPANIES COMPARE WITH THAT OF FPL?

A. On both a SAIDI and SAIFI basis, FPL has performed better than the Hawaiian Electric Companies when using the same methodology—the Institute of Electrical and Electronics Engineers (“IEEE”) 2.5 Beta Methodology—to adjust for major events for both FPL and the Hawaiian Electric Companies. The Hawaiian Electric Companies adjust for major events following the Commission’s 1990 guidance and FPL adjusts for major events per Florida Administrative Code, Rule 25-6.0455. Certainly, FPL’s distribution system appears more reliable than the Hawaiian Electric Companies based on SAIDI and SAIFI.

Q. HOW DO THE HAWAIIAN ELECTRIC COMPANIES COMPARE TO THEIR PEERS IN TERMS OF RELIABILITY?

A. Understandably, specific circumstances such as geography, climate, and storm patterns all play a role in influencing a utility’s reliability performance. That aside, utilities, including the Hawaiian Electric Companies, participate in peer group benchmarking studies to compare themselves to other utilities. Generally in the last few years, Hawaiian Electric has performed in the third or

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25 Ibid.

26 Ibid.
fourth quartile relative to other participating utilities. MECO and HELCO have not participated in benchmarking studies since 2010 and 2011, respectively. Generally, Hawaiian Electric has better reliability performance relative to MECO and HELCO, so I would infer that MECO and HELCO would receive a similar rank as Hawaiian Electric if they had been included in similar benchmarking studies. While the Hawaiian Islands have unique circumstances and challenges with reference to reliability, that should not be an excuse for the Hawaiian Electric Companies to have third or fourth quartile reliability relative to other utilities consistently year to year.

Q. DOES FPL PARTICIPATE IN BENCHMARKING STUDIES?

A. FPL does participate in benchmarking studies, but does not report its results due to confidentiality agreements. FPL does track itself relative to its peer utilities in Florida.

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27 Applicants’ Response to CA-IR-292, Attachment 1.

28 First quartile represents the top 25 percent. Conversely, fourth quartile represents the bottom 25 percent.

29 Applicants’ response to CA-IR-292, Attachment 1.


31 Applicants’ response to CA-IR-328. While the response is specific to the Hawaiian Electric Companies, I understand that FPL cannot release its relative performance in Edison Electric Institute surveys for similar confidentiality reasons.
Q. HAVE THE APPLICANTS QUANTIFIED POST-MERGER RELIABILITY IMPROVEMENTS TO HELP DETERMINE A POST-MERGER RELIABILITY COMMITMENT?
A. No, the Applicants have not quantified nor commissioned any analyses on how NextEra would favorably impact the ability of the Hawaiian Electric Companies to provide safe, adequate, and reliable service.32

Q. WILL THE APPLICANTS SEEK THE COMMISSION’S APPROVAL TO ESTABLISH A RELIABILITY COMMITMENT?
A. No, I understand the Applicants will not seek the Commission’s approval in establishing a reliability commitment, but would be willing to address questions or concerns about the established baseline reliability enhancement plans developed post-closing.33

Q. HAVE THE APPLICANTS STATED THAT THEY WILL SUBMIT TO A PENALTY IF THE HAWAIIAN ELECTRIC COMPANIES FAIL TO MEET THEIR SELF-IMPOSED RELIABILITY COMMITMENTS?
A. Not specifically. The Applicants have indicated that they are willing to discuss the imposition of penalties and/or incentives associated with future reliability

32 Applicants’ response to CA-IR-286.
33 Applicants’ response to CA-IR-275.
commitments.\textsuperscript{34} However, it appears that the Applicants will make this commitment conditional upon the Commission’s approval of the Merger.

\textbf{Q.} ARE YOU CONCERNED ABOUT THE ESTABLISHMENT OF A BASELINE RELIABILITY STANDARD IN THE ABSENCE OF COMMISSION OR INTERVENOR INPUT?

\textbf{A.} Yes. Simply put, NextEra could propose a baseline reliability commitment that would show minor improvement compared to recent historical reliability performance, but not materially improve the reliability of the Hawaiian Electric Companies. Thus, the Applicants would be able to comply with the letter of the Commission’s merger considerations, but certainly not the spirit of the Commission’s inclinations.

\textbf{Q.} YOU MENTIONED THE HAWAIIAN ELECTRIC COMPANIES’ HISTORICAL RELIABILITY PERFORMANCE. PLEASE SHOW THE HAWAIIAN ELECTRIC COMPANIES’ HISTORICAL RELIABILITY PERFORMANCE AND 2015 INTERNAL COMMITMENTS GRAPHICALLY.

\textbf{A.} Figure MPC 1 and Figure MPC 2 below show the following:

1) Hawaiian Electric Companies’ historical SAIFI (Figure MPC 1) and SAIDI (Figure MPC 2) performance for the last five years and their internal 2015

\textsuperscript{34} Applicants’ response to CA-IR-162.
target for just SAIDI, which I discuss below.\textsuperscript{35,36,37} The Hawaiian Electric Companies do not have a target for SAIFI for 2015.\textsuperscript{38}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure.png}
\caption{Hawaiian Electric Companies' SAIFI (normalized interruptions): Historical (2010-2014)\textsuperscript{39}}
\end{figure}

\begin{itemize}
\item \textsuperscript{35} Applicants’ response to CA-IR-172.
\item \textsuperscript{36} Both figures are presented as normalized values per Commission’s definition for “normalization” that addresses "abnormal" situations such as hurricanes, tsunamis, earthquakes, floods, catastrophic equipment failures, and a single equipment outage that cascades into a loss of load that is greater than ten percent of the system peak load. The definitions are from “Methodology for Determining Reliability Indices for HECO Utilities,” dated December 1990.
\item \textsuperscript{37} Applicants’ response to DOD-IR-95.
\item \textsuperscript{38} Ibid.
\item \textsuperscript{39} http://www.hawaiianelectric.com/heiro/ hidden_Hidden/Community/Service-Reliability?cpsextcurrchannel=1
\end{itemize}
As shown in Figure MPC 1 and Figure MPC 2, HELCO’s historical SAIFI and SAIDI performance has generally lagged behind HECO’s and MECO’s performances. SAIFI trends for the three Hawaiian Electric Companies appear to be increasing, indicating more frequent interruptions. SAIDI appears to be increasing for MECO and HELCO. While HECO’s SAIDI appears to improve between 2010 and 2014, the inter-year variability fluctuates from a high in 2011 of 211 minutes to a low in 2014 of 108 minutes.

Figure MPC 2. Hawaiian Electric Companies’ SAIDI (normalized and in minutes): Historical (2010-2014) and Internal Target (2015)\(^\text{40}\)

\(^{40}\) Ibid.
Q. PLEASE EXPLAIN WHY YOU INCLUDED A 2015 PERFORMANCE METRIC FOR THE HAWAIIAN ELECTRIC COMPANIES.

A. Figure MPC 2 includes an internal performance target for 2015 established by the Hawaiian Electric Companies in February 2015 for the determination of incentive compensation.\(^{41}\) The Hawaiian Electric Companies established these self-imposed reliability metrics on a consolidated basis.\(^{42}\) The 115 minutes target represents an improvement in SAIDI of over two minutes compared to the 2014 consolidated SAIDI of 117.74 minutes or about 2.3 percent.\(^{43}\) The Hawaiian Electric Companies note:

In setting the 2015 reliability target of 115 minutes, the Hawaiian Electric Companies wanted to set a target that resulted improvement over the prior year that would lead to better reliability and customer satisfaction.\(^{44}\)

Figure MPC 2 shows the 2015 goal in relation to the historical performance for each Hawaiian Electric Company. The figure shows that the Hawaiian Electric Companies’ goals only represent a slight improvement over the current reliability trends. In fact, both HECO and MECO met the 2015 target in 2014. Nonetheless, their goals are an improvement over current reliability metrics.

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\(^{41}\) Applicants’ response to CA-IR-328.

\(^{42}\) Applicants’ response to DOD-IR-95.

\(^{43}\) In the Applicants’ response to CA-IR-328, I note that in May 2015, the Hawaiian Electric Companies established a 2020 internal SAIDI target of 100 minutes or an improvement of about 15 percent relative to 2014 performance.

\(^{44}\) Applicants’ response to CA-IR-328.
This example illustrates my concern that, should the Commission approve the merger, NextEra could establish a reliability target such as the one established by the Hawaiian Electric Companies that would result in only a minor improvement to reliability in the absence of the Commission's pre-approval.

