Before the Public Utilities Commission

of the State of Hawai'i

In the Matter of the Application of	)	
	)	
Hawaiian Electric Company, Inc.	)	**Docket No. 2015-0022**
Hawaii Electric Light Company,	)	
Inc., Maui Electric Company,	)	
Limited, and NextEra Energy, Inc.,	)	
	)	
For Approval of the Proposed Change of	)	
Control and Related Matters	)	
	)	

Rebuttal Testimony of
Scott Hempling

On Behalf of
State of Hawai'i Office of Planning

October 7, 2015

PLANNING OFFICE EXHIBIT-7

REBUTTAL TESTIMONY OF SCOTT HEMPLING

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Introduction

Q. Are you the same Scott Hempling who offered Direct Testimony in this proceeding?

A. Yes.

Q. What is the purpose of your Rebuttal Testimony?

A. I explain that the Applicants do not, and cannot, fix the flaws in a transaction whose central purpose embodies private interests that conflict with Hawai'i's public interest. Applicants' central purpose is twofold: (1) to give NextEra control of the HECO utilities' monopoly markets, along with an unearned advantage in Hawai'i's still-developing competitive markets; and (2) to give HEI shareholders a control premium of $568 million, nearly ten times the $60 million Applicants offer to HECO customers. My Rebuttal Testimony covers seven points:

1. Applicants' proposed approval standard makes Hawai'i worse off, not better off.

2. NextEra wants to win the HECO franchises without competing on the merits.

3. Mr. Reed's "regulatory compact" would disable the Commission from protecting the public interest.

4. NextEra insists on making future acquisitions unilaterally, without Commission review and regardless of Commission concerns.

5. NextEra's talk of "local control" is contradicted by legal realities.

6. "Benefits" should not count unless backed by commitments.

7. NextEra resists regulatory protections against its incentive and ability to distort competition.

As in my Direct Testimony, when I refer to "HECO" or the "HECO utilities" or the "Hawai'i utilities," I am referring to all three of HEI's utility subsidiaries—HECO, MECO and HELCO.

I.
Applicants' proposed approval standard makes Hawai'i worse off, not better off

Q. What standard for approval do the Applicants propose?

A. Mr. Gleason states (Rebuttal at 88-89) that the "primary question" is "whether the customers of the Hawai'ian Electric Companies and the State of Hawai'i are *better off with or without* the Proposed Transaction" (emphasis added).

Q. Comment on Mr. Gleason's standard.

A. "Better off with or without" is the wrong standard because it is a weak standard. It means, literally, that anyone who can make Hawai'i just slightly better off is qualified to control the HECO utilities. It is a minimalist standard, one that both relieves Applicants of the pressure typically faced by companies subject to competition, and denies customers all the benefits that would flow from that competition. It means that customer benefits can be marginal while shareholder gain can be massive—precisely what we have here, where customers are guaranteed rate savings of only $60 million while HEI shareholders are guaranteed stock valued at $568 million.[1]

Compare Mr. Gleason's standard to the one HEI applied in assessing NextEra's purchase offer. Had HEI applied Mr. Gleason's standard (Are HEI shareholders "better off with or without the Proposed Transaction"?), NextEra could have paid just a small sum above HEI's stock value—much less than the $568 million premium that NextEra is

[1] As explained in my Direct Testimony at p.13 and note 9.

paying. But as made clear in the S-4 Proxy Statement (discussed in my Direct Testimony at 115), the standard HEI's Board applied was this: "[N]o other party was likely to offer greater consideration"; and, the transaction "is in the *best* interests of HEI's shareholders" (emphasis added). The price HEI expected was not merely a notch higher than the then-current market price (*i.e.*, merely "better off" with the Proposed Transaction than without); it was the *best* price HEI could get.

A company's investors do not tell its executives "Just do slightly better than last year." They say: "Beat your competitors." It is the same when Walmart deals with its vendors, when parents talk to their children, when a governor directs his cabinet members and when an electorate chooses a governor. In effectively competitive markets, companies that merely improve on the status quo lose out to companies that aim for excellence. A utility with a monopoly must perform as if subject to competition;[2] if it fails to do so it does not serve the public interest. Mr. Gleason's standard therefore is contrary to the public interest.

Mr. Gleason and his co-witnesses repeatedly claim that NextEra is the best in the world. But they want the Commission's standard to be not "best in the world." but merely "better than HECO." Underlying Mr. Gleason's wrong standard, therefore, is the wrong comparison. NextEra wants the Commission to compare the NextEra acquisition to HECO-business-as-usual. This is an incorrect comparison, framed narrowly to make NextEra the sure winner. NextEra vs. HECO-business-as-usual is not Hawai'i's only choice. Hawai'i has other choices, including:

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[2] As explained in my Direct Testimony at 25.

1. HECO improved by stronger, more directed, better-resourced regulation by the Commission.

2. HECO acquired by a company approved by the Commission after a competition based on benefits for the customers, rather than a company approved by HEI based on gain to its shareholders.

3. HECO replaced by one or more companies, whether investor-owned, municipal-owned or cooperative-owned, again approved by the Commission after a competition based on benefits.

As a practical matter, choosing NextEra precludes all these options. Thus Mr. Reed is wrong when he says (Rebuttal at 11) that "approving the deal only takes one option off the table, *i.e.*, continued ownership by HEI's existing shareholders; any other option that the Commission could consider will still be available to it in the future." By approving this transaction, the Commission takes plenty off the table: the benefits to which NextEra would have committed had it faced competition for its position, and the chance to attract other suitors who might bring more improvements than NextEra would. The Commission also will have lost the opportunity to select, as HECO's acquirer, a company simpler and smaller than NextEra—one focused on Hawai'i singularly, rather than one that sees HECO as one of many strategic acquisitions.[3]

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[3] At the same time NextEra was seeking to buy HEI, it was bidding to acquire Oncor, the main utility subsidiary of the bankrupt Texas holding company Energy Future Holdings. See my Direct Testimony at 96. And with the repeal of the Public Utility Holding Company Act of 1935, NextEra now can acquire any business anywhere. *Id.* at 71-76. NextEra insists that it be free to make any acquisition, anywhere at any time, regardless of the risk posed to the Hawai'i utilities and their customers, without any Commission review—or even advance notice. I discuss this point further in Part IV below.

II.
NextEra wants to win the HECO franchises without competing on the merits

Q. Your Direct Testimony argued that HECO's private, self-interested selection of NextEra denied Hawai'i's customers the benefits other acquirers could bring. How do Applicants react?

A. By admitting that if NextEra had to compete for its role it would lose interest in Hawai'i. I recommended (Direct Testimony at Parts II and V.B) that the Commission not allow HEI to sole-source control of HECO to the first suitor. Rather, the Commission should determine what Hawai'i needs, then find the best companies to satisfy those needs. In that process, NextEra could be a candidate.

Instead of welcoming this chance to display its abilities and emerge the winner, NextEra, through Mr. Gleason, says it would lose interest in Hawai'i:

> If the Commission rejects the Application there will be no second opportunity for the Commission to approve the proposal and take advantage of the benefits the merger provides, because by the terms of the merger agreement the time within which approval must be secured would have expired.

