Louisiana Public Service Commission

Docket Number U-33434

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

Direct Testimony of Scott Hempling

On Behalf of
Alliance for Affordable Energy

July 2015

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Exhibit SH-1: Excerpts from CLECO Corp.'s Definitive Proxy Statement

Exhibit SH-2: Resume of Scott Hempling

I.

Overview and Summary

A. Qualifications

Q. State your name, position and business address.

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

Q. Describe your employment background, experience and education.

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

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

addition to overseeing the planning and publication of over 80 research papers by NRRI's staff experts and outside consultants, I published my own research papers, advised contract clients (including state commissions, regional transmission organizations, private industry and international institutions), and wrote monthly essays on effective regulation.

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

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

[1] These proceedings include: Toledo Edison and Cleveland Electric Illuminating (1985); PacifiCorp and Utah Power & Light (1987-88); Northeast Utilities and Public Service of New Hampshire (1990-91); Kansas Power & Light and Kansas Gas & Electric (1990-91); Northern States Power and Wisconsin Electric Power Co. (1992); Entergy and Gulf States (1995); Potomac Electric Company and Baltimore Gas & Electric (1997-98); Carolina Power & Light and Florida Power Corp (1999); Sierra Pacific Power and

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

I received a B.A. *cum laude* from Yale University in 1978, where I majored in (1) Economics and Political Science and (2) Music. I received a J.D. *magna cum laude* from Georgetown University Law Center in 1984. I am a member of the Bars of the District of Columbia and Maryland.

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 Holdings (2014-15) (before the commissions in Maryland and the District of Columbia); and NextEra and Hawaiian Electric Industries (2015-16).

My resume is attached to this testimony as Exhibit SH-2. More information is at www.scotthemplinglaw.com.

Q. Have you provided testimony in prior regulatory proceedings?

A. Yes, before the following fora: Hawaii Public Utilities Commission, Connecticut Public Utilities Regulatory Authority, District of Columbia Public Service Commission, Maryland Public Service Commission, Mississippi Public Service Commission, U.S. District Court for Minnesota, Illinois Commerce Commission, California Public Utilities Commission, Minnesota Public Utilities Commission, U.S. District Court for Wisconsin, New Jersey Board of Public Utilities, Indiana Utility Regulatory Commission, North Carolina Utilities Commission, Wisconsin Public Service Commission, Texas Public Utilities Commission and the Vermont Public Service Board. These proceedings are listed on my resume.

Q. On whose behalf are you submitting this testimony?

A. The Alliance for Affordable Energy.

Q. What information did you review in preparing this testimony?

A. I reviewed the Application and accompanying testimony, the financial reports of the acquiring entities, CLECO Corp.'s Definitive Proxy Statement relating to the transaction (January 13, 2015) (hereinafter referred to as "Proxy Statement"), Louisiana's public utility statutes, Commission orders relating to mergers and acquisitions, and responses to data requests submitted in this proceeding.

B. Description of the transaction

Q. Describe the transaction.

A. Today, Cleco Power is the dominant holding of CLECO Corp.[2] After the acquisition, Cleco Power will be but one of hundreds of companies controlled by private equity funds managed by Macquarie and its partners. The thousands of small shareholders owning CLECO stock—many of them Louisiana residents—will be replaced by a three-party consortium calling itself Cleco Partners. The three members and their ownership percentages are:

MIP Cleco Partners (54%)
British Columbia Investment Management Corporation (bcIMC) (37%)
John Hancock Financial (9%)[3]

MIP Cleco Partners will be controlled by Macquarie Infrastructure Partners III (MIP III), an "independent infrastructure private equity fund managed by the Macquarie Infrastructure and Real Assets ("MIRA") division of Macquarie Group Limited."[4] MIP III and its co-investors make up an "unlisted fund" managed by MIRA.[5] bcIMC is an investment management corporation that "invests in all major asset classes."[6] John Hancock Financial is a division of Manulife, a "Canadian-based financial services group"

[2] In this testimony, "Cleco Power" or "Cleco" refers to the utility serving in Louisiana. "CLECO Corp." or "CLECO" refers to the holding company that owns all the stock of Cleco Power.

