

Louisiana Public Service Commission

Docket Number U-33434

**In re: Joint Application of Cleco Power LLC and Cleco Partners L.P. for:
(i) Authorization for the Change of Ownership and Control of Cleco Power
LLC and (ii) Expedited Treatment.**

Cross-Answering Testimony of Scott Hempling

**On Behalf of
Alliance for Affordable Energy**

August 2015

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1 **Introduction**

2 **Q. Are you the same Scott Hempling who presented Direct Testimony in this**
3 **proceeding?**

4
5 A. Yes.

6 **Q. Describe the purpose and organization of your cross-answering testimony.**

7 A. The Staff witnesses have done an impressive job of identifying the transaction's risks to
8 consumers, and of offering conditions that could reduce those risks. See Direct
9 Testimony of Robert Lane Sisung (Exhibit B). In Part II below, I offer some changes to
10 Mr. Sisung's conditions that increase their chance of success.

11 I differ with Staff, however, on whether that success is achievable. In my Direct
12 Testimony (at Part VI.D), I conceded that in trying to design conditions that would
13 effectively protect consumers, I failed. The Staff makes no such concession. Their
14 position appears to be that with their conditions the transaction "could be in the public
15 interest."¹ I do not think the Commission can logically reconcile that statement with
16 Staff's other statement that the commitments do not "eliminate the risk."² For all the

¹ See Direct Testimony of Robert Lane Sisung at 60 ("For all the detailed reasons provided in Staff's testimony, summarized in the above 17 factors, it is Staff's opinion that the Transaction as currently proposed is not in the public interest. However if the Commission were to approve the Transaction, the Transaction could be in the public interest if all of the Staff's modifications and additions to the Proposed Regulatory Commitments were implemented.").

² See Direct Testimony of Robert Lane Sisung at 51:

Q. "Do the proposed regulatory commitments, with the Staff's recommended additions and modifications, eliminate the financial risk to the ratepayer associated with this transaction?"

A. No. The Proposed Regulatory Commitments go a long way to mitigating the risks of the transaction, but they do not eliminate the risk."

1 reasons I describe in my Direct Testimony, conditions cannot fix a leveraged private
2 equity buyout whose core purpose is to buy territory rather than improve service.

3 That brings me to my larger difference with Staff. Its testimony is essentially
4 reactive. By offering the Commission no affirmative vision on how corporate structure
5 should serve the public interest, it allows this proceeding to be dominated by the
6 Acquirers' private interest. The result is asymmetry of effort—the Acquirers pressing
7 for what is best for them, but Staff not pressing for what is best for consumers. As I
8 explain in Part I below, this Commission owes consumers more.

9
10 **I. Without a vision for the public interest, the Commission becomes a**
11 **host to the Acquirers' private interests**

12
13 **Q. Explain the necessity for the Commission to establish a public interest vision for**
14 **corporate structure.**

15
16 A. Consumers are best served by a utility whose unconflicted purpose is to provide
17 consumers the best possible service at the lowest reasonable cost. Whether a utility has
18 this unconflicted purpose, or whether instead that purpose is diluted and diverted by
19 other priorities, depends on Commission decisions: decisions about permissible
20 business activities, corporate and governance structure, financial structure and market
21 structure. My Direct Testimony (at Part II) urged the Commission to assert itself on
22 those four topics. Doing so would establish a beachhead for consumer protection—one
23 not easily dislodged by acquirers seeking only financial expansion. Louisiana needs a
24 screen, to separate acquisitions that serve the public interest from those that do not.

25 Instead of screening Macquarie and its partners out, the Staff invited them in.
26 Then, in a monumental effort to rid the transaction of its risks, Staff designs 77
27 conditions—conditions whose craftsmanship is admirable but whose full effectiveness

1 is unprovable, as Staff itself acknowledges. See Direct Testimony of Robert Lane
2 Sisung at 51 ("The Proposed Regulatory Commitments go a long way to mitigating the
3 risks of the transaction, but they do not eliminate the [financial risk to the ratepayer]").
4 Harm requires rejection.