Q. WHY IS COMMISSION APPROVAL OF THE HAWAIIAN ELECTRIC COMPANIES’ FUTURE BASELINE RELIABILITY COMMITMENTS CRITICAL?

A. The Hawaiian Electric Companies' internal reliability targets described above reflect easily attainable goals that require only minimal improvement but do not appear to reflect the relationship between reliability and budgets or other initiatives. As the Applicants have noted, the Hawaiian Electric Companies are in the midst of a major transition in other current and future proceedings such as the Power Supply Improvement Plan (“PSIP”), Distributed Generation Improvement Plan (“DGIP”), Integrated Demand Response Portfolio Plan (“IDRPP”), and Smart Grid Roadmap.45 These initiatives may be intrinsically linked to reliability such that the Commission may want to consider how improvements or the lack of improvements in reliability may affect the other Commission initiatives.

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45 Applicants’ response to Tawhiri-IR-6.
Q. ARE THERE OTHER considerations that could affect the Hawaiian Electric Companies’ ability to improve reliability performance?

A. Yes. For instance, operations and maintenance (“O&M”). The Hawaiian Electric Companies will need to maintain and sustain adequate staffing across the islands to maintain and improve reliability. The Applicants will also need to link capital and O&M budgets to appropriate design and construction standards for the Hawaiian Electric Companies’ distribution assets.

Q. HAVE THE APPLICANTS PROVIDED DETAILS REGARDING DESIGN AND CONSTRUCTION STANDARDS IN THE FUTURE?

A. No. In response to discovery, the Applicants stated that they are just in the initial stages of the integration process. The integration process could also impact planning and O&M programs. Such integration may take several years and the Applicants have only recently started to form integration committees.

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46 Applicants’ response to CA-IR-22.
48 Applicants’ response to DOD-IR-37.
49 Applicant’s response to DOD-IR-35.
50 Applicants’ response to CA-IR-298.
Q. SO, HOW MEANINGFUL IS THE APPLICANTS’ RELIABILITY BASELINE COMMITMENT IN LIGHT OF YOUR ANALYSIS?

A. It is not meaningful because the Commission will only learn about the Applicants’ commitment sometime after approving the merger. Thus, the Applicants have not provided sufficient information for the Commission to determine if the Proposed Transaction could yield a meaningful improvement in reliability and at what cost.

Q. PLEASE STATE YOUR CONCERNS REGARDING THE APPLICANTS’ COMMITMENTS FOR BASELINE RELIABILITY COMMITMENTS WITHOUT DETAILED BUDGETS.

A. I am concerned that, should the Commission approve the merger, the Applicants may assert that such an approval is at least an implicit endorsement of the budgets that have yet to be provided. My experience with rate cases tells me that the Hawaiian Electric Companies will need to continue to demonstrate to the Commission that their reliability-related expenditures remain reasonable and prudent. With or without a merger, the Hawaiian Electric Companies need to examine ways to improve reliability at a reasonable cost.
Q. HAVE THE APPLICANTS MADE ANY CLAIMS TO LINK RELIABILITY COMMITMENTS TO BUDGETS?

A. No, the Applicants have only indicated that they are open to discussing mechanisms including rewards and penalties. 51

Q. WHAT ARE YOUR RECOMMENDATIONS REGARDING YOUR RELIABILITY CONCERNS?

A. I recommend that there should be a condition requiring the Applicants to develop, within six months of the closing of the Merger's closing, a long-term plan to achieve first quartile reliability performance as measured through benchmarking studies. The reliability performance metrics should include, but not be limited to, standard reliability indices such as SAIDI, SAIFI, and CAIDI and should be based on IEEE 2.5 beta methodology. The plan will need to include budgets with supporting justification and analyses in order to ensure that the Hawaiian Electric Companies are developing a plan that achieves the first quartile goals at reasonable cost. For example, the New Jersey settlement in the Exelon-Pepco merger requires Exelon to provide the New Jersey Board of Public Utilities with a plan to improve Atlantic City Electric's reliability to first quartile performance. 52 A similar planning process

51 Applicants’ response to CA-IR-162.

should be established in Hawaii that is reflective of the Commission's
inclinations and other proceedings. More importantly, such a plan would
enable the Commission to evaluate associated costs to achieve improved
reliability.

V. ISSUE 1(C): CONCERNS ABOUT EMPLOYEE COMMITMENTS.

Q. HAVE THE APPLICANTS PROVIDED DETAILS REGARDING FUTURE
STAFFING REQUIREMENTS AT THE HAWAIIAN ELECTRIC COMPANIES?

A. The Applicants have made a two-year commitment not to institute an
involuntary workforce reduction at the Hawaiian Electric Companies.\(^{53}\)
In response to information requests, the Applicants have indicated that they do
not have current plans to reduce employment levels at the Hawaiian Electric
Companies.\(^{54}\) On the other hand, the Applicants have indicated that the
involuntary workforce commitment is limited to two years.\(^{55}\)

\(^{53}\) Applicants Exhibit-7, at 31:2-3.

\(^{54}\) Applicants’ response to CA-IR-180.

\(^{55}\) Applicants’ response to DBEDT-139.
Q. DOES THE TWO-YEAR COMMITMENT APPLY TO THE HEI EMPLOYEES?

A. It is unclear. On one hand, the Applicants indicate that the two-year commitment applies to the HEI employees. On the other hand, it appears that some of the leadership of HEI are exempted from the involuntary workforce commitment and could receive payouts should the Commission approve the Merger.

Q. HAVE THE APPLICANTS MADE A COMMITMENT TO MAINTAIN OVERALL EMPLOYMENT HEAD COUNTS?

A. No, the Applicants’ commitment only applies to involuntary workforce reductions. The commitment would allow the Hawaiian Electric Companies to evaluate whether or not it will fill unfilled positions. At the end of 2014, the Hawaiian Electric Companies had 107 positions that were unfilled. I understand that the HECO Companies have trended some level of vacancy and the 107 vacancy represents a 4.38 percent vacancy.

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56 Applicants’ response to CA-IR-69.
57 Applicants’ response to CA-IR-341.
59 Applicants’ response to CA-IR-341.
60 Applicants’ response to DBEDT-IR-117. The distribution of unfilled positions were: 27 at MECO, 25 at HELCO, and 55 at HECO.
61 Ibid.
Q. WHY IS THIS DISTINCTION IMPORTANT?

A. I note above that the Applicants have committed to a two-year moratorium on involuntary workforce reduction. However, voluntary reductions still may occur across the Hawaiian Electric Companies as individual circumstances warrant. The pool of bargaining unit employees eligible for retirement (normal and early) is shown in the figure below.

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<tr>
<td>PERCENT OF 2015 BUDGET</td>
<td>27.9%</td>
<td>31.3%</td>
<td>34.2%</td>
<td>37.4%</td>
<td>41.5%</td>
<td>44.8%</td>
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Data From Applicants Response to CA-IR-180.

Figure MPC 3 Annual Number of Employees Eligible for Early or Normal Retirement.

The percentages shown are based from the 1,417 bargaining unit employees of Hawaiian Electric Companies budgeted for 2015. If retirement-eligible employees retire and are not replaced, this process effectively reduces the workforce across the Hawaiian Electric Companies without resorting to involuntary workforce reductions.

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62 Applicants’ response to CA-IR-180.
Q. DO YOU HAVE ADDITIONAL CONCERNS REGARDING THE RETIREMENT ELIGIBLE WORKFORCE?
A. Yes, Figure MPC 3 shows the gradual increase of retirement age bargaining unit employees should the 2015 budgeted headcount remain the same. By 2020, 44.8 percent of the Hawaiian Electric Companies bargaining unit employees will be eligible for early or normal retirement. The HECO Companies’ trend in workforce aging is consistent with findings from a 2011 MIT Study. Also in 2011, the Florida Public Service Commission commissioned a study to assess the issue of aging workforce across the Florida investor owned utilities. The Hawaiian Electric Companies’ data and the studies highlight the concerns about the aging workforce and the loss of institutional knowledge from the loss of experienced employees.

Q. DID THE 2011 FLORIDA PUBLIC SERVICE STUDY IDENTIFY POSSIBLE SOLUTIONS TO ADDRESS AGING WORKFORCE CONCERNS AT FPL?
A. Yes. The report noted that FPL has undertaken several partnerships with local Florida colleges and universities to develop and foster possible hires for

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For instance, the report highlights a program between FPL and Indian River State College that was started in 2006 to develop a skilled worker pipeline targeted to meet FPL’s nuclear division workforce needs in the future. This program is still continuing and has resulted in the hiring of over 60 employees at FPL since 2006.

