

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

**DIRECT TESTIMONY OF  
SCOTT HEMPLING**

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

4 **A. *Qualifications***

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

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

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

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

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

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

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

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

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

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

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

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

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



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

3 My resume is attached to this testimony. More information is at  
4 [www.scotthemplinglaw.com](http://www.scotthemplinglaw.com).

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

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

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

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

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

25 This responsibility includes, among other things,

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

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

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

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

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

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

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

23 **B. *Executive Summary***

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

4 ***The absence of conditions that are both practical and enforceable (Part VI):*** If  
5 the Commission does approve a NextEra takeover, conditions are necessary to eliminate  
6 harms, create benefits, and ensure compliance. I tried to design such conditions, but I  
7 failed, due to problems of practicality and enforceability. If the Commission accepts this  
8 acquisition it will need not only to establish conditions, but also to reserve the power to  
9 require disaffiliation if the conditions fail—or are violated—or if the Commission finds  
10 that control of HECO by an acquisition-oriented, vertically integrated monopoly, one  
11 facing no limits on the scope of its future acquisitions, is no longer in Hawai'i's interest.  
12

1 **II.**

2 **To Assess NextEra's Fit with Hawai'i's Needs,**  
3 **the Logical First Step is to Define Those Needs**

4 **A. *The context for this transaction***

5  
6 **Q. Describe the context for this transaction.**

7  
8 **A.** There are few decisions more important to a state than what company should control the  
9 electricity infrastructure—that combination of hardware, software, skills, and services  
10 essential to economic activity and to life. In Hawai'i, that company has always been  
11 HECO.

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

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

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

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<sup>4</sup> *Inclinations* Order at 1.

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



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

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

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

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<sup>6</sup> *Id.* at 18.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.* at 2 n.3.

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

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

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

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

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

3           Though the basis of this marriage is the size of the dowry rather than the fit of the  
4 partners (indeed, the partners admit they know little about each other<sup>11</sup>), the Applicants  
5 offer it as the single answer to Hawai‘i's many questions. But there can be no single  
6 answer. If the main question is "How do we diversify Hawai‘i's markets?" the answer  
7 cannot be "By granting control to a Florida company whose preferred business model is  
8 vertically integrated monopoly."<sup>12</sup>

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

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<sup>10</sup> As detailed in Part III.G.1 below.

<sup>11</sup> As detailed in Part III.C and D below.

<sup>12</sup> As explained in Part III.B below.

1        **B.     *Legal standards***

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

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

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

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

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

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

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<sup>13</sup> Order No. 32695 (Mar. 2, 2015).

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

<sup>15</sup> Decision and Order No. 32695 (emphasis added).

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

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

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

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

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

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

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

10 *I. Business activities*

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

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

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

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

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

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

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

---

<sup>16</sup> I discuss interaffiliate relations in more detail at Part III.B.3 below.

1                   2.        *Corporate and governance structures*

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

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

13                   3.        *Financial structures*

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

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



1                   4.     ***Market structures***  
2

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

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

10                   The preponderant case for mergers is that they will improve efficiency.  
11                   The preponderant case against them is their possible impairment of  
12                   competition, for two reasons: first, the merging companies are typically  
13                   actual or potential competitors in some parts of their business, and,  
14                   second, they may be enabled by joining together to deny outside firms a  
15                   fair opportunity to compete.<sup>17</sup>  
16

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

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

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

---

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



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

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

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

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

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

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

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<sup>19</sup> As discussed in Part III.C.6.



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

**A. Overview: *The meaning of harm***

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

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

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

**1. *Status quo harm***

**Q. Explain what you mean by status quo harm.**

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

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

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

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

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

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

5 **2. Opportunity cost harm**

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

17  
18      **Q.     What is the connection between Hawai‘i's energy future, and the possibilities for**  
19      **accommodating competition and choice?**

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

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

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

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

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

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

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

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

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

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

10  
11 **A.** The potential for generation competition in Hawai‘i, stimulated initially by PURPA 1978,  
12 is embodied in the Commission's competitive bidding rules. But consider how the  
13 NextEra acquisition changes the playing field. HECO will be controlled<sup>23</sup> by a holding  
14 company that has paid a \$568 million control premium. It paid that premium based on its  
15 expectation of the value that will flow from making profit-earning investments in  
16 Hawai‘i. Those investments necessarily include generation investments. In the  
17 competitions to develop new generation, NextEra will have an advantage because under

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

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

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

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

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

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

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

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

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

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

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

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

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<sup>26</sup> As I explain in Part III.B.2 below.

<sup>27</sup> Response to HREA-IR-2 (emphasis added).

<sup>28</sup> *Id.*

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

4 The Applicants then turn to municipalization. They declare, again without factual  
5 support, that municipalization is "unlikely to produce benefits to all customers and, in  
6 fact, [is] likely to increase costs to at least some customers, namely residential  
7 customers."<sup>29</sup> This is the intellectual equivalent of schoolboy name-calling. Worse, in  
8 fact, because it omits the fact that 2000 public sector entities have served 21.4 million  
9 customers (companies and households—the number of humans is much higher), most of  
10 them for decades and many since the electric industry's beginnings a century ago.<sup>30</sup> If  
11 municipal ownership had only "illusory advantages," as Applicants put it (*id.*), municipal  
12 systems would not likely have lasted in such large numbers for so many years.  
13 Applicants then say that "[m]unicipalization efforts tend to take 5 to 10 years or longer"  
14 (*id.*), without noting that these long time periods are due in part to opposition from the  
15 incumbent investor-owned utility. Applicants then talk about the "years" it takes to  
16 "replicate/duplicate the investor-owned assets necessary to provide that service." But the  
17 efficient approach to municipalization is to buy the assets that exist, not "replicate" or  
18 "duplicate" them. Again, one need not be an advocate of municipal systems or

---

<sup>29</sup> *Id.*

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

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

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

14 \* \* \*

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

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

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<sup>31</sup> *Id.*

<sup>32</sup> *Inclinations* at 2.

<sup>33</sup> *Id.* at 2 n.3.



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

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

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

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

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

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

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

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

9  
10 NEE is seeking new shareholder growth avenues beyond the next few  
11 years of identified projects and to circumvent the industry outlook for flat-  
12 to-declining power sales due to energy efficiency and new technologies.  
13 The company also wants to reduce business risk by increasing the  
14 proportion of regulated and contracted assets.<sup>35</sup>

15  
16 In regulated markets, the way to avoid "flat" earnings from "flat-to-declining power  
17 sales" is to own assets; and then either put them in a regulated monopoly's rate base or  
18 persuade that monopoly to buy the output under a long-term contract approved by  
19 regulators. That is why NextEra is buying HECO: to own assets, and either put them in  
20 HECO's rate base or persuade HECO to buy the output under long-term contracts.  
21 NextEra's expectation is it will have more opportunities to execute that strategy if it owns  
22 HECO than if it continues in Hawai'i as an independent developer. Otherwise, NextEra  
23 would not be offering \$4.3 billion to buy the three utilities.<sup>36</sup>

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

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

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

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

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

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

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

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<sup>37</sup> Response to COM-IR-7.

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

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

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

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

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

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

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

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

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

*i. Vertical features*

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

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

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

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<sup>40</sup> Response to CA-IR-6, CA-IR-174.

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

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

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

7 *ii. Horizontal features*

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

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

---

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

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

<sup>42</sup> Response to CA-IR-149.

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

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<sup>43</sup> Response to CA-IR-174.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> Response to CA-IR-6.

<sup>48</sup> Response to CA-IR-6.

<sup>49</sup> Response to CA-IR-6.

\* \* \*

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

11  
12 Their recommended solution is nondiscriminatory access:

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

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

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

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

29 who can—

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

36  
37 Their recommended solution is data access:

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

7  
8 ...

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

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

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

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

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

---

<sup>53</sup> Citing Smart Metering with a Focus on Electricity Regulation, available at :  
[http://www.energy-regulators.eu/portal/page/portal/EER\\_HOME/EER\\_PUBLICATIONS/CEER\\_ERGEG\\_PAPERS/Customers/2007/E07-RMF-04-03\\_SmartMetering\\_2007-10-31\\_0.pdf](http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Customers/2007/E07-RMF-04-03_SmartMetering_2007-10-31_0.pdf).

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

4 Their recommended solution is open standards:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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



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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 Power Supply: Transform Hawai‘is generation portfolio from primarily  
2 imported oil-based generation to low cost renewable energy resources  
3 enabled by flexible and fuel efficient LNG generation.<sup>61</sup>  
4

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

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

---

<sup>61</sup> Response to PUC-IR-177.

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

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

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

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

22 \* \* \*

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

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

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

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

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

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

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

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

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

15  
16 **A.** When two companies are in an arm's-length relationship, they behave as if unrelated.

17 That means that each company (a) has no economic need to deal with any other affiliate  
18 because each one has alternative trading partners, and (b) has no legal obligation to deal

---

<sup>64</sup> Response to SunEdison-IR-6.

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

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

3 *a. Faulty interaffiliate pricing*

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

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

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

---

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

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

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

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

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

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

<sup>68</sup> Response to CA-IR-127.



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

10 *b. Favorable purchases of certain utility property*

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

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

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<sup>69</sup> Response to FOL-IR-40.

<sup>70</sup> Response to SunEdison-IR-6.

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

6 *c. Utility loans to NextEra affiliates*

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

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

14 Whoever wrote this jaw-dropping answer<sup>72</sup> chose not to define "unforeseen  
15 circumstances." But we can readily foresee one: A NextEra affiliate bids too low on  
16 some project (inside or outside Hawai'i), wins the bid, has trouble paying its contractors,  
17 and needs money fast. Instead of having to confess its sins to an independent bank, it has  
18 NextEra's Florida-based CEO order HECO's CEO (who reports to him) to make the loan.  
19 The very possibility that a NextEra affiliate could have favorable access to the cash of a

---

<sup>71</sup> See Response to OP-IR-52.

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

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

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

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

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

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

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<sup>73</sup> As explained in Part III.C.3 below.

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

<sup>75</sup> Response to SunEdison-IR-6.

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

3 *d. Weaknesses in compliance and enforcement*

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

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

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

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

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

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<sup>76</sup> Response to OP-IR-31.

<sup>77</sup> Response to PUC-IR-51.

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

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

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<sup>78</sup> Response to COM-IR-9.

<sup>79</sup> Response to COM-IR-14.

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

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

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

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

15  
16 **A.** NextEra asserts there is "no meaningful risk" of impropriety because it "has in place a  
17 compliance program to help ensure improper cross-subsidization does not occur."<sup>83</sup>  
18 NextEra says it does regular training, uses physical separation, and prevents unauthorized  
19 computer access with passwords.<sup>84</sup> NextEra's compliance program includes (according to  
20 its discovery response) these elements:

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<sup>80</sup> Response to OP-IR-50.

<sup>81</sup> *Id.*

<sup>82</sup> As explained in Part III.C below.

<sup>83</sup> Response to OP-IR-48.

<sup>84</sup> Response to UL-IR-33.

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

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

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

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<sup>85</sup> Response to OP-IR-123.

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

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

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

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

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

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

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<sup>86</sup> Response to OP-IR-45.

<sup>87</sup> Response to OP-IR-51.

<sup>88</sup> See Part III.B.3 above.



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

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

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

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

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

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

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

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

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

11 \* \* \*

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

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

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

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

1 The acquisition will increase HECO's risk exposure immediately

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

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

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

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

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

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

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

19  
20 **A.** Yes. Until its repeal in 2005, the federal Public Utility Holding Company Act of 1935  
21 (PUHCA) required, subject to certain exceptions, that each utility holding company  
22 constitute a "single integrated public-utility system."<sup>89</sup> The purpose of this mandate was  
23 to align each utility's corporate form with its public service obligations. While the Act  
24 had many provisions, the key tools were these:

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

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

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

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

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

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

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

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

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

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

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

18  
19 **A.** The 1992 amendments<sup>90</sup> permitted utility holding companies to acquire, exempt from the  
20 integrated system principle, geographically dispersed generating companies whose  
21 exclusive business was selling electricity at wholesale. Holding companies could own

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

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

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

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

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

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

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

---

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

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

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

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

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

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



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

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

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

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

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<sup>92</sup> Response to OP-IR-31.

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

3 NextEra's subsidiaries have eight nuclear units at five sites, totalling 6174 MW.<sup>95</sup>  
4 NextEra's nuclear capacity comprises "one of the largest fleets of nuclear power stations  
5 in the U.S.," about 6% of total U.S. nuclear capacity as of December 31, 2013.<sup>96</sup> Nuclear  
6 power accounts for 26% of NextEra's 2014 generation profile (based on MWh  
7 produced).<sup>97</sup> NextEra is adding another 2200 MW of nuclear capacity at its Turkey Point  
8 site.[Applicants' Ex. 10 (NextEra 2014 10-K Report) at 16.

9 The risks associated with nuclear investment are undisputed:

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

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

---

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

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

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

<sup>96</sup> NextEra 2014 10-K at 4.

<sup>97</sup> Response to OP-IR-2.

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

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

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

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

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

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

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

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

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

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<sup>98</sup> *Id.* at 40-42.

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

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

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

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

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

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

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

---

<sup>99</sup> *Id.* at 37-39, 42.

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

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

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

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

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

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

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

<sup>101</sup> Response to PUC-IR-91.

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

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

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

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

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

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

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<sup>103</sup> Response to CA-IR-91.

<sup>104</sup> Response to CA-IR-86.

<sup>105</sup> Response to PUC-IR-48.

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

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

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

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

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

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

<sup>107</sup> HEI 2014 10-K at 85.

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

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

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

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

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

<sup>109</sup> Response to OP-IR-30.

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



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

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

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

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

<sup>112</sup> Response to OP-IR-30.

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

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

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

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

16 NextEra "regularly acquires or sells subsidiaries."<sup>113</sup>

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

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

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<sup>113</sup> Response to OP-IR-31.

<sup>114</sup> Response to OP-IR-15.

<sup>115</sup> I present this condition in Part VI.B.1.a below.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

3 *iii. Bankruptcy risk*

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

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

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

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

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

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

15 *v. Interaffiliate transaction abuse*

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

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

---

<sup>116</sup> As discussed in Part III.B and C above.



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

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

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

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

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

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

12 \* \* \*

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

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

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

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

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

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

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

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

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

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

- 1
- 2           2.     NextEra's next-era acquisition activities will occur outside the
- 3                 Commission's jurisdiction and control. That is a fact.
- 4
- 5           3.     NextEra's acquisition aspirations are in tension with the HECO utilities'
- 6                 public service obligations. That is a fact.
- 7
- 8           4.     The Commission does not know how small HECO's utilities will become
- 9                 relative to NextEra. After this acquisition the Hawai'i utilities will account
- 10                for only 15% of NextEra's revenues, down from 91.5% of HEI's based on
- 11                2014 figures.<sup>117</sup> Nor does the Commission know how small is too small, or
- 12                how many unrelated affiliates are too many unrelated affiliates (NextEra
- 13                has more than 900<sup>118</sup>), before the utilities' welfare becomes too small to
- 14                matter to NextEra. That is a fact.
- 15

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

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

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

<sup>118</sup> Response to OP-IR-31.

1 Energy does not currently have any plans to create any new nonutility subsidiaries under  
2 Hawai‘ian Electric Holdings or the Hawai‘ian Electric Companies."<sup>119</sup> That is the picture  
3 of NextEra only on the day of the acquisition (and only if we ignore NextEra efforts to  
4 buy the \$10-20 billion Texas electric company Oncor from the bankrupt Energy Future  
5 Holdings <sup>120</sup> and also ignore NextEra's 900 subsidiaries). And the issue is not whether  
6 the to-be-acquired non-utility subsidiaries are "under" the Hawai‘i utilities. If they are in  
7 the same corporate system as the Hawai‘i utilities, their risks can affect the Hawai‘i  
8 utilities. Wisconsin's holding company statute recognizes this problem by limiting the  
9 size and types of non-utility businesses that may be in the same holding company family  
10 as a Wisconsin utility.<sup>121</sup>

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

---

<sup>119</sup> Response to OP-IR-29.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

<sup>123</sup> Response to OP-IR-1 (based on 2014 figures).

<sup>124</sup> Applicants' Exh. 16 at 93.

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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<sup>125</sup> Response to OP-IR-26.

<sup>126</sup> Response to OP-IR-14.

<sup>127</sup> Exh. 10 at p.6/160.

<sup>128</sup> Response to OP-IR-14.

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

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

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<sup>129</sup> Response to OP-IR-27.

<sup>130</sup> Response to OP-IR-26.

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

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

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

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

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<sup>132</sup> See NextEra 2014 10-K at 74; HEI 2014 10-K at 87.

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

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

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

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

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

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

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

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

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

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**Q. What types of utility decisions could NextEra control?**

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

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

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

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<sup>135</sup> Response to PUC-IR-103 (emphasis added).

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

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

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

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

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

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

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<sup>136</sup> Response to DBEDT-IR-41.

<sup>137</sup> Response to PUC-IR-41 (emphasis added).

<sup>138</sup> Response to OP-IR-7 (emphasis added).

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

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

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

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

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<sup>139</sup> Response to CA-IR-29 (emphasis added).

<sup>140</sup> Response to OP-IR-35.

<sup>141</sup> Response to OP-IR-102 (emphasis added).



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

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

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

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<sup>142</sup> Response to OP-IR-102.