5 It is human to want to say "yes." And "yes" can be the right answer, if a
6 transaction emerges from competitive pressures to win and keep new customers by
7 serving them better. But this transaction has other origins. As I explained in my Direct
8 Testimony (at Part III.G), this transaction is not about using performance to win new
9 customers. It is about the Acquirers borrowing billions to buy CLECO's monopoly over
10 existing customers, and it is about CLECO Corp. choosing its buyer based on the price
11 paid to CLECO shareholders rather than the benefits provided to CLECO consumers. A
12 transaction with such self-interested origins does not deserve the Commission's
13 deference—even with 77 conditions. Those conditions cannot compensate for the
14 benefits foregone due to CLECO's failure to make any effort to see what skills and
15 services other acquirers could offer its customers (as discussed in my Direct Testimony
16 at Part V).

17 Staff has accommodated a transaction whose roots are in private interest
18 maximization, while not responding with policies aimed at public interest maximization.
19 Its position contributes, inadvertently, to a mergers-and-acquisitions culture in which
20 the sacred opportunity to serve the public is treated like a private commodity, bought
21 and sold for profit; a culture in which the benefits flowing from that opportunity accrue
22 disproportionately to acquirers who can afford these acquisitions, rather than to those
23 whose loyal monthly payments are what make these acquisitions affordable.

1 **Q. What about Staff's proposed benefit of \$65 million?**

2 A. Recognizing the presence of risk and the absence of benefit, Staff insists on a benefit:
3 \$65 million over 10 years (See Commitment 25). That \$65 million pales next to the
4 \$435 million control premium CLECO shareholders will receive.³ What also pales is
5 the thought-effort that went into the figure, next to the importance of the issue. For the
6 \$65 million is merely a pro rata derivation from Macquarie's \$100 million offer when
7 acquiring Puget Energy.⁴ There is no testimony on whether that number was the right
8 number in that case. Public interest regulation in general, and Louisiana's customers in
9 particular, deserve more than merely replicating what a self-interested acquirer offered
10 before. And no knowledgeable customer would accept the risks of a Macquarie-
11 controlled CLECO for a mere \$1.89 a month for ten years.⁵

12 My Direct Testimony explained that conditions cannot correct a transaction
13 whose very purpose conflicts with the consumer interest. But I addressed benefits
14 anyway. I recommended (Direct Testimony at 71) that if the Commission chooses to
15 approve the merger, it should rebuttably presume that the appropriate amount of
16 consumer benefits is 50 percent of the control premium: \$217.5 million of the \$435
17 million control premium, on the grounds that the value to the Acquirers of gaining
18 control of CLECO was at least halfway attributable to the presence of captive
19 ratepayers. I acknowledge that such a condition would likely cause the transacting

³ As explained in my Direct Testimony at Part I.B. The proper comparison is even less favorable to consumers, because it would compare the \$435 million, which shareholders receive upfront, not with \$65 million but the lower net present value of the 10 years of \$6.5 million/year payments.

⁴ See Direct Testimony of Robert Lane Sisung at 52.

⁵ (6.5 million/286,000 customers)/12 months.

1 parties to walk away. That would leave us where we are today: with a status quo less
2 risky than living with the three acquirers, their future unknown acquisitions, and 77
3 complex conditions—many of whose effectiveness and enforceability are untested.
4

5 **II. Modifications to some Staff conditions will reduce, but not remove, the**
6 **risks to consumers**

7
8 **Q. Despite your recommendation to reject this transaction, have you proposed**
9 **conditions?**

10
11 A. Yes. Part VI of my Direct Testimony offered conditions to eliminate harms, create
12 benefits and increase the likelihood of compliance. But as I explained in Part VI.D of
13 that submission, problems of practicality and enforceability make my conditions
14 insufficient to align this transaction with the public interest. Should the Commission
15 still proceed with the transaction, I recommend it combine my conditions with Staff's,
16 an effort that will require some detail work to eliminate overlaps and fill gaps.