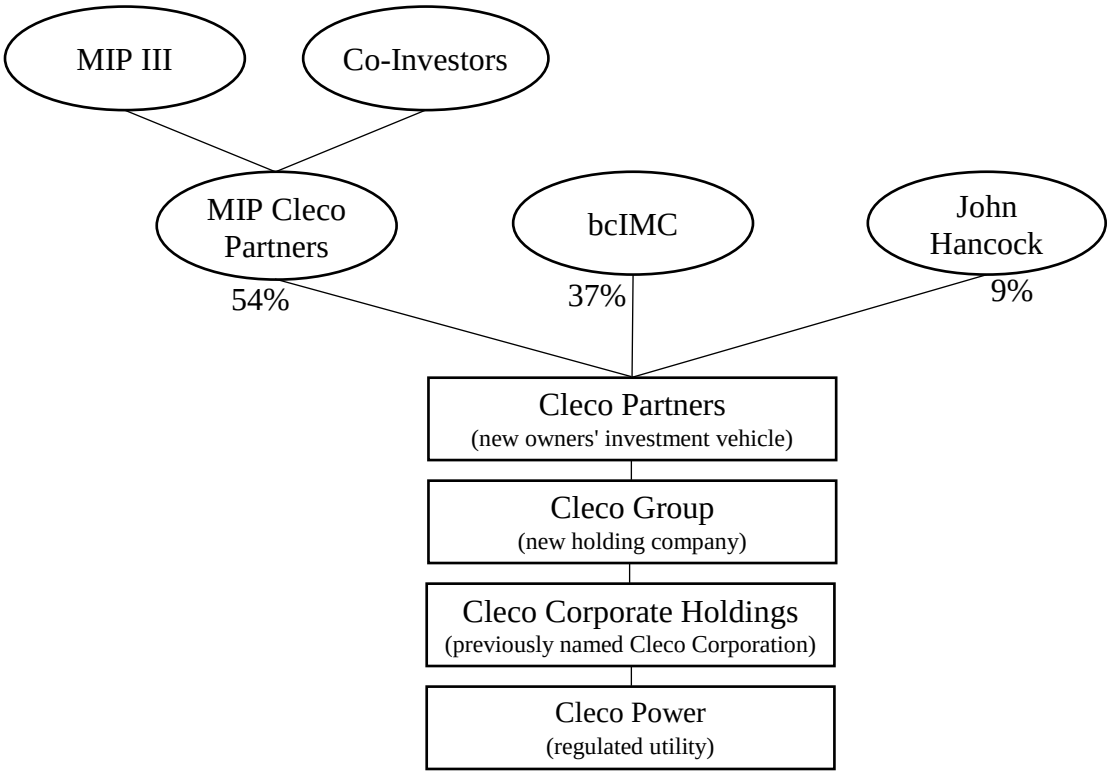
[3] Hereinafter referred to as the "Acquirers."

[4] Application at 1 and n.3.

[5] Application at 6.

[6] Direct Testimony of Andrew Murphy at 5-7.

that "offers clients a diverse range of financial protection products and wealth management services."[7] The following diagram, taken from Mr. Murphy's Direct Testimony (at 15) displays the post-acquisition structure.



Mr. Murphy has simplified his diagram, showing only the entities acquiring CLECO directly. But in simplifying, he oversimplified. He omitted the entities that ultimately control the Acquirers. And he omitted the hundreds of other companies that the three members of Cleco Partners control. Mr. Murphy thus has kept from the Commission the answers to the very questions they must ask to assess this transaction: Who ultimately will control CLECO? What business risks exist in the family of which Cleco Power will be such a small part?

[7] *Id.*

This transaction is a leveraged private equity buyout. The term "buyout" refers to the fact that CLECO's shareholders, after receiving the Acquirers' purchase price of $55.37 per share, will disappear. The term "private equity" refers to the fact that after the transaction, CLECO Corp. stock will no longer be traded on the New York Stock Exchange or any other public stock exchange, so its financial condition will no longer be public information, at least under federal law. The term "leveraged" refers to that part of the $3.53 billion purchase price[8] that will be financed by debt borne by CLECO Corp. In other words, the to-be-acquired company (CLECO Corp.) is borrowing money so that its shareholders can be bought out by the Acquirers. CLECO Corp. will thus have more debt after the acquisition than before. This new CLECO Corp. debt will be "secured by a pledge of the stock of Cleco Power,"[9] and will be, I assume, non-recourse to the Acquirers. That means that if CLECO Corp. defaults on its debt, ownership of Cleco Power would pass to CLECO Corp.'s lenders.[10]

The transaction price reflects a 14.8% acquisition premium above CLECO Corp.'s closing stock price on the last trading day before the acquisition announcement.[11] That

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[8] The purchase cost to the Acquirers also includes estimated assumed debt of $1.37 billion. Murphy Direct Testimony at 15.

[9] Application at 12.

[10] Whether this change in ownership would occur without Commission approval (by virtue of the Commission approving this transaction and all its terms), notwithstanding the 1994 General Order's requirement that control of a utility cannot be transferred without Commission approval, is a legal question the Commission should have the Applicants brief.

[11] Definitive Proxy Statement at 19.

14.8% translates into about $435 million.[12] This premium is, by definition, above and beyond the "just and reasonable" return CLECO shareholders receive from the rates lawfully set by this Commission.[13]

C. Legal standards

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

A. Article IV Section 21 of the Louisiana Constitution of 1974 provides, in pertinent part:

> The Commission shall regulate all common carriers and public utilities and have such other regulatory authority as provided by law. It shall adopt and enforce reasonable rules, regulations and procedures necessary for the discharge of its duties, and perform other duties as provided by law.