Q. HAVE RECENT ELECTRIC UTILITY MERGERS ATTEMPTED TO ADDRESS AGING WORKFORCE CONCERNS?

A. Yes. The Maryland Public Service Commission’s (“PSC”) Order approving the Exelon-Pepco Merger required Exelon to fund $4 million workforce development programs within Maryland. The Maryland PSC noted that:

The potential of these initiatives to yield a supply of Maryland-based skilled employees constitutes not only an investment in the community stemming from this transaction, (footnote omitted) but also a likely invaluable contribution to the employment ranks of all Maryland electric companies given the universal issue of a graying workforce in the utility industry. As such, we find that the condition pertaining to the funding of workforce development issues is consistent with the public interest, convenience, and necessity.

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65 Ibid. page 11.
66 Ibid. page 11.
I envision that a similar workforce development partnership with Hawaii institutions could help provide the training necessary to ensure qualified individuals will be available in the future to help address Hawaiian Electric Companies’ workforce needs.

Q. DO YOU HAVE ANY RECOMMENDATIONS FOR THE COMMISSION REGARDING EMPLOYMENT LEVELS?

A. Yes. The Commission should encourage the Applicants’ to identify opportunities to improve the reliability and performance of the Hawaiian Electric Companies as a result of the merger. However, it should be made clear that the Applicants are accountable for their proposed reliability commitments and that staffing changes designed to reduce O&M costs should not occur if they will detrimentally impact the Hawaiian Electric Companies’ obligation to provide safe and reliable service. First and foremost, the Applicants should provide the Commission with workforce estimates and supporting analysis to identify the specific staff requirements necessary to achieve the Hawaiian Electric Companies’ post-merger reliability commitments. Second, I recommend that the Commission require that the Applicants provide shareholder funding to implement a workforce development program between the HECO Companies and local Hawaii institutions similar to FPL’s partnerships in Florida to foster energy sector workforce development.
VI. ISSUE 1(F): FINANCIAL SAFEGUARDS: NUCLEAR.

Q. DO YOU HAVE CONCERNS ABOUT NEXTERA’S NUCLEAR GENERATION FLEET?

Yes. I have concerns that NextEra’s merchant and regulated nuclear generation fleet could impact the Hawaiian Electric Companies without adequate ring-fencing protections should the Commission approve the merger. The Commission should ensure that the Joint Applicants’ proposed ring-fencing measures protect the Hawaiian Electric Companies’ ratepayers from all risks associated with future nuclear decommissioning costs, since the decommissioning process for any one nuclear unit may last up to 60 years upon retirement.

Q. WHY IS IT IMPORTANT FOR THE HAWAII COMMISSION TO CONSIDER THE NEXTERA NUCLEAR FLEET IN WEIGHING THE BENEFITS OF THIS MERGER?

A. The operations of nuclear generation are very complex both organizationally and operationally. I note that the acquisition of the operations of two of the three merchant nuclear stations (Duane Arnold and Point Beach) appear to be the largest organizational absorption made by NextEra in the last 10 years. The two acquisitions required NextEra to integrate 460 employees for Duane Arnold and 596 employees for Point Beach at the time of the

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69 Applicants’ response to CA-IR-340.
acquisition. To date, the Commission has not had to consider the impacts of nuclear operations to the Hawaiian Electric Companies. Should the Commission approve the merger, then the Commission could find itself concerned with the operations and status of the NextEra nuclear fleet.

Q. PLEASE SUMMARIZE NEXTERA’S NUCLEAR GENERATION FLEET CAPACITY AND LOCATION OF NEXTERA’S NUCLEAR UNITS.

A. As stated in Applicants Exhibit-10, NextEra has one of the largest nuclear generation fleets in the country. The Applicants have eight nuclear units within the NextEra/FPL portfolio. The FPL nuclear fleet as of December 31, 2014, represented approximately 23 percent of FPL’s 2014 generation. The four merchant nuclear units represented approximately 28 percent of NextEra Energy 2014 generation. The eight nuclear reactors are in four states: Florida, New Hampshire, Wisconsin, and Iowa. They are summarized below.

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70 Applicants Exhibit-10, at 5 of 160.
71 Applicants Exhibit-10, at 15 of 160.
72 Applicants Exhibit-10, at 24 of 160.
73 Applicants Exhibit-10, at 16 and 24.
<table>
<thead>
<tr>
<th>Unit Location</th>
<th>Year of License Expiration</th>
</tr>
</thead>
<tbody>
<tr>
<td>St. Lucie Unit 1, Florida</td>
<td>2036</td>
</tr>
<tr>
<td>St. Lucie Unit 2, Florida</td>
<td>2043</td>
</tr>
<tr>
<td>Turkey Point Unit 3, Florida</td>
<td>2032</td>
</tr>
<tr>
<td>Turkey Point Unit 4, Florida</td>
<td>2033</td>
</tr>
<tr>
<td>Seabrook, New Hampshire</td>
<td>2030</td>
</tr>
<tr>
<td>Duane Arnold, Iowa</td>
<td>2034</td>
</tr>
<tr>
<td>Point Beach Unit 1, Wisconsin</td>
<td>2030</td>
</tr>
<tr>
<td>Point Beach Unit 2, Wisconsin</td>
<td>2033</td>
</tr>
</tbody>
</table>

**Figure MPC 4. Summary of NextEra/ FPL Nuclear Generation Fleet**

The figure above also summarizes the year when the unit’s nuclear license expires. NextEra currently does not anticipate the first nuclear license expiration to occur before 2030.

Q. HAS NEXTERA PUBLICLY HIGHLIGHTED CONCERNS REGARDING NUCLEAR GENERATION OPERATIONS, EVEN THOUGH THE FIRST LICENSE EXPIRATION IS NOT EXPECTED UNTIL 2030?

A. Yes, in NextEra’s 2014 Form 10-K (Applicants Exhibit-10), NextEra noted that:

The inability to operate any of NEER’s or FPL’s nuclear generation units through the end of their respective operating licenses could have a material adverse effect on NEE’s and FPL’s business, financial conditions, results of operations and prospects.74

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74 Applicants Exhibit-10 at 40 of 160.
For these eight units, a “premature retirement” would be the end of commercial operation at a date earlier than the Nuclear Regulatory Commission (“NRC”) license expiration shown on column d of Figure MPC 4.

Q. WHAT WOULD BE THE RESULT OF EARLIER-TAN-EXPECTED RETIREMENT OF ANY OF THE EIGHT NUCLEAR UNITS?

A. The Applicants describe the impact of a premature unit retirement in detail. These are stated by NextEra as:

The operating licenses for NEE’s and FPL’s nuclear generation facilities extend through at least 2030. If the facilities cannot be operated for any reason through the life of those operating licenses, NEE or FPL may be required to increase depreciation rates, incur impairment charges and accelerate future decommissioning expenditures, any of which could materially adversely affect their business, financial condition, results of operations and prospects.75

Because decommissioning is not merely a technical or safety matter, but also a financial one, the robustness of each plant’s decommissioning savings (the decommissioning fund) is important. The current status of NextEra’s decommissioning fund in aggregate is currently at $5.1 billion.76

The Applicants contend that NextEra/FPL would be solely responsible for decommissioning costs if it gave its corporate parental guarantee and that

75 Applicants Exhibit-10, at 40 of 160.
76 Applicants’ response to CA-IR-185, part a.
Hawaiian Electric Companies’ ratepayers would not bear any liability for nuclear decommissioning of NextEra Generation units.\(^77\)

Q. DO YOU HAVE CONCERNS ABOUT FUTURE NUCLEAR DECOMMISSIONING ASSOCIATED WITH THE NEXTERA NUCLEAR GENERATION UNITS?

A. Yes, I do. Although it is not known whether or when any of the identified units will retire prematurely, and the Applicants assert that Hawaiian Electric Companies’ ratepayers will not bear any liability for decommissioning costs, the decommissioning process is allowed to take up to 60 years for any one unit.\(^78\) Thus, for the two units with 2030 nuclear license expirations, the decommissioning process could extend to 2090. This time period extends well beyond any commitments made by the Applicants.

Q. WHAT ARE YOUR RECOMMENDATIONS?

A. I recommend that the Commission require NextEra to put in place, within six months of the Merger closing, the strongest protections for Hawaiian Electric Companies’ ratepayers to shield them from any costs associated with NextEra’s or FPL’s nuclear plant retirements, premature or otherwise.

\(^77\) Applicants’ response to CA-IR-185. part f.

I recommend that the protections extend as far as the potential end to
decommissioning of each of the Applicants’ nuclear plants and be subject to
Commission approval.