17 Below I offer some comments on, and modifications and additions to, Staff's
18 impressive effort. I have numbered the commitments consistent with the document
19 entitled "Redline of Proposed Regulatory Commitments to LPSC," attached as the
20 second half of Exhibit B to the Direct Testimony of Robert Lane Sisung. That
21 document renumbers the Acquirers' original list beginning with new Commitment 5.

22 **Commitment 1**

23 Staff proposes that the Acquirers agree that should they breach a commitment,
24 the Commission can "employ injunctive relief as a remedy" before other agencies and
25 courts. But no one can "agree" to vest jurisdiction in a body that by existing law does
26 not already have that jurisdiction. And if the agency or court already has jurisdiction,

1 Staff's addition is not necessary. To have value, the commitment should be this: If the
2 Acquirers oppose jurisdiction and fail, they must pay the Commission's reasonable
3 expenses incurred in arguing about jurisdiction, along with expenses incurred to obtain
4 the relief.

5 **Commitment 5**

6 Staff's new Commitment 5 properly forbids CLECO Power from seeking rate
7 recovery for a cost of debt or equity higher than would have been appropriate absent the
8 transaction. On this point I offer four comments.

9 1. The word "Transaction" requires clarification. The utility's debt and equity
10 costs can be affected not only by the transaction itself but by any of innumerable events
11 that will occur within the ever-growing corporate family of which CLECO Power will
12 be a part.

13 2. There is a problem of implementation. Many factors affect the cost of debt
14 and equity. Isolating those factors that are attributable to the transaction from those that
15 are not is regulation's equivalent of brain surgery. The brain surgeon's fee—the cost of
16 consultants--needs to be paid by the Acquirers rather than customers, because it is the
17 Acquirers' private interest action that necessitates the regulatory analysis.

18 3. The Commission should make clear that it is CLECO Power's evidentiary
19 burden to prove the negative, i.e., that its requested cost of debt and equity are not
20 inflated due to its affiliation with the Acquirers (and all other companies that the
21 Acquirers later acquire). It is not the intervenors' legal burden to prove the opposite.

22 4. Staff's requirement should apply asymmetrically. Suppose CLECO Power's
23 affiliation with the Acquirers causes its debt costs or equity costs to drop. That decrease

1 must be reflected in retail rates, even though an increase should not be reflected in retail
2 rates. The asymmetry is appropriate because this transaction offers only negatives and
3 no positives. Any positive that does emerge merely starts to offset the negatives that we
4 know are there, and the negatives we cannot anticipate due to the Acquirers' unrestricted
5 ability to acquire more companies. (Unrestricted, that is, unless the Commission adopts
6 the condition I recommend in Part VI.A.1 of my Direct Testimony.)

7 **Commitment 7 (old Commitment 6)**

8 Staff has added (to original Commitment 6) this sentence: "Prior to the
9 expiration of the five (5) year term of the SQP [Service Quality Program], a new five (5)
10 year SQP must be negotiated and submitted to the Commission for approval." Perhaps
11 it goes without saying, but regulators do not "negotiate" with utilities. Regulators
12 establish standards for utility performance, then induce utility compliance—by allowing
13 the utility its reasonable cost when the standards are satisfied, and penalizing the utility
14 when the standards are not satisfied. The Commission should revise performance
15 standards, prospectively, not merely every five years but at any time. While Staff's
16 sentence does no damage, the Commission should make clear that no sentence
17 diminishes its duty to advance the public interest every day of every year.