Pursuant to that authority, the Commission in 1994 issued a General Order, requiring parties to an acquisition proposal to address the following 18 factors:

1. Whether the transfer is in the public interest.

2. Whether the purchaser is ready, willing and able to continue providing safe, reliable and adequate service to the utility's ratepayers.

3. Whether the transfer will maintain or improve the financial condition of the resulting public utility or common carrier ratepayers.

4. Whether the proposed transfer will maintain or improve the quality of service to public utility or common carrier ratepayers.

5. Whether the transfer will provide net benefits to ratepayers in both the short term and the long term and provide a rate making method that will ensure, to the fullest extent possible, that ratepayers will receive the forecasted short and long term benefit.

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[12] Acquisition premium in dollars = (# shares outstanding) * (stock price on day prior to announcement) * (0.148). So 60,875,561 x 48.27 x 0.148 = $434.9 million. The number of shares outstanding comes from the Definitive Proxy Statement (at 1). The stock price on day prior to announcement comes from the Application (at 37).

[13] As explained in Part III.H.3 below.

6. Whether the transfer will adversely affect competition.

7. Whether the transfer will maintain or improve the quality of management of the resulting public utility or common carrier doing business in the state.

8. Whether the transfer will be fair and reasonable to the affected public utility or common carrier employees.

9. Whether the transfer would be fair and reasonable to the majority of all affected public utility or common carrier shareholders.

10. Whether the transfer will be beneficial on an overall basis to State and local economies and to the communities in the area served by the public utility or common carrier.

11. Whether the transfer will preserve the jurisdiction of the Commission and the ability of the Commission to effectively regulate and audit public utility's or common carrier's operations in the State.

12. Whether conditions are necessary to prevent adverse consequences which may result from the transfer.

13. The history of compliance or noncompliance of the proposed acquiring entity or principals or affiliates have had with regulatory authorities in this State or other jurisdictions.

14. Whether the acquiring entity, persons, or corporations have the financial ability to operate the public utility or common carrier system and maintain or upgrade the quality of the physical system.

15. Whether any repairs and/or improvements are required and the ability of acquiring entity to make those repairs and/or improvements.

16. The ability of the acquiring entity to obtain all necessary health, safety and other permits.

17. The manner of financing the transfer and any impact that may have on encumbering the assets of the entity and the potential impact on rates.

18. Whether there are any conditions which should be attached to the proposed acquisitions.[14]

D. Executive summary

Q. Summarize your testimony.

A. In 2014, CLECO Corp.'s Board recognized that the company was entering a "phase of limited growth."[15] Seeking some way to get gain for its shareholders, it found one: sell out to two "newly formed entities with essentially no assets other than the equity commitments of the Investors...."[16] In selecting these entities and negotiating terms, CLECO's Board had a single goal: highest price for its shareholders. The goal was never the best service for its customers.[17]

CLECO's chosen Acquirers are financial companies. They manage investments for investors. They do not build power plants, buy fuel, create new energy services, integrate distribution with transmission with generation, forecast demand, or deal with operational efficiency, consumption efficiency and reliability. They assess financial prospects, then buy and sell those prospects—all with the aim of maximizing gain.

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[14] *In Re: Commission Approval Required of Sales, Leases, Mergers Consolidations, Stock transfers, and All Other Changes of Ownership or control of Public Utilities Subject to Commission Jurisdiction* (March 18, 1994) (hereinafter cited as "1994 General Order").

[15] Definitive Proxy Statement at 33.

[16] Definitive Proxy Statement at 41.

[17] As explained, using CLECO's own words, in Part III.G below.

Among residential customers of Louisiana's investor-owned utilities, those served by Cleco Power have the highest monthly bills.[18] Nowhere in the Application is that fact mentioned. According to the public record, at no point during CLECO's search for acquirers, or during its negotiations with the Acquirers, was that fact mentioned. Of all the things high-cost Cleco needs, new owners with no expertise in making, selling and conserving electricity is not one of them.

Serving electricity to Louisiana customers is a privilege—a franchise granted by government to provide an essential service. CLECO Corp. treated that franchise like a New York City taxi medallion—created by government as a public good, converted by CLECO into a private commodity and sold to the highest bidder.

This proposal arises from pure self-interest.[19] In a competitive market, self-interest is a valid motivation, because market forces align that seller interest with the consumer interest. But in a monopoly market, seller self-interest can be contrary to the

[18] Based on a comparison of hypothetical monthly bills for a 1000 kWh customer, taking into account customer charge, base rate, fuel adjustment charge, environmental charge, storm charge, franchise fee, infrastructure charge, CWIP refund rider, Ninemile generation charge, and MISO recovery rider. The comparison did not take into account tax or formula rate plan adjustments.