Gleason Rebuttal at 86. Assuming Mr. Gleason means what he says, he means this: NextEra is willing to help Hawai'i only if it gains control now, the way it did here—by buying the favor of HEI shareholders rather than winning the favor of HECO's customers.[4] This is an unattractive attitude for any business to have—

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[4] Mr. Gleason has confirmed my understanding. See Response to OP-IR-176, which asked Mr. Gleason to "confirm" that "NextEra would have no interest in competing against other companies for the privilege of serving Hawai'i retail customers":

especially one seeking the government-granted privilege, and the government-granted favor, of providing a monopoly service free of competition for a profit. But at least the Commission now knows the truth. If NextEra has to compete to serve HECO's customers, it will walk.

More generally, Mr. Gleason (*id.*) objects to the very notion choosing acquirers based on merit. He says it—

> would establish a precedent that would almost certainly ensure no other mergers would be proposed. Other potential merger partners would be unlikely to commit to the time, effort and expense to put together a merger proposal only to have it exposed to the likelihood that the Commission would put the proposal 'out for bid.'

Mr. Gleason misunderstands the procedure I proposed. Having a single contestant reveal its offer, then be forced to watch as competitors exceed that offer, of course makes no sense. What I proposed, and what NextEra seeks to avoid, is this: The Commission establishes criteria for excellence, then invites applicants submit their offers simultaneously. The winner earns the right to acquire the HECO utilities (or become responsible for whatever service the Commission has subjected to the bidding process—recall that the Commission separated out energy efficiency services from HECO's other duties and used competition to find a provider). NextEra prefers HEI's process because (a) NextEra was the winner, and (b) NextEra needed to make only minor commitments

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> Confirmed. NextEra Energy has already gone through an extensive process to reach this point. It has spent significant funds and many thousands of employee hours since May 2014 to conduct due diligence, negotiate the merger, plan integration, and pursue the requisite approvals. NextEra Energy has no desire to go through such a process twice, and does not perceive any disconnect between its position and Hawai'i's values.

(like giving ratepayers only one-tenth of what it is giving HEI's shareholders). Beyond the minor commitments, NextEra then promised nothing—nothing other than mere aspirations for HECO's improvement rather than commitments for improvement. Aspiration rather than commitment means that the risk of non-achievement falls on the customers rather than on NextEra. In a real competition, NextEra would have to commit to the outcomes it advertised, putting the risk of non-achievement on itself.

Implicit in Mr. Gleason's position is that NextEra is Hawai'i's only hope; that if the Commission invited others to acquire HEI, no one would bother to try. This view is undermined by three decades of electricity acquisitions.[5] That history displays an inarguable fact: Buying and owning a retail monopoly is an attractive proposition, attractive for a diverse group of acquirers and merger partners: neighboring utilities; remote utilities; private equity companies; and holding companies from Australia, Germany, Spain and the United Kingdom.

NextEra has not discovered some secret value in owning HEI that no other company could discover. A Hawai'i welcome mat would bring others to Hawai'i's door. It would signal a pro-business attitude, where the "pro" favors companies based on merit rather than purchase price. In fact, de-emphasizing purchase price would make Hawai'i even more attractive, more pro-business, because the cost to enter the Hawai'i market would be lower. Mr. Gleason's view that Hawai'i's only choices are NextEra or nothing has no basis in fact or logic.

[5] According to Mr. Reed (Rebuttal at 15), 50 utility mergers have been approved and closed in the past 20 years. Based on my own experience I know that the preceding ten years added many more.

Mr. Gleason (Rebuttal at 26) asserts that "the Intervenors do not point to any other company that would be a better fit for Hawai`i or the Hawai'ian Electric Companies." This statement erroneously shifts the burden of proof. In a proceeding to determine the prudence of new power plant construction, it is the utility's burden to prove that it chose the best alternative. It is not the intervenor's burden to prove the availability of better alternatives. The same logic applies here.

Q. Is there an inconsistency between wanting the best for Hawai'i and offering other businesses a chance to serve here?

A. Of course not. Mr. Reed (Rebuttal at 12) says "it would seem incontrovertible that having an experienced, industry leading owner/operator of that grid is a good thing for the State, electric consumers, and the environment." I agree. But what is also "incontrovertible" is that if Hawai'i wants these things, it first should decide the services and skills it needs, then invite to Hawai'i the companies best able to provide these things. NextEra wants to brag and buy its way in; I recommend that Hawai'i cause aspirants to compete their way in. Mr. Reed wants NextEra to be considered in isolation from all other options; I recommend that NextEra be considered in comparison to all other options. Mr. Reed wants the decision to be based on achievements in NextEra's past; I recommend the decision be based on commitments made for Hawai'i's future. On the question of how a state government should choose who controls its utilities, Mr. Reed and I differ fundamentally.

In sum: No Applicant witness ever explains what is wrong, from a public interest standpoint (as distinct from NextEra's and HEI's standpoints), with a procedure that grants franchise control based on who can perform the best for consumers, rather than who can pay the most to shareholders. Nor does anyone explain why consumers would be worse off if NextEra had to compete against others for control of the franchise based on performance commitments.

III.
Mr. Reed's "regulatory compact" would disable the Commission from protecting the public interest

Q. On choosing an owner of HECO and sharing the control premium, what did your Direct Testimony recommend?

A. On those topics I recommended two things. First, if Hawai'i wants new owners for HECO, they should be chosen based on best performance, not highest purchase price. (Direct Testimony at Part V.) Second, even if the Commission ignores this principle and approves NextEra, the Commission should allocate the $568 million control premium (the excess of the purchase price over HEI's stock price) between HEI shareholders and HECO ratepayers based on their relative contribution to the franchise value that the premium represents. (Direct Testimony at 129-36.) The Applicants, in contrast, would give the HEI shareholders 100 percent automatically. I then explained there was no evidence that shareholders either gave the franchise its value, or caused that value to rise by $568 million. Given that evidentiary absence, I recommended a rebuttable presumption that the relative ratepayer-shareholder contribution be 50-50.

Q. How does Mr. Reed respond to your recommendations?

A. Mr. Reed (Rebuttal at 30) says that my recommendations "from a business perspective ... would radically and irrevocably change the regulatory compact upon which shareholders made their investments." I will explain the problems with his response by addressing six points:

a. Mr. Reed defines his "compact" circularly.

b. The legally required compensation to shareholders is recovery of and return on rate base.

c. Relative to the legally required compensation, payment of the control premium is overcompensation

d. The franchise is a privilege Hawai'i bestowed on HECO to serve the public interest; it is not an asset HEI may exploit for its private interest.

e. Corporate law does not dictate regulatory obligations.

f. Mr. Reed's "compact" omits the service component of the regulatory relationship.