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

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

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

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

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

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

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

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

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

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

<sup>144</sup> "It is envisioned that members of the advisory board will be appointed by the Chairman and Chief Executive Officer ("CEO") of NextEra Energy based upon the

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

3  
4           **Q.**     **You have explained how this transaction will cause Hawai‘i consumers five**  
5                     **categories of harm. Does this harm have a common source?**

6  
7           **A.**     Yes. The common source is the actions of HEI Board in choosing NextEra and  
8                     negotiating the terms. In Part III.G, I will establish factually that HEI's goal was highest  
9                     return for its shareholders, not best performance for its utilities' customers. I then will  
10                    explain that by seeking the highest return for its shareholders, HEI undermined its  
11                    utilities' obligations to their customers. The value that HEI obtained, known as the  
12                    control premium, overcompensates HEI shareholders, denies customers benefits  
13                    proportionate to their burdens, and distorts the market for utility mergers.

14                    **1.**     ***HEI's goal was highest return for its shareholders, not best performance***  
15                    ***for its utilities' customers***

16  
17           **Q.**     **Describe the premium to HEI's shareholders from NextEra's acquisition offer.**

18  
19           **A.**     Although this transaction is largely a stock-for-stock exchange, NextEra is paying a  
20                     premium to HEI shareholders.<sup>145</sup> The purchase price (in the form of NextEra stock  
21                     received by HEI stockholders) represents a premium of 26.2% - 29.4% over the implied  
22                     market valuation of the Hawai‘ian Electric Companies' utility business.<sup>146</sup> Other

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advice and recommendation of the President and CEO of the Hawai‘ian Electric Companies." Response to CA-IR-19.

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

<sup>146</sup> NextEra Energy Inc., Amendment No. 3 to Form S-4 at 38 (Mar. 24, 2015) (hereinafter referred to as "Form S-4"). See also Response to CA-IR-213: "JPM's [J.P. Morgan Securities] analysis supported the conclusion that the merger proposal provided a

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

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

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

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

<sup>147</sup> Response to DBEDT-IR-57.

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

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

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

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

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

9  
10 July 21: HEI Board authorizes management to tell NextEra that the price "was  
11 insufficient but that if NEE would be willing to consider increasing the proposed  
12 merger consideration, HEI would be willing to enter into a confidentiality  
13 agreement and allow the commencement of due diligence to support an increase  
14 in proposed merger consideration." As clarified by Applicants: "Since the  
15 *amount of the merger consideration was a gating issue* for the HEI Board, the  
16 HEI Board determined at the July Board Meeting only that the amount of the  
17 merger consideration was unacceptable."<sup>150</sup> Again no mention of, let alone  
18 required commitment to, customer benefits.

19  
20 Aug. 11: HEI's Executive Vice President and Chief Financial Officer Ajello  
21 sends letter to NextEra's Vice Chairman and Chief Financial Officer Dewhurst,  
22 "reiterating the need for NEE to increase the value of its proposal and attaching  
23 initial diligence information with respect to American Savings Bank and  
24 Hawai‘ian Electric and a term sheet with respect to certain high level terms of a  
25 possible transaction between NEE and HEI.... The proposal specified that the  
26 operational headquarters of HEI's utility business would remain in Honolulu,  
27 Hawai‘i and expressed the need for commitments by NEE relating to employee  
28 job protections in connection with the merger and the maintenance of HEI's  
29 historic levels of community involvement and charitable contributions." Once  
30 again, no mention of, let alone required commitment of, customer benefits.

31  
32 Late Aug.: Dewhurst sends letter to Ajello effectively raising the price offer. He  
33 acknowledged HEI's wish to spin off American Savings Bank and proposing that  
34 NEE would pay HEI shareholders \$24.50 for each share of common stock in HEI

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

<sup>150</sup> Response to PUC-IR-110 (emphasis added).

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

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

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

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

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

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

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

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

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

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

7  
8 **A.** Yes; there are two types of evidence—one affirmative, one negative. The affirmative  
9 evidence is the narrative in the Form S-4, confirming that the HEI Board sought and  
10 received assurance that it could not get a better price from some other suitor:

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

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

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

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<sup>151</sup> NextEra S-4 at 40 (emphases added).

<sup>152</sup> NextEra S-4 at 41 (emphases added).



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

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

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

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

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

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<sup>153</sup> Response to DBEDT-IR-12 (emphasis added).

<sup>154</sup> NextEra S-4 at 39 (emphases added).

<sup>155</sup> Response to DBEDT-IR-97 (emphasis added).

<sup>156</sup> Response to CA-IR-213 (emphasis added).

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

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

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

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

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

5 **2. *By seeking highest return for its shareholders, HEI undermined its***  
6 ***obligations to the customers***  
7

8 **Q. By placing priority on highest return for shareholders rather than best possible**  
9 **service to its customers, how did the HEI Board's behavior square with its utilities'**  
10 **obligation to serve?**  
11

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

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

19  
20  
21  
22 Had HEI'S Board viewed its utilities' obligations as its primary obligation, it  
23 would first have sought and screened prospective acquirers for their ability to meet the  
24 above-quoted standards. Then, having selected a sample of performers based on merit, it

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

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

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

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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<sup>161</sup> As discussed in Part VI.B.1.g below.

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

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

11           NextEra states it will not seek to recover the acquisition premium in rates.<sup>165</sup> But  
12          that statement diverts attention from the real question. The real question point is not  
13          whether NextEra should recover the premium; the real question is whether HEI's  
14          shareholders should receive the premium. To understand this question it is useful to  
15          distinguish again the two parts of the premium: (a) the excess of pre-acquisition stock  
16          value over book value, and (b) the excess of purchase price over pre-acquisition stock  
17          value.

18           Part (a) has nothing to do with the acquisition because it pre-dated the acquisition.  
19          It reflects the common tendency for utility stock to trade at levels exceeding book value.  
20          In contrast, Part (b), the control premium, reflects new value NextEra seeks to gain by

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<sup>164</sup> 262 U.S. at 307-08. For additional discussion of this point, *see* Scott Hempling, *Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction* at 104-05 (American Bar Association 2013).

<sup>165</sup> See Direct Testimony of John Reed at 19-20.

1 taking control of HEI's utilities. There is no clear reason why HEI's shareholders should  
2 receive that value. There is no evidence that this value was created by HEI shareholders'  
3 risk-taking or its executives' managerial merit. The value, rather, reflects NextEra's  
4 desire to control the utilities' franchise. But that franchise has value because of the  
5 Hawai'i government's decision to grant HECO a monopoly over retail service, and also to  
6 require ratepayers to support that monopoly by paying government-mandated rates  
7 calculated to give the utility a reasonable opportunity to earn a fair return. Since the  
8 value to NextEra of controlling the franchise results from the combination of  
9 government-granted monopoly and government-mandated rates, there is no clear reason  
10 why the value should go to HEI shareholders. At least some portion of the control  
11 premium is logically deserved by the ratepayers. Yet the Merger Agreement grants 100%  
12 of the control premium to HEI shareholders.

13 **Q. Do you have other concerns about the control premium?**

14  
15 **A.** Yes. To allow the target shareholders to keep the control premium is to treat the utility  
16 franchise like a New York City tax medallion—private good, a mere commodity, to be  
17 sold by its owners to the highest bidder. But a utility is not like a taxi—one of thousands  
18 of market participants competing for customers who can skip the cab in favor of a bus or  
19 subway. A utility is not like a taxi, because a utility's customers are mostly guaranteed.  
20 And so the utility franchise is not like a taxi medallion; it is not a private commodity.  
21 The utility franchise is a privilege granted by government, an opportunity for private  
22 profit accompanied by an obligation to provide a public utility service. The franchise  
23 never loses its public character.

1           Here is another way to understand the control premium. When NextEra buys  
2 100% of HEI stockholders' shares, NextEra is actually buying two things: the HECO  
3 utilities' assets, and the HECO utilities' franchises. The assets were at book value on  
4 HECO's books, and they will remain at book value after the acquisition (that is the  
5 necessary result of NextEra's commitment not to recover the control premium in rates).  
6 So if NextEra is paying only book value for the assets, the control premium must be  
7 attributable to the franchises. NextEra is paying HEI shareholders a control premium to  
8 get control of the franchises. But the franchises are not private commodities; they are not  
9 like taxi medallions. *The franchises are not the HEI shareholders' assets to sell.* A  
10 franchise is a government-granted right—the right to be the sole provider of a  
11 government-defined service in a government-defined service territory. The franchise was  
12 not created by the shareholders; it was created by government; it is not owned by the  
13 shareholders; it is owned by the government. The value NextEra sees in the franchise is  
14 not value created by shareholders through skill, risk or any other means; it is value by  
15 government actions; specifically, the actions of granting HECO an exclusive right to  
16 serve and of compelling customers to pay rates that comply with statutory and  
17 constitutional standards.<sup>166</sup> And that is why allowing the HEI shareholders to keep the

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<sup>166</sup> It is possible to argue that some part of the total premium is attributable to investors' expectation that the utility's *earned* return on equity will exceed the level *authorized* by regulators. Such excess earnings are possible if the utility incurs costs below, or makes sales above, the levels assumed by the regulator when establishing rates. (Or, conversely, if the utility persuades the regulator to set rates that reflect costs higher than, and/or sale volumes lower than, what the utility expects will occur.) But this increment of extra earnings—which can always be corrected prospectively in the next rate case—would not likely explain the control premium that exists here.

1 control premium is illogical: It reflects the franchise being auctioned by shareholders to a  
2 bidder they chose based on the value paid them, rather than being awarded by the  
3 government to the best performer.

4 As I explained in Part III.G.1, the HEI Board's priority was to get the highest  
5 value for its shareholders. In an unregulated context, if corporate acquisition decisions  
6 are driven by effective competition, paying and receiving a premium is routine and  
7 legitimate. (Take careful note of the "if," because the preceding sentence does not work  
8 if the acquirer is seeking to gain market power—the ability to exclude competitors and  
9 then charge prices above competitive levels.). In markets subject to effective  
10 competition, paying and receiving a premium is routine and legitimate because the  
11 shareholder and customer interests are aligned. (Recall the apartment building  
12 hypothetical: An acquirer facing effective competition in its ultimate product market will  
13 pay no more for the target company than what it predicts it can recover by pricing  
14 competitively, setting prices high enough to cover costs and reasonable profit but not so  
15 high as to lose customers to competitors.) But in the context of regulated monopolies, the  
16 shareholder and customer interests are not aligned. They are not aligned because the  
17 acquirer sells its products in a monopoly market, where there is little risk of losing  
18 customers. HEI resolved the shareholder-customer conflict by placing shareholder  
19 benefit ahead of customer benefit. In doing so, HEI violated its utilities' duty to serve the  
20 interests of its utilities' customers.

21 There are only two ways to fix this error. The Commission can either disapprove  
22 acquisitions that are rooted in shareholder-customer conflict, or eliminate the conflict by  
23 allocating to ratepayers the portion of the control premium attributable to their

1 contribution to its value. Either solution will disappoint those HEI shareholders who bet  
2 on the Commission approving the transaction and allowing them to keep the control  
3 premium. But the Commission's obligation is not to honor shareholder bets; it is to  
4 enforce the utility's obligation to serve—an obligation that, as in a competitive market,  
5 puts customers first.

6 **Q. Given your concerns, what is the appropriate treatment of the control premium if**  
7 **the Commission approves this transaction?**

8  
9 **A.** Since shareholders have no constitutional entitlement to the control premium, the  
10 Commission is free to allocate it according to whatever principle that satisfies the  
11 statutory public interest standard. I recommend this principle: The control premium  
12 should be allocated between shareholders and ratepayers according to their relative  
13 contribution to the value represented by the premium. Commissions apply this same  
14 principle when they allocate the gain on sale of an asset used for utility service. That is,  
15 when a generating asset has been in a utility's rate base, and the utility then sells that asset  
16 at a gain above net book value, the gain goes (or should go) to ratepayers. The gain goes  
17 to ratepayers because through their historic rate payments (reflecting the asset's presence  
18 in rate base), they have borne the economic burden associated with the asset. Benefit  
19 follows burden. And when an asset is not in rate base and then is sold at a gain, the gain  
20 belongs to the shareholders because they have borne the economic burden associated with  
21 the asset. Benefit follows burden.<sup>167</sup>

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<sup>167</sup> In *Democratic Central Comm. of the District of Columbia v. Washington Metropolitan Area Transit Comm'n*, the court stated:

1 (I caution readers that the gain-on-sale-of-asset analogy works only up to that  
2 point: as an example of the principle that value goes to those whose economic  
3 contribution produced the value. I am not saying that the ratepayer's burden-bearing in

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Ratepayers bear the expense of depreciation, including obsolescence and depletion, on operating utility assets through expense allowances to the utilities they patronize. It is well settled that utility investors are entitled to recoup from consumers the full amount of their investment in depreciable assets devoted to public service. This entitlement extends, not only to reductions in investment attributable to physical wear and tear (ordinary depreciation) but also to those occasioned by functional deterioration (obsolescence) and by exhaustion (depletion). . . . [Since customers] have shouldered these burdens, . . . it is eminently just that consumers, whose payments for service reimburse investors for the ravages of wear and waste occurring in service, should benefit in instances where gain eventuates—to the full extent of the gain.

485 F.2d 786, 808–11, 822 (D.C. Cir. 1973) (footnotes omitted); *id.* at 808 ("[I]f the land no longer useful in utility operations is sold at a profit, those who shouldered the risk of loss are entitled to benefit from the gain."). *See also Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities*, 2 FCC Rcd. 6283, 6295 ¶¶ 113–14 (Sept. 17, 1987) (order on reconsideration) (observing that "[t]he equitable principles identified in [*Democratic Central Committee*] have direct application to a transfer of assets out of regulation that produces gains to be distributed," and requiring "that ratepayers receive the gains on assets when the market value of the assets exceeds net book cost."); *N.Y. Water Serv. Corp. v. Pub. Serv. Comm'n of N.Y.*, 12 A.D.2d 122, 129 (N.Y. App.Div. 1960) (allocating gain on sale to ratepayers when ratepayers bore the risk of a loss in value of the assets); *N.Y. State Elec. & Gas*, Case No. 96-M-0375, 1996 N.Y. PUC LEXIS 671, at \*8 (N.Y. Pub. Serv. Comm'n Nov. 19, 1996) (memorandum opinion) (reserving the net gains on the sale of land for ratepayers is "equitable and reasonable"); *N.Y. Tel. Co. v. N.Y. Pub. Serv. Comm'n*, 530 N.E.2d 843 (N.Y. 1988) (ratepayers entitled to benefits on sale of yellow pages advertisements).

*But see Bd. of Pub. Util. Comm'rs v. N.Y. Tel. Co.*, 271 U.S. 23 (1926) ("Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses or to capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for the convenience or in the funds of the company.").

1 the context of a generating asset sold at a gain is itself analogous to the ratepayer's  
2 contribution to the control premium.)

3 The challenge, then, is how to determine, for the control premium offered by  
4 NextEra, the relative contribution as between shareholders and ratepayers. There is  
5 nothing in the record to support a particular number. There is, however, logic to support  
6 a finding that the value of the control premium is attributable to ratepayers. That logic is  
7 as follows:

- 8 1. NextEra is paying the control premium to get control of the HECO  
9 utilities' franchises.
- 10 2. The value of those franchises is due to their stable source of revenue.
- 11 3. That source of revenue is stable because of the government decision to  
12 make the utilities' distribution franchise exclusive.
- 13 4. That exclusivity means that the ratepayers have no choice but to be the  
14 source of revenue that creates the value NextEra sees in the franchises.  
15  
16  
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19 That is the argument for the ratepayers' contribution. What about the HEI shareholders'  
20 contribution? HEI might argue that but for its shareholders' investment, there would be  
21 no service for which ratepayers contributed revenue. Looking at the various arguments,  
22 the Commission might even decide that the control premium is, technically, a windfall—  
23 a value to which no one actually contributed. Given the likely existence of arguments on  
24 both sides, and to give both sides a chance to bring forward facts, I recommend that the  
25 Commission rebuttably presume that the relative contribution to the franchises' value, as  
26 between shareholders and ratepayers, is 50-50. Then the logic of rebuttable presumptions  
27 does the work. If facts rebutting the presumption do not emerge, the presumption  
28 becomes the result. My Condition VI.B.2.c reflects this approach.



1 **Q. Aren't the HECO shareholders entitled to the control premium because their**  
2 **investment is subject to risk, or because of the utilities' operational effectiveness?**  
3

4 **A.** No. As to shareholder risk, it is necessary to distinguish (a) the utility's investment in  
5 public utility assets, from (b) a shareholder's investment in stock purchases. Regulatory  
6 law, embodied in the Constitution's Fifth Amendment Takings Clause and the statutory  
7 just and reasonable standard, is concerned only with the former: compensating the utility  
8 for its investment in public utility assets. As I explained above, the "private property"  
9 protected by the Fifth Amendment is the utility's investment in utility assets, not the  
10 shareholder's investment in utility stock. Justice Brandeis again: "The thing devoted by  
11 the investor to the public use is capital embarked in the enterprise", *i.e.*, "rate base." In  
12 the public utility context, shareholder risk-taking on stock purchases lies outside the  
13 constitutional analysis. And while a utility's investment in public utility assets involves  
14 some risk, ratepayers already compensate investors for that risk through the authorized  
15 return on equity that is included in the utility's annual revenue requirement.