[19] As is the case with mergers and acquisitions generally, according to the Commission: "[U]tilities make acquisitions for the benefit of their shareholders, not their ratepayers." *In Re: Institution of Investigation Into Proposed Acquisition of Central Louisiana Electric Company Inc., Joint Application of Teche Electric Cooperative, Inc. and Central Louisiana Electric Company, Inc. for Approval of Acquisition*, Order No. 21128 at 3 (Sept. 9, 1997). *See also Southwestern Electric Company, Central and South West Corporation, American Electric Power Company*, Order No. U-23327 at 11 (July 28, 1999) ("[W]e believe that AEP and CSW have agreed to merge, first and foremost, because those two companies believe that the merger is in the best interest of their shareholders.").

consumer interest. That is why we have regulation: to align the seller interest with the consumer interest. Like the forces of competition, regulation should cause utilities to make customer satisfaction their priority. But when CLECO sought acquirers, customer satisfaction was not its priority; shareholder gain was.

Regulation's central questions are these: How can we attract the best companies to help achieve our goals? and How can we induce those companies to perform with excellence? CLECO and its Acquirers asked two very different questions. CLECO asked: How can we obtain the maximum return for our shareholders?[20] The Acquirers asked: How can we extend our business model—owning government-protected monopolies—into a new territory?[21]

The Commission should not approve a transaction that imposes risks on ratepayers to create gain for shareholders. The Commission should instead tell CLECO to focus on its franchise—to improve its service and reduce its costs. Instead of questions like "How do we get more gain?" and "How do we buy more monopolies?", the Commission should ask questions like this: "What are Louisiana's needs and wishes?

[20] And CLECO got this answer: "With this agreement, Cleco's existing investors will receive an exceptional value for their shares." Statement of Bruce Williamson, Cleco's chairman, president and chief executive officer, quoted in news release (Oct. 20, 2014), attached to the letter-request of Alan C. Wolf (Oct. 20, 2014).

[21] And the Acquirers got this answer: "[N]ow is the right time for this transaction" because "bcIMC's clients are supportive of investing in infrastructure and utilities, such as Cleco Power, and this Transaction provides an opportunity for bcIMC to become a long-term infrastructure owner, which is consistent with bcIMC's business practices." Webb Direct Testimony at 9. See also Murphy Direct Testimony at 12-13 (liking this acquisition because Cleco Power is a "well-run" company, a "well-capitalized, vertically integrated utility with opportunities for growth through the expansion of the wholesale business").

What types of companies can most cost-effectively respond to those needs and wishes? What Commission policies will most likely attract those companies and induce the best performance? " And most immediately: "Will approving this transaction make answering those questions easier or harder?"

Because the questions the Applicants asked diverged from the questions the Commission should ask, their Application is not a foundation on which we can build Louisiana's future. This testimony explains the reasons why, in six major Parts, summarized next.

The public interest requires consistency between the Acquirers' attributes and Louisiana's needs (Part II): There are many kinds of utility acquirers, ranging from next-door vertically integrated companies to remote financial management firms. Their characteristics can be consistent with a state's needs, or they can be a source of conflict—conflict between the acquirer's business aims and the local utility's obligation to serve. The job of regulation is to prevent corporate structures that cause conflict between shareholders and customers. It is better to prevent conflict upfront, rather than allow conflict to develop and then try to "regulate away" the consequences.

To prevent conflict upfront, the Commission should articulate policies in four key areas: (a) the permissible business activities within the acquirer's corporate family; (b) the types of corporate family governance structures that may control or influence the utility; (c) the permissible financial structures and relationships that connect the corporate family's members and thereby affect the utility; and (d) the market structures affected by the acquisition. Examining these four areas is especially important here, where CLECO's relatively simple, Louisiana-focused corporate structure will be subordinated to the

Macquarie-led group's global complexity. Without this clarity, the Commission risks receiving proposals like CLECO's, where applicants simply copy the Commission's 18 phases into their Application and deem them satisfied.

Subordinating CLECO to its private equity acquirers brings five distinct harms (Part III): In the context of utility monopolies, "harm" occurs when a utility performs less effectively than if it were subject to effective competition. If the utility fails to provide high-quality service cost-effectively, there is harm. This transaction brings harm from five sources. First, it diminishes Cleco Power's importance to its holding company owner. Second, it risks subordinating Cleco Power's Louisiana-based operational decisions to the Acquirers' globally-based strategic decisions. Third, the Acquirers' business activities—current and future, known and unknown—bring risks to Cleco Power's customers. Fourth, the investment goals of CLECO's owners, and the resulting pressures put on CLECO, will change in unknown ways. Fifth, the Acquirers' "business model"—buying regulated monopolies and protecting their revenue stream—can impede the Commission's future policies on market structure.

These harms should not surprise, because as acknowledged by CLECO Corp., it chose its acquirers based on acquisition price rather than customer benefit.

Merely complying with the law is not a benefit (Part IV): While paying CLECO Corp.'s shareholders a 14.8% control premium, the Acquirers offer customers virtually nothing they are not already entitled by law to receive. The "Service Quality Program" and the "Proposed Regulatory Commitments" merely "maintain" and "continue" existing practices and standards—as required by existing law. The only tangible benefit is 35 cents a month per customer. Enough said.