A. Mr. Reed defines his "compact" circularly

Q. Comment on Mr. Reed's use of the term "regulatory compact."

A. His testimony never defines the phrase, let alone defines it objectively. Instead he uses it subjectively, to mean Hawai'i's obligation to approve the two actions HEI took: (1) choosing a buyer based on price offered rather than customers benefited; and (2) treating the government-granted franchise as HEI-owned property—property HEI is free to sell at a gain for HEI shareholders alone. But whether HEI can do those two things is the very issue the Commission must decide. To treat them as rights under some undefined "compact," when their existence is the issue, is to speak in a circle. Mr. Reed (Rebuttal at 30) protests "I am not an attorney so I cannot comment on the legal issues or ramifications of this action." But if he wants the Commission to honor some "compact"—a term that implies legal obligation—he must step up and define what that legal obligation is.

And that is where his boat runs aground. If the phrase "regulatory compact" is to bind the regulator and the utility, it must have a basis in law. The law that matters is the law regarding the regulatory treatment of shareholder investment under the statutory "just and reasonable" standard and the Constitution's Fifth Amendment Takings Clause.[6] Those two sources do impose legal obligations on the regulator. But those legal obligations have never had the clarity implied by the phrase "regulatory compact"; nor do they require the treatment Mr. Reed seeks. The legal obligations are instead, as the U.S. Supreme Court has said, "essentially ... ad hoc and factual."[7] Mr. Reed ascribes to the phrase "regulatory compact" such precision as to block the Commission from requiring that customers receive any part of the HEI shareholders' $568 million gain. But the phrase "regulatory compact" has never crossed the Court's lips, let alone been interpreted to produce the result Mr. Reed seeks here.

B. The legally required compensation to shareholders is recovery of and return on rate base

Q. In the utility context, what compensation to shareholders is legally required?

A. In the context of utility investments, just compensation" is the reasonable opportunity to earn a fair return on the prudent investment made by the utility in assets necessary to serve the public. See my Direct Testimony at 132-34. As Justice Brandeis famously said:

> The thing devoted by the investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. Upon the

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[6] The Fifth Amendment, in relevant part, provides that "nor shall private property be taken for public use, without just compensation." The Fifth Amendment applies to the states through the Fourteenth Amendment's Due Process Clause.

[7] *Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d at 1192 (Starr, J., concurring) (quoting *Kaiser Aetna v. United States*, 444 U.S. 164, 175 (1979)).

> capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return.[8]

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

> The adoption of the amount prudently invested as the rate base and the amount of the capital charge as the measure of the rate of return would give definiteness to these two factors involved in rate controversies which are now shifting and treacherous, and which render the proceedings peculiarly burdensome and largely futile. Such measures offer a basis for decision which is certain and stable. The rate base would be ascertained as a fact, not determined as matter of opinion.[9]

Utility shareholders receive this constitutionally required compensation when the regulator sets rates based on an annual revenue requirement that includes the net book value of prudent utility investment in assets used to provide service.

C. Relative to the legally required compensation, payment of the control premium is overcompensation

Q. Given your discussion of the legally required compensation, explain your difference with Mr. Reed over the control premium.

A. If fair return on prudent rate base is the legally required compensation, then the control premium is necessarily extra compensation—overcompensation. The control premium does not represent "capital embarked in the [public utility] enterprise"; *i.e.*, funds invested in assets used to provide public utility service. It represents, rather, the price HEI shareholders are extracting for selling to NextEra the right to control the utility franchises

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

[9] 262 U.S. at 307-08.

granted by the state. Because the control premium does not represent investment in utility service assets—because it is overcompensation—HEI shareholders have no legally protected expectation to receive it.

Mr. Reed's view of the "regulatory compact," therefore, is unconnected from legal reality. The legal reality is that government is required to give shareholders a reasonable opportunity to earn a fair return on dollars prudently invested in utility assets. Those dollars have no connection to the premium paid by an acquirer to control a franchise. Mr. Reed wants his "regulatory compact" to cover both the utility's tangible investment in rate base *and* the speculative increase in stock value that results when a prospective acquirer offers to pay a premium.[10] But Justice Brandeis's formulation, repeated by

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[10] That is the necessary inference from Mr. Reed's rebuttal, where he cites the "regulatory compact" as a basis for his view that HEI shareholders are entitled to the full control premium. But when, in discovery, he defines the phrase (Response to OP-IR-165(a)), his definition omits the control premium entirely:

> Mr. Reed used the term regulatory compact to mean the regulatory structure operating across the U.S. in which utilities take on a service obligation, typically an exclusive service obligation, commit capital and assets to fulfill that service obligation, and accept regulatory restrictions on the prices they can charge and the returns they can earn, and, in exchange, receive an opportunity to earn a compensatory return on and return of that capital, and often receive some form of limited monopoly or restrictions on competition from others.

He then says (*id.*) that he "does not believe that the regulatory compact is the product of any law, but is a regulatory policy concept that has been recognized by many regulatory agencies and courts." Again he is wrong. No court or agency, as far as I am aware (and Applicants have cited none), has defined "regulatory compact" to include a legal entitlement to the control premium. And even if it is a mere "regulatory policy concept" it must be a "product of [some] law," because in a nation of laws a policy must have a basis in law. Despite numerous questions of Mr. Reed and Applicants in discovery, no one has provided a basis in law. There is none.

courts and commissions for decades, says nothing about protecting stock value. Rate base is where government honors its obligations; stock value is where shareholders gamble their money. To say, as Mr. Reed does (Rebuttal at 123-24), that "[s]hareholders are entitled to any appreciation on stock value," is to speak in a circle again. The word "entitled" implies a legal right, but he has identified no right.[11] And he forgets that in a regulated setting, "rights" are conditioned on regulatory obligations.[12] That has been the law since medieval times, memorialized in the landmark case of *Munn v. Illinois*, 94 U.S. 113 (1877). There is, therefore, no "regulatory compact" barring the Commission from conditioning the acquisition on ratepayers receiving part of the control premium.

Adding to his errors of circularity is an error of logic; specifically, applying a non-regulated market concept to a regulated market context. In a non-regulated market, the acquirer's willingness to pay the premium, and the target's expectation of a premium, are both disciplined by competitive market forces. Those forces limit the acquirer's

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The punch line finally arrives in the response to OP-IR-181. Referring to what the question posited as the "right to sell the franchise to the highest bidder and to keep the resulting gain," Mr. Reed responded: "The regulatory compact does not address this right."

[11] And when asked in discovery to provide any legal support for Mr. Reed's explicitly legal statement (explicitly legal because he uses the term "entitled"), Applicants object, on two grounds. They say that our question "asks Applicants to provide legal conclusions and/or opinions not properly the subject of discovery," and that "Mr. Reed cannot offer a legal opinion on this issue." Response to OP-IR-152. On a central issue in this case, the Applicants refuse to explain and their witness is unable to explain.