16 As for justifying the premium to HEI shareholders due to its utilities' operational  
17 effectiveness: Effective operation is what customers pay for when they pay commission-  
18 mandated rates reflecting the utility's reasonable cost. There is no logical basis for extra  
19 compensation in the form of an acquisition premium.

20 Since the control premium is justified by neither HEI shareholder risk-taking nor  
21 the utilities' operational effectiveness, we must infer that NextEra is paying the premium  
22 to get the utilities' franchises—those government-granted, exclusive rights to provide an  
23 essential service in return for monthly customer payments mandated by statutory and  
24 constitutional standards. (Consider this: If the Commission, prior to NextEra committing  
25 to pay a premium, had declared that the utilities' exclusive franchises would be subjected

1 to a nationwide competition, with the Commission selecting the best performer to replace  
2 HECO, would NextEra have offered a same control premium? Unlikely.)

3 **Q. Doesn't the control premium necessarily belong to HEI's shareholders because they**  
4 **are HEI's legal owners?**

5  
6 **A.** No. The Applicants assert that the "value [of the control premium] will be paid directly  
7 to the shareholders and cannot be 'shared' with other parties that don't have title to the  
8 securities being purchased."<sup>168</sup> This assertion assumes, incorrectly, that the franchise is a  
9 private good to which the shareholders have "title;" then it incorrectly equates "title"  
10 with "entitlement." We cannot facilely transplant concepts from unregulated markets into  
11 a regulated utility market. In an unregulated market, one with no government  
12 intervention, buyers and sellers trade freely. They are entitled to the value of that to  
13 which they have title. If you want what I own, you must pay me what I want for it—its  
14 full value. But in regulation, and utility regulation in particular, legal ownership does not  
15 always entitle the owner to full value. Otherwise, utilities with monopolies could charge  
16 whatever price the market could bear, thereby earning full value. That is not how  
17 regulation works. When utility shareholders volunteer to enter a government-regulated  
18 market, they necessarily accept that regulators can take action to limit the value of what  
19 they own. That has been the law since medieval times, memorialized today in the  
20 landmark case of *Munn v. Illinois*, 94 U.S. 113, 126 (1877) (reasoning that when  
21 someone "devotes his property to a use in which the public has an interest, he, in effect,  
22 grants to the public an interest in that use, and must submit to be controlled by the public

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<sup>168</sup> Response to OP-IR-18.

1 for the common good, to the extent of the interest he has thus created. He may withdraw  
2 his grant by discontinuing the use; but, so long as he maintains the use, he must submit to  
3 the control.")

4 In sum, to argue that shareholders are entitled to the control premium because  
5 they paid money for their stock is to misunderstand what the Constitution protects. As I  
6 explained above, the "just compensation" guaranteed by the Fifth Amendment's Takings  
7 Clause is the reasonable return on dollars invested in public utility assets used to carry  
8 out the obligation to serve. Expectations of a premium arise from shareholders betting on  
9 the stock market, not utilities investing in public service assets. The regulatory  
10 obligation, and the legitimate shareholder expectation to which that obligation applies,  
11 relate only to the latter.

12 Applicants also argue that "the value paid for HEI shares is paid to the owners of  
13 those shares who provided equity capital to HEI (forgoing other competitive investment  
14 opportunities) and took on the risk of loss in value of HEI stock and therefore are entitled  
15 to any appreciation or control premium in the stock if realized."<sup>169</sup> This argument is  
16 circular—it assumes the answer the question being asked. It assumes that in "provid[ing]  
17 equity capital to HEI," the shareholders had a reasonable expectation of receiving the  
18 control premium. But since the control premium represents the value of controlling the  
19 franchise, which value is not theirs to sell, they are not entitled to receive it. (Note also  
20 the imprecision in the phrase "any appreciation or control premium." This phrase mixes  
21 together the distinct layers of the full acquisition premium. The portion of the premium

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<sup>169</sup> Response to OP-IR-18.

1 represented by pre-acquisition appreciation, *i.e.*, the appreciation from book value to  
2 market value, is not at issue. As Applicants point out, that portion "existed prior to the  
3 merger as HEI's stock was trading above the company's book value."<sup>170</sup> See also:  
4 "[S]hares of HEI are sold at a premium above book value every day on the New York  
5 Stock Exchange, and these ordinary sales certainly do not trigger any form of gain  
6 recapture by customers."<sup>171</sup> That is not the premium portion at issue. At issue is the  
7 premium portion on top of that appreciation—the control premium.)

8 In particular cases, there might be a factual basis for dividing up the premium  
9 between shareholders and customers. But to argue that all of it goes to the shareholders,  
10 merely because they are the "owners," conflates what they own (the company and its  
11 assets) with what they do not own (the government-granted franchise). Under this  
12 mistaken reasoning, were the government to exercise its power to revoke the incumbent's  
13 franchise and award it to some other company, the government would have to pay the  
14 incumbent not only the unrecovered book value of the assets, but also some value  
15 associated with the franchise, *i.e.*, a premium. That makes no sense, because the  
16 incumbent did not create the franchise. The same result holds if the incumbent were to  
17 seek permission to withdraw from the franchise; if, say, the company wanted to depart  
18 from the utility business. We would not award the shareholders a special payment on top  
19 of their unrecovered prudent investment. And if the incumbent's shareholders have no  
20 right to a premium when their utility's franchise is revoked or when their company

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<sup>170</sup> Response to OP-IP-20.

<sup>171</sup> Response to CA-IR-213.

1 chooses to exit the utility business, then they have no right to a premium when they "sell"  
2 it voluntarily. The franchise is not theirs to sell.

3 **Q. What about NextEra's commitment not to recover the premium from ratepayers?**

4  
5 **A.** In NextEra's commitment not to recover the premium from ratepayers, we must  
6 distinguish what is stated from what is not. NextEra says HECO's utilities will not seek  
7 to recover the premium explicitly, *i.e.*, by placing it explicitly into the rate base as an  
8 element of their revenue requirements. But that commitment does not preclude the  
9 utilities from attempting to recover the premium implicitly, by charging rates exceeding  
10 reasonable cost. The Commission needs to prevent both means of recovering the  
11 premium. That is the purpose of my Condition VI.B.2.b.

12 Assuming we prohibit recovery of the control premium through rates, explicitly or  
13 implicitly, one might then argue that the premium causes no problem: If NextEra wants  
14 to pay more for HECO than it can recover from HECO's customers, that is NextEra's  
15 business; the Commission need not care. That view ignores two problems. First, once  
16 NextEra pays the premium it must absorb it, thereby weakening its own fiscal picture,  
17 including its ability to finance HECO's utilities as necessary.

18 Second, by approving a transaction that pays a control premium, absent evidence  
19 that the recipients created the value associated with that premium, the Commission would  
20 be validating and stimulating a market for acquisitions that operates inconsistently with  
21 economic efficiency. The acquisitions market would embody a mismatch between risk  
22 and reward, between performance and compensation. Acquisitions would be based on  
23 who is willing and able to pay the most for the target company, rather than on who is  
24 willing and able to offer the most to customers. By entertaining and approving such

1 transactions, the Commission would be rewarding acquirers based on ability to pay rather  
2 than on ability to perform. The competition to control a franchise would be based on  
3 making the target's shareholders more affluent rather than making ratepayers better off.  
4 Allowing such results denies utility customers what they pay for: service at a quality and  
5 cost that replicates competitive market outcomes.

6 For all these reasons, the control premium is a cost to ratepayers, even if it never  
7 enters the rates.

8 \* \* \*

9 This Part III has explained that NextEra's acquisition of HECO's monopoly  
10 conflicts with Hawai'i's needs in multiple ways. Each harm described in this Part causes  
11 a distinct risk to customers: competition risk, business risk, size risk, type-of-shareholder  
12 risk, loss-of-local-control risk, and shareholder-customer conflict risk. Each of these  
13 risks has a probability of occurrence above zero and a cost of occurrence above zero. In  
14 hundreds of pages of submissions—Application, exhibits, testimony, discovery—  
15 Applicants made no effort to quantify these costs. Nowhere do they identify possible  
16 negative events, estimate their probabilities and apply those probabilities to the likely  
17 costs. Even if they had made that effort, they could have addressed only the risks that are  
18 known—the risks from NextEra's current holdings. We still would face the risks that are  
19 unknown: the risks associated with all the future acquisitions that NextEra will make  
20 without the Commission approval.

21 If NextEra's acquisition motivation was to serve the public interest, its  
22 Application would present specific ideas for improving HECO's utilities, and binding

1 commitments to do so. As discussed next, on the topic of real benefits the Applicants are  
2 silent again.

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**IV.  
NextEra's Claimed "Benefits" are Mostly  
Claims Without Commitments**

**Q. NextEra's claims that the acquisition will bring consumer benefits. Describe the context for your critique of these claims.**

**A.** In a competitive market, an acquirer that overestimates its benefits risks losing its shirt. To reduce that risk, it makes real calculations based on real plans. But NextEra is buying a utility in a monopoly market, so it does not risk losing its shirt. Rather than make real calculations based on real plans, it praises its past and makes claims without commitments. In this Part IV, I will address each category of claim, as follows:

NextEra cites its "experience." But owning a vertically integrated, non-renewables monopoly in Florida does not give NextEra experience creating competitive distributed resources markets in Hawai'i.

The claimed "synergies" are guesses without commitments.

The claimed operational improvements cannot be attributed to the merger because the Applicants lack plans, metrics and commitments.

NextEra's size does not guarantee quality.

The "financing" benefit mistakenly assumes that the only way to finance new electricity infrastructure finance is through HECO.

Before addressing NextEra's claims, I would like to address the concept of "benefit," so that we can distinguish (a) benefits that are truly attributable to the acquisition, and therefore deserve to be counted, from (b) benefits that are unrelated to the acquisition but that can distract from an assessment of its merits.



1        **A.        *The multiple meanings of "benefit"***

2  
3        **Q.        In determining whether an acquisition satisfies the public interest, how should**  
4        **regulators evaluate an applicant's assertions of benefits?**

5  
6        **A.**        Assertions of benefits are relevant because of the relation of benefits to costs. Part III  
7        explained the risks and costs arising from this acquisition. An acquisition should not be  
8        approved if the relationship of its benefits to its costs is less favorable than other  
9        alternatives (including no acquisition). Otherwise, the acquisition incurs opportunity  
10       costs—harm to consumers.

11                If the purpose of benefits is to compare them to costs, what benefits should count?  
12        This subsection describes the three categories of benefits typically asserted by merger  
13        proponents. I explain that only one category—so-called "synergies"—should be counted,  
14        and then only if the assertions are backed by commitments. The other two categories—  
15        improvements in the to-be-acquired utility's performance, and payouts unrelated to the  
16        transaction, should not be counted because they distort the market for acquisitions.

17                After describing the three categories of benefit and distinguishing them in terms  
18        of appropriateness, I turn to the sufficiency of the benefit: How do we know if there is  
19        enough benefit to justify the cost?

20                **1.        *The appropriateness of the benefit: Three categories***

21  
22        **Q.        Discuss the first category of benefits—synergies.**

23  
24        **A.**        Synergies are benefits arising because two companies operate more efficiently together  
25        than apart. When a winter-peaking utility merges with a summer-peaking utility, or a  
26        renewables-heavy utility merges with a gas-heavy utility, these couplings can reduce the  
27        cost of energy and capacity because of how the resources mesh. When a merger results  
28        in economies of scale, scope or integration, or allows resource-sharing that reduces

1 overhead expense, that is a merger benefit also—a benefit caused by the merger and  
2 unavailable without the merger. This type of benefit should be counted because it is  
3 caused by the coupling and could not be achieved without it.

4 **Q. Discuss the second category of benefits—performance improvements.**

5  
6 **A.** When an acquirer improves the target's performance, this benefit arises not because two  
7 operations mesh, but because we substitute higher quality practices for lower quality  
8 practices. The acquirer is using its control of the target to bring superior performance to  
9 the target. It is a benefit, but it is not a benefit attributable to the merger.

10 Consider this exaggerated hypothetical: The target company was using quill pens  
11 and Roman numerals; the acquirer introduces computers. This benefit arises not from the  
12 meshing of operations; it occurs because an under-performing target learned new lessons.  
13 Those new lessons don't need a merger to be learned. The target could have hired new  
14 managers or consultants, learned from peers, attended professional conferences, or raised  
15 internal standards by sharpening its recruitment and compensation policies. Or the  
16 regulator could raise standards and consequences for failing to meet those standards; or  
17 even hold a competition to find the best performer for a particular function (as Hawai‘i,  
18 Maine, Oregon and Vermont did in choosing energy efficiency companies to replace their  
19 utilities' energy efficiency efforts<sup>172</sup>).

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<sup>172</sup> See *How Efficiency Vermont Works*, EfficiencyVermont.com, [http://efficiencyvermont.com/about\\_us/information\\_reports/how\\_we\\_work.aspx](http://efficiencyvermont.com/about_us/information_reports/how_we_work.aspx) (describing Efficiency Vermont's responsibility to provide "technical assistance and financial incentives to help Vermont households and businesses reduce their energy costs with energy-efficient equipment and lighting" and "energy-efficient approaches to construction and renovation"); *About Us*, Hawai‘i Energy.com, <http://www.Hawai‘ienergy.com/4/our-team> (describing Hawai‘i Energy's ratepayer-

1 To attribute to an acquisition benefits that can occur without the acquisition  
2 therefore conflicts with economic efficiency. We count merger benefits to justify merger  
3 costs (like the costs and risks described in Part III above). Counting performance  
4 improvements as merger benefits means that customers bear extra costs—merger costs—  
5 merely to cause their company to perform prudently. To credit consolidation as a  
6 solution to imprudence, rather than addressing imprudence directly, is illogical. Worse,  
7 the more suboptimal the target's pre-merger performance, the "better" an acquisition  
8 (with all its costs) looks, and so the higher the acquisition premium that regulators will  
9 view as justified. Put another way, the poorer the target's performance, the higher the  
10 customers' cost and the greater the target shareholders' gain. That is illogical also. If  
11 HECO's utilities are performing below standards that other utilities meet, then the  
12 Commission should find out why, instead of entertaining an acquisition that brings other  
13 costs and risks.

14 This category of benefit has another problem: It is often unquantifiable, and  
15 therefore incapable of tracking, proof and accountability. As the Maryland Public  
16 Service Commission has stated:

17 [P]rojections of benefits through synergies, 'shared services' or 'best  
18 practices' are inherently speculative and, to the extent they materialize,

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funded conservation and efficiency programs); *About Us*, EnergyTrust of Oregon, <http://energytrust.org/about> (describing Energy Trust of Oregon's responsibility to invest in cost-effective energy efficiency and assist with the above-market costs of renewable energy); *About Efficiency Maine*, EfficiencyMaine.com, <http://www.energymaine.com/about> (describing Efficiency Maine's technical assistance, cost-sharing, training, and education programs to reduce the use of electricity and heating fuels through energy-efficiency improvements and the use of cost-effective alternative energy).]

1 will likely benefit ratepayers only as 'forgone requests for rate relief,'  
2 which we have previously held to be too intangible to qualify as a benefit  
3 under PUA sec. 6-105 [*i.e.*, Maryland's merger statute, which require  
4 benefits from the acquisition]."<sup>173</sup>  
5

6 In short, making customers pay extra for something they are already supposed to  
7 receive is a form of customer abuse that would not occur in an effectively competitive  
8 market.

9 **Q. Discuss the third category of benefits—financial offers unrelated to the acquisition**  
10 **transaction.**

11  
12 **A.** Financial offers unrelated to the acquisition transaction arise from merger strategy rather  
13 than merger execution. They become available not because two companies have  
14 combined to make operations more efficient, but because the acquirer is willing to offer  
15 resources it already has, to persuade others to grant what it does not have. Treating these  
16 offers as "merger benefits" favors acquirers who have those extra resources, over  
17 alternative acquirers who have fewer resources but could make a better fit. We would be  
18 valuing an acquisition not for its intrinsic merit but for inducements that distract from its  
19 lack of merit. Doing so undermines the purpose of regulation: to induce high-quality  
20 utility performance. A student should get an A for excelling at her schoolwork, not for  
21 planting flowers in the schoolyard.

22 Finally, counting non-merger inducements also invites discrimination, because the  
23 benefits flow only to some customers, usually current ones, while the merger's risks fall  
24 on all customers, including future ones.

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<sup>173</sup> *In the Matter of the Merger of Exelon Corporation and Constellation Energy Group*, Order No. 84698 (Feb. 17, 2012), 2012 Md. PSC LEXIS 12 at text accompanying note 356.

1 **Q. Do other jurisdictions reject merger benefits not uniquely attributable to the**  
2 **merger?**  
3

4 **A.** Yes. Applying the Communications Act of 1934, the Federal Communications  
5 Commission has rejected non-merger benefits repeatedly: "[T]he claimed benefit must  
6 be transaction- or merger-specific. This means that the claimed benefit 'must be likely to  
7 be accomplished as a result of the merger but unlikely to be realized by other means that  
8 entail fewer anticompetitive effects.'"<sup>174</sup> That principle was applied by the FCC Staff to  
9 the proposed merger of AT&T and T-Mobile. The Staff rejected benefits that the  
10 applicants claimed would result from "the adoption of each company's best business  
11 practices, including customer service best practices . . . because the improvement of  
12 specific business functions by either AT&T or T-Mobile could be achieved absent the  
13 proposed transaction."<sup>175</sup>

14 In the antitrust context, the Department of Justice and the Federal Trade  
15 Commission disregard benefits achievable without a merger. Their Horizontal Merger

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<sup>174</sup> *AT&T, Inc. & Bellsouth Corp.*, 22 FCC Rcd at 5761 (quoting *EchoStar/DirecTV Order*, 17 FCC Rcd 20,559, 20,630 (2002) (citing *Ameritech Corp. & SBC Communications Inc.*, 14 FCC Rcd 14,712, 14,825 (1999) ("Public interest benefits also include any cost saving efficiencies arising from the merger if such efficiencies are achievable only as a result of the merger")); *Comcast Corp.*, 17 FCC Rcd 23,246 (2002) (Commission considers whether benefits are "merger-specific").