Rather than let CLECO sell out to the Acquirers, the Commission should see what skills and services others can offer (Part V): If the purpose of regulation is to improve performance, the logical path is not to accept the first acquirer that comes to the Commission, chosen through a secret selection process run by a utility monopoly pursuing acquirers who want to buy a utility monopoly. The Commission should reject the transaction. But merely rejecting the transaction risks repeating this process with other prospective acquirers. If the idea of serving Cleco Power's customers was attractive to the Acquirers, it will be attractive to others. Instead of limiting itself to this one option, the Commission instead should consider multiple ways to find the best providers for the services customers need—or to induce Cleco Power to be the best provider for the services customers need.

If the Commission does approve this takeover, conditions will be necessary—but not sufficient—to reduce the risk of harm and increase the probability of benefit (Part VI): I propose conditions in three categories: eliminate harms, create benefits, and ensure compliance. But not all these conditions are practical and enforceable. Their vulnerabilities make them insufficient to correct the transaction's imbalance between harm and benefit, and between private and public interests.

Conclusion: The acquisition fails most of the 18 factors (Part VII): This acquisition fails each of the General Order factors that apply here. Behind these multiple failures is a common reason: The transaction's origins are in the buyers' and seller's private interests. Those interests combined and interacted without any regard for the public interest.

II.
The Public Interest Requires Consistency Between the Acquirers' Attributes and Louisiana's Needs

Q. How do the characteristics of a utility's acquirers affect the public interest?

A. From next-door, vertically integrated companies to remote financial management firms, the characteristics of prospective acquirers vary. These characteristics can be consistent with a state's needs or they can be a source of conflict. The job of regulation is to prevent conflict upfront, rather than deal with its consequences once they occur.

A commission can prevent conflict upfront by articulating policies in four key areas: (a) the permissible business activities within the acquirer's corporate family; (b) the types of corporate governance structures that may control or influence the utility; (c) the permissible financial structures and relationships that connect the corporate family's members; and (d) the market structures affected by the acquisition. Examining these four areas is especially important here, where CLECO's relatively simple, Louisiana-focused corporate structure will be subordinated to the Acquirers' global complexity. I will discuss each area in turn.

A. Business activities

Q. How might an acquirer's business activities cause conflicts for the utility?

A. A standalone utility—one affiliated with no other business, serving a single local territory—experiences no inter-business conflict. The potential for conflict grows as the holding company's business activities expand, in terms of either geography or type of business. Geographic expansion (acquiring other utilities in other locations) can benefit customers if there are increasing economies of scale; but it can hurt customers if operations are impaired by managerial remoteness or diseconomies of scale. Type-of-

business expansion (acquiring companies in other industries) is another two-edged sword: Non-utility affiliates can support a utility (as might a subsidiary experienced in acquiring land or buying fuel); or distract it (like affiliates investing in nuclear power or hedge funds).

Q. How can a commission address these conflicts?

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

The first is that investments in unrelated businesses distract utility management from its obligation to excel in its core business—serving utility customers. Failures force management to spend time saving or selling the non-utility losers; successes spur management to pursue more non-utility winners—instead of improving utility service for customers.

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

The third risk is a weakened utility. Every month, customers pay for their utility service in cash. When non-utility affiliates fail, the utility's cash flow tempts the holding company to prop up the bleeding businesses by drawing dividends from the utility or

reducing equity flows to the utility. And because utilities are capital-intensive, their assets are attractive collateral for third-party loans to the failing affiliates. The utility, initially strong from ratepayer support, can be weakened when its siblings face financial difficulty. Utilities need capital, sometimes quickly—such as after a hurricane or in response to new environmental requirements. If other affiliates suffer losses at the same time, and there is internal competition for capital, utility consumers—who have no alternatives—can be the losers.

B. Corporate governance structures

Q. How might an acquirer's corporate governance structure cause conflicts for the utility?

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

C. Financial structures

Q. How might an acquirer's financial structure cause conflicts for the utility?

A. Financial structure involves the mix of equity and debt, including who holds or controls that equity and debt, and which business activities get priority when financial capital is scarce. How these financial features can affect the utility subsidiary is illustrated by two simple examples, both relevant to this transaction. First, if the utility's holding company finances the acquisition with debt, this leveraging can cause the holding company to

pressure the utility to divert cash flow from utility operations to the holding company; or to limit the flow of holding company equity into the utility. Second, when there is financial failure by the parent company or another affiliate other than the local utility, investors view the utility as more risky, making borrowing more expensive.

D. Market structures

Q. How can an acquisition affect the structure of markets in which the post-acquisition entity will participate?

A. The term "market structure" refers to the number and types of entities selling and buying a particular product or service within a particular geographic area. Market structure also refers to the sellers' and buyers' market shares, the assets they control, and the ease with which they can enter and exit the market. An acquisition can make a market more competitive or less competitive, thereby affecting efficiency, cost, quality, customer service and innovation.