[12] See *Munn*, *supra*, 94 U.S. at 126: When someone "devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created. He may withdraw his grant by discontinuing the use; but, so long as he maintains the use, he must submit to the control."

ability to recover its acquisition cost. In our regulated utility market, that discipline is not as strong. Yes, the regulator can (and should) disallow the premium from rates. But if by paying the premium the acquirer suffers financially, and if the state's health is linked to the acquirer's health (due to the acquirer's monopoly status), the regulator may feel it has no choice but to allow some recovery of the premium.[13]

Look closely at Mr. Reed's words: "Shareholders are entitled to *any* appreciation on stock value" (emphasis added). If that statement were literally true, then HEI shareholders could demand $10 billion instead of $568 million. The Commission then would have to approve the transaction, merely because "[s]hareholders are entitled to *any* appreciation on stock value." That is not the law. Because there is no legally protected expectation to receive a control premium, the Commission is free to reject an acquisition for the sole reason that the acquirer is paying a control premium—either one above some stated number or percentage, or any control premium at all. (Such a policy would achieve public interest goals, such as (1) preventing transactions that burden the acquirer with debt or the acquirer's shareholders with stock dilution, and (2) discouraging target companies from seeking acquirers based on the prospect of gain rather than the prospect

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[13] *See, e.g., Gulf States Utilities Co. v. Louisiana Pub. Serv. Comm'n*, 578 So.2d 71 (La. 1991) (upholding Commission's decision to make ratepayers pay for part of the utility's imprudence because full disallowance of the imprudent costs would weaken the utility's ability to serve). See also the California Commission's determination of penalties on Pacific Gas & Electric for its role in the San Bruno gas explosion. The Commission there stated: "There is no dispute that the Commission must consider PG&E's financial resources in setting the penalty amount." *See 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).

of service improvement.) And if the Commission can reject a merger because there is a control premium, it can approve a merger subject to a condition that there be no control premium, or that any control premium be allocated between shareholders and customers based on their relative contributions to the value of the franchise whose control is the reason for the premium. As *Munn v. Illinois* made clear, shareholders are not "entitled" to be free of a regulator's public interest decisions.

Mr. Reed also states (Rebuttal at 125) that "[i]f the franchise has an identifiable value, it is captured in the traded stock price for a utility, since that reflects all of the earnings' capacity of the utility." Mr. Reed speaks circularly again. A utility's "earnings' capacity" depends on regulatory decisions; decisions, specifically, on what level of compensation the utility should receive. Because the regulator determines the utility's compensation (including whether they should be compensated for the value of the franchise), saying that shareholders must receive a stock price reflecting the acquirer's offer to pay a control premium assumes the answer to the question, which is whether the regulator should allow the shareholders to receive the premium. That is the essence of circular reasoning.[14]

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[14] In a discovery response, Mr. Reed denied circularity, stating that "A utility's earnings' capacity depends upon a number of factors including economic and financial conditions, weather, management and operational expertise, state regulation, and the risk borne by investors." Response to OP-IR-153. The quoted sentence is correct. But by including "state regulation" in this list, Mr. Reed confirms that his original statement (quoted in the text above) is in fact circular. He also says that the pre-offer trading price (above which is the control premium) "reflects investor's views of the earning potential of the utility, including the value of all of the utility's assets." *Id.* Also correct—but again, that "earning potential" depends on "state regulation."

In short, by focusing "stock value" rather than rate base, Mr. Reed defines a "regulatory compact" that does not exist. Here is the key principle: *What shareholders spend to buy stock is constitutionally distinct from what the utility spends to acquire utility assets.* The latter is constitutionally relevant, the former is not. When the state grants HECO the franchise privilege, HECO undertakes an obligation to serve. To fulfill that obligation, HECO must invest in the necessary assets. In imposing this obligation to invest, the state has "taken" private property for which the Constitution requires "just compensation." Thus the just compensation relates to the utility's investment in utility assets. The shareholder's decision to buy stock is an entirely different matter. It is not an obligation imposed by government to ensure the public is served; it is a voluntary act made by the purchaser to increase his wealth. The stockholder is not "entitled" to any government protection of that wealth—let alone an increase in "value" arising solely from an acquirer's desire to control the franchise.

D. The franchise is a privilege Hawai'i bestowed on HECO to serve the public interest; it is not an asset HEI may exploit for its private interest

Q. What is your response to Mr. Reed's position on "franchise rights"?

A. Mr. Reed (Rebuttal at 29) says that "[t]he franchise rights held by HEI's subsidiaries have both value and obligations, both of which are the responsibility of the management team appointed by the shareholders." This sentence is not 100% clear, but if Mr. Reed means that the value of the franchise belongs to shareholders, he is wrong. A "franchise right" is the right to provide legally-defined services under legally-defined constraints, in return for legally-defined compensation.[15] The "value" of the franchise right necessarily depends on those legally-defined parameters. To assume, as Mr. Reed does, that this "value" includes the value of selling the franchise right for gain, is once again to reason in a circle; *i.e.*, to assume the answer to the question at issue. That question—whether HEI's "right" includes the right to sell the franchise for gain—is for the Commission to answer. The answer cannot be, as Mr. Reed asserts (I assume), that HEI is entitled to keep the gain because there is value from keeping the gain. That is, again, circular.

Mr. Reed's argument, to the extent I understand it, distills to this syllogism:

1. HEI shareholders are entitled to the value of the franchise.

2. The value of the franchise includes the gain from selling control of the franchise to a bidder selected by HEI based on the bidder's offer.

3. Therefore, HEI is entitled to the gain from selling control of the franchise to NextEra, and so the Commission cannot constitutionally condition the acquisition on HEI sharing the gain with the ratepayers.

This distillation reveals the problem. Step 1 is not correct just because Mr. Reed says it is. Step 1 can be correct only if the Commission decides it is correct. Because the franchise was created by the state, not HEI, and because the franchise is owned by the state, not HEI, the decision on who gets the value of the franchise is a decision for the state, not for HEI.

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[15] The Applicants do not disagree. They say that "[f]ranchise rights are the rights to provide defined services within the defined area or service territory." Response to OP-IR-162. This understanding of the franchise right says nothing about a right to sell control of the franchise to the highest bidder and keep the gain. And Mr. Reed, asked whether the franchise right includes a "right to sell control of it to the highest bidder," said the question calls for a legal opinion "which [he] is unable to provide." *Id.* Then the company objects that the question calls for a legal conclusion. *Id.* The question does no more than ask the witness to explain himself.

And the decision must be this: The value of the franchise belongs to the state, not to HEI, because the franchise belongs to the state, not HEI. The state grants the right to a grantee, from whom the state may remove the right—according to the very terms of the franchise.[16] The franchise is not the utility's private property. It is not like the land under my house—land I bought, land I own, land which I risked buying so I could sell it at a gain. Here, the "land" granted to HEI's utilities—their franchises—is the privilege to provide electric service in Hawai'i. That privilege does not translate into a right to sell the privilege for gain. It may well be that NextEra views the privilege as a profit opportunity, and is thus willing to pay a premium for it. But NextEra's desire does not become HEI's gain, just because Mr. Reed uses the term "entitled."