<sup>175</sup> *Applications of AT&T Inc. and Deutsche Telekom Ag for Consent to Assign or Transfer Control of Licenses and Authorizations*, WT Docket No. 11-65, Staff Analysis and Findings 6 241 (2011), available at <http://www.wirelessestimotor.com/publicdocs/ATT-TMO-FCC.pdf>. The FCC Staff's document is not an official Commission document; nor was it part of the official record in the named Docket. It was a draft report prepared by the Staff and released to the public by the FCC Chairman. No FCC order was issued in this proceeding, because the merger applicants withdrew their proposal.

1 Guidelines (2010) states (at Section 10): "The Agencies credit only those efficiencies  
2 likely to be accomplished with the proposed merger and unlikely to be accomplished in  
3 the absence of either the proposed merger or another means having comparable  
4 anticompetitive effects." *See also id.* at n.13: "The Agencies will not deem efficiencies  
5 to be merger-specific if they could be attained by practical alternatives that mitigate  
6 competitive concerns, such as divestiture or licensing."<sup>176</sup>

7 **2. The sufficiency of the benefit: The proper relationship of benefit to cost**  
8

9 **Q. For the benefits that deserve to be counted, how should regulators determine if their**  
10 **quantity is sufficient?**

11 **A.** For an acquisition to be consistent with the public interest, it must promise an appropriate  
12 level of benefits in relation to its costs. When a rational person makes an investment  
13 (costs), she seeks the highest possible return relative to other investments of comparable  
14 risk (benefits). A prospective acquirer of a utility has the same goal: a benefit/cost ratio  
15 at least as high as the most attractive alternative investment of comparable risk. And the  
16

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<sup>176</sup> Some state commissions have adopted a similar policy. In the proposed Southern California Edison-San Diego Gas & Electric merger, the California Commission rejected the applicants' claimed labor savings. Given the smaller utility's (SDG&E's) growth, "some of the efficiencies SDG&E might realize by merger into Edison may be achieved if SDG&E remains independent and becomes larger." *SCEcorp, Southern California Edison Co. & San Diego Gas & Electric Co.*, Decision No. 91-05-028, 1991 Cal. PUC Lexis 253, at \*25. And when a merger applicant offered ratepayers 90 percent of the net proceeds from divesting a fossil fuel plant, the New York Commission disregarded this "benefit" because the Commission had full authority to determine the proceeds' disposition without any merger. *NextEra, S.A., Energy East Corp., New York State Electric & Gas Corp. & Rochester Gas & Electric Corp.*, Case 07-M-0906, 2008 N.Y. PUC Lexis 448, at \*10. *See also* NextEra-Constellation Merger, Order No. 84698, 2012 Md. PSC Lexis 12, at \*162-163 (finding the possibility of BGE adopting its post-merger affiliates business practices "too intangible to qualify as a benefit").

1 target utility's shareholders also have that goal: Given the cost and risk incurred to buy  
2 stock, they want the highest possible return relative to comparable alternatives.

3 If utility ratepayers had competitive options, they would choose suppliers based  
4 on that same standard: they would shop to receive the greatest value for the dollars they  
5 spend. When evaluating a proposed acquisition, therefore, regulators should ask the  
6 same question investors (and shopping consumers) ask: Will this transaction produce for  
7 customers the best possible benefit-cost relationship, compared to alternative actions the  
8 utility could take? This question repeats the principle that regulation always applies to  
9 utilities: Having received protection from competition, a utility must perform as if it were  
10 subject to competition; it must provide its customers the best possible benefit-cost ratio.

11 This transaction fails that standard. To understand why, one need only contrast  
12 what HECO's shareholders got from NextEra with what the Applicants are offering  
13 HECO's customers. Like any rational investor, NextEra and HECO each sought "biggest  
14 bang for the buck."<sup>177</sup> While each applicant received biggest bang for buck, what they  
15 are offering HECO's utilities customers is, literally, nothing. That asymmetry of outcome  
16 makes this merger inconsistent with the public interest.

17 Returning to the relationship between regulation and competition: Effective  
18 competition serves the public interest because it forces a never-ending search for  
19 improvements, from horses to stage coaches to street cars to buses to jet engines; from  
20 telegrams to telephones to faxes to cell phones to the internet to the world wide web. The  
21 same dollars spent on a computer 25 years ago buys a much better computer today. If we

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<sup>177</sup> As described in Part III.G.1 above.

1 protect a utility from competition, we need regulation to make it perform as if it were  
2 subject to competition. That means assuring that a transaction offering biggest-bang-for-  
3 buck to the target and its acquirer provides comparable benefit to the utility's customers.

4 ***B. Owning a vertically integrated, non-renewables monopoly in Florida does not***  
5 ***give NextEra experience creating competitive distributed resources markets in***  
6 ***Hawai'i***

7  
8 **Q. Is NextEra's experience consistent with Hawai'i's needs?**

9  
10 **A.** No. Hawai'i has a mission: to transform a decades-old, vertically integrated,  
11 unidirectional monopoly market into a dynamic set of unbundled, bidirectional  
12 competitive markets. Today's market structure provides plain vanilla electric service to  
13 captive consumers. Hawai'i's new markets will provide diverse services to  
14 entrepreneurial "prosumers."<sup>178</sup> Integrating diverse suppliers, electrically and  
15 commercially, along bi-directional, distribution-level networks: These are the steps  
16 required to fulfill the new statutory command of 100 percent renewables by 2045.

17 NextEra claims to have experience. But its majority experience, and its majority  
18 source of profit, is from owning and maintaining FPL's vertically integrated monopoly.  
19 That is not the experience Hawai'i needs. NextEra has no experience in—nor has it  
20 demonstrated any commitment to—supplementing (and possibly supplanting) a vertically  
21 integrated monopoly market with diverse product markets. FPL's generation sources are  
22 the opposite of diverse: The dominant owner of generation serving FPL's customers is

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<sup>178</sup> See *Inclinations* at p.13 (discussing goal of "open[ing] the opportunity for the DER-equipped customer to become a "prosumer", that is a customer who both consumes or uses utility services and may also provide services to the utility").



1 FPL;<sup>179</sup> and the amount of renewable energy in FPL's service territory is token.<sup>180</sup>  
2 Substantial renewable energy projects in Florida are utility-owned.<sup>181</sup> Regardless of the  
3 reasons (FPL says its own low costs create a "significant hurdle to-date for many  
4 renewable energy sources"<sup>182</sup>), FPL lacks experience stimulating and managing the entry  
5 of numerous small renewable producers.<sup>183</sup>

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<sup>179</sup> As of December 31, 2013, of the 26,236 MW necessary to serve its load, FPL owned 24,273 MW. Only 1,963 MW came from non-FPL sources. NextEra 2014 10-K at 4, 7.

<sup>180</sup> "FPL's 2014 fuel mix, based on MWh produced, as shown on page 9 of the 2014 10-K, includes less than 1% of solar and oil generation collectively and no wind generation." Response to OP-IR-3.

<sup>181</sup> FPL is undertaking various utility-owned solar projects, as NextEra describes in its Responses to OP-IR-4, but their size is small compared to FPL's total generation.

<sup>182</sup> Response to CA-IR-2.

<sup>183</sup> NextEra seems to acknowledge this point. In OP-IR-136, NextEra was asked: "What experience does NextEra have in creating markets that attract the best renewable competitors?" NextEra responded:

NextEra Energy rejects the premise of the information request as inferring [sic—the word is "implying"] that a company, such as NextEra Energy, creates markets. Rather, NextEra Energy participates in various energy markets and has experience as a leader in successfully competing to provide renewable energy to utilities and businesses throughout North America. Having successfully participated in hundreds of solicitations, NextEra Energy's low cost position and technical expertise can help ensure that customers are receiving the most affordable and cost-effective energy, whether that is provided by NextEra Energy- or third party-owned renewable generation.

NextEra has made my point. To develop the distributed services and renewable markets to their full potential, Hawai'i will need a neutral entity creating a neutral platform so that the best performers win roles. NextEra is not neutral; it wants to win roles.

1           The experience FPL claims thus relates not to stimulating diverse new markets  
2 but to running a vertically integrated monopoly. That is what FPL claims to do well in  
3 Florida. But Hawai'i is not Florida. While HECO does need help being a better  
4 vertically integrated monopoly,<sup>184</sup> Hawai'i's goal is to reduce its dependence on this  
5 vertically integrated monopoly.<sup>185</sup>

6           NEE does have experience with renewable energy. But that experience is in  
7 owning and controlling renewable energy: developing its own projects and arguing for  
8 their selection. NextEra has neither experience nor motivation concerning soliciting bids  
9 from other companies and encouraging their selection.

10           In short, NextEra is a vertically integrated monopoly, seeking to buy and control  
11 another vertically integrated monopoly. Its experience, skill set and its business model  
12 do not match Hawai'i's long-term needs. Worse, they conflict.<sup>186</sup> If we approve an  
13 acquisition by a company with conflicts, we then will need "incentives" to overcome the  
14 conflicts. The better approach is to invite to Hawai'i companies whose business models  
15 are consistent with the structural transformation Hawai'i wishes to induce.

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<sup>184</sup> As the *Inclinations* document details.

<sup>185</sup> See, e.g., *Inclinations* at 19 ("The Commission will consider whether it is reasonable and in the public interest to preclude the HECO Companies ... from ownership of new generation ....").

<sup>186</sup> As detailed in Part III.B and C above.

1           **C.     *The claimed "synergies" are guesses without commitments***

2  
3           **Q.     Should the Commission count as merger benefits NextEra's claims of synergies?**

4  
5           **A.**    No. Applicants mention "expected savings"—savings that "*should* be achieved through  
6           such means as shared services, productivity improvement and improved contracting,  
7           among other means."<sup>187</sup> Behind that ambiguous "should" (Actual prediction, or  
8           normative statement?) is—nothing. Applicants confess that "a detailed quantification of  
9           "synergies" has not been performed. A breakdown by functional category has not been  
10          developed."<sup>188</sup> And they "have not developed specific plans or details on how and when  
11          merger savings will be realized."<sup>189</sup> There are "no plans of reorganization, restructuring  
12          and/or alignment of responsibilities under development, and considered and/or approved  
13          for post-sale implementation in Hawai`i."<sup>190</sup>

14                 Lacking any "specific plans or details," any "breakdown by functional category"  
15                 or any "detailed quantification," Applicants' synergy claims boil down to guesswork.  
16                 And this guesswork is not a projection based on anything that actually happened, like a  
17                 study of prior mergers. The guesswork is based on prior mergers, yes. But it is not based  
18                 on merger outcomes; it is based on merger advocacy. It is based on applicant testimony  
19                 advocating for prior mergers. The nine things Mr. Reed calls "studies" are "estimates by  
20                 the merger applicants of what the savings the [prior merger advocates] hoped to produce,

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<sup>187</sup> Response to PUC-IR-50 (emphasis added).

<sup>188</sup> Response to PUC-IR-10.

<sup>189</sup> Response to PUC-IR-50.

<sup>190</sup> Response to PUC-IR-134.

1 not savings they actually produced."<sup>191</sup> Each "study" was all filed in a regulatory  
2 proceeding by a merger applicant seeking approval.<sup>192</sup> No one at NextEra troubled  
3 themselves to see if the savings prior applicants advertised actually occurred. No one  
4 bothered to see whether the witnesses who offered these studies were in any way  
5 accountable, to their companies or respective commissions, if their predictions turned out  
6 to be wrong. Mr. Reed is basing his advocacy on their advocacy.

7 Worse, Mr. Reed's "studies" come from transaction bearing no resemblance to a  
8 merger of utilities located 4600 miles apart. Asked which of the cited transactions was a  
9 "reasonable proxy" for the NextEra-HECO transaction, Mr. Reed avoided the question,  
10 substituting a *non sequitur*: "No two transactions are exactly the same."<sup>193</sup> The question  
11 did not ask which transaction were "exactly the same"; it asked for which ones were  
12 "reasonable proxies." Mr. Reed could have answered this straightforward question  
13 straightforwardly, explaining for each of the nine their similarities and differences from  
14 the NextEra proposal. He chose instead to evade—an evasion tolerated by NextEra, who  
15 filed his non-answer rather than instruct him to give an answer. If this is the type of  
16 witness cooperation we get before the transaction, the Commission cannot hope for better  
17 after the transaction.

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<sup>191</sup> Response to OP-IR-81(a) (OP's wording, with which Mr. Reed agreed).

<sup>192</sup> Response to CA-IR-102, referring to Applicants' Exhibit-33, Page 31, Lines 1-8.

<sup>193</sup> Response to PUC-IR-164.

1 All this factlessness could be forgiven if the claims were accompanied by  
2 commitments. But on the issue synergies, NextEra has made no commitments—other  
3 than the four-year moratorium, whose weakness I will discuss in Part IV.G below.

4 ***D. The claimed operational improvements cannot be attributed to the transaction***  
5 ***because the Applicants lack plans, metrics and commitments***

6  
7 **Q. Should the Commission count as merger benefits NextEra's claims that it will**  
8 **improve HECO's operations?**

9  
10 **A.** No, because there are no plans, metrics or commitments. There is, therefore no evidence  
11 of causation—no link between the acquisition and any benefits of the appropriate type  
12 and magnitude to justify the acquisition's costs. Without such a showing, there is no  
13 accountability; there is only advertising.

14 ***1. No plans***

15  
16 **Q. What do Applicants say about plans to bring improvements?**

17 **A.** They say that "[t]he specifics of potential best practices have not yet been evaluated or  
18 decided."<sup>194</sup> There are no plans because "the integration planning team is still in the early  
19 stages of formalization. Oversight and administrative processes are in the process of  
20 being identified and will be presented for approval by the Applicants' joint executive  
21 steering committee once developed."<sup>195</sup>  
22

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<sup>194</sup> Response to PUC-IR-28.

<sup>195</sup> Response to PUC-IR-104.

1                   2.       *No metrics and no commitments*

2  
3 **Q.     What do Applicants say about metrics and commitments for improving HECO?**

4  
5 **A.**     They say they "have not identified or developed measurement tools for quantifying how  
6 NextEra Energy will strengthen and accelerate the Hawai‘ian Electric Companies' clean  
7 energy transformation relative to what would be accomplished on a standalone basis."<sup>196</sup>  
8 "Except for reliability..., the specific metrics for improvement to be used to evaluate all  
9 areas currently under the responsibility of Mr. Ching - one year, three years and five  
10 years from now - have not been determined."<sup>197</sup> And as for reliability, Applicants insist  
11 on establishing the "baseline"—against which improvements would be measured—only  
12 after the acquisition's closing.<sup>198</sup> But once the acquisition occurs, the Commission's  
13 influence over the baseline declines, while NextEra's influence rises.

14                   3.       *No causation*

15  
16 **Q.     In Part IV.A.1 above, you stressed causation—that only benefits attributable to the**  
17 **merger, meaning not achievable without the merger, should count. On causation,**  
18 **how do the Applicants fare?**

19  
20 **A.**     To attribute HECO improvements to the acquisition, the Applicants have to assume that  
21 HECO would not be required to make those improvements without the acquisition. But  
22 that assumption has no basis, legally or factually. Legally, any utility receiving  
23 protection from competition is obligated to use "best practices." Indeed, "[t]he Hawai‘ian  
24 Electric Companies do not contend that these cost-saving methods are currently

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<sup>196</sup> Response to DBEDT-IR-17.

<sup>197</sup> Response to OP-IR-56.

<sup>198</sup> Response to PUC-IR-88.

1 unavailable to the Hawai‘ian Electric Companies...."<sup>199</sup> A utility's failure to learn and  
2 apply best practices is grounds for revoking its franchise, not approving a sale of that  
3 franchise at a profit to the shareholders.

4 Factually, "best practices" are, by definition, practical, not imaginary. They are  
5 not some secret formula; they are available to the intelligent and entrepreneurial. And so  
6 they are available without the acquisition; they are not properly attributable to the  
7 acquisition. That HECO itself might lack the competence to achieve best practices is  
8 beside the point. Best practices are an obligation of the franchisee, whoever that is; best  
9 practices are therefore not made possible by the NextEra's acquisition.

10 **4. Result: Acquisition without accountability.**

11  
12 **Q. When there are claims of post-acquisition improvement, but no plans, metric or**  
13 **commitments, and no showing of causation, what should the Commission find as the**  
14 **result?**

15  
16 **A.** Because there are no plan, metrics, or commitments, and no evidence of causation, the  
17 Commission has no way to determine either the probability or the value of the  
18 improvements. Without evidence of probability and value, the Commission cannot  
19 weigh the transaction's benefits against its costs.<sup>200</sup> And so if improvements occur after  
20 the acquisition, the Commission will be unable to determine which ones were attributable  
21 to the acquisition (as opposed to one ones that would have, or should have, occurred

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<sup>199</sup> Response to CA-IR-14.