VII. ISSUE 1(G): CLEAN ENERGY: RENEWABLES.

Q. WHAT ARE YOUR FINDINGS REGARDING NEXTERA’S RENEWABLE
ENERGY PORTFOLIO?

A. I am concerned that while NextEra does have a large renewable energy
portfolio, almost all of the portfolio is associated with NextEra’s unregulated
business and almost none of the renewable energy assets are located in FPL,
with the exception of 35 MW of utility-scale solar. Since it appears that FPL
has limited experience with renewable energy resources and it is not known
how the Hawaiian Electric Companies will interact with the unregulated
NextEra Energy affiliates with renewable expertise, I am not sure how the
merger will benefit the Hawaiian Electric Companies’ ability to meet the state’s
aggressive clean energy goals.79

79 http://governor.hawaii.gov/newsroom/press-release-governor-ige-signs-bill-setting-100-
percent-renewable-energy-goal-in-power-sector/
Q. WHAT IS YOUR UNDERSTANDING OF NEXTERA ENERGY RESOURCES’ RENEWABLE ENERGY PORTFOLIO?

A. I acknowledge that NextEra Energy Resources has extensive wind and solar resources throughout North America in its total portfolio of 19,578 MW as of December 31, 2014.80,81 However, I note that none of the 11,427 MW of wind and the 842 MW of solar resources of NextEra Energy Resources are located within Florida as shown in the map provided in Applicants Exhibit-9 and summarized below in Figure MPC 5.82 83 The Applicants further note that no NextEra affiliates, aside from FPL, have developed or operated renewable utility-scale power generation in the FPL service territory.84

Q. WHAT IS YOUR UNDERSTANDING OF FPL’S RENEWABLE ENERGY PORTFOLIO?

A. As of December 31, 2014, only 35 MW of FPL’s fleet of 25,092 MW of net capability are renewable energy resources, and all of that is solar PV.85 FPL has no wind resources, and of its 4.2 million customers, only 2,961 customers

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80 Applicants Exhibit-7, at 21:4-7.
81 Applicants Exhibit-10, at 44-46. Of the total 19,578 MW, 11,427MW is wind, 842MW is solar resources, and the remaining capacity (7,309MW) is comprised of nuclear and fossil fuel units.
82 Applicants Exhibit-10, at 45 and 46.
83 Applicants Exhibit-9, at 1.
84 Applicants’ response to Tawhiri-IR-22.
85 Applicants Exhibit-10, at 43.
have solar PV as of April 2015. A summary of NextEra’s and FPL’s renewable resources is shown below with Florida and Hawaii broken out separately:

<table>
<thead>
<tr>
<th></th>
<th>NextEra (MW)</th>
<th>FPL (MW)</th>
<th>NextEra FL (MW)</th>
<th>NextEra HI (MW)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wind</td>
<td>11,427</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Solar Utility</td>
<td>842</td>
<td>35</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>12,269</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Notes
Data taken from Applicants Exhibit-10, pages 43, 45, and 46.

Figure MPC 5. Summary of NextEra Renewable Resources

Q. WHAT IS YOUR CONCERN ABOUT THE LACK OF RENEWABLES IN FLORIDA GIVEN THE SIZE OF NEXTERA’S GENERATION PORTFOLIO?

A. I am concerned that of the 44,670 MW of generation in the combined NextEra Energy and FPL portfolio, only 35 MW of renewable energy in the form of solar PV is currently located in Florida. As I have noted above, virtually all of NextEra’s renewable resources are affiliated with NextEra Energy Resources, and all of NextEra Energy Resources’ renewable resources are located outside of Florida. The Applicants have asserted that the affiliation with NextEra Energy would help accelerate the Hawaiian Electric Companies’

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86 Applicants’ response to CA-IR-273.

87 Even counting the 3,453 MW of nuclear generation would only bring the total to 3,488 MW of carbon-free generation in Florida.
clean energy transformation. On the other hand, the Applicants have also stated that they do not have current plans or roles for renewable generation affiliates in Hawaii. Thus it is unclear to what extent the Hawaiian Electric Companies will rely upon the expertise of NextEra Energy Resources, the unregulated affiliate of NextEra Energy, and a possible independent supplier in Hawaii.

Q. DOES NEXTERA OWN COAL, OIL, AND NATURAL GAS GENERATION?

A. Yes. As of December 31, 2014, FPL’s fossil fuel fleet was 21,604 MW and NextEra Energy Resources’ fossil fuel fleet was 4,787 MW. By fuel type, 72 percent of FPL’s 2014 generation was from coal (4 percent) and natural gas (68 percent). Including the FPL nuclear units, 95 percent of FPL’s 2014 generation was from fossil fuels or nuclear generation. Based on available data related to FPL, renewable energy resources do not currently contribute materially to Florida’s generation mix.

89 Applicants’ response to DBEDT-IR-3.
90 Applicants’ response to Tawhiri-IR-14, Part b.
91 Applicants Exhibit-10, at 15.
92 Applicants Exhibit-10, at 46.
93 Applicants Exhibit-10, at 15.
Q. BASED ON YOUR ASSESSMENT OF NEXTERA’S AND FPL’S ENERGY
RESOURCES PORTFOLIOS, DO YOU BELIEVE THE PROPOSED
TRANSACTION, IF APPROVED, WILL ENHANCE THE ABILITY OF HAWAII
TO ACHIEVE ITS CLEAN ENERGY GOALS?

A. At this time, I am not sure if the Proposed Transaction will enhance or
detrimentally impact the State’s clean energy goal since NextEra’s sizeable
renewable portfolio is almost entirely outside of its home state of Florida. Of
the 12,304 MW of renewable resources in NextEra’s generation fleet, 12,269
MW, or approximately 99 percent, are located outside Florida. I find it difficult
to accept Applicants’ assertions that they will be willing to advance Hawaii’s
clean energy goals, when one considers that in Florida, where NextEra is
headquartered, very limited renewable energy resources are incorporated in
its generation mix. I recommend that the Commission encourage the
development of cost-effective renewable generation that can help serve the
needs of Hawaiian Electric Companies’ ratepayers and meet the state’s clean
energy goals.
VIII. ISSUE 1(G): CLEAN ENERGY: SMART GRID.

Q. PLEASE STATE YOUR CONCERNS REGARDING THE APPLICANTS’ TO-BE-FILED SMART GRID PROPOSAL.

A. I have concerns that the Applicants are prejudicing expectations of a Smart Grid proposal that has not been filed before the Commission. I find it premature for the Commission to make any determination as to the ability of NextEra to provide additional cost savings to the Hawaiian Electric Companies in the absence of any definitive plans or analyses.

Q. HAS FPL DEPLOYED SMART METERS ACROSS ITS SERVICE TERRITORY?

A. Yes. FPL, as the Applicants noted, was one of the grant recipients of the Department of Energy (“DOE”) Smart Grid Investment Grants program that was part of the American Reinvestment and Recovery Act. FPL received $200 million from the DOE to fund its $826 million smart grid implementation in 2008.

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95  Applicants’ response to CA-IR-160.
Q. HAVE THE HAWAIIAN ELECTRIC COMPANIES FILED THEIR PROPOSAL FOR SMART GRIDS?

A. No. In fact, the Applicants have indicated that the Hawaiian Electric Companies will file a petition to deploy smart grid with and without approval of the merger.\[96\] Thus, I cannot determine whether or not the Applicants will be able to make quantifiable contributions to the Hawaiian Electric Companies’ Smart Grid filing. The Applicants have stated that the affiliation with NextEra has already resulted in tangible benefits, but the Applicants have not quantified those benefits.\[97\]

Q. WHAT IS YOUR RECOMMENDATION REGARDING FUTURE SMART GRID PETITION?

A. Since the Hawaiian Electric Companies have yet to file their Smart Grid petition, I will reserve my recommendations until such time that I have been able to analyze the filing. That said, the Hawaiian Electric Companies will need to substantiate and demonstrate that their future smart grid filing is cost-effective.

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\[96\] Applicants’ response to CA-IR-229.

\[97\] Ibid.
IX. ISSUE 1(H): CONCERNS ABOUT THE COMPETITIVE RFP PROCESS.

Q. WHAT ARE YOUR FINDINGS AND CONCERNS REGARDING HOW THE PROPOSED MERGER MAY IMPACT THE OUTCOMES OF THE COMPETITIVE RFP PROCESS?

A. At this time, I find that the merger of NextEra and the HECO Companies would not change the current generation ownership to cause market power concerns, since NextEra does not currently own any active facilities in Hawaii. However, the merged NextEra-Hawaiian Electric Companies could create several other concerns. These concerns pertain to possible impacts on the competitive RFP process in Hawaii, since the merged entity could be simultaneously a potential power supplier, a potential merchant transmission provider, and the purchaser of competitively procured power.