Those are the problems with Step 1 of Mr. Reed's syllogism. Step 2 suffers from both circularity and substance. As I have explained several times now, Step 2 is circular because the value of the franchise includes the gain from selling control only if the Commission allows that gain to remain with the franchise holder. That is the very question we are trying to determine. The substantive problem is Mr. Reed's assumption that we measure the "value" of a franchise based on what the acquirer is willing to pay for it. But that willingness to pay will depend on whether the Commission allows the

[16] See Applicants Response to LOL-IR-38, which includes the utilities' franchises. Section 15 says the franchise is not exclusive. Section 18 says the franchise is subject to amendment or repeal. Section 13 makes the franchise subject to forfeiture by the commission, after reasonable notice and with the consent of the governor and attorney general, if the franchisee "refuses or fails to do or perform or comply with any act, matter or thing requisite or required to be done under the terms of this chapter, and shall continue so to refuse or fail to do or perform or comply therewith...."

incumbent utility to insist on a premium. If the Commission decides that the incumbent is not entitled to a premium, then the acquirer will not need to pay a premium—unless the Commission demands a premium for the state or the customers. And my recommendation is not that the state auction off the franchise for money, but that it consider using its powers to require any acquisition proposal to be preceded by HEI's effort to find the entities best qualified to provide the franchise services.

Mr. Reed is treating the utility franchise as if it were a McDonald's franchise: a business opportunity bought at one price (although we have no evidence that the original grantee of Hawai'i's utility franchises paid any price), owned by the buyer to be resold at a higher price. But HECO's franchise is not a McDonald's franchise and it is not owned by HECO. It is a privilege held by HECO—that privilege being to serve customers for a reasonable profit, not to sell it off for a $568 million premium.[17]

My recommendation, if accepted by the Commission, will cause HEI shareholders disappointment. But shareholder disappointment matters legally only if the state government made some kind of commitment, with the disappointment caused by a breach of that commitment. Put more generally, a right exists only if the government has created a right, by making some commitment. Mr. Reed has identified no state government commitment regarding the control premium. He only repeats his circular phrases—"regulatory compact," "entitled," and "right." But a compact, by definition, is based on

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[17] And Mr. Reed "has no knowledge of how the franchises were granted." Response to OP-IR-162(a). So he cannot say that in acquiring the franchises, the HECO utilities gained the "right" to sell them for profit.

mutuality between two entities. Mr. Reed's "compact" is one-sided. It contains only what HEI shareholders want; it says nothing about what the state promised.

In granting a franchise, the state grants the utility a right to engage in a particular activity: selling the obligatory services that are the subject of the franchise. Other than this right to sell obligatory service, the government has given nothing else. The value of the franchise, therefore, is the stream of profit available from providing the obligatory service. That stream of profit does not include extra gain from selling the right to serve—a right that only the government can grant. HEI's shareholders may have *hopes* for additional profit, such as from selling the franchise to acquirers seeking to use the utility's status as leverage for other investments. But those hopes are not supported by any government action, because the sole government action here—the State of Hawai'i's action—was to grant a right to provide the obligatory service. And because such hopes are not supported by government action, the government owes the shareholders nothing when those hopes turn to disappointment.

In conclusion: In terms of compensation promised by the government, the reasonable shareholder expectations derived from owning a franchise do not include an entitlement to anything exceeding the value of the income associated with selling the obligatory utility services. It is true that utility stock often trades above book value. But the trading values result from hopes and guesses by private stockholders, not promises from the government.

E. Corporate law does not dictate regulatory obligations

Q. Doesn't HEI have a corporate law obligation to consider profitable offers from acquirers?

A. Yes, but that obligation is subject to other legal constraints. Mr. Reed misses this point. He asserts (Rebuttal at 27) that HEI's Board "not only had a right to consider selling HEI to NextEra Energy, it had an obligation to do so after it received NextEra Energy's offer." This sentence, half right, omits the point that makes it all wrong. Mr. Reed is describing rights and obligations under corporate law. But rights and obligations under corporate law are subject to rights and obligations under substantive utility law. If corporate fiduciary obligations trumped substantive law, companies could spill toxic waste into rivers without consequences, because spilling waste costs less than treating it properly. But environmental law constrains a Board's obligations under corporate law.

The same goes for substantive utility law, which is the Commission's province to declare. The HEI Board chose NextEra because its offer price was the best for HEI shareholders, not because NextEra's abilities and commitments were the best for customers. Mr. Reed wants the Commission to take the HEI Board's decision as a given—as a constraint on the Commission's decisionmaking. Mr. Reed has his law backwards. It is for the Commission to determine the constraints arising from substantive utility law, and for the HEI Board to live with those constraints.

F. Mr. Reed's "regulatory compact" omits the service component of the regulatory relationship

Q. Does Mr. Reed's "regulatory compact" omit a component?

A. Yes. He focuses only on money—the gain to HEI shareholders from selling franchise control to NextEra. But viewing the utility-regulator relationship as merely about money misses the real reason for having utilities: To provide cost-effective, innovative service to the customers. The regulatory relationship involves not only regulators granting compensation. It also involves setting standards for the performance that merits that compensation.

What are those standards for performance? A utility must satisfy the regulator's standards for performance at "lowest feasible cost,"[18] use "all available cost savings opportunities,"[19] and pursue its customers' legitimate interests free of conflicting business objectives. The Fifth Amendment does not ensure recovery of imprudent costs (Brandeis talks of "amounts prudently invested"); and even prudence is not a guarantee of recovery.[20]

So in defining whatever "regulatory compact" Mr. Reed has in mind, service is central. It is built into the very foundation of regulatory law. Mr. Reed ignores this feature entirely. In so doing, he fails to rebut my central point: that transferring the franchise to the one that pays the most rather than the one who performs the best conflicts with a utility's obligation to serve at "lowest feasible cost" and to use "all available cost savings opportunities."

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[18] *Potomac Electric Power Co. v. Public Service Commission*, 661 A.2d 131, 137 (D.C. 1995).

[19] *Midwestern Gas Transmission Co. v. East. Tenn. Natural Gas Co.*, 36 FPC 61, *28 (1966), *aff'd sub nom. Midwestern Gas Transmission Co. v. Federal Power Commission*, 388 F.2d 444 (7th Cir. 1968).

[20] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 315-16 (1989) (rejecting utility association's argument that the Constitution compels regulators to allow recovery of prudent costs).

G. Conclusion on the "regulatory compact"

Q. Has Mr. Reed characterized your views accurately?

A. No, in at least two respects. First, Mr. Reed (Rebuttal at 29) says my view is "that shareholders are not entitled to any value associated with the Hawai'ian Electric Companies' franchise rights." Mr. Reed is off—by $568 million, potentially. I recommended the Commission adopt a rebuttable presumption that shareholders are entitled to 50% of the control premium. The presumption can be rebutted by shareholders seeking more, or by customers seeking more, with the outcome determined by who contributed what to the franchise's value. If the shareholders demonstrate they contributed 100% of the value of the franchise, they keep 100% of the control premium—all $568 million.