Before addressing an acquisition, a commission should envision the types of market structures most likely to produce, cost-effectively, those goods and services the commission wants consumers to have. Only then can the Commission assess whether a proposed acquisition assists or impedes progress toward that market structure.

I will explain later that the Acquirers want market structures that benefit government-protected monopolies.[22] Approving this acquisition necessarily means supporting that private desire. But that desire conflicts with a future in which customers have more choices. To see this issue in the present context, a short history of market

[22] See Part III.F.2.

structure will be useful. Until Congress enacted the Public Utility Regulatory Policy Act of 1978 ("PURPA"), electricity in a typical service territory was available only from a single vertically integrated utility company. That company provided the conventional, "plain vanilla" bundle of generation, transmission and distribution, at a uniform price every hour of the year. PURPA introduced diversity into that vertically integrated monopoly market structure by requiring existing utilities to buy capacity and energy from "qualifying facilities"—nonutility companies that sold wholesale power from renewable energy facilities or cogenerators. Four decades of transition later, we have choices: independent power producers, LNG, microgrids, energy efficiency, demand response, rooftop solar, utility-scale solar and wind, and storage. Diverse options are now coming to market, brought by equally diverse companies.

Due to these developments, state regulators now can give customers choices, rather than leave them with no choice but the incumbent monopoly. Whether those choices are positive or negative for Louisiana is not at issue in this docket. What is at issue is whether this transaction will constrain the Commission's options later. The Commission therefore will need to have some sense of what options it wants to preserve, and then assess whether a Cleco Power controlled by Macquarie et al. could limit those options.

*** * ***

Q. How should regulators apply their preferences on business activities, corporate governance structure, financial structure and market structure to a proposed acquisition?

A. By assessing the Acquirers' business activities, corporate governance structure and culture, financial structure and market structure, the Commission can determine if the

post-acquisition entity will have motivations, opportunities and powers in conflict with Cleco Power's obligation to serve, and with the market structure options the Commission wishes to preserve. If there is conflict, the Commission should determine whether it is feasible to design conditions that will prevent the conflict from undermining the Commission's goals. If conditions are feasible, then the regulator must also find that it has the legal authority and resources to impose those conditions.

The Commission also must determine whether it has the practical ability to enforce the conditions. By "practical ability," I mean the ability to impose on a violator consequences proportionate to the harm caused. Practical ability does not exist if those proportionate consequences would have to be moderated due to customers' dependence on the violator—such as when the violator is "too big to fail." This Commission faced just such a situation when it felt it necessary to allow imprudent costs in rates due to concern over the utility's solvency.[23] A transaction that puts the regulator in this position of "moral dilemma"—a position of weakness—conflicts with the public interest because it disables the regulator from protecting the public interest.

[23] *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). A more recent example is 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).

On these four major areas—business activities, corporate structure, financial structure and market structure—the Commission has not expressed preferences, as far as I am aware. Its 1994 General Order lists subjects to address; it does not describe corporate arrangements to avoid. Until now, there was no need for the Commission to state its preferences, because CLECO's corporate picture was relatively simple. This transaction changes the picture, literally overnight, by placing the simply structured CLECO under the control of three partners whose interests are not aligned with Louisiana's, and whose future acquisitions and actions, and the risks they represent, are outside this Commission's control (all as discussed in Part III below). For these reasons, articulating a mergers-and-acquisitions policy is a necessary part of this proceeding.

III.
Subordinating CLECO to Its Private Equity Acquirers Brings Five Distinct Harms

A. The meaning of "harm"

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

A. To have teeth, a no-harm policy must define harm. On this point, the Commission's current policy[24] could benefit from clarification. In the context of monopoly utilities—companies not subject to effective competition—"harm" occurs when those utilities, or the markets in which they participate, perform less effectively than if they were subject to effective competition. If those utilities or markets fail to provide high-quality service cost-effectively, there is harm. If a utility receives government protection from competition, it must perform as if subject to competition. It must make all feasible, cost-effective efforts to reduce costs and increase quality. Failure to do so denies ratepayers what they deserve. That denial is harm.

An acquisition can cause two distinct types of harm: status quo harm and opportunity cost harm. I discuss each type next.

[24] See 1994 General Order (requiring that ratepayers "not be harmed"); *Southwestern Electric Company, Central and South West Corporation, American Electric Power Company*, Order No. U-23327 at 9, 14 (July 28, 1999) (finding that the acquisition itself does not cause harm, and imposing on SWEPCO the burden of proving in future rate cases that the merger will not harm ratepayers).