18 **Commitment 10 (old Commitment 7)**

19 This commitment requires the utility to retain as executives Messrs. Olagues,
20 Crump and Fontenot. There is no reason for a Commission order to grant job security to
21 any executive—especially executives who agreed to a leveraged private equity buyout
22 that brought \$435 million to CLECO shareholders and only risks to CLECO customers.
23 Not only does this commitment guarantee these gentlemen their jobs; it does so without

1 specifying a single performance standard. The Commission should delete this
2 Commitment; or, at least add a phrase like "such retention to depend on the Commission
3 determining that these individuals' performance for the consumer meets the highest
4 possible standards as determined by the Commission." But even that addition
5 inappropriately enmeshes the Commission in internal company hiring decisions—as did
6 the original commitment. All the more reason to delete it.

7 **Commitment 11 (old Commitment 8)**

8 This commitment requires that there be "no adverse material change in Cleco
9 Power's pension plans or pension design or in current benefits for retiree medical plan
10 participants for at least five years." An addition is necessary. Should there be an
11 adverse material change, the Acquirers should prove, before it goes into effect, that the
12 change is not attributable to the transaction (or to problems attributable to the
13 transaction).

14 **Commitment 26 (old Commitment 20)**

15 Staff has added this sentence: "Any affiliate transactions of Cleco Power, and
16 all activities of Cleco Power, that may result in affiliate costs should be adequately
17 documented and performed in such a way so as to have the same result as arm's length
18 transactions." I would amend this sentence as follows (additions italicized, deletions
19 bracketed): "Any affiliate transactions of Cleco Power, and all activities of Cleco
20 Power *or any of its affiliates*, that may result in affiliate costs [should] *shall* be
21 adequately documented and performed *according to Commission requirements designed*
22 [in such a way so as] to have the same result as arm's length transactions."

23 **Commitment 31**

1 Staff has added this passage: "Cleco Power shall not issue any security for or
2 become liable for another entity's obligations, without the LPSC's prior authorization.
3 Cleco Power customers will be held harmless for the liabilities of any non-regulated
4 activity of Cleco Corporate Holdings, LLC or Cleco Group, LLC." The purpose
5 underlying these two sentences is sound. A utility should never in any way, for any
6 reason, assist in or bear the costs of business activities other than its own utility
7 activities. But two clarifications are necessary.

8 1. The first sentence, taken literally, invites CLECO Power to request
9 Commission permission to become liable for another entity's obligations—without any
10 limit on the context for such request. We do not want the Acquirers pressuring CLECO
11 Power to seek Commission permission to bail out unrelated businesses. To prevent
12 such pressures, and to avoid wasting the Commission's time on such self-interested
13 requests, the first sentence's invitation should be available only where CLECO Power
14 demonstrates that the other entity is one whose purpose is to assist CLECO Power in
15 carrying out its public utility obligations, specifically by providing a good or service
16 more efficiently than CLECO Power could provide itself.

17 2. The second sentence should be amended by deleting all the words after the
18 phrase "non-regulated activity." There could be non-regulated entities other than "Cleco
19 Corporate Holdings, LLC or Cleco Group, LLC" whose activities could cause customers
20 harm.

21 **Commitment 36**

22 This commitment would require the Acquirers to "notify the Commission of any
23 material change in the administration, management or condition of either Cleco Power

1 or Cleco Corporate Holdings, LLC's books and records within ten days prior to such
2 event." I recommend changing "ten" to "forty-five." Otherwise there is risk that the
3 change will occur during a vacation period, or when a key staff person is on leave.
4 These "material changes" are unlikely to be crises requiring immediate action.

5 **Commitment 37**

6 My Direct Testimony (at Part VI.A.1) recommended that the acquisitions of
7 material unrelated businesses, into the corporate family of which CLECO Power is a
8 part, be subject under certain circumstances to Commission review and approval.
9 Staff's Commitment 37 provides only for notice to the Commission, "as soon as
10 practicable following any public announcement" of the acquisition. After-the-fact
11 notice of an acquisition that causes risks to consumers leaves the Commission unable to
12 protect consumers. Risk-causing acquisitions exceeding certain thresholds should be
13 approved in advance, and then only if they are risk-free to CLECO Power customers, as
14 the Commission defines that standard.