But when challenged, Mr. Reed could provide no evidence that shareholders contributed *anything* to the value of the franchise. OP-IR-163 stated:

> Describe how shareholders contributed to the distinct value of the franchise. Distinguish this contribution from the dollars invested by the utility in the assets necessary to provide franchise service, and work performed by utility employees that is their obligation in return for customer paying their monthly bills.

Mr. Reed answered:

> Shareholders contributed to the value of the corporation holding the franchise by creating the corporation which holds the franchise, capitalizing the corporation to enable it to meet the obligations of the franchise, and securing management for the corporation so it could operate according to the franchise. Utility employees execute their responsibilities in a manner which allows the franchise to be fulfilled.

These actions—of "capitalizing the corporation" to meet its franchise obligations, "securing management," and paying employees to "execute their responsibilities"—are all things for which the utility already receives compensation, through Commission-set rates paid by captive, loyal customers. The control premium is a whole other layer on that cake. So Mr. Reed still has provided no evidence that shareholders created the value represented by the $568 million control premium.

Second, Mr. Reed (at 30) says that my proposal "would put the Commission in the position of owner and operator of a company it neither owns nor operates." He has confused company with franchise. I have not. Having the Commission determine who will control the franchise does not make the Commission an owner of any company. The Commission already has the power and duty to determine who will control the franchise. That is why HEI needs Commission permission to transfer control to NextEra. The only question is whether the company receiving that permission wins that status because HEI selected it in secret based on its self-interest criteria, or whether the Commission selected it in public based on public interest criteria.

That is the difference between me and Mr. Reed—a difference having nothing to do with "owning" or "operating" a company. When a government agency grants a food service company a franchise to sell meals in a government building, the agency does not then "own and operate" the business. We expect the agency to select the first company based on public interest criteria—food quality and safety, prices, training and treatment of the workers. And we expect any successor to be chosen by the agency based on the same criteria. The successor is not chosen by the incumbent based on opportunity for gain.

Similarly, Mr. Reed (Rebuttal at 29) attributes to me a view that some "portion of the company is government-owned or operated...." There is no basis for this statement—not in my testimony and not in anything I have ever written or said in 31 years of public utility law practice. What I have said is that the franchise is government-created, that its transfers are government-approved, and that the franchise is a right granted to the company temporarily, under circumstances determined by the state—which circumstances, as far as I know, do not include permanent control of or right to its value.

There is no dispute on this point: If the Commission finds that allowing the HEI shareholders to retain 100% of the control premium is not in the public interest, the Commission can reject the transaction entirely.[21] If that is true, then it necessarily follows that the Commission can condition its approval on a sharing of the premium between shareholders and ratepayers, based on their relative contribution to its value.

Once one accounts for the circularity, Mr. Reed's argument distills to this: HEI shareholders have a right to the control premium because they want the control premium. But that is not how law or policy works.

> [T]he word "right" is one of the most deceptive of pitfalls; it is so easy to slip from a qualified meaning in the premise to an unqualified one in the conclusion. Most rights are qualified.[22]

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[21] See Mr. Reed's response to OP-IR-180(a), which asked Mr. Reed to admit that "the Commission "has the ability to reject the Proposed Transaction" if it finds that allowing the HEI shareholders to retain 100% the control premium is not in the public interest." Mr. Reed did not respond to that request directly. But when then asked, in OP-IR-180(b), to admit that "such a decision would not 'confiscate shareholder capital,' he stated: "If the transaction is denied approval, such a decision would not confiscate shareholder capital in Mr. Reed's non-legal opinion." If his answer was not an answer to OP's question, Mr. Reed can clarify in surrebuttal.

[22] *American Bank & Trust Co. v. Federal Reserve Bank*, 256 U.S. 350, 358 (1921).

IV.
NextEra insists on making all future acquisitions unilaterally, without Commission review and regardless of Commission concerns

Q. What concerns should the Commission have about NextEra's future acquisitions?

A. My Direct Testimony (at Part III.C) described the risks to consumers of NextEra making future acquisitions without Commission review. This situation is made more worrisome by the 2005 repeal of the federal Public Utility Holding Company Act, because now there is no legal limit (except for antitrust law) on the number, type or location of businesses NextEra can acquire. Given these risks, I proposed a condition allowing the Commission to screen such transactions for risk. NextEra resists this condition. Without my condition, the entity deciding whether the benefits to NextEra of an acquisition are worth the risks to Hawai'i's ratepayers (already a lopsided equation) would be the subjective NextEra rather than the objective Commission.

Rather than explain why such public interest decisions should be made by a private actor, Mr. Gleason misstates my position. He states (Rebuttal at 83) that I would require Commission approval for NextEra's "routine business transactions." Wrong. Only transactions defined by the Commission as causing risk to ratepayers would require review. The Commission can readily balance ratepayer risk with administrative convenience by defining tiers of accountability. Examples are:

1. a category of safe harbor transactions, so minor (and "routine") that no Commission review is necessary;

2. a category of transactions that might be risky—so NextEra must inform the Commission in advance, and if the Commission does nothing after some period of time, say 60 days, the transaction can go forward; and

3. a category of transactions that are likely risky, and therefore cannot go forward without affirmative Commission approval.

There should of course be a fourth category of transactions—acquiring companies in particular nations or industries that pose inherently large risks—that should be banned outright. What the Commission cannot allow is for NextEra's definition of "routine" to substitute for the Commission's duty to protect Hawai'i's customers.

NextEra treats such concerns as speculative. But it is NextEra that speculates. NextEra speculates that no matter what risks it takes on, nothing negative will happen in Hawai'i. NextEra might be right—or it might be wrong. The question answered by my condition is not whether NextEra is right or wrong, but whether the one making the judgments should be NextEra or the Commission. If NextEra does not trust the Commission to make responsible decisions, it should come out and say so. If NextEra does trust the Commission, then we can collaborate on designing workable tiers. NextEra declines to collaborate.

Mr. Reed states (Rebuttal at 121) that he is "not aware of any precedent for a utility regulator to exercise authority over the formation of affiliates by the parent holding company of the utilities which the Commission regulates." The reason should be obvious—although Mr. Reed refuses to admit it (at Response to OP-IR-159). Until its 2005 repeal, the Public Utility Holding Company Act of 1935 directly and indirectly restricted the location and types of affiliates a utility could have. (As explained in my Direct Testimony at 71-73.) So from 1935 to 2005, a state had much less need for the condition I propose here.

Q. Does the Commission have enough resources to monitor the acquisitions risks NextEra's takes on?

A. I am not an expert on the Commission's internal resources. But if NextEra has no limits on its future acquisitions, and if the Commission has limits on its resources, the objective answer must be no. NextEra's expansion will require extra oversight. That extra oversight will require resources. Yet Mr. Gleason resists paying for regulatory resources made necessary by NextEra's non-Hawai'i activities. He says (Rebuttal at 84): "A Commission and Consumer Advocate that are properly resourced and staffed is generally the responsibility of the State, and there appear to be adequate fees and taxes collected from customers to fund both agencies." Mr. Gleason misses the point. It is one thing for Hawai'i customers and taxes to fund the Commission's main job of aligning HECO's performance with the Hawai'i's needs. NextEra's future acquisitions will likely do nothing for Hawai'i, yet they will impose risks on Hawai'i and thus cause regulatory costs for Hawai'i. A tenet of regulation, and of economic efficiency, is that costs must be assigned to the cost-causers. If NextEra caused the cost, it must bear the cost.