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. This harm can take at least four forms.

a. As the holding company's acquisitions grow, the attention paid to each utility by the holding company's leadership necessarily shrinks. As those individuals become responsible for more businesses and more assets, a utility's specific needs fall in priority.

b. As the corporate family invests in ventures less financially secure than state-regulated, monopoly distribution service, the investor portrait can change. Conservative investors—those who buy-and-hold patiently, content with stable dividends and stable share value or modest growth—no longer can treat the corporate family as a predictable place to put their money. A different type of investor enters: one seeking higher risks and higher returns. These new investors can bring pressures on the corporate family leadership for more "growth." That additional growth requires additional risks, thereby affecting the leadership's priorities and drawing its attention further away from the core utility business. Also, bond rating agencies can no longer give consistently stable ratings based on historic operational performance and regulatory treatment, because the corporate family's financial health no longer is based solely on those relatively predictable variables.

c. If the holding company is acquiring non-utility businesses, utility employees may believe that the best path to advancement is not through the traditional utility activities, but instead through non-utility activities and "corporate strategy." The risk is that the utility loses good workers—people whose development was funded by

customers' rate payments—to non-utility ventures. And essential craftspeople—men and women who make things work—face more job risk, because failures in the unrelated businesses can create financial strains that cause the utility to reduce or defer maintenance and modernization. That greater job risk can make recruitment more difficult.

d. An acquisition can harm competition—the force our economy relies on to improve and diversify service and keep prices reasonable. The harm can be direct (by allowing incumbents to raise prices, reduce quality or slow innovation without fear of losing sales to competitors) or indirect (by discouraging other companies from entering, because they view the jurisdiction as uncommitted to competition on the merits).

2. Opportunity cost harm

Q. Explain what you mean by opportunity cost harm.

A. In the context of utility acquisitions, opportunity cost harm occurs if the proposed transaction displaces some other opportunity that would produce more benefits to consumers. A utility is obligated to provide service at a quality and cost comparable to what effective competition would produce. If a transaction diverts or displaces resources from more productive uses, thereby incurring what economists call "opportunity cost," it fails this test.[25]

[25] "[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).

In competitive markets, transactions that disregard opportunity cost have less success than transactions that take opportunity cost into account, all else equal. In the utility acquisition context, disregarding this type of harm violates the principle that regulation should induce performance comparable to what would be produced by competition.

Q. How does the concept of opportunity cost harm apply to acquisitions of utilities?

A. A utility acquisition proposal arises, directly or indirectly, explicitly or implicitly, from a competition for control: acquirers competing for control of a target. The target has a fiduciary obligation to pick the acquirer that offers the most to the target's shareholders. But if the target pursues that fiduciary obligation to its shareholders while ignoring its service obligation to its customers, it will choose the acquirer offering the highest price rather than the acquirer promising the best service. Selecting the wrong acquirer necessarily precludes selecting the right acquirer (from the customers' perspective). This foregoing of consumer benefit is opportunity cost—harm. To see it otherwise, to be indifferent to the opportunity cost, is to allow the merging companies' interests to prevail over the consumers' interest, and to sacrifice economic value. That is not a public interest outcome.

*** * ***

Q. How will you apply these concepts of status quo harm and opportunity cost harm to the proposed acquisition of CLECO?

A. The Applicants claim there will be no harm. They say that "Cleco Power would continue to provide safe, reliable, and efficient electric service at reasonable rates," that "[t]he Transaction would have no effect on the LPSC's jurisdiction over Cleco Power or its rates," that "[t]here would be no impact on customers either in the manner in which they

interact with Cleco Power or in their rates as a result of the Transaction," and that Cleco Power will "remain[] financially sound...."[26]

These statements contain neither facts nor reasoning. They are advertisements rather than proof. And they ignore the five sources of harm I will describe next, in Parts III.B through III.F, as follows:

> The acquisition diminishes Cleco Power's importance to its holding company owner.
>
> Cleco Power's decisions will be subject to the Acquirers' control.
>
> The Acquirers' business activities—current and future, known and unknown—cause risk to Cleco's customers.
>
> The investment goals of CLECO's owners, and the resulting pressures put on CLECO, will change in unknown ways.
>
> The Acquirers' "business model"—buying regulated monopolies and protecting their revenue stream—can impede the Commission's future policies and limit its options.

Each of these sources can cause status quo harm (by raising the cost of current operations) and opportunity cost harm (by precluding structural options that would increase the efficiency of current and future utility operations). These harms should not surprise, because as I explain in Part III.G, in choosing these acquirers CLECO put acquisition price ahead of customer interest.

[26] Application at 2.

B. The acquisition diminishes Cleco Power's importance to its holding company owner

Q. How does this transaction affect Cleco Power's importance to its holding company owner?

A. Cleco Power's importance will drop dramatically. Today, Cleco Power dominates CLECO Corp., contributing 95% of its consolidated revenue.[27] After the acquisition, Cleco Power will be, literally, a decimal point. CLECO's new owners have $700 billion in assets under management.[28] With market value of its capitalization of $4.4 billion,[29] CLECO's share of that total will be 0.63 percent.[30]

Q. How will Cleco Power's diminished role affect the Commission's ability to regulate its performance?

A. As Cleco Power's relative contribution to shareholder earnings shrinks, so will Macquarie's, British Columbia's and Hancock's stakes in what the Commission thinks. The Acquires will literally care less about Louisiana than CLECO Corp. does. That is a mathematical inevitability.