15 **Commitments 40, 45**

16 Commitment 40 requires the applicants to implement the ring-fencing and
17 corporate governance measures "within 90 days of the Proposed Transaction." If this
18 means within 90 days *after* the transaction, it is wrong. Measures necessary to protect
19 the consumer from this transaction must be in place before the transaction takes place.
20 Otherwise the Commission's influence over the outcome drops, like someone who tests
21 the tires only after buying the car.

22 Indeed, Commitment 45 makes plain the need to get measures in place in
23 advance. Commitment 45 anticipates a situation in which the ring-fencing provisions

1 "are found to be insufficient to obtain a non-consolidation opinion." In that instance,
2 Commitment 45 requires CLECO Corp. and CLECO Power to notify the Commission
3 and propose additional provisions sufficient to obtain the non-consolidation opinion.
4 But what if they can't find a solution? Does the Commission then order dis-affiliation?
5 Or just sigh, wishing it had required compliance before the closing? And during the
6 search for solutions, do the Acquirers simply go about their risky business ventures, as
7 if the ring-fencing requirements did not exist? (Inexplicably, Commitment 45 creates
8 no deadline for finding the solution, leading to a situation where the companies are
9 saying "We're doing our best—trust us.", with the Commission forced to micro-manage
10 the companies' efforts to make sure they are in fact doing their best.) In the meantime,
11 what happens to consumer protection—the Commission's legal priority?

12 These problems are all avoided by requiring ring-fencing measures to be
13 approved not after the fact, but in advance. Indeed other commitments proposed by the
14 Staff, such as Commitment 65, require the Applicants to provide the required
15 information prior to the transaction's closing.

16 Applicants may argue that they want no delays in their transaction. But there is
17 no urgency from the customer perspective, because the transaction offers no customer
18 benefits. So there is no public interest reason to allow the transaction to occur first. In
19 any event, the Acquirers will not need excessive time to create and implement the ring-
20 fencing and governance measures. These measures have been implemented elsewhere;
21 so there are counsel somewhere who have the necessary language. Anyone who resists
22 the notion that conditions necessary to reduce harm from the transaction must be in

1 place before the transaction closes reveals himself as placing private interests before the
2 public interest.

3 **Commitment 43**

4 This commitment seeks to preserve, among other things, the Commission's
5 "general supervisory authority" over CLECO Power and CLECO Corp. The
6 commitment should make explicit that such general supervisory authority includes
7 authority to consider, and if necessary order, CLECO Power or CLECO Corp. (or both)
8 to dis-affiliate from the Acquirers. The Acquirers must understand, now, what risk they
9 take by breaching a commitment: the loss of that which they are trying to obtain by
10 making that commitment. The point is simple. A condition of an acquisition is a
11 condition of an acquisition. If the condition fails, so must the acquisition.

12 I also recommend the Commission direct the Staff to design language that
13 creates a clear procedure by which the dis-affiliation will happen. With the procedure in
14 place, there is less likelihood of disruption from litigation or other forms of resistance.
15 Knowing that the Commission means business, the companies will more likely comply.

16 * * *

17 **Q. Does this conclude your cross-answering testimony?**

18 A. Yes.

19


AFFIDAVIT

STATE OF MARYLAND

COUNTY OF MONTGOMERY

NOW BEFORE ME, the undersigned authority, personally came and appeared, Scott Hempling, who after being duly sworn by me, did depose and say:

That the above and foregoing is his sworn testimony in this proceeding and that he knows the contents thereof, that the same are true and stated, except as to matters and things, if any, stated as on information and belief, and that as to those matters and things, he verily believes them to be true.



Scott Hempling

SWORN TO AND SUBSCRIBED
BEFORE ME, THIS 21st
DAY OF AUGUST, 2015.

Leydine Zapata
NOTARY PUBLIC

My Commission expires: 03/31/2017