DO THE APPLICANTS SEE A PROBLEM WITH THE PROPOSED MERGER AND THE COMPETITIVE RFP PROCESS?

A. No. Not surprisingly, the Applicants do not foresee detrimental impacts on competition should the merger proceed. In fact the Applicants claim that

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99 Applicants’ response to SunEdison-IR-5.
NextEra affiliates would be subject to applicable rules and regulations of the Commission and thus obviate possible problems.\textsuperscript{100}

Q. \textbf{HOW COULD THE PROPOSED MERGER AFFECT THE COMPETITIVE RFP PROCESS?}

A. The proposed merger will allow one market participant to be both a potential supplier and the purchaser of power in a market that should remain competitive for the benefit of ratepayers. I believe that this could create a perception that might discourage other third-party providers from competing in Hawaii if there is a presumption that a NextEra affiliate would always win future Hawaiian Electric Companies’ RFPs. This would have a chilling effect on the competitive process. The Applicants have already noted that a future affiliation with NextEra Energy would help accelerate the Hawaiian Electric Companies’ clean energy transformation.\textsuperscript{101,102} I believe that other potential suppliers may interpret such an affiliation as a tacit endorsement of NextEra affiliates over third parties in future RFPs.

\textsuperscript{100} Applicants’ response to Tawhiri-IR-13.

\textsuperscript{101} Applicants Exhibit-7, at 21:1-2.

\textsuperscript{102} Applicants’ response to DBEDT-IR-3.
Q. DO YOU HAVE OTHER CONCERNS ABOUT THE COMPETITIVE RFP PROCESS BEYOND THE PERCEPTION CONCERNS DESCRIBED ABOVE?

A. Yes. I am also concerned that NextEra and a Hawaiian Electric Companies’ operating unit may both bid on the same RFP. While it is desirable to have more competition, I am concerned that a NextEra affiliate and the Hawaiian Electric Companies bid may be duplicative, and this raises a possible concern that the additional costs associated with preparing an “extra” bid would provide no value to consumers. I am also concerned that the new NextEra-Hawaiian Electric Companies could structure future RFPs in a manner that would unduly favor NextEra affiliates and thus become less competitive.

Q. WHAT ARE YOUR RECOMMENDATIONS TO REDUCE CONCERNS ABOUT THE NEW MERGED ENTITY’S IMPACT ON THE COMPETITIVE RFP PROCESS?

A. To lessen, but not eliminate, the impacts of these potential detriments, the Commission should only approve the merger if the following conditions are met.

- Any NextEra affiliate and Hawaiian Electric Companies’ operating entity should not both be allowed to participate in the same competitive RFP.
  
- Only one or the other entity should participate.
The HECO Companies and NextEra should not directly or indirectly communicate on matters of planning or procurement efforts. Measures to prevent improper communication should be presented to the Commission for review and approval, and an annual independent certification of compliance should be required.

The HECO Companies or any NextEra affiliate should submit its bid in advance of any procurement deadline to ensure that its bid does not reflect information inappropriately gained from competitors’ bids.

Any NextEra proposal should be submitted under “open book” requirements to allow the Commission and the Consumer Advocate to review its inputs and assumptions. If a NextEra proposal is selected, a final cost report should be required.

While not a condition of the Proposed Transaction, I strongly urge the Commission to update the 2006 Competitive Bidding Framework\textsuperscript{103} to ensure, among other things, greater transparency.

\textsuperscript{103} Docket No. 03-0372, Decision and Order No. 23121.
X. ISSUE 6: RECOMMENDED CONDITIONS.

Q. HAVE YOU COMPILED A COMPLETE LISTING OF THE CONDITIONS THAT ARE SUPPORTED IN YOUR TESTIMONY?

A. Yes. The following list of conditions for the issues that I have reviewed is proposed for this docket, in the event the Commission determines that the Proposed Transaction should be approved:

Low Income Customer Protections

1. NextEra will work with the Commission, Consumer Advocate, and other relevant agencies to develop specific programs that will benefit low-income customers directly.

Charitable Contributions

2. NextEra will maintain or increase its current charitable contributions. NextEra will also ensure that, as part of the spinoff of ASB Hawaii, the new owner maintains or increases its current level of charitable contributions.

Reliability

3. NextEra will develop, within six months of the Merger’s closing, a long-term plan to achieve first quartile reliability performance as established through benchmarking studies. The reliability performance metrics should include, but not limited to, standard reliability indices such as SAIDI, SAIFI, and CAIDI and should be based on IEEE 2.5 beta methodology. The plan should include budgets with supporting
justification and analysis to ensure that the plan can achieve these first quartile goals at reasonable cost.

**Employment**

4. NextEra will provide workforce estimates and supporting analysis to identify the specific staff requirements necessary to achieve post-merger reliability commitments.

5. NextEra will provide shareholder funding to implement a workforce development plan between the Hawaiian Electric Companies and local Hawaii institutions similar to FPL’s partnerships in Florida to foster energy sector workforce development.

**Ring-Fencing**

6. NextEra will put in place, within six months of the Merger’s closing, ring-fencing measures to protect Hawaiian Electric Companies’ ratepayers from the costs associated with NextEra’s or FPL’s nuclear plant retirements (premature or otherwise.) These protections should extend as far as the potential end to decommissioning of each of the NextEra/FPL nuclear plants and be subject to Commission approval.
Competition

7. Pending the completion of an independent Commission investigation into updating the competitive bidding framework:

- Any NextEra affiliate and Hawaiian Electric Companies’ operating entity should not both be allowed to participate in the same competitive RFP. Only the entity with the lowest bid should participate.

- The HECO Companies and NextEra should not directly or indirectly communicate on matters of planning or procurement efforts. Measures to prevent improper communication should be presented to the Commission for review and approval, and an annual independent certification of compliance should be required.

- The HECO Companies or any NextEra affiliate should submit its bid in advance of any procurement deadline to ensure that its bid does not reflect information inappropriately gained from competitors’ bids.

- Any NextEra proposal should be submitted under “open book” requirements to allow the Commission and the Consumer Advocate to review its inputs and assumptions. If a NextEra proposal is selected, a final cost report should be required.
Q. IN YOUR OPINION, IF ALL OF THESE CONDITIONS WERE ACCEPTED BY THE APPLICANTS, WOULD THE PROPOSED TRANSACTION BE CONSISTENT WITH THE PUBLIC INTEREST FOR THE ISSUES REVIEWED IN YOUR TESTIMONY?

A. Separate witnesses sponsored by the Consumer Advocate address different concerns with the Proposed Transaction in their respective testimonies. However, with regard to the specific concerns addressed in my testimony, the proposed conditions in this listing serve to adequately mitigate my stated concerns.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes. It does.
Maximilian Chang, Principal Associate

Synapse Energy Economics I 485 Massachusetts Avenue, Suite 2 I Cambridge, MA 02139 I 617-453-7027
mchang@synapse-energy.com

PROFESSIONAL EXPERIENCE


Consults and provides analysis of technologies and policies, electric policy modeling, evaluation of air emissions of electricity generation, and other topics including energy efficiency, consumer advocacy, environmental compliance, and technology strategy within the energy industry. Conducts analysis in utility rate-cases focusing on reliability metrics and infrastructure issues and analyzes the benefits and costs of electric and natural gas energy efficiency measures and programs.


Managed complex EPA-mandated abatement projects involving polychlorinated biphenyls (PCBs) in building-related materials. Provided green building assessment services for new and existing construction projects. Communicated and interpreted environmental data for clients and building occupants. Initiated and implemented web-based health and safety awareness training system used by laboratories and property management companies.


Authored investment reports on Real Estate Investment Trusts (REITs) for buy-side research boutique. Advised institutional clients on REIT investment strategies and real estate asset exchanges for public equity transactions. Wrote and edited monthly publications of statistical and graphical comparison of coverage universe.


Teaching Assistant for Environmental Management I and Ocean Environments.

Brigham and Women’s Hospital, Boston, MA. Cancer Laboratory Technician, 1992 – 1994.

Studied the biological mechanism of tumor eradication in mouse and human models. Organized and performed immunotherapy experiments for experimental cancer therapy. Analyzed and authored results in peer-reviewed scientific journals.

EDUCATION

Harvard University, Cambridge, MA
Master of Science in Environmental Science and Engineering, 2000

Cornell University, Ithaca, NY
Bachelor of Arts in Biology and Classics, 1992

REPORTS


ABSTRACTS


TESTIMONY


State of New Jersey Board of Public Utilities (Docket No. EM14060581): Direct testimony on the reliability commitments filed by Exelon Corporation and Pepco Holdings, Inc. in their joint petition for the merger of the two entities. On behalf of the New Jersey Division of Rate Counsel. November 14, 2014.