Instead of accepting responsibility, Mr. Gleason resorts to vagueness. True, regulatory costs are "generally the responsibility of the state." But subordinating HECO to the acquisitive, complex NextEra is not "generally" what has existed in Hawai'i. And he offers no basis for saying the resources "appear to be adequate" to fund agencies. He has made no study of the Commission's resources, or ever worked within a regulatory agency. His response is no more than words linked to make sentences—sentences that both avoid responsibility and reveal his priority—that NextEra should be free to buy what it wants, where and when it wants, while the Commission sits on the sidelines until problems arise.

Mr. Gleason will likely respond that so-called ring-fencing will protect the utilities from NextEra's extracurricular activities; and that if the consumers are harmed, the Commission has the power to penalize the utilities. I addressed these points in my Direct Testimony, at Part III.C.4 through III.C.7 (pp. 86-98).

V.
NextEra's talk of "local control" is contradicted by legal realities

Q. Do the Applicants' rebuttal witnesses resolve concerns about local control of HECO's utilities?

A. No. We are told that the HECO executives will be free to spend $20 million annually. But even that spending must be consistent with "an approved overall budget"—the approval coming from NextEra's Chairman and CEO and its Board. Gleason Rebuttal at 20-21. Those individuals are not subject to local control. Even for expenditures under $20 million, there is no legal restriction on NextEra overruling HECO spending. And $20 million per year is tiny relative to the $8 billion described by Applicants as the "potential investments" required by the HECO utilities' three Power Supply Improvement Plans.[23] See Reed Direct at 21, 25.

Q. Why do Applicants decline to back their statements about local control with legal commitments?

A. Mr. Gleason made the reasons clear. My Direct Testimony recommended a condition by which the Applicants would mate work with deed. If NextEra executives committed

[23] That $20 million is *one quarter of one percent* of the $8 billion. Yes the $20 million is an annual figure and the $8 billion is a multi-year figure. But still.

legally not to overrule Hawai'i executives' decisions, local control would mean local control. But my condition produced this response (Gleason Rebuttal at 22):

> That is not practical. NextEra Energy is a strategic investor with extensive experience in electric utility planning and operations, not a passive financial investor....

This is not the language of "Hawai'i local control." It is the language of "NextEra trusts its judgment more than it trusts HECO's judgment." Mr. Gleason then brings the point home—by revealing NextEra's priorities (*id.*):

> NextEra Energy's management and Board of Directors have a fiduciary duty to the company's investors to review and approve, modify or reject proposals from each of the company's business units, including the Hawai'ian Electric Companies.... [Letting HECO make its own decisions would] effectively strip the duties of business managers from the representatives of the investors.

And that is the point: The "representatives of the investors" must control HECO's business decisions, because the investors' goals take priority over Hawai'i executives' judgments. That is not local control.

Mr. Gleason then proceeds to mischaracterize my proposal. He says (*id.*) that my condition would "unnecessarily isolate local Hawai'i business units from the proven financial resource management expertise of NextEra Energy." No. There would be no isolation. HECO's executives would have every opportunity to learn from NextEra; they just would not be controlled by NextEra. That is what "local control" means—not being controlled by someone else. But NextEra needs to control HECO, because NextEra is a "strategic investor" and the "representative of the investors." NextEra's profit interest comes first; local control second. In some situations, these two things may be consistent; but when they conflict, NextEra prevails. I am not saying NextEra's approach is the wrong way to run a holding company. But calling it "local control" is the wrong way to describe it.

Mr. Reed (Rebuttal at 32) complains that my quoting Mr. Robo on his business purposes ("to be focused on both regulated operations, as well as on renewables"), and describing HECO as "Robo-controlled" (my Direct Testimony p.38 lines 20-23), is *ad hominem*. I disagree. Statements are *ad hominem* if they are gratuitous and non-factual. Mine were neither. I intended not to muddy a reputation but to make a point. The power to control HECO lies with Mr. Robo. That is a fact. He has legal power, directly or through his subordinates, over HECO executives' decisions. That is a fact. He has power over their careers: If he decides Ms. Sekimura and Mr. Ching must go, they are gone. That is a fact. I recommended that Mr. Robo cede that power, and NextEra refused. That is a fact. Relevant facts may cause discomfort, but they are never *ad hominem*.

Mr. Reed (Rebuttal at 151) insists that "NextEra Energy's Board will not 'overrule' the utilities 'whenever NextEra wishes'—any more than HEI's Board could." The "will not" in Mr. Reed's sentence is only Mr. Reed's prediction; it is not NextEra's commitment. Indeed, Mr. Reed's "will not" is precisely what I asked NextEra to commit to, but NextEra refused. Mr. Reed cannot bind NextEra, so his statement is legally useless. That is also a fact—and it is not *ad hominem*.

Q. What about your concern with the independence of HECO's employees?

A. I described (Direct Testimony at 109) the risk that once the HECO utilities became subject to NextEra's control, the Hawai'i employees might "focus on pleasing NextEra Energy superiors based on financial factors, rather than achieving performance excellence based on customer satisfaction." Mr. Reed (Rebuttal at 161) opposed this concern, but mischaracterized what he opposed. I said there was a *risk* of this occurrence; he said I said it "will" occur. The risk is real. Employers set expectations for employees; employees, unless they can change their jobs costlessly, make efforts to please their superiors. That is what superiors expect. As long as NextEra has business objectives in conflict with Hawai'i's needs, there is risk that the Hawai'i employees' efforts will be diverted toward NextEra's priorities and away from Hawai'i's. Recognizing this risk is not "disrespectful" to employees (Reed Rebuttal at 161 l.17); it is protective of them. What is "disrespectful" to the Hawai'i employees is to insist on having the power to overrule their decisions. Indeed, Ms. Lapson (Rebuttal at 43) states: "It would be imprudent for a parent company that owns 100% of its subsidiary's equity to cede control over the financial decisions of its subsidiary." What she necessarily means is that NextEra does not trust HECO to make its own decisions, because those decisions might be contrary to the decisions that NextEra would make. That attitude, coupled with NextEra's refusal to "cede control," is the precise opposite of local control.

And there is more at issue than "trust." Ms. Lapson stated (Response to OP-IR-178):

> Even if every investment decision by the subsidiary were individually well-considered, the aggregate amount of equity required and the impacts upon the parent's capital resources could destabilize the parent company if the amounts and timing were not adequately coordinated.

"Coordinated" with what? In HEI today there are only three utilities. Coordination is straightforward. Ms. Lapson's "coordination" necessarily means coordination with NextEra's ventures—both those today and the unlimited numbers it insists on being free to acquire in the future—such as its failed bid to acquire Oncor from the bankrupt Texas holding company Energy Future Holdings. And that is precisely the point. Hawai'i's utilities will be controlled by a holding company whose deference to Hawai'i executives' decisions will depend on how they "coordinate" with all of NextEra's other ventures.