<sup>200</sup> For the discussion of the necessary relationship between benefits and risks, see Part IV.A.2 above.

1 without the acquisition). If there is nothing the Commission can count on, there is no  
2 way to hold anyone accountable. Regulation will have lost its purpose.

3 Contrast the way in which a commission approves a new purchased power  
4 agreement or generating unit. No utility proposes these things without presenting a year-  
5 by-year, lifetime benefit-cost path comparing life with and without the expenditure,  
6 accompanied by alternative scenarios and sensitivity studies. Specific witnesses present  
7 these numbers, their reputations (and the utility's finances) at stake if they are wrong.  
8 The utility's contracts with its vendors will assign accountability for performance  
9 shortfalls. But in the testimonies of Mr. Chung, Mr. Reed, Mr. Olnick, Mr. Gleason, and  
10 Mr. Oshima, and others, nothing remotely like these methods of accountability appears.  
11 There is less clarity, commitment and accountability in this \$4 billion dollar transaction  
12 than there is in the purchase of a used car.

13 By committing to nothing, the Applicants keep expectations low. But doing so  
14 denies the Commission any objective, credible basis on which to judge this transaction.  
15 In competitive markets, things don't work that way. If NextEra had to compete for the  
16 privilege of serving Hawai'i customers, it would have to supplant self-praise and  
17 vagueness with real facts and commitments. The Commission then could compare those  
18 facts and commitments to alternatives; and, if it chose NextEra, impose conditions on the  
19 acquisition approval that made NextEra accountable for its claims. Competition produces  
20 accountability. But as the S-4 narrative demonstrates,<sup>201</sup> when NextEra and HECO  
21 designed this transaction, competition for the consumer was not what they had in mind.

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<sup>201</sup> See Part III.G.1 above.



1                   5.       *The antitrust argument*  
2

3 **Q.    Are Applicants' reasons for the absence of plans, metrics and commitment**  
4 **persuasive?**

5  
6 **A.**    No. As I understand it, Applicants have no plans, metrics or commitments because  
7 NextEra has not been able to get inside the HECO utilities to acquire the necessary  
8 information and familiarity. On reliability, for example, they say: "The specific details  
9 for these improvements cannot be known until NextEra Energy has sufficient opportunity  
10 as owner to better understand Hawai'ian Electric Companies' resources and the strengths  
11 and any limitations in the Hawai'ian Electric Companies' respective electric grids,  
12 systems, operations and plans."<sup>202</sup>

13                    Asked why they could not acquire the necessary information and familiarity now,  
14 Applicants give five reasons:

- 15                   1.        "The concept of gun-jumping under antitrust law restricts an  
16 acquirer from exercising control prematurely. The Hart-Scott-  
17 Rodino Act, Section 7A of the Clayton Act, 15 U.S.C. sec. 18a  
18 ("HSR") prohibits an acquirer from exercising "substantial  
19 operational control" prior to expiration of the HSR mandated  
20 waiting period. In addition, the Sherman Act, 15 U.S.C. sec. 1  
21 prohibits anti-competitive agreements between independent  
22 firms."<sup>203</sup>  
23  
24                   2.        "[T]he Merger Agreement itself does not allow NextEra Energy to  
25 assume operational or managerial control, nor would ceding such  
26 control to a third party prior to consummation of the merger be  
27 reasonable, customary, or in the best interests of the Hawai'ian  
28 Electric Companies' customers and other stakeholders...."<sup>204</sup>

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<sup>202</sup> Response to PUC-IR-88.

<sup>203</sup> Response to OP-IR-7; OP-IR-128.

<sup>204</sup> *Id.*

- 1  
2 3. "NextEra Energy's ability to develop plans and projects in  
3 coordination with the Hawai'ian Electric Companies prior to the  
4 transaction's consummation is impeded by the desire to allow the  
5 Hawai'ian Electric Companies to remain focused on their  
6 transformation efforts. NextEra Energy is consciously avoiding  
7 activities that might adversely impact or slow down those  
8 efforts."<sup>205</sup>  
9
- 10 4. "[T]he Applicants did not contemplate, and NextEra Energy should  
11 not be exposed to the risk of using its proprietary information,  
12 expertise and models to develop valuable business plans for the  
13 Hawai'ian Electric Companies and, at the end of one year, give the  
14 Hawai'ian Electric Companies the ability to terminate the  
15 transaction. Had that been contemplated, the negotiated break-up  
16 fee would have been much higher to compensate for the increased  
17 risk."<sup>206</sup>  
18
- 19 5. "The level of access and information that would allow NextEra  
20 Energy to develop these plans in a prudent manner can only be  
21 gained while exercising operational control as owner of the  
22 Hawai'ian Electric Companies, as only then would NextEra  
23 Energy be able to fully understand the strengths and any  
24 limitations in the Hawai'ian Electric Companies' respective electric  
25 grids, systems, operations, and plans."<sup>207</sup>  
26

27 Each of these points has a hole:

28 1. The antitrust argument implies that it is impossible to make any study of  
29 HECO's internal workings without "exercising control" or making an "anti-competitive  
30 agreement." One can study one's counterpart without exercising control and without  
31 making an agreement. Applicants in fact "agree that the applicable law does not prohibit  
32 NextEra Energy from developing more generalized integration plans for post-merger

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<sup>205</sup> *Id.*

<sup>206</sup> OP-IR-7.

<sup>207</sup> OP-IR-128.

1 activities, as long as the plans are not implemented to the point where they are construed  
2 to constitute control of the Hawaiian Electric Companies." But they insist that "though  
3 'developing plans and projects' does not necessarily constitute control in and of itself,  
4 from NextEra Energy's perspective it will need to have full and complete access and  
5 control prior to the prudent development of plans and projects that will guide the future  
6 operation of the Hawaiian Electric Companies."<sup>208</sup> It appears, then, that the problem is  
7 not antitrust law's requirement but NextEra's preference. It wants control first, plans  
8 second.

9 2. The same argument goes for the Merger Agreement's restrictive language—  
10 language which, by the way, is entirely within the Applicants' power to revise so that the  
11 necessary study can occur.

12 3. There is no reason why NextEra's internal study of HECO's operations would  
13 have to "adversely impact or slow down" HECO's "transformation efforts." Those

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<sup>208</sup> Response to OP-IR-138. NextEra also says (*id.*) that

the level of access and information that would allow NextEra Energy to prudently develop the type of detailed plans necessary and appropriate to the future operation of the Hawaiian Electric Companies can only be gained while exercising operational control as owner of the Hawaiian Electric Companies. Only then would NextEra Energy be able to fully understand the strengths and limitations of the electric grids, systems, operations and plans of the Hawaiian Electric Companies, all of which will need to be addressed in future plans and projects.

One can agree that the level of detail in plans depends on the "level of access and information," but still find that some type of detail useful in creating some type of plans can be achieved without the type of control that triggers antitrust concerns. And NextEra's response still cites no antitrust cases or guidelines for its inflexible position. My position remains: NextEra has not offered a sufficient basis for asking the Commission to take on faith NextEra's insistence that it will cause improvements.

1 "transformation efforts" did not seriously begin until after the Commission's *Inclinations*  
2 Order, as Mr. Oshima admitted.<sup>209</sup> ("In the summer of 2014, based on the direction and  
3 guidance provided by the Commission in its [*Inclinations* Order], our Companies set in  
4 motion a companywide transformation effort that will change the way we do business  
5 and, even more importantly, deliver the value and results our customers want.").

6 Transformation can wait a few more months, if the result is to give the Commission (and  
7 NextEra, actually) information they need to evaluate this transaction on its merits.

8 4. NextEra said it had not "contemplated" the "risk of using its proprietary  
9 information, expertise and models to develop valuable business plans." And so a  
10 company that lauds its ability to manage risks is using its failure to "contemplate" a risk  
11 to justify its literal ignorance about the improbability of assets, operations and personnel  
12 for which it is paying \$4 billion. Instead of taking the risk of "develop[ing] valuable  
13 business plans, "NextEra took a different risk: that self-praise and generic aspirations  
14 would substitute, as substantial evidence, for serious knowledge about and accountability  
15 for the benefits that will accompany its control. But NextEra's failure to "contemplate" is  
16 not cause for lessening its burden of proof. As for the breakup fee, nothing prevents the  
17 parties from renegotiating that clause. If their goal is Hawai'i's well-being, and if they  
18 trust the Commission to make good decisions, they can revise their agreement, gather the  
19 necessary information and present real commitments that the Commission can weigh  
20 against the costs.

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<sup>209</sup> See Oshima Direct Testimony at 7.



1        *E.     NextEra's size does not guarantee quality*

2  
3        **Q.     The Applicants have argued that one advantage to Hawai'i is NextEra's large size.**  
4        **What value should the Commission place on this argument?**

5  
6        **A.**     The argument lacks evidentiary value. NextEra offers no evidence on whether, or how,  
7        its size (or any utility's size) is causally related to performance. I don't doubt that under a  
8        given set of circumstances, there is likely some size range within which cost-effective  
9        performance is more likely to occur, compared to sizes above and below that range. But  
10       NextEra gives us no evidence about what size range fits with Hawai'i's circumstances.  
11       NextEra could have offered statistical studies to prove its point, but did not. (I am  
12       reasonably sure that the cost of such studies would be less than the \$90 million break-up  
13       fee.<sup>210</sup>) Lacking statistical studies, NextEra at least could have offered anecdotal  
14       evidence comparing small utilities like Madison [Wisconsin] Gas & Electric with large  
15       utilities like Pacific Gas & Electric. NextEra could have compared the HECO utilities  
16       with larger utilities. NextEra could have compared the HECO utilities with KIUC—a  
17       much smaller entity that seems to draw more praise from the Commission. NextEra did  
18       none of this. Nor did it compare the utilities' current costs with their likely post-  
19       acquisition costs, to test the bare verbal statement that "size" matters at all, let alone  
20       matter at NextEra's post-acquisition size. This reference to size is mere advertising—  
21       possibly true, possibly false, but in no way resembling substantial evidence.

22                     In short, there is no evidence that HECO's performance is suboptimal because of  
23       its size; that its costs would decline and performance would improve if only it were part

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<sup>210</sup> See Ex. 1 to the Application (NextEra Form 8-K, Dec. 3, 2014) at 2.

1 of a larger organization. One could just as facilely say that HECO needs to shrink to  
2 improve.<sup>211</sup> Indeed, a serious investigation of Hawai‘i’s future market structure would  
3 consider that very possibility. It would look into whether different combinations of asset  
4 ownership (such as allowing for separate distribution grids within one or more islands,  
5 managing their own consumption while purchasing generation, transmission and/or  
6 ancillary services from a central organization), would better serve the customer than the  
7 status quo. As I explained in Part III.B.2 above, allowing one vertically integrated  
8 monopoly to acquire another, under circumstances where the acquirer has intention and  
9 expectation to continue controlling a vertically integrated monopoly, heads precisely in  
10 the opposite direction. That is why the Commission should reject this transaction.

11 ***F. The "financing" benefit mistakenly assumes that the only way to finance new***  
12 ***electricity infrastructure finance is through HECO***

13  
14 **Q. Describe your concerns with NextEra's argument that its financial strength will**  
15 **assist with HECO's capital expenditure demands.**

16  
17 **A.** Applicants describe a 10-year capital expenditure plan of approximately \$6.2 billion.<sup>212</sup>

18 They add:

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<sup>211</sup> See, e.g., the recent statement by the President of the California Public Utilities Commission, that in reference to safety issues at Pacific Gas & Electric, "[t]he question may not be whether PG&E is too big to fail, but instead 'Is the company too big to succeed?'" David Baker, "Too Big? PUC Chief suggests breaking giant utility apart," *San Francisco Chronicle* (10 April 2015), available at <http://www.pressreader.com/usa/san-francisco-chronicle/20150410/282295318721865/TextView>.

<sup>212</sup> Response to PUC-IR-138 (referring to other sources). See also Response to UL-IR-50 (noting that the PSIPs identified, according to the Response, "\$8 billion of capital to be deployed over the next 15 years").

1 Given Hawai‘ian Electric Industries' market capitalization absent the  
2 proposed merger with NextEra Energy, it is apparent that the Hawai‘ian  
3 Electric Companies would be challenged to raise the common equity  
4 necessary to fund the growth set forth in the PSIPs. The PSIP capital is  
5 three to four times the size of Hawai‘ian Electric Industries' market  
6 capitalization (excluding the value of its subsidiary American Savings  
7 Bank....).<sup>213</sup>  
8

9 They then reason:

10 Applicants believe that the annual incremental savings to the Hawai‘ian  
11 Electric Companies resulting from the three-notch upgrade by Standard &  
12 Poor's from BBB- to A- and anticipated capital expenditure spend and  
13 following the approximate 43.7% debt funding based on the existing  
14 equity ratio of 56.3% will approximate \$0.5 million. This annual savings  
15 amount builds to \$6.8 million by the tenth year (2024) of capital  
16 deployment, with the nominal interest savings accumulating over the life  
17 of the 30-year financings totaling \$203.0 million."<sup>214</sup>  
18

19 I will leave to financial experts the task of assessing the assumptions about  
20 differentials in bond ratings and interest rates (along with the necessary job of translating  
21 the nominal \$203 million over 30 years into a net present value the Commission needs to  
22 make sense of the statement. I will focus instead on the two-part assumption NextEra  
23 makes to support its point.

24 The assumption is that (a) without the acquisition, HECO would be the only entity  
25 to carry out the capital expenditure plan; and (b) with the acquisition, NextEra would be  
26 the only entity to carry out that plan. The comparison of (a) to (b) favors NextEra. But  
27 the comparison is false, because (a) and (b) are not the only outcomes. Under either the  
28 no-acquisition or yes-acquisition scenarios, the Commission could—and should—require

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<sup>213</sup> *Id.*

<sup>214</sup> Applicants' Response to PUC-IR-138.



1 competitive bidding for one or more major capital projects. Indeed, "Mr. Reed  
2 recognizes that some of these investments are likely to be made by nonutilities."<sup>215</sup> As do  
3 the Applicants, when challenged: "The Applicants understand and support that the  
4 Commission may require competitive bidding on various components of the PSIPs."<sup>216</sup>  
5 Under that assumption—an assumption consistent with the Commission cost-minimizing  
6 responsibilities rather than the Applicants' profit-maximizing aspirations—each  
7 investment opportunity will go to the least cost supplier, all else equal. NextEra's false  
8 comparison will be irrelevant. Financial savings will result from the competition, not  
9 from the acquisition.

10 NextEra thus has tied financial benefit to control. NextEra's offer to finance  
11 Hawai'i infrastructure does not apply to projects developed by third-parties; it applies  
12 only to projects developed by NextEra. Its private interest strategy of control conflicts  
13 with the public interest goal of diversity.

14 Furthermore, NextEra again makes no commitments, so it has no obligation to  
15 invest. Since NextEra is not "pure play," and since its growth is unconstrained by the  
16 now-repealed PUHCA 1935 or any Commission condition (if NextEra has its way in  
17 opposing my proposed Condition VI.B.1.a), NextEra is free to invest its capital  
18 elsewhere—unless its agrees to a condition requiring it to invest capital in Hawai'i on  
19 command of the Commission. NextEra is trying to have it both ways: It argues that its

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<sup>215</sup> Applicants' Response to UL-IR 69.

<sup>216</sup> Response to OP-IR-117.

1 capital availability will be a major benefit from this transaction, while retaining the  
2 unrestricted ability to make that very capital available for non-Hawai'i destinations.

3 And in terms of HECO's access to financial resources, this acquisition moves in  
4 the opposite direction. As I explained in Part III.C.2 above, interposing NextEra between  
5 HECO and the equity markets creates three problems for the utilities. First, their access  
6 to equity will depend on NextEra's unilateral decisions (which could involve conflicting  
7 demands from NextEra's other family members—the number and international dispersion  
8 of which has no limit, as explained in Part III.C.3). Today, the Hawai'i utilities' access to  
9 equity depends on HECO, whose near-exclusive business is providing low-risk monopoly  
10 utility service in Hawai'i. Second, after the acquisition, equity may come to HECO's  
11 utilities at a higher cost should NextEra's profile become riskier—a possibility that the  
12 Commission cannot control unless it conditions this acquisition on NextEra getting the  
13 Commission approval for future acquisitions. Third, the risks NextEra incurs could leave  
14 the utilities' bond ratings at levels lower than they would be without the transaction—  
15 again due to NextEra investments that the Commission cannot control. By blocking  
16 HECO's access to the equity markets, and by exposing the utilities to new and unknown  
17 business risks that can affect their access to the bond markets, this acquisition cannot  
18 claim, except rhetorically, to make the utilities financially stronger.

19 **Q. Does it matter if the rating agencies view this transaction favorably?**

20  
21 **A.** Only if one ignores the long term. The factual basis for these ratings is necessarily  
22 limited to the Applicants' current loans and current activities, plus the Applicants'  
23 generic, non-committal statements about future plans. Positive outlooks last only as long  
24 as positive facts do. Current ratings therefore tell us nothing about the future—the future

1 NextEra insists on keeping unknown and under its exclusive control. Extrapolating from  
2 an allegedly positive present into an indefinite future is an insufficient basis for a public  
3 interest finding.