New Jersey Board of Public Utilities (Docket No. GO12050363): Testimony regarding the petition of South Jersey Gas Company for approval of the extension of energy efficiency programs and the associated cost recovery mechanism pursuant to N.J.S.A 48:3-98:1. On behalf of the New Jersey Division of Rate Counsel. November 9, 2012.

Resume dated August 2015
DIRECT TESTIMONY AND EXHIBITS

OF

TYLER COMINGS

ON BEHALF OF
THE DIVISION OF CONSUMER ADVOCACY

SUBJECT: ECONOMIC IMPACTS ON THE STATE OF HAWAII
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DIRECT TESTIMONY OF TYLER COMINGS

I. INTRODUCTION.

Q. PLEASE STATE YOUR NAME, POSITION AND PLACE OF EMPLOYMENT.
A. My name is Tyler Comings and I am a Senior Associate with Synapse Energy Economics, an energy consulting company located at 485 Massachusetts Avenue, Cambridge, Massachusetts.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS CASE?
A. I am testifying on behalf of the Department of Commerce and Consumer Affairs of the State of Hawaii, as represented by the Division of Consumer Advocacy (“Consumer Advocate”).

Q. PLEASE DESCRIBE SYNAPSE ENERGY ECONOMICS.
A. Synapse Energy Economics (“Synapse”) is a research and consulting firm specializing in energy and environmental issues, including: electric generation, transmission and distribution system reliability, market power, electricity market prices, stranded costs, efficiency, renewable energy, environmental quality, and nuclear power.
Q. PLEASE STATE YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGROUND.

A. Please see CA Exhibit-23. I have 10 years of experience in economic research and consulting. At Synapse, I have filed expert testimony on coal economics and resource planning in Kentucky, Indiana, Ohio, and Oklahoma; and on economic impacts of utility mergers in New Jersey, Maryland, and the District of Columbia. I have provided comments on integrated resource plans by Entergy Louisiana, Indianapolis Power and Light, Duke Energy Indiana, Cleco Power, and the state of Connecticut. At Synapse and elsewhere, I have conducted many economic impact analyses using models such as REMI and IMPLAN. Recently, I estimated the economic impacts of investments in wind, solar, and energy efficiency in Montana.

I have provided consulting services for a variety of clients at Synapse including: American Association of Retired Persons, Citizens Action Coalition of Indiana, Consumers Union, District of Columbia Office of the People’s Counsel, District of Columbia Government, Earthjustice, Energy Future Coalition, Illinois Attorney General, Maryland Office of People’s Counsel, Massachusetts Energy Efficiency Advisory Council, Mountain Association for Community Economic Development, Nevada State Office of Energy, New Jersey Division of Rate Counsel, Sierra Club, Southern Environmental Law Center, U.S. Department of Justice, and West Virginia Consumer Advocate Division.
Prior to joining Synapse, I performed research in consumer finance for Ideas42 and economic analysis of transportation and energy investments at Economic Development Research Group.

I hold a B.A. in Mathematics and Economics from Boston University and an M.A. in Economics from Tufts University.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to evaluate whether the proposed merger ("the Merger" or "Proposed Transaction") of NextEra Energy Incorporated and the Hawaiian Electric Companies ("the Applicants", "the Joint Applicants" or "the Companies") provides benefits to ratepayers in connection with the following issue identified by the Hawaii Public Utilities Commission ("the Commission").¹

• **Issue 1(a)** - Whether approval of the Proposed Transaction would be in the best interests of the state's economy and the communities served by the Hawaiian Electric Companies.

Separate witnesses sponsored by the Consumer Advocate will address other questions and/or other elements of this issue.

¹ Docket No. 2015-0022 Order 32739, at 8-10.
II. ISSUE 1(A): THE JOINT APPLICANTS HAVE NOT SHOWN THAT THE PROPOSED MERGER WOULD HAVE A POSITIVE IMPACT ON THE ECONOMY OF HAWAII.

Q. WHAT ARE YOUR FINDINGS REGARDING THE IMPACTS OF THE MERGER ON THE ECONOMY OF HAWAII?

A. The Joint Applicants have not provided sufficient information for the Commission to determine whether the Merger will have a positive impact on the economy of Hawaii. Applicants’ witness John Reed conducted an economic impact analysis that only includes a rough assumption of ratepayer savings but does not include changes in the Companies’ workforce, spending on Hawaii vendors that could shift with the Merger, and corollary effects, such as reduced tax collections. The Applicants have instead presented a one-sided analysis that focuses on potential savings and ignores detrimental impacts on the Hawaii economy.

Q. DO THE JOINT APPLICANTS CLAIM THAT THE MERGER WILL BENEFIT THE HAWAII ECONOMY?

A. Yes. The Applicants claim that the Merger:

...will benefit the State’s economy and the communities served by the Hawaiian Electric Companies by facilitating more affordable, reliable clean energy, on an accelerated basis.²

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² Direct Testimony of Eric S. Gleason, Applicants Exhibit 7, at 14:7-9.
Q. HAVE THE JOINT APPLICANTS SHOWN NET BENEFITS TO RATEPAYERS AS A RESULT OF THE MERGER?

A. No. The net benefits to ratepayers will depend on how savings and costs to achieve those savings are passed on to them. As it stands, it is unclear whether ratepayers would benefit or not, since the Applicants have not provided sufficient evidence to support the estimates they have provided to date and have not clearly described the manner in which the savings and benefits would be realized by customers. Instead, the Applicants have discussed general categories of savings, including rough estimates that lack rigor.

Q. HAVE THE JOINT APPLICANTS ATTEMPTED TO MODEL THE IMPACT OF THE MERGER ON THE HAWAII ECONOMY?

A. Yes, in part. Mr. Reed estimated the economic impact of ratepayers re-spending savings in the local economy. His analysis assumed ratepayers would save $25 million per year for four years as a “reasonable estimate of what will be achieved by the Proposed Transaction.” He then used the IMPLAN model to estimate the economic impacts of residents and businesses re-spending this savings in Hawaii. The resulting impacts include 678 “person-years” of employment and $66.7 million in value added.

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3 Direct Testimony of John Reed, Applicants Exhibit 33, at 44:3-4.
(or Gross Domestic Product) over four years. Stated differently, that is an average annual impact of 170 jobs and $17 million in GDP.

Q. HOW DO THESE IMPACTS COMPARE TO THE HAWAII ECONOMY AS A WHOLE?

A. Relative to the entire Hawaii economy, these impacts represent 0.02 percent of total state employment and 0.03 percent of state GDP. The job impact represents between (+/-) 1 and 2 percent of changes in employment from year to year—shown in Figure 1. As I will discuss further, these impacts do not include potential job losses at the Companies, which could easily exceed the estimated gains.

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4 Applicants’ response to CA-IR-108, Attachment 8, at 221.


Hawaii GDP in 2014 was $77 billion (or $79 billion in 2015 dollars, assuming 2.5% inflation). Federal Reserve St. Louis. Available at: https://research.stlouisfed.org/fred2/series/HINGSP.
A. THE ECONOMIC IMPACTS OF THE MERGER ASSUME NO JOB LOSSES.

Q. DOES THE JOINT APPLICANTS’ ECONOMIC IMPACT ANALYSIS ESTIMATE CHANGES IN EMPLOYMENT AT THE COMPANIES AS A RESULT OF THE MERGER?

A. No. Despite modeling the economic impact over a four-year period following the Merger, the economic impacts do not model changes in employment at the merged companies. When asked about potential job losses, the Applicants responded that:

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6 Local Area Unemployment Statistics, change in Hawaii employment from June of each year relative to June of previous year. Available at: http://www.bls.gov/eag/eag_hi.htm.
Mr. Reed has made no claims regarding whether the merger will result in reductions in employment at the Hawaiian Electric Companies for the five years following the merger.\(^7\)

A reduction in employment or relocation of workers outside of Hawaii would mean a decrease in total economic activity in the state. The Applicants have only focused on the positive impact of ratepayer savings but ignored the negative impacts of involuntary job reductions.

Q. **COULD THE MERGER RESULT IN JOB LOSSES AT THE MERGED COMPANIES?**

A. Yes. Utility mergers typically involve workforce reductions and relocation of staff from the companies involved. The Joint Applicants have offered a two-year moratorium on involuntary job reductions. When asked if extending that commitment to a three-year moratorium was **not** appropriate, the Joint Applicants responded:

Yes, the Applicants determined that a two year commitment provided adequate time for each party to gain an understanding of the operations of the companies and to develop a long-term plan taking into account the impact of the Hawaiian Electric Companies’ clean energy transformation and renewable resource goals.\(^8\)

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\(^7\) Applicants’ response to CA-IR-277.b.2.