VI.
"Benefits" should not count unless backed by commitments

Q. What are your comments on the Applicants' discussion of benefits?

A. The Commission should credit only the commitments, not the aspirations. Mr. Reed (Rebuttal at 16) refers to "savings [that] begin at $27.8 million in the first year, and rise to $132.9 million by the fourth year, after the merger." But only $60 million of this four-year total is actually a commitment; the rest are just aspirations—possibilities of which Applicants are sufficiently unsure that they make no commitment. Anyone can say what is possible; only the committed make commitments.

Understand the asymmetry. The Applicants want the certainty of approval while offering only the possibility of benefits (other than the $60 million). This asymmetry of commitment is mirrored in the asymmetry of benefit: The Applicants guarantee HECO customers benefits of $60 million, while transaction promises HEI's shareholders a control premium of $568 million.

VII.
NextEra resists regulatory protections against its incentive and ability to distort competition

Q. How does NextEra respond to concerns over its dual involvement in monopoly and competitive businesses?

A. By "threatening" to drop the transaction if it does not get its way. Throughout the history of regulated industries, the mixing in one corporate family of monopoly activities and competitive activities has been a source of struggle. Given that history, I recommended a condition requiring that the post-acquisition entity not participate as a competitor in markets for generation or for distributed energy resources. Mr. Reed responded (Rebuttal at 179-180) that this prohibition would "threaten[] the viability of the transaction."

See what Mr. Reed has revealed. "Threaten the viability of the transaction" means that NextEra might walk away if it doesn't get its way. It means that the ability to control monopoly assets, while entering competitive markets served by those monopoly assets, was foundational to NextEra's offer to pay HEI the $568 million control premium; that if this ability is removed, the transaction might no longer be worth it. In other words, what NextEra finds worth the purchase price is the opportunity to gain a competitive advantage in Hawai'i's markets. For if NextEra's main reason for acquiring HEI were only to improve HECO's performance, losing the chance to enter Hawai'i's competitive markets would not "threaten the viability of the transaction."

It is true, as Mr. Reed says, that other states have approved acquisitions without prohibiting the acquirer from owning both the monopoly business while also competing in generation. But other states are not like Hawai'i. In most other portions of mainland U.S., electric interconnectedness means there are multiple generation companies competing in regional power markets (organized markets, bilateral markets or both). That fact, coupled with oversight by the Federal Energy Regulatory Commission and the regional transmission organizations subject to its jurisdiction, contributes to competitive pressures that can discipline prices and performance. Hawai'i is isolated from these markets. Its competitive bidding procedures cannot easily replicate the type of competition that occurs in the mainland markets.

Q. Doesn't NextEra offer to live under a "Code of Conduct"?

A. Yes, but NextEra insists on putting off the work of designing this Code until after the transaction is consummated. See Reed Rebuttal at 188 ("NextEra Energy will provide the Consumer Advocate, within 90 days of closing, a draft Code of Conduct governing such communications between representatives of NextEra Energy and the Hawai'ian Electric Companies."). Mutual trust, and common sense, require that conditions essential to the public interest be in place before the transaction is consummated.

Q. What about NextEra's other arguments against your proposed condition to separate the monopoly businesses from the competitive businesses?

A. NextEra complains that my condition would deprive the market of a competitor. That is not a necessary result, because the NextEra or HECO employees freed up by the prohibition can form an independent company to compete. And if the market is already as competitive as NextEra insists it is (thereby supporting its view that my protective condition is not necessary), the loss of one competitor should not make a difference to competitiveness. The only "competitor" we lose is the one competitor that would have an unearned advantage due to its affiliation with the NextEra-HECO monopoly.

Mr. Reed also asserts (Rebuttal at 190-91) that non-utility generation is less subject to Commission control than is utility generation, so the Commission should not be discouraging utility-owned generation. His reasoning is circular again. The Commission can control what it chooses to control, by requiring contract clauses that subject the non-utility company to penalties sufficiently large to induce compliance, including clauses that move the generation ownership from the non-utility company to the utility. He offers no evidence that the independent power producers in Hawai'i have performed less effectively than have the HECO utilities. As for the risk that no non-utility company will bid to supply necessary generation, the Commission can preserve the option of the utility presenting a proposal as a last resort.

It is long past time to resist the reality that combining monopoly and competitive activities in the same corporate family invites abuse. "Agencies do not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall."[24] Inviting NextEra to improve HECO's performance is one thing. Allowing NextEra to use its control of HECO's monopoly to gain an unearned advantage in competitive markets is another.

Finally, Mr. Reed (Rebuttal at 234) states that the federal Public Utility Holding Company Act of 1935 (PUHCA) was "repealed, at least in part, in order to encourage consolidation within the utility industry and to remove barriers to industry consolidation that had previously inhibited multi-state mergers." Mr. Reed is wrong. I was actively involved in the Congressional debate over PUHCA repeal from the late 1980s onward. I testified on the subject before Congressional committees five times in the Senate and five times in the House. I participated in dozens of meetings and conferences on the subject. I recall no one arguing that the goal was "consolidation."[25] The most frequently stated

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[24] *Associated Gas Distrib. v. FERC*, 824 F.2d 981, 1008 (D.C. Cir. 1985).

[25] Asked in discovery to provide support for his view that a purpose of PUHCA repeal was to "encourage consolidation," Mr. Reed referred to his "work" and his "understanding," with no elaboration. He then stated that his "understanding" was "confirmed" by two documents. Neither document discusses the goals for repeal advocates. The first document, *The Electric Industry After PUHCA Repeal: What Happens Next?* (American Public Power Association Oct. 2005) does not say that consolidation was a *goal* of repeal advocates; it says that consolidation will be an *effect* of repeal. See *id. at* 4 (stating that the "effect will likely be greater consolidation of the

purpose, other than "reduce regulatory burden" and cause more capital to flow into the industry, was to inject more competition—by allowing more companies to enter more electricity markets that were then served solely by utility monopolies. (PUHCA limited each holding company to a "single integrated public-utility system." So a company with utility assets in one part of the country could not readily compete in a distant part of the country.) Mr. Reed's statement is not only erroneous, it is ironic: ironic because while PUHCA repeal was motivated by a desire for more competition, NextEra wants to win control of HEI's utility franchises without any competition.

Conclusion

Q. Does this conclude your cross-rebuttal testimony?

A. Yes.

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electric industry, greater concentration of ownership, more complex company structures, and more opportunities for the exercise of market power"). The second document, *M&A Advisor* (Nixon Peabody LLP Aug. 2005), similarly says nothing about goals; it talks about effects. See *id.* at 1 (stating that repeal "removes a significant obstacle to long distance business combinations between utility companies, and consequently the range of utility merger and acquisition transactions that may now be considered has increased"). My distinct memory remains that no one "sold" Congress on repeal by saying it would "encourage consolidation."