4 **G. *The rate moratorium's benefit to consumers is only 1/11th the acquisition's***  
5 ***benefit to HEI Shareholders***

6  
7 **Q. What value should the Commission place on the Applicants' proposed "rate**  
8 **moratorium"?**

9  
10 **A.** The Applicants propose that the HECO utilities "will not file for a general base rate  
11 increase for at least four years following closing of the transaction, and will forego  
12 recovery under the decoupling mechanism of the incremental 'O&M RAM Adjustment'  
13 during that period...." This commitment, they say, is worth "an estimated \$60 million in  
14 customer savings."<sup>217</sup> I will leave to the more technical witnesses to address the clarity of  
15 the proposal and the quality of the estimate. Recall that HEI's shareholders will receive a  
16 control premium of \$568 million—9 times the \$60 million offered here. This  
17 lopsidedness reflects HEI's strategy of seeking shareholder gain rather than customer  
18 benefit.<sup>218</sup>

19 \* \* \*

20 NextEra wants this proceeding to be about performance; specifically, how  
21 NextEra can improve HECO's performance. But making an acquisition proceeding a  
22 performance proceeding creates an awkwardness: By the Applicants' own admission,  
23 their ignorance of each other's costs and practices—an ignorance they blame on antitrust

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<sup>217</sup> Application at 13.

<sup>218</sup> As explained in Part III.G above.

1 law and other factors<sup>219</sup>—makes performance promises impossible. So we have a  
2 performance proceeding in which the acquirer can offer only self-praise about the past,  
3 and noncommittal optimism about the future.

4 If the information-sharing necessary to improve performance is not possible when  
5 an acquisition is pending, it is more sensible to address performance when an acquisition  
6 is not pending. Then we can open the information windows, allowing offerors to present  
7 real plans and make real commitments. That is how generation competition works. We  
8 do not make generation bidders guess about HECO's needs. Nor do we evaluate their  
9 offers based on their boasts. We give them access to HECO's operational information  
10 and we require binding offers. To do less in this acquisition proceeding, when the stakes  
11 are so much greater, is neither logical nor necessary.

12

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<sup>219</sup> As discussed in Part IV.D.5 above.

V.

**Rather Than Let HEI Sell Its Monopolies to NextEra,  
the Commission Should See What Skills and Services Others Can Offer**

A. *This proceeding's unstated purpose: To address the Commission's dissatisfaction with HECO*

**Q. Having discussed the presence of harms and the absence of benefits, what are your recommendations to the Commission?**

A. I recommend the Commission reject this application, without prejudice to a future application that is submitted in a context in which multiple paths to Hawai'i's future can be compared based rigorous criteria and information requirements. I will explain my recommendation in the three ensuing subparts.

**Q. What is the relationship between this proceeding and HECO's performance?**

A. If this transaction were a pure takeover for profit, say by a leveraged buyout firm without no electricity expertise, no one would take it seriously. The reason to consider this transaction—and to divert months of Commission and intervenor time and resources away from essential efforts to assess Hawai'i's needs—is because NextEra argues it can run Hawai'i's utilities better than HECO has. (The key verb is "can," not "will," because "can" becomes "will" only with commitments. NextEra has made no performance commitments.) In name and procedure, this proceeding is about an exchange of stock between two holding companies. In reality, this proceeding is about one alleged path toward pushing HECO to improve its performance.

But if the goal is to improve performance, the logical path is not accepting the first applicant that walks in the door. The logical approach is to seek out the entities that can do the job the best, then cause them to back their claims with commitments. That approach is exactly what Applicants resist, as discussed next.

1       **B.     *The illogical way to address dissatisfaction with HECO: Have HEI select its***  
2       ***successor secretly, based on maximum gain to HEI's shareholders***

3  
4       **Q.     If our main concern is HECO's future performance, is this transaction a logical way**  
5       **to address it?**

6  
7       **A.**    No. Whether choosing a college, a spouse or a business partner, no rational person  
8       makes a lifetime decision by taking the first option that appears—especially if one is still  
9       trying to define one's goals. If I am dissatisfied with my physician, I don't ask her to  
10      recommend another—let alone accept a successor she chose based on how much they  
11      paid her.

12            But these examples are close analogies to the proposed HECO-NextEra  
13      succession. And they are all equally illogical. The franchise—the right to provide an  
14      essential service, free from competition—is a valuable privilege. Created by government  
15      action, it can be transferred only with government approval. And since government  
16      created the value, government should receive the value. This transaction takes a different  
17      approach. Its proponents have agreed on the value—it's the \$568 million control  
18      premium. But they insist that entire value go to HEI's shareholders, even though those  
19      very shareholders elected the HEI Board that hired the management responsible for  
20      HECO's suboptimal performance that has created the Commission dissatisfaction that is  
21      at the core of this case. To any neutral observer, the illogic should be clear. Having  
22      expressed unprecedented dissatisfaction with the incumbent,<sup>220</sup> the Commission should  
23      not hand the job over to a company hand-picked by the incumbent.

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<sup>220</sup> In 31 years in the utility business I have seen very few orders as articulate, vigorous and fact-specific as the Commission's *Inclinations* order.

1 To see that approving this transaction is not logical path, one must remove two  
2 mental obstacles created by the Applicants. The first is to see that the solution to HECO's  
3 performance problems need not be one vertically integrated monopoly buying another.  
4 HECO needs help, but NextEra has no monopoly on the necessary assistance. Consider  
5 these points:

- 6 1. If we focus on cost-effective supply and customer-empowered choices, on  
7 diversity of supply and democratization of demand, we must put on the  
8 table all possible market structures. To pick NextEra because it is a  
9 vertically integrated monopoly is to assume without question the answer  
10 that Maine, New York and others are asking: Is vertically integrated  
11 monopoly—the market structure that dominated the 20th century—  
12 necessarily the solution for the 21st century? Or do technology and  
13 economics support multiple suppliers—even within the distribution space?  
14
- 15 2. Financing for the billions in new infrastructure need not come from one  
16 source. Individual segments can be subjected to competition, resulting in  
17 multiple winners each financing their own piece. Utilities use this model  
18 routinely for generation competition, and FERC has required it for  
19 transmission competition.  
20

21 The second is to recognize that there is no emergency requiring approval of NextEra.  
22 Hawai'i's situation is urgent. The urgency involves clarifying choices, specifying  
23 tradeoffs and inviting options. But urgency does not mean emergency. There is no  
24 emergency requiring us to choose NextEra.

25 Yet Applicants warn that if the Commission does not approve the transaction in  
26 time for the contractual "End Date," the deal could dry up:

27 If the transaction closing does not occur before the End Date, neither party  
28 to the Merger Agreement (NextEra Energy or HEI) has an obligation to  
29 proceed and either could decide not to do so for any number of reasons,  
30 including a change in market conditions and other unforeseen changes in  
31 circumstances.<sup>221</sup>

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<sup>221</sup> Response to PUC-IR-92.

1  
2 This is the language of transactional impatience. The End Date is the boundary on the  
3 time period within which both sides were comfortable with the exchange ratio they  
4 negotiated. What disappears on the deadline is not the public interest value allegedly  
5 created by having NextEra control HECO; what disappears is the negotiators' comfort  
6 with the price they negotiated. Hawai'i's needs, its ability to pay for those needs, and the  
7 availability of human and financial capital suited to meet that needs, do not disappear on  
8 some End Date imposed by outsiders. If a corporate coupling has public interest value,  
9 that value survives the End Date; what needs to be renegotiated is merely the price. If the  
10 parties choose to walk away, they expose the truth: Their priority was not Hawai'i's  
11 long-term interest; their priority was the price.

12 I am not saying that the Commission should be indifferent to commercial  
13 pressures, including the pressures of time. Hawai'i needs investors willing to make bets;  
14 and all financial bets are time-sensitive. Investors will be attracted to Hawai'i not only  
15 for its willingness to pay for transformational help but also for its disciplined procedures  
16 that recognize the realities of time. But those realities of time should reflect the  
17 Commission's priorities, not Applicants' ultimatums.

18 **C. *The logical way to address dissatisfaction with HECO: Open Hawai'i's door***  
19 ***wide, inviting all to offer their skills and services***

20  
21 **Q. Is it enough for the Commission to reject this transaction?**

22  
23 **A.** No. Rejection opens the door for alternatives. I recommend the Commission focus on  
24 how to attract those alternatives. The question is how.

25 In Part II I recommended the Commission to develop a vision for the types of  
26 companies it wishes to have in the state—by defining the mix of products and services it



1 seeks, then considering the types of companies—in terms of business mix, corporate  
2 structure, financial structure and market structure—most likely to excel in providing  
3 those products and services. We can fashion that vision only after studying and  
4 answering these questions:

- 5 1. What are the products and services that offer the diversity of supply, and  
6 democratization of demand, that Hawai‘i most needs?  
7
- 8 2. For providers of essential services, what should be the corporate structure,  
9 in terms of the mix of utility and non-utility businesses, and layers of  
10 affiliates between the utility and the board that ultimately controls it?  
11
- 12 3. What should be the relationship of debt to equity in the corporate family's  
13 various levels?  
14
- 15 4. Which markets should be monopoly markets and which should be  
16 competitive markets?  
17
- 18 5. What rules will be necessary to prevent temptations that misalign  
19 executive decisions with consumer needs?  
20
- 21 6. What regulatory resources and statutory authority will the Commission  
22 need to prevent inappropriate behavior and induce performance  
23 excellence?  
24
- 25 7. What consequences must the Commission be prepared to impose on those  
26 who fail to get the message that consumers come first?  
27

28 Finally, what procedure should we expect a Hawai‘i utility to follow, so that the acquirer  
29 it picks is the one that offers consumers the best services rather than the one that offers  
30 shareholders the highest price?

31 With that clear vision in place, the Commission will be positioned to invite  
32 alternatives to this transactions. It then can issue requests for proposals to find the best  
33 companies, and design a procedure for comparing, assessing and selecting those  
34 proposals. (The Commission's experience with the energy efficiency contract awarded to  
35 SAIC will provide important insights.) That is how businesses find the best employees,

1 how government agencies find the best consultants, and how customers find the best  
2 home improvement contractors. To look only at the NextEra acquisition, giving it merely  
3 an up or down vote, is to judge its merits in isolation from all other possibilities,  
4 including not only acquisitions of all HEI stock, but partial acquisitions (of one company,  
5 or of certain assets of one or more companies), creations of cooperative or municipal  
6 systems, construction of microgrids, and other structural possibilities.

7 By inviting alternative applicants to offer diverse services and structures, the  
8 Commission also will improve the quality of the applications. Had NextEra thought it  
9 was competing for the Commission's favor, it would have offered what it thought was  
10 necessary to win. It would offer real commitments—commitments it believed would  
11 exceed those offered by its competitors. But because NextEra saw its sole objective as  
12 winning over HEI's Board, it offered what the HEI Board wanted—a premium over  
13 market price high enough such that "no other party was likely to offer greater  
14 consideration in a sale of the company...."<sup>222</sup> And to the Commission it offered nearly  
15 nothing. HEI's Board insisted on the best deal for its shareholders, while the Commission  
16 has not required the best deal for consumers. That is why the ratio of shareholder gain to  
17 customer gain—nine to one—is so lopsided. The difference in positioning yields a  
18 differential in the benefits.

19 In short, to prevent future lopsidedness, and to get for Hawai'i the service  
20 excellence it deserves, we must require each future acquisition applicant to show why it,

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<sup>222</sup> NextEra Form S-4 at 40.

1           above any other company, deserves the extraordinary privilege of controlling a  
2           government-granted, exclusive franchise to serve the state's citizens.

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**VI.**

**If the Commission Does Approve a NextEra Takeover,  
Conditions Will be Necessary—but not Sufficient—  
to Reduce the Risk of Harm and Increase the Probability of Benefits**

**A. *The cost-benefit imbalance***

**Q. On the transaction presented here, HEI's sale of its stock to NextEra's, what is your recommendation?**

**A.** I recommend the Commission reject the transaction. HEI's decision to sell out to NextEra conflicts with its utilities' obligations to their customers. This transaction brings all the risks and costs described in Part III, including the risks from NextEra's current and unknown future holdings, the costs associated with adding Commission staff to monitor those holdings, and the risks associated with HECO's shrinkage in size and importance relative to its new holding company owner. HECO will face inter-family conflicts over capital access and cost allocation that it does not face today. Weighed against these risks and costs are benefits which, as explained in Part IV, are nearly non-existent.

Although I recommend rejection, I believe an expert witness should, where possible, offer options that diverge from his recommendation. Part VI.B therefore presents conditions that could reduce the risk of harm. But as I will explain in Part VI.C, even if all of these essential conditions were practical and enforceable (and some are not, as I will explain), taken together they are insufficient to correct the transaction's imbalance between and benefit, and between private and public interests.

**B. *Conditions to address the imbalance***

**Q. How have you organized your recommended conditions?**

**A.** I have organized the conditions according to three objectives: eliminate harms, create benefits, and ensure compliance.

1                   **1.     *Eliminate harms***  
2

3                   **a.     *Protect Hawai'i's utilities from NextEra's business risks***  
4

- 5                   i.     No member of the NextEra corporate family shall  
6                   acquire any interest in any business, where such  
7                   interest exceeds a dollar level established by the  
8                   Commission to eliminate the possibility of harm to  
9                   HECO's utilities, unless the Commission has  
10                  determined that the acquisition and continued  
11                  ownership of such interest will cause no harm to a  
12                  HECO utility or increase the cost of the  
13                  Commission oversight. The Commission will make  
14                  such determinations using a procedure to be  
15                  developed in a separate Commission rulemaking,  
16                  before the completion of which NextEra shall make  
17                  no additional acquisitions. Such procedure may  
18                  include a combination of safe harbors (no  
19                  Commission review necessary), advance notice  
20                  (after which the transaction may proceed unless the  
21                  Commission determines that review is necessary),  
22                  and express decisions granting or denying approval,  
23                  all as necessary to distinguish, expeditiously,  
24                  acquisitions that pose risks to consumers from those  
25                  that do not.  
26
- 27                  ii.    The Commission shall have access, in Honolulu, to  
28                  the books and records of any NextEra affiliate  
29                  whose business activities the Commission  
30                  reasonably believes could affect HEI's utilities  
31                  adversely.  
32

33                   **Comment:** The Applicants have offered books and records access only with  
34                   respect to affiliates engaged in interaffiliate transactions with Hawai'i utilities.<sup>223</sup> But

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<sup>223</sup> See Response to PUC-IR-174 (restricting access to "the books and records of [NextEra affiliates] ... that provide services chargeable to the Hawai'ian Electric Companies, to the extent necessary for the Commission to fulfill its statutory responsibilities over the Hawai'ian Electric Companies").

1 given the risks to the Hawai‘i utilities of affiliate ventures, as described in Part III.C  
2 above, regulatory access is necessary to the affiliates engaged in those ventures.

3 ***b. Prevent inappropriate movement of capital away from the***  
4 ***Hawai‘i utilities***

5  
6 NextEra shall maintain the elements of the Hawai‘i utilities'  
7 capital structure within the ranges established by the  
8 Commission from time to time. Accordingly:  
9

- 10 i. NextEra shall inject equity into the HECO utilities  
11 consistent with Commission policies.  
12  
13 ii. HECO utilities shall not pay dividends except to the  
14 extent consistent with the Commission policies.  
15  
16 iii. HECO utilities shall not incur debt except to the  
17 extent consistent with Commission policies.  
18  
19 iv. HECO utilities shall not provide financial support  
20 of any type to any NextEra business venture, other  
21 than through the purchase of goods or services  
22 consistent with the Commission's rules in  
23 interaffiliate transactions.  
24

25 ***c. Prohibit inappropriate interaffiliate transactions***

- 26  
27 i. NextEra shall not consummate this transaction until  
28 it has submitted to the Commission, and the  
29 Commission has approved, internal procedures  
30 designed to ensure that all employees will comply  
31 with the Commission's rules and conditions. Such  
32 procedures shall include not merely rules and  
33 training, but procedures for monitoring, detecting  
34 and penalizing inappropriate actions.  
35  
36 ii. No HEI utility shall undertake any obligation to  
37 make any payment to an affiliate for any service, or  
38 to sell to any affiliate any service, unless the  
39 Commission first has determined, by advance rule  
40 or transaction-specific review, that such transaction  
41 produces the maximum cost-effective benefit to that  
42 utility's ratepayers relative to all feasible  
43 alternatives.  
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- iii. No Hawai'i utility shall become a party to any NextEra interaffiliate agreement, including agreements for the allocation of overhead costs, unless the Commission first has found that such agreement is in the best interest of Hawai'i utility customers and is otherwise consistent with the Commission requirements. In any Commission rate proceeding, the utility shall have the burden of proof (including the burden of producing evidence supporting such proof), that any payment made or received by any Hawai'i utility under any interaffiliate agreement was reasonable.
  - iv. A utility's decision to use its own employees or services, rather than using corporate shared services, shall not be overruled or influenced by any NextEra official outside such utility.