\(^8\) Applicants’ response to DBEDT-IR-139.
The two-year commitment put forth by the Joint Applicants does not preclude them from reducing jobs after that. In fact, evidence suggests that they may reduce jobs after two years—as I discuss further.

Q. DID THE JOINT APPLICANTS RELY ON PAST TRANSACTIONS TO ESTIMATE SAVINGS FROM THIS MERGER?

A. Yes. Mr. Reed reviewed non-fuel operation and maintenance (O&M) savings from nine other mergers over the last 10 years. These savings estimates were developed before the mergers took place. Mr. Reed calculated an average of the anticipated savings across the nine mergers (15 percent) and adjusted it downward to a 10 percent non-fuel O&M savings for this Merger.9 The Applicants later offered that the costs to achieve this savings was an estimated 25 percent of savings. Once again, this figure was not based on a “comprehensive analysis” but rather “on experience in other mergers.”10

Q. DOES MR. REED’S 10 PERCENT NON-FUEL O&M SAVINGS ESTIMATE INCLUDE SAVINGS FROM LABOR COSTS?

A. It is unclear, because Mr. Reed does not specify whether his estimates for savings incorporate labor reductions after the two-year involuntary labor reduction moratorium. He claims that the 10 percent savings estimate is

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9 Direct Testimony of John Reed, Applicants Exhibit 33, at 32:9-12.

10 Applicants’ response to CA-IR-303, p.37.
smaller than the average savings of the other nine mergers, in part, because
the merged companies in this transaction are not geographically contiguous.\footnote{11}

He also claims that the savings would be smaller for this Merger—relative to
the other nine mergers—because of the two-year moratorium on job
reductions, stating that:
\section*{The near-term potential savings in this Proposed Transaction}
stem exclusively from non-labor synergies as a result of
NextEra’s commitment not to make any involuntary headcount
reductions or changes in the compensation or benefits provided
to the employees at the Hawaiian Electric Companies for at least
two years.\footnote{12} (emphasis added)

If there were to be job cuts after two years, the Applicants correctly
surmise that these could lead to cost savings:
\section*{If there were involuntary reductions three or four years after the
merger was approved, the reduced payroll and associated
expenses would count towards near-term potential savings.\footnote{13}}

The Applicants claim that the 10 percent “steady state” savings could
take five to 10 years to achieve.\footnote{14} However, this is far past the two-year job
cut moratorium, which the Applicants stated was inappropriate to extend
further.\footnote{15} Therefore, we are left with a rough savings estimate that claims not
to include labor costs, yet is expected to be achieved at a later date—when involuntary job reductions could occur.

Q. DID THE NINE MERGERS REVIEWED BY MR. REED HAVE PROJECTIONS OF JOB REDUCTIONS?
A. Yes. Table 1 shows the nine mergers that Mr. Reed refers to in his testimony, including the non-fuel O&M savings he reported from each merger. In part, as justification for these mergers, the companies involved projected job reductions that would occur. These projected job reductions contributed to the savings estimates presented by Mr. Reed. I have added the corresponding job reductions reported by companies involved in these nine mergers along with brief explanations underlying those reductions.

Q. DID THE JOINT APPLICANTS REPORT THE PROJECTED JOB REDUCTIONS FROM THESE MERGERS?
A. No. Mr. Reed reported and relied upon savings estimates from these mergers but did not show the associated job reductions.
Q. HAVE THE JOINT APPLICANTS ESTIMATED INVOLUNTARY JOB REDUCTIONS THAT WOULD OCCUR WITH THE PROPOSED TRANSACTION?

A. No. Unlike all nine mergers listed by Mr. Reed, the Proposed Transaction in this case has no estimate of job cuts. Instead, the Applicants have offered rough savings estimates based on past mergers as a “free lunch”—plenty of savings but, with no effect on the Companies’ employees.
### Table 1: Job Reductions from Past Utility Mergers

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Projected direct job reductions</th>
<th>Notes</th>
<th>Savings % of Non-Fuel O&amp;M (Reed, Table 1)</th>
</tr>
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<tbody>
<tr>
<td>PNM Resources/</td>
<td>&gt;20</td>
<td>20 corporate cuts on completion of merger, more in following 18 months.</td>
<td>2.14%</td>
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<tr>
<td>TNP Enterprises</td>
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<tr>
<td>Exelon/Constellation</td>
<td>631</td>
<td>Most cuts expected at Constellation (acquired company) headquarters including legal, IT, financial and other corporate jobs.</td>
<td>5.94%</td>
</tr>
<tr>
<td>Duke Energy/Progress Energy</td>
<td>1,800 to 1,900</td>
<td>6% reduction in combined workforce (30,000 workers)</td>
<td>8.39%</td>
</tr>
<tr>
<td>Exelon/Pepco</td>
<td>480</td>
<td>Corporate only. Estimates of Pepco utility workforce cuts after two-year moratorium were not provided.</td>
<td>10.24%</td>
</tr>
<tr>
<td>First Energy/Allegheny</td>
<td>245</td>
<td>FirstEnergy agreed to maximum 29% reduction at Allegheny (acquired company) headquarters for five years</td>
<td>17.49%</td>
</tr>
<tr>
<td>Duke/Cinergy</td>
<td>1,500</td>
<td>5% reduction in combined workforce (29,350 workers)</td>
<td>19.91%</td>
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<tr>
<td>Northeast Utilities/NSTAR</td>
<td>220</td>
<td>2% reduction in combined workforce (9,000 workers)</td>
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<tr>
<td>Gaz Metro/CVPS</td>
<td>116</td>
<td>16% reduction in combined workforce in Vermont (715 workers)</td>
<td>23.80%</td>
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<tr>
<td>WPS Resources/Peoples Energy</td>
<td>295</td>
<td>6% reduction in combined workforce (5,000 workers)</td>
<td>26.26%</td>
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<tr>
<td>NextEra/HECO</td>
<td>?</td>
<td>No involuntary job reduction for 2 years, 10% savings in 5 to 10 years</td>
<td>10%</td>
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</table>

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Q. SHOULD AN ESTIMATE OF CHANGES TO UTILITY JOBS BE INCLUDED IN THE ECONOMIC IMPACT ANALYSIS?

A. Yes. The economic impact analysis, as it stands, includes no changes in utility jobs and is merely based on a savings figure “without any specific assumptions regarding the origins of those cost reductions.”\(^{25}\) If the Joint Applicants are not willing to commit to a moratorium for more than two years, then their five to ten year savings analysis should clarify whether the assumptions are based upon jobs that may not be retained. The Joint Applicants are attempting to have it both ways: 1) ignore the impact of future job cuts, and 2) assume that savings loosely based on previous mergers—that did cut jobs--can be achieved.

B. SAVINGS FROM THE MERGER COULD MEAN LESS IS SPENT ON HAWAII BUSINESSES.

Q. BESIDES JOB LOSSES AT THE COMPANIES, COULD SAVINGS FROM THE MERGER ALSO TRANSLATE INTO LESS ECONOMIC ACTIVITY IN HAWAII IN OTHER WAYS?

A. Yes. If NextEra were to decrease the business they do with in-state vendors, this would lead to a decrease in economic activity compared to what would have happened without the Merger.

\(^{25}\) Applicants’ response to CA-IR-282.
Q. HAVE THE JOINT APPLICANTS SHOWN THAT THERE WILL BE NO DECREASE IN ACTIVITY BETWEEN THE COMPANIES AND OTHER HAWAII BUSINESSES?

A. No. The Joint Applicants discuss “the benefit of joint procurement and supply chain management,” but when asked how savings would affect Hawaii businesses they state that:

As a result of this uncertainty regarding the sources, scale and timing of the merger savings that would ultimately result from this transaction, Mr. Reed is not able to model the impacts to the State’s economy of reduced expenditures at the Hawaiian Electric Companies resulting from merger savings. Any such reduction in economic activity would likely have a modest impact on the State of Hawai’i’s economy and does not change the fact that this transaction provides substantial economic benefits to ratepayers and the State of Hawai’i.26

The Applicants also refer to “quick hit” savings but have not estimated how spending on goods and services in Hawaii will change after the Merger.

Again, the Applicants have presented an unclear and incomplete account of how this Merger will affect Hawaii’s economy.

Q. SHOULD AN ESTIMATE OF CHANGES TO ACTIVITY WITH HAWAII BUSINESSES BE INCLUDED IN THE ECONOMIC IMPACT ANALYSIS?

A. Yes. As with utility job losses, the potential for reduced economic activity with Hawaii vendors has not been estimated as part of the Joint Applicants’ analysis. Unlike the discussion of job losses, however, the Joint Applicants

26 Applicants’ response to CA-IR-250.
have not pledged to retain or increase spending on Hawaii businesses for any length of time. The Joint Applicants should conduct a detailed analysis of how relationships with Hawaii businesses will change and model the impacts of those changes on the state’s economy.

III. CONCLUSION.

Q. WHAT ARE YOUR FINDINGS?
A. It is currently unknown whether the Merger would have a positive or negative impact on Hawaii’s economy. The Joint Applicants have not provided a complete story because they fail to account for how such savings could come at the expense of other areas of Hawaii’s economy.

Q. WHAT ARE YOUR RECOMMENDATIONS?
A. To establish whether the Merger would be in the best interests of Hawaii’s economy, the Joint Applicants must provide an updated economic impact analysis for (at least) five years following the transaction that includes the following inputs: 1) projected changes in employment at the Companies, 2) projected changes of spending on services and supplies located in Hawaii, and 3) projected changes in customer bills. Provided that these inputs are sound and properly account for what would have happened absent the Merger (i.e., a “but-for” case), the Merger could be found to have a positive impact on the economy of Hawaii. Without such an analysis, the economic impacts of
the Merger are undetermined and the Joint Applicants have not met their
burden of proof to demonstrate that the proposed transaction will positively
affect Hawaii’s economy.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?
A. Yes. It does.
Tyler Comings, Senior Associate

Synapse Energy Economics I 485 Massachusetts Avenue, Suite 2 I Cambridge, MA 02139 I 617-453-7050 tcomings@synapse-energy.com

PROFESSIONAL EXPERIENCE


Conducts research on energy system planning and coal plant economics, and performs economic modeling and analysis in support of a wide range of projects. Performs economic impact and benefit-cost analyses, statistical modeling, and research on environmental issues. Conducts economic impact analyses using models such as REMI and IMPLAN.


Organized studies analyzing behavior of consumers regarding finances, and worked with top researchers in behavioral economics. Managed implementation and data analysis for a study of mitigation of default for borrowers that were at-risk of delinquency. Performed case studies for World Bank on financial innovations in developing countries.


Performed economic impact modeling and benefit-cost analyses using IMPLAN and REMI for transportation and renewable energy projects, including support for Federal stimulus applications. Performed statistical modeling, including results on the timing of effects of highway construction on economic growth in Appalachia. Developed a unique Web-tool for the National Academy of Sciences on linkages between economic development and transportation, and presented findings to state government officials around the country. Created economic development strategies and improvements to company’s economic development software tool.


Allocated IOLTA and Escrow funds, performed bank reconciliation and accounts receivable. Projected legal fees and costs for cases at the firm.

Massachusetts Department of Public Health, Boston, MA. Data Analyst (contract), 2002.

Designed statistical programs using SAS based on data taken from health-related surveys. Extrapolated trends in health awareness and developed benchmarks for performance of clinics and other healthcare facilities for statewide assessment.
EDUCATION

Tufts University, Medford, MA
Master of Arts in Economics, 2007

Boston University, Boston, MA
Bachelor of Arts in Mathematics and Economics, 2002. Cum Laude, Dean’s Scholar.

ADDITIONAL SKILLS

Software: MS Office, STATA, SPSS, SAS, REMI, IMPLAN, Mathematica
Programming: C++
Languages: Conversant in French

PUBLICATIONS


**TESTIMONY**

**Ohio Public Utilities Commission (Case No. 14-1297-EL-SSO):** Direct and supplemental testimony evaluating the assumptions and analysis used by FirstEnergy Ohio in support of its application for approval of an electric security plan and related Retail Rate Stability Rider. On behalf of Sierra Club. December 22, 2014 and May 11, 2015.

**Oklahoma Corporation Commission (Cause No. PUD 201400229):** Direct and rebuttal testimony evaluating the assumptions in the analysis supporting Oklahoma Gas & Electric’s request for authorization and cost recovery of a Clean Air Act compliance plan and Mustang modernization. On behalf of Sierra Club. December 16, 2014 and January 26, 2015.

**Maryland Public Service Commission (Case No. 9361):** Direct and surrebuttal testimony on the economic impact analysis filed by Exelon Corporation and Pepco Holdings, Inc. in their joint petition for the merger of the two entities. On behalf of the Maryland Office of the People’s Counsel. December 8, 2014 and January 21, 2015.
State of New Jersey Board of Public Utilities (Docket No. EM14060581): Direct testimony on the economic impact analysis filed by Exelon Corporation and Pepco Holdings, Inc. in their joint petition for the merger of the two entities. On behalf of the New Jersey Division of Rate Counsel. November 14, 2014.


Resume dated July 2015
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<td>VICE PRESIDENT, REGULATORY AFFAIRS HAWAIIAN ELECTRIC COMPANY, INC. VICE PRESIDENT HAWAII ELECTRIC LIGHT COMPANY, INC. MAUI ELECTRIC COMPANY, LIMITED P.O. Box 2750 Honolulu, Hawaii 96840</td>
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<td>DOUGLAS A. CODIGA, ESQ. SCHLACK ITO, A LIMITED LIABILITY LAW COMPANY TOPA FINANCIAL CENTER 745 Fort Street, Suite 1500 Honolulu, Hawaii 96813</td>
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<td>PATRICK K. WONG CORPORATION COUNSEL MICHAEL J. HOPPER DEPUTY CORPORATION COUNSEL COUNTY OF MAUI 200 South High Street Wailuku, Maui, Hawaii 96793</td>
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<td>Attorneys for Hawaii Island Energy Cooperative and Kauai Island Utility Cooperative</td>
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<td>CHRIS MENTZEL CEO HINA POWER CORP P. O. Box 158 Kihei, Hawaii 96753</td>
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<td>DANIEL W. S. LAWRENCE PAUL S. AOKI DEPUTIES CORPORATION COUNSEL CITY AND COUNTY OF HONOLULU 530 S. King Street, Room 110 Honolulu, Hawaii 96813</td>
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<td>Attorneys for Honolulu Board of Water Supply</td>
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<td>AMY E. EJERCITO DIRECTOR OF GOVERNMENT AND LEGAL AFFAIRS</td>
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<td>INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS LOCAL UNION 1280 700 Bishop Street, Suite 1600 Honolulu, Hawaii 96813</td>
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<td>HENRY Q CURTIS TREASURER KA LEI MAILE ALI'I HAWAIIAN CIVIC CLUB P.O. Box 37313 Honolulu, Hawaii 96837</td>
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| HENRY Q CURTIS  
VICE PRESIDENT FOR CONSUMER ISSUES  
LIFE OF THE LAND  
P.O. Box 37158  
Honolulu, Hawaii 96837 | | | |
| THOMAS L. TRAVIS  
VICE-PRESIDENT  
PUNA PONO ALLIANCE  
RR 2 Box 3317  
Pahoa, Hawaii 96778 | 1 | 1 | |
| ERIK KVAM  
PRESIDENT  
RENEWABLE ENERGY ACTION COALITION OF HAWAII, INC.  
1110 University Avenue, Suite 402  
Honolulu, Hawaii 96826 | 1 | 1 | |
| ISAAC H. MORIWAKE  
EARTHJUSTICE  
850 Richards Street, Suite 400  
Honolulu, Hawaii 96813 | 1 | 1 | |
| Attorney for Sierra Club | | | |
| BRUCE NAKAMURA  
JOSEPH A. STEWART  
AARON R. MUN  
KOBAYASHI, SUGITA & GODA  
999 Bishop Street, Suite 2600  
Honolulu, Hawaii 96813 | | | |
| Attorneys for SunEdison, Inc. | | | |
| SANDRA-ANN Y.H. WONG  
ATTORNEY AT LAW, A LAW CORPORATION  
1050 Bishop Street, #514  
Honolulu, Hawaii 96813 | 1 | 1 | |
<p>| Attorney for SunPower Corporation and Tawhiri Power LLC | | | |</p>
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<td>Attorneys for Ulupono Initiative LLC</td>
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<td>Counsel to The Alliance for Solar Choice</td>
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<td>DR. KAY DAVOODI</td>
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<td>ELLISON, SCHNEIDER &amp; HARRIS L.L.P.</td>
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| DON J. GELBER  
JONATHAN B. GELBER  
CLAY CHAPMAN IWAMURA PULICE & NERVELL  
700 Bishop Street, Suite 2100  
Honolulu, HI 96813  
Attorneys for AES Hawaii, Inc. | 1 | 1 | 1 |


[Signature]