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***d. Prevent NextEra interference with local management***

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- i. Subject to paragraph (ii) below, NextEra shall guarantee that (a) HECO utility management will create its own budgets unconstrained by NextEra, and (b) such budgets will be approved by NextEra as submitted by each HECO utility to NextEra. NextEra shall provide each HECO utility with any funds required by such utility to carry out its budget. Executives of both HECO and NextEra shall certify, according to a form and schedule established by the Commission, that NextEra has taken no action to constrain any utility's budget or to constrain any utility from raising or receiving the funds necessary to carry out that budget.
  - ii. In the event that NextEra executives wish to modify a budget originally submitted to them by a Hawai'i utility, NextEra shall submit to the Commission the original budget and NextEra's proposed modifications, with full explanation of the original budget, the desired modifications, and the reasons for the modifications. This paragraph shall not apply to modifications below a dollar threshold established by the Commission.
  - iii. NextEra shall guarantee that if the Commission orders any HECO utility to make any expenditure

1 that causes such utility to exceed its budget, no  
2 NextEra entity or official will prevent such utility  
3 from carrying out such order. This condition does  
4 not preclude such utility from acting on its own to  
5 contest such order.  
6

7 iv. Prior to consummation of this acquisition, NextEra's  
8 CEO shall certify, under penalty of perjury, that no  
9 one within the NextEra corporate system and  
10 outside a HECO utility has authority to overrule any  
11 decision made by a HECO utility, except under the  
12 circumstances described in paragraph (ii) of this  
13 condition. On December 31 of each year, the CEOs  
14 of NextEra and the HECO utilities shall certify,  
15 under penalty of perjury, that in the preceding year  
16 no one within the NextEra corporate system and  
17 outside a HECO utility has overruled any decision  
18 made by a HECO utility.  
19

20 v. Without advance Commission approval, NextEra  
21 shall make no corporate governance rules affecting  
22 the HECO utilities' decisionmaking autonomy.  
23

24 ***e. Eliminate unearned advantages in the markets for distributed***  
25 ***energy services***  
26

27 i. No NextEra affiliate providing in Hawai'i a  
28 competitive or potentially competitive service (as  
29 defined by the Commission) may receive from any  
30 other NextEra affiliate any form of support unless  
31 such support is consistent with Commission rules  
32 designed to ensure that no NextEra affiliate has any  
33 unearned advantage in any market subject to the  
34 Commission's jurisdiction.  
35

36 ii. No NextEra affiliate shall deny to any provider of  
37 distributed energy services any service, or access to  
38 any facility, if the Commission determines that such  
39 service or access is necessary for such provider to  
40 compete effectively. The Commission shall ensure  
41 reasonable compensation to NextEra or its affiliate  
42 for any such service or access.  
43

44 ***f. Clarify HECO's franchise privilege***  
45



1 Approval of this transaction creates no expectation that  
2 NextEra or any of its affiliates has any right, beyond what it  
3 had prior to this transaction, to provide any service within  
4 Hawai‘i for any time period.  
5

6 ***g. Protect against strategic sale of HECO***  
7

8 NextEra shall not begin any effort to sell HEI or any  
9 Hawai‘i utility except according to competitive procedures  
10 that the Commission has determined will result in the  
11 selection of that acquirer able and willing to provide the  
12 most cost-effective, responsive and innovative service for  
13 the utility customers.  
14

15 ***h. Payment of regulatory fee***  
16

17 The HECO utilities shall pay to the Commission pay an  
18 annual fee, not recoverable from utility customers, to cover  
19 the Commission's incremental cost, as determined by the  
20 Commission, associated with ensuring that this acquisition  
21 causes no harm to utility customers or to the market for any  
22 services subject to the Commission's jurisdiction.  
23

24 ***2. Create benefits***  
25

26 ***a. Improve operations***  
27

28 Prior to consummating the proposed acquisition, NextEra  
29 and the HECO utilities shall jointly submit a plan that  
30 identifies each improvement the acquisition will make in  
31 the Hawai‘i utilities' performance, and the schedule for  
32 such improvements, along with specific metrics by which  
33 the Commission can determine whether such improvement  
34 occurs. The parties shall not consummate the proposed  
35 acquisition until the Commission has approved such plan,  
36 along with any conditions.  
37

38 ***b. Flow "synergy" savings to customers***  
39

40 i. Prior to consummating the acquisition, the HECO  
41 utilities shall submit for Commission approval a  
42 tracking mechanism that identifies all costs and cost  
43 reductions attributable to the transaction, for the  
44 first five years after consummation.  
45

- 1                   ii.     The Applicants shall agree that all cost reductions  
2                             attributable to the acquisition (net of costs to  
3                             achieve) shall flow to customers, regardless of the  
4                             timing of such costs and cost reductions in relation  
5                             to a general rate case. The HECO utilities shall  
6                             propose methods, which may include interim rates,  
7                             deferrals or other methods, by which to achieve this  
8                             result without resulting in prohibited retroactive  
9                             ratemaking.

10  
11                   **Comment:** My understanding is that Applicants oppose this method of ensuring  
12                   that utility customers receive the savings that occur between rate cases. Applicants state,  
13                   in relevant part:

14                             This proposal, as drafted, would represent an inequitable "one way" rate  
15                             adjustment mechanism, in which rates could go down to reflect merger  
16                             savings without any ability to increase rates if other factors dictate that an  
17                             increase is warranted. In addition, such a proposal would reduce or  
18                             eliminate the incentives that exist under the current ratemaking approach,  
19                             as modified by the Applicants' merger commitments, to achieve merger  
20                             savings as promptly and fully as possible. Such a proposal would also  
21                             create four years of significant rate uncertainty which would create risk for  
22                             both investors and consumers.<sup>224</sup>

23  
24                   The Applicants misunderstand the concept. Making rates interim or using a deferral, can  
25                   preserve the possibility of a rate increase or a rate decrease. That is what a tracker does:  
26                   It records the information, positive and negative, during a specified period, to allow for a  
27                   true-up at the end of that period. With that information, the Commission can decide what  
28                   to do. Perhaps the Commission will flow through to customers all costs and cost  
29                   reductions, regardless of how they net out, such that customers gain the benefits and bear  
30                   the risks. Or the Commission could say "During the acquisition proceeding, the  
31                   Applicants always expressed optimism while dismissing any basis for pessimism. So

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<sup>224</sup> Response to OP-IR-87.

1 they must now lie in the bed they made: net cost reductions flow to consumers, net cost  
2 increases are borne by Applicants." Or the Commission could create some kind of risk-  
3 sharing arrangement, where above and below some "deadband" various percentages are  
4 applied to determine who bears what portion of positive and negative results. The point  
5 is to eliminate the asymmetry of information arising from the Applicants' control of the  
6 data. Using a tracker and "true-up" procedure gets the Commission after-the-fact the  
7 information the Applicants have throughout, thus allowing the Commission to make  
8 decisions that induce efficient performance. When the Commission makes those  
9 decisions, the Applicants can object if they wish, but there is no legitimate reason to hide  
10 information the Commission needs to make the decisions.

11 Supporting the need for a tracker is the Applicants' necessary acknowledgment  
12 that the four-year "moratorium" is a moratorium on rate decreases as well as rate  
13 increases. It is a rate freeze during a period when cost reductions might occur: "If during  
14 the proposed four year moratorium the Hawai'ian Electric Companies' actual revenues  
15 and costs differ from what was allowed in its most recent general base rate case, both  
16 savings and costs will be 'retained' by the Hawai'ian Electric Companies to the extent that  
17 they are not flowed back to customers through other normal ratemaking channels (*e.g.*,  
18 the earnings sharing mechanism, energy cost adjustment clause, rate adjustment  
19 mechanism)."<sup>225</sup> If net cost decreases occur during the four years, they increase  
20 NextEra's profit rather than decrease consumers' rates.

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<sup>225</sup> Response to OP-IR-129.

1           The Applicants have discretion over the timing of their integration efforts. The  
2 possibility therefore exists that they take net-cost-reducing actions during the four-year  
3 moratorium, thereby increasing their profits without reducing rates; while leaving the net-  
4 cost-increasing actions to the period following the moratorium, when they can seek a rate  
5 increase to recover the cost. The tracking concept gets the Commission the information it  
6 needs to ensure appropriate treatment of costs and benefits over the full implementation  
7 period (whose length we do not know because there are no plans or commitments).

8                   ***c.       Allocate control premium between shareholders and customers***  
9

10                   The Commission shall allocate the control premium  
11 (defined as the excess of purchase price over market value  
12 as of a day determined by the Commission) between  
13 shareholders and ratepayers according to each group's  
14 relative contribution to the premium's value. There shall be  
15 a rebuttable presumption that each group's relative  
16 contribution is 50-50. Upon the Commission's final  
17 determination of the contribution by ratepayers, the post-  
18 acquisition entity shall pay that amount to the HECO  
19 utilities' customers according to terms determined by the  
20 Commission.  
21

22                   ***3.       Ensure compliance***  
23

24                   ***a.       Ensure internal procedures for compliance***  
25

26                   Prior to consummation of the acquisition, NextEra shall  
27 demonstrate to the Commission's satisfaction that (a)  
28 NextEra has instituted internal procedures, with  
29 consequences for violations, sufficient to prevent or detect  
30 all violations of these conditions; and (b) NextEra  
31 employees face no incentives to violate these conditions.  
32

33                   ***b.       Preserve Commission authority to order spin-off for***  
34 ***noncompliance***  
35

36                   NextEra agrees that in addition to any power the  
37 Commission has under current law, by accepting these  
38 conditions the Applicants recognize, and commit not to  
39 contest, the Commission's authority to order NextEra to

1 spin off HEI (or one or more of its utilities) to NextEra's  
2 shareholders, or to require HEI or its utilities otherwise to  
3 disaffiliate from NextEra, should the Commission find that  
4 (a) there is any violation of any of these conditions or (b)  
5 one or more HEI utilities' affiliation with NextEra can  
6 cause harm to Hawai'i ratepayers.  
7

8 **Comment:** Even marriages have divorces. Some marriages have "pre-nups."

9 This marriage has a special need for one because, as the companies have admitted, they  
10 know so little about each other. So everyone—NextEra, HEI, the Commission and the  
11 public—needs clarity about how things will unwind. It is a matter of simple symmetry.  
12 If this transaction does not work out for NextEra, it has clear paths for departure: selling  
13 the Hawai'i utilities to a third party or spinning them off to the shareholders. If the  
14 transaction does not work out for the Commission, it needs similarly clear paths to cause  
15 NextEra's departure.

16 **C. *Problems with the conditions: Practicality and enforceability***

17  
18 **Q. Do you have concerns about the practicality and enforceability of your conditions?**

19  
20 **A.** Yes. Some of these conditions apply not to HEI or its utilities, but to NextEra and its  
21 other affiliates. NextEra might argue that conditions as outside the Commission's current  
22 legal powers. The direct answer would be that if the condition is necessary to protect the  
23 public interest, then NextEra has a choice: accept the condition or lose the transaction.  
24 But that leads to the next problem: It is not clear whether NextEra's acceptance of  
25 conditions can vest in the Commission the power to enforce them, if the Commission  
26 would not otherwise have that power. The Commission therefore must assure itself of  
27 these conditions' lawfulness and enforceability before relying on them. If a particular  
28 condition is necessary to the public interest but it is not clear that the Commission has the

1 statutory authority to impose it, the acquisition cannot go forward—at least not until the  
2 Legislature acts to clarify the Commission's authority.

3 **Q. Is there another way for the Commission to protect against the possibility of the**  
4 **conditions' non-enforceability?**

5  
6 **A.** Yes. If the Commission believes there is doubt about a condition's enforceability, it can  
7 make clear that a Commission finding of a NextEra violation will empower the  
8 Commission to order the Hawai'i utilities to disaffiliate from NextEra—or give up its  
9 franchise privilege. My Condition VI.B.3.b reflects this reasoning. I will refer to this  
10 condition as the "spin-off" condition because to satisfy it, NextEra would need to transfer  
11 ownership of the utilities to NextEra's ultimate shareholders, or to some other company  
12 approved by the Commission to be the utility's new owner.

13 **Q. Under what circumstances would the Commission consider taking this action?**

14  
15 **A.** The Commission would consider this spin-off option whenever it determines that a  
16 utility's affiliation with NextEra has become, or is likely to become, detrimental to the  
17 utility's ability to carry out its public service obligations at cost and quality levels that  
18 meet the Commission's standards. A non-exhaustive list of such situations would include  
19 the following:

- 20 1. NextEra has blocked a utility's initiatives required or approved by the  
21 Commission.
- 22 2. NextEra has declined to provide capital to a utility in amounts and types  
23 the Commission deems necessary.
- 24 25 3. The cost to a utility of equity or debt is higher than it would have been  
26 absent its affiliation with NextEra.
- 27 28 4. The magnitude or nature of the business activities in which NextEra or its  
29 affiliates are engaged has exceeded some level determined by the  
30 Commission to cause a risk of harm to a utility.  
31  
32

- 1           5.     A rating agency has downgraded, or has indicated the possibility of  
2           downgrading, a utility's debt due to its affiliation with NextEra.
- 3
- 4           6.     The Commission discovers an interaffiliate transaction that violates  
5           appropriate interaffiliate transaction standards to the possible detriment of  
6           a utility.
- 7
- 8           7.     A NextEra affiliate resists reasonable requests, by the Commission or  
9           others, for information about business activities that could affect a Hawai'i  
10          utility's well-being.
- 11
- 12          8.     The Commission determines that NextEra has intervened in a utility's (or  
13          an affiliate's) decision-making in a manner potentially detrimental to the  
14          utility or its customers.
- 15
- 16          9.     An event external to NextEra changes the risk level of NextEra's business  
17          activities negatively, so as to affect a utility detrimentally.
- 18

19           If one of these events occurred, the Commission would have the option of initiating a  
20           proceeding to determine whether spin-off or franchise revocation is necessary. In that  
21           proceeding, the Commission would take into account any possible advantages accruing to  
22           the utility from the affiliation that would be lost with a dis-affiliation. I am not  
23           suggesting that spin-off is a necessary response to a violation of a condition. Penalties  
24           must be proportionate to violations. I am saying that because there can be violations that  
25           justify spin-off or franchise revocation, the public interest requires that the Commission  
26           have this option available, and be willing and ready to invoke it when necessary.

27   **Q.     Do you have concerns about the feasibility of the spin-off option?**

28

29   **A.**    Yes. Even if NextEra accepts such a condition now, some interested party (*e.g.*, an  
30           NextEra shareholder, bondholder, vendor or contract partner) could later challenge the  
31           Commission's authority to order a spin-off. If that possibility is real, the Commission  
32           should pause, because if a condition necessary to the public interest is not clearly  
33           enforceable, then the acquisition itself cannot be in the public interest.

1 Another concern is practical: There is no way to know now whether there will be  
2 an alternative provider willing to take over the spun-off utility, or whether in that  
3 situation the spun-off utility will be able to serve effectively on its own. That fact too  
4 must give the Commission pause. If the Commission lacks the legal and practical means  
5 to undo the affiliations it has approved, then it must avoid those affiliations to begin with.  
6 A plane without landing gear should not be allowed to leave the runway.

7 **Q. If NextEra objects to these conditions, what does that say about its priorities?**

8  
9 **A.** NextEra will likely object that these conditions impede its plans for its future. But the  
10 relevant concern is not NextEra's future; it is Hawai'i's future. To return a utility to  
11 simpler times, to its prior low-risk, public interest-dedicated context, might  
12 inconvenience NextEra but it will benefit Hawai'i's consumers.

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**VII.  
Conclusion**

**Q. Does NextEra support its application with facts?**

**A.** No. Since the mid-1980s, there have been dozens of utility mergers. These transactions provide a large data set from which the Applicants could have compiled drawn evidence to back up its many unsupported claims. Instead of hypotheses, data, logic and conclusions—the foundations of serious policymaking—the Applicants offer vagueness, self-praise, and the same adjectival formulas that appear in every merger case.

But words cannot offset risks. Each of the conflicts and risks discussed in Part III causes some level of harm. How much harm is unknowable. One can try to quantify the costs of the risks we know about, by identifying cost-causing scenarios, then estimating the costs of each scenario and the probability of their occurrence. NextEra has made no effort to do so; implicitly it treats the harm as "zero." But treating the harm as "zero" does not make the harm "zero."

There is, therefore, an absence of proof for the very issue on which the statute requires proof. Even if NextEra had made the effort, and done so properly, that effort would have addressed only the conflicts and risks that are known. There still would be the unknown: all future acquisitions that NextEra will make, without the Commission approval—all without geographic or type-of-business limit, all without any customer-benefitting rationale. NextEra's application, like its future, is too indefinite to deserve the Commission's approval.

**Q. Does this conclude your Direct Testimony?**

**A.** Yes.

**PLANNING OFFICE EXHIBIT-5  
DOCKET NO. 2015-022**

**EXCERPTS FROM NEXTERA'S FORM S-4**

From NextEra Energy Inc., Amendment No. 3 to Form S-4 at pp. 30-41 (Mar 24, 2015).

[May 2014] NEE Chairman and CEO Robo gives Connie Lau, Pres and CEO of HEI with a "preliminary, confidential written proposal valuing HEI in its entirety (including both Hawai'ian Electric and American Savings Bank) at \$30.00 per HEI share, with the merger consideration to consist of either cash or NEE common stock at HEI's option."

[HEI Board's July 21, 2014 mtg.] "Following discussion, the HEI board authorized HEI's management to communicate to NEE that the amount of the proposed merger consideration was insufficient but that if NEE would be willing to consider increasing the proposed merger consideration, HEI would be willing to enter into a confidentiality agreement and allow the commencement of due diligence to support an increase in proposed merger consideration."

[Aug. 11, 2014.] "James A. Ajello, Executive Vice President and Chief Financial Officer of HEI, delivered a letter to Mr. Moray Dewhurst, Vice Chairman and Chief Financial Officer of NEE, reiterating the need for NEE to increase the value of its proposal and attaching initial diligence information with respect to American Savings Bank and Hawai'ian Electric and a term sheet with respect to certain high level terms of a possible transaction between NEE and HEI." ... "The proposal specified that the operational headquarters of HEI's utility business would remain in Honolulu, Hawai'i and expressed the need for commitments by NEE relating to employee job protections in connection with the merger and the maintenance of HEI's historic levels of community involvement and charitable contributions. Finally, HEI proposed a strong commitment to obtaining regulatory approvals for the proposed transaction and the payment by NEE of a termination fee if regulatory approvals were not obtained." [no required commitment re customer benefits]

"In late August 2014, Mr. Dewhurst [Vice Chairman and Chief Financial Officer of NEE,] delivered a letter to Mr. Ajello acknowledging HEI's preference to separate American Savings Bank through a spinoff to HEI shareholders in connection with any transaction and proposing that NEE would pay HEI shareholders \$24.50 for each share of HEI common stock, in cash or NEE stock at HEI's election, with HEI's bank business to be spun off to HEI's shareholders immediately prior to completion of the NEE/HEI transaction. NEE also indicated that it would be willing to absorb up to \$130 million of the corporate tax liability resulting from the spin-off of American Savings Bank. The letter also discussed NEE's commitments regarding job protections and obtaining necessary regulatory approvals."

"In late August 2014, Mr. Dewhurst and Mr. Ajello discussed by telephone the terms of NEE's letter, with Mr. Ajello indicating that HEI would be seeking improved financial terms."

"On September 5, 2014, the HEI board met, together with management and representatives of J.P. Morgan and Skadden. Mr. Ajello provided an update on the ongoing negotiations with NEE,

1 and J.P. Morgan provided an updated valuation analysis based on NEE's revised proposal. The  
2 HEI board, together with HEI's management and representatives of J.P. Morgan and Skadden,  
3 also engaged in further discussion of the benefits and risks of contacting third parties who might  
4 have an interest in engaging in a strategic transaction with HEI. The HEI board concluded, in  
5 light of the proposed merger consideration and the regulatory approvals required to complete a  
6 transaction, that the likelihood of securing a superior proposal was low, from both a financial and  
7 a deal certainty perspective....[T]he HEI board authorized management to enter into further due  
8 diligence and negotiations with NEE to seek enhanced value and to negotiate the terms of a  
9 potential merger agreement with NEE."

10  
11 "Following this board meeting [of Sept. 5, 2014], management of HEI and NEE continued to  
12 negotiate the terms of the proposed transaction. On September 11, 2014, NEE communicated a  
13 revised proposal to HEI, in which NEE would pay HEI shareholders \$25.00 per share of HEI  
14 common stock and HEI's bank business would  
15 be spun off to HEI's shareholders. NEE further agreed that it would bear the full expected  
16 corporate tax liability resulting from the bank spin-off."

17  
18 "Following discussion [at an NEE board meeting of Oct. 16, 2014], the NEE board of directors  
19 authorized NEE management to proceed with the proposed transaction at a valuation of up to  
20 \$25.50 per HEI share."

21  
22 "Through mid-November, HEI and NEE continued to discuss the level and calculation of the  
23 proposed merger consideration. In addition, HEI proposed that it would pay a special cash  
24 dividend to HEI shareholders immediately prior to completion of the proposed merger. NEE  
25 agreed that HEI could pay such a special cash dividend in the amount of \$0.25 per share without  
26 impacting the merger consideration. Following further discussion, HEI continued to seek an  
27 increase in the merger consideration and proposed increasing the special cash dividend to \$0.50  
28 per share. NEE indicated that the increased special cash dividend was acceptable to NEE. In the  
29 context of these discussions, HEI also acceded to NEE's position that the merger consideration  
30 be determined by a fixed exchange ratio, while NEE agreed to HEI's position that the fixed  
31 exchange ratio should be calculated based on the twenty day volume weighted average price of  
32 NEE common stock as of the day prior to the signing of the merger agreement."

33  
34 "Through the end of November, HEI and NEE continued to negotiate the terms of the merger  
35 agreement. Following further discussions regarding the merger consideration, NEE indicated that  
36 it was unwilling to increase the proposed merger consideration above \$25.00 in NEE stock per  
37 HEI common share in light of its acceptance of HEI's proposed special cash dividend to HEI  
38 shareholders of \$0.50 per share. On December 2, 2014, the parties agreed to embody the  
39 proposed merger consideration to HEI shareholders in a fixed exchange ratio of 0.2413 shares of  
40 NEE common stock for each outstanding share of HEI common stock, which was derived by  
41 dividing the agreed upon \$25.00 per HEI common share merger consideration by the volume  
42 weighted average price of NEE common stock for the twenty trading days ended December 2,  
43 2014."

44  
45 "Alternatives to the Merger. The HEI board took into consideration its belief that, after careful  
46 consideration of potential alternatives to the merger, the merger with NEE is expected to yield

1 greater benefits to HEI shareholders (including the benefits discussed above) than would the  
2 range of alternatives considered. The potential alternatives considered included various  
3 standalone strategies, including generation portfolio diversification and business separation, and  
4 the attendant risks of each of them, including the risks of HEI's utility's transformation plan. The  
5 HEI board also took into account its belief that no other party was likely to offer greater  
6 consideration in a sale of the company, particularly taking into account NEE's agreement to bear  
7 the expected corporate tax liability of the bank spin-off."  
8

9 "Management Recommendation. The HEI board took into account the recommendation of senior  
10 management of HEI that the merger is in the best interests of HEI's shareholders based on their  
11 knowledge of current conditions in the electricity generation, distribution and transmission  
12 industry and markets and the likely effects of these factors on HEI's and NEE's potential growth,  
13 productivity and strategic options, and on their understanding of the benefits that would flow  
14 from the separation of HEI's banking operations."  
15

16 As stated in the response to DEBDT-IR-12: "Subsequent to receiving NextEra Energy's formal  
17 proposal for the merger, Hawai'ian Electric Industries, Inc.'s ('HEI') board of directors ('Board')  
18 carefully considered other potential strategic alternatives including remaining as a standalone  
19 company and identifying companies that possibly might be interested in acquiring the utility  
20 business or the bank business. On the basis of careful consideration of the information and  
21 analysis provided to the Board by its staff and consultants, the Board concluded in the exercise  
22 of its business judgment that it was highly unlikely that a possible counterparty existed that  
23 would be willing and able to match the terms of the proposed transaction agreed to by NextEra  
24 Energy and that the risks of 'shopping' the company under these circumstances exceeded any  
25 likely benefits."



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## **Education**

B.A. *cum laude*, Yale University (majors: Economics and Political Science, Music),  
1978. Recipient of a Continental Grain Fellowship and a Patterson Research Grant.

J.D. *magna cum laude*, Georgetown University Law Center, 1984. Recipient of  
*American Jurisprudence Award* for Constitutional Law; editor of *Law and Policy in  
International Business*; instructor, and legal research, and writing.

## **Professional Experience**

President, Scott Hempling, Attorney at Law LLC (2011–present)

Adjunct Professor, Georgetown University Law Center (2011–present)

Executive Director, National Regulatory Research Institute (2006–2011)

Founder and President, Law Offices of Scott Hempling, P.C. (1990–2006)

Attorney, Environmental Action Foundation (1987–1990)

Attorney, Spiegel and McDiarmid (1984–1987)

## **Past Clients**

### **Independent Power Producers and Marketers**

California Wind Energy Association, Cannon Power Company, Electric Power Supply  
Association, EnerTran Technology Company, National Independent Power Producers,  
SmartEnergy.com, and U.S. Wind Force.

### **Investor-Owned Utilities**

Madison Gas & Electric, Oklahoma Gas & Electric.

### **Legislative Bodies**

Vermont Legislature, South Carolina Senate.

### **Municipalities and Counties**

Connecticut Municipal Electric Energy Cooperative; Iowa Association of Municipal  
Utilities; City of Winter Park, Florida; Montgomery County, Maryland; and American Public  
Power Association.

1     **Public Interest Organizations**

2             Alliance for Affordable Energy, American Association of Retired Persons, Consumer  
3 Federation of America, Energy Foundation, Environmental Action Foundation, GRID2.0  
4 (Washington, D.C.), Illinois Citizens Utility Board, and Union of Concerned Scientists.

5     **Regulatory Commissions and Consumer Agencies**

6             Arkansas Public Service Commission, Arizona Corporation Commission, Connecticut  
7 Department of Public Utility Control, Connecticut Office of Consumer Counsel, Delaware  
8 Public Service Commission, Hawai‘i Public Utilities Commission, State of Hawai‘i Office of  
9 Planning, Indiana Utility Regulatory Commission, Kansas Corporation Commission, State of  
10 Maryland, Maryland Energy Administration, Maryland Attorney General, Massachusetts  
11 Attorney General, Massachusetts Department of Public Utilities, Mexico's Comisión Reguladora  
12 de Energía, Minnesota Public Utilities Commission, Mississippi Public Service Commission,  
13 Mississippi Public Utilities Staff, Missouri Public Service Commission, Montana Public Service  
14 Commission, National Association of Regulatory Utility Commissioners, Nevada Consumer  
15 Advocate, Nevada Public Service Commission, New Hampshire Public Utilities Commission,  
16 New Jersey Division of Ratepayer Advocate, North Carolina Utilities Commission, Ohio Public  
17 Utilities Commission, Oklahoma Corporation Commission, Pennsylvania Office of Consumer  
18 Advocate, Puerto Rico Energy Commission, South Carolina Public Service Commission, Texas  
19 Office of Public Utility Counsel, Vermont Department of Public Service, Virginia State  
20 Corporation Commission, and Wisconsin Attorney General.

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**Testimony Before Legislative Bodies**

24     **United States Senate**

25             Committee on Energy and Natural Resources, May 2008 (addressing the adequacy of  
26 state and federal regulation of electric utility holding company structures).

27             Committee on Energy and Natural Resources, Feb. 2002 (analyzing bill to amend the  
28 Public Utility Holding Company Act) (PUHCA).

29             Committee on Energy and Natural Resources, May 1993 (analyzing bill to transfer  
30 PUHCA functions from SEC to FERC).

31             Committee on Banking and Urban Affairs, Sept. 1991 (analyzing proposed amendment to  
32 PUHCA).

33             Committee on Energy and Natural Resources, March 1991 (analyzing proposed  
34 amendment to PUHCA).

35             Committee on Energy and Natural Resources, Nov. 1989 (analyzing proposed  
36 amendment to PUHCA).

1 **United States House of Representatives**

2 Subcommittees on Energy and Power and Telecommunications and Finance, Commerce  
3 Committee, Oct. 1995 (regulation of public utility holding companies).

4 Subcommittee on Energy and Power, Energy and Commerce Committee, July 1994  
5 (analyzing future of the electric industry).

6 Subcommittee on Energy and Power, Energy and Commerce Committee, May 1991  
7 (analyzing proposed amendment to PUHCA).

8 Subcommittee on Environment, Energy and Natural Resources, Government Operations  
9 Committee, Oct. 1990 (assessing electric utility policies of FERC).

10 Appropriations Subcommittee on Commerce, Justice, State and the Judiciary, Apr. 1989  
11 (discussing proposals to increase staff administering PUHCA).

12 Subcommittee on Energy and Power, Sept. 1988 (discussing "independent power  
13 producers" and PUHCA).

14 **State Legislatures**

15 Committee on Energy and Public Utilities, California Senate (December 1989)  
16 (discussing relationships between electric utilities and their non-regulated affiliates).

17 Interim Committee on Electric Restructuring, Nevada Legislature (1995-97) (discussing  
18 options for structuring the electric industry).

19 Committees on General Affairs, Finance, Vermont Senate (February-March 1997)  
20 (discussing options for structuring the electric industry).

21 Task Force to Study Retail Electric Competition, Maryland General Assembly (1997).

22 Electricity Restructuring Task Force, Virginia General Assembly (1999).

23 Judiciary Committee, South Carolina Senate (Fall 2000).

24  
25

26 **Testimony Before Commissions, Courts and Arbitration Panels**

27 Louisiana Public Service Commission: Holding company acquisition of utility holding  
28 company (2015).

29  
30 Hawai'i Public Utilities Commission: Holding company acquisition of utility holding  
31 company (2015).

32  
33 Connecticut Public Utilities Regulatory Authority: Holding company acquisition of  
34 utility holding company (2015).

35



1 District of Columbia Public Service Commission: Holding company acquisition of utility  
2 holding company (2014-15).

3  
4 Maryland Public Service Commission: Holding company acquisition of utility holding  
5 company (2014-15).

6  
7 Mississippi Public Service Commission: Utility's divestiture of transmission assets  
8 (2013).

9  
10 U.S. District Court for Minnesota: Effects of Minnesota statute limiting reliance on fossil  
11 fuels (2013).

12  
13 Tobacco Arbitration Panel: Principles for regulating cigarette manufacturers (on behalf  
14 of State of Maryland) (2012).

15  
16 Illinois Commerce Commission: Performance-based ratemaking (2012).

17  
18 Maryland Public Service Commission: Holding company acquisition of utility holding  
19 company (2011).

20  
21 California Public Utilities Commission: Performance-based ratemaking (2011).

22  
23 Superior Court of Justice, Ontario, Canada: Renewable energy contractual relations under  
24 the Public Utility Regulatory Policies Act (2007).

25  
26 Florida arbitration panel: Financial responsibility for stranded investment arising from  
27 municipalization (2003).

28  
29 Minnesota Public Utilities Commission: Transmission expansion for renewable power  
30 producers (2002).

31  
32 U.S. District Court for Wisconsin: State corporate structure regulation in relation to the  
33 Commerce Clause of the U.S. Constitution (2002).

34  
35 New Jersey Board of Public Utilities: Conditions for provider of last resort service  
36 (2001).

37  
38 Indiana Utility Regulatory Commission: Risks of overcharging ratepayers using "fair  
39 value" rate base (2001).

40  
41 North Carolina Utilities Commission: Effect of merger on state regulatory powers  
42 (2000).

43  
44 Wisconsin Public Service Commission: Effect of merger on state regulatory powers  
45 (2000).

46

1 New Jersey Board of Public Utilities: Affiliate relations in telecommunications sector  
2 (1999).

3  
4 Illinois Commerce Commission: Affiliate relations and mixing of utility and non-utility  
5 businesses (1998).

6  
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25 Ready?" (National Regulatory Research Institute 2011).

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## Speaker and Lecturer

1  
2       **United States:** American Antitrust Institute; American Association of Retired Persons;  
3 American Bar Association; American Power Conference; American Public Power Association;  
4 American Wind Energy Association; Chicago Bar Association (Energy Section); Columbia  
5 University Institute for Tele-Information; Columbia University Institute for Tele-Information;  
6 Electric Cooperatives of South Carolina; Electric Power Research Institute; *Electric Utility*  
7 *Week*; Electricity Consumers Resource Council; *Energy Daily*; Executive Enterprises; Exnet;  
8 Federal Energy Bar Association; Federal Energy Bar Association; Harvard Electricity Policy  
9 Group; Infocast; Louisiana Energy Bar; Management Development Institute at Gurgaon, India;  
10 Management Exchange; Maryland Resiliency Through Microgrids Task Force; Mid-America  
11 Association of Regulatory Commissioners; MidAtlantic Demand Resources Initiative; Mid-  
12 Atlantic Conference of Regulatory Utility Commissioners; National Association of Regulatory  
13 Utility Commissioners; National Association of State Utility Consumer Advocates; National  
14 Conference of Regulatory Attorneys; National Governors Association; National Independent  
15 Energy Producers; New England Conference of Public Utility Commissioners; New England  
16 Public Power Association; New York Bar Association (Energy Section); North Carolina Electric  
17 Membership Corporation; Pennsylvania Bar Institute; Puerto Rico Energy Policies Forum;  
18 Regulatory Studies programs at Michigan State University, New Mexico State University and  
19 University of Idaho; Society of American Military Engineers; Society of Utility and Regulatory  
20 Financial Analysts; Southeastern Association of Regulatory Utility Commissioners; U.S.  
21 Department of Energy Forum on Electricity Issues; U.S. Environmental Protection Agency;  
22 World Regulatory Forum; and Yale Alumni in Energy.

23       **International:** Canadian Association of Members of Utility Tribunals; Canadian Energy  
24 Law Forum; Central Electric Regulatory Commission (India); Comisión Reguladora de Energía  
25 (Mexico); Independent Power Producers Association of India; India Institute of Technology-  
26 Kanpur; Ludwig-Maximilians-Universität (Munich, Germany); National Association of Water  
27 Utility Regulators (Italy); New Zealand Electricity Authority; New Zealand Commerce  
28 Commission; Nigeria Electric Regulatory Commission; Office of Utility Regulation of Jamaica;  
29 OSIPTEL (the Peruvian Telecom Regulator) Training Program on Regulation for University  
30 Students; Regulatel (an international forum of telecommunications regulators); Regulatory  
31 Policy Institute (Cambridge, England); and The Energy and Resources Institute (India).  
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## Community Activities

35       Member, PEPCO Work Group, appointed by County Executive of Montgomery County,  
36 Maryland (2010–2011).

37       Sunday School Teacher, Temple Emanuel, Kensington, Maryland (2002–2006, 2008).

38       Board of Trustees, Temple Emanuel (2005–2006).

39       Musical performer (cello), Riderwood Village Retirement Community (2003–present).  
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