When a company cares less about its regulator's priorities, internal accountability necessarily diminishes. As a result, the regulator must work harder to maintain that

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[27] CLECO Corp.'s 2014 revenues were $1.293 billion. The electric share was $1.226 billion. See CLECO's 2014 10-K Report at 54.

[28] MIRA has over $100 billion, British Columbia has $91 billion (U.S.), and Manulife (John Hancock's owner) and its subsidiaries have $509 billion. Application at 7-8.

[29] CLECO 10-K (2014) at 28.

[30] And if we calculate the percentage using Macquarie Group Limited's $486.3 billion (2015 Annual Report at 228) rather than MIRA's $100 billon, CLECO's share drops to 0.41 percent.

accountability. The regulator must set clear expectations, then align the utility's compensation with its performance. The utility must value the regulator's expectations as if its life depended on meeting them. Success on these efforts requires a productive relationship between utility and regulator.

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

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

Regulators cannot force performance. They cannot create the utility's corporate culture, hire its top executives or set executive and employee compensation. Regulators cannot order excellence. They can try to induce certain behaviors through financial consequences, both positive and negative. But these are blunt, limited tools. Granting extra profits for certain initiatives risks under-investment in other initiatives. And

penalties are problematic: Where the regulator has no alternative to the incumbent, a penalty proportionate to the error can leave the utility unable to correct that error.[31]

For these reasons, a productive utility-regulator relationship must be more than hierarchical; it must be rooted in mutual commitments—a set of public interest values defined by the regulator and absorbed by the utility. The utility's leadership must be active, focused and cooperative. Its priorities must be aligned, always, with the regulator's. And when CLECO Corp., most of whose profit depends today on satisfying the Commission, is acquired by companies whose profit stake in Louisiana is much lower, there is less basis for confidence that this alignment exists.

Q. What is the solution to this problem?

A. The solution—other than to reject the transaction—is to condition this acquisition on the Acquirers' commitment—a legally binding commitment, not a rhetorical commitment—that without the Commission's permission there will be no further reduction in the CLECO utilities' importance to their holding company owners. I offer such a condition in Part VI.A.1.a below.

C. Cleco Power's decisions will be subject to the Acquirers' control

Q. Have the Acquirers made a commitment to local control?

A. No. "Commitment" means "a promise to do or give something."[32] The Acquirers make statements like "Cleco Partners would not seek to eliminate personnel or operating

[31] See, e.g., the cases in footnote 23.

[32] See http://www.merriam-webster.com/dictionary/commitment. The quoted definition is the dictionary's first (and thus primary) definition. The dictionary's third

groups at Cleco Power as a result of the Transaction," and "Nor would Cleco Partners seek to institute any other major operational changes." App. at 13. But these statements are only advertisements about attitude. They are not legal promises, the breach of which causes a negative consequence to the breach-er. Nowhere does the Merger Agreement or any governance document prohibit the Acquirers from directing or overriding Cleco Power's local decisions. Regulators cannot rely on attitude, because attitude is not enforceable. And customers have no alternative to the utility should attitude favoring local control be supplanted by interference with local control. Regulators must create obligations and enforce them.

Q. What types of utility decisions could Acquirers control?

A. As a legal matter, all of them, because the Acquirers have not agreed, legally, to forego controlling any aspect Cleco Power decisions. 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—it is reasonable to assume that no executive at Macquarie, British Columbia or John Hancock will try to intervene. But since the Acquirers have yet to agree not to control these local decisions, the Commission should make their restraint a condition of any approval.

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definition of "commitment" is "the attitude of someone who works very hard to do or support something."

Then there are other utility decisions, integral to any utility's public service obligations, which the Acquirers will want to control because they affect CLECO Corp.'s financial picture and thus the Acquirers' bottom lines. Examples include:

1. if and when the utilities should seek rate increases or decreases;

2. how to make tradeoffs between reliability and cost, *e.g.*, when to invest in distribution, transmission, generation, demand management or energy efficiency;

3. how to make tradeoffs 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

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

Today Cleco Power and CLECO Corp. can make all these decisions themselves. But when Cleco Power becomes 0.63% of three partners' holding company systems, both Clecos will be subject to the influences and orders of the Acquirers—companies whose business aims, as I explained throughout this Part III, are not aligned with Louisiana's needs.

Q. How might the Acquirers exercise control over Cleco Power?

A. We don't know, because the testimony nowhere describes a reporting hierarchy. The Applicants identify some executives and some boards. They say the boards will have some independent members. But the Acquirers have other executives and other boards not disclosed in the Application. We don't know who will report to whom and who will

control whom. We don't know who will do the promoting and the firing. The real world picture is more complex and less transparent than what the Applicants describe; much more complex and much less transparent than the relationship Cleco Power and CLECO Corp have today.

So the Commission can only guess. But one fact requires no guessing. There will be hierarchical control, because hierarchical control is inherent in the holding company form. As the Supreme Court has stated:

> A parent and its wholly owned subsidiary have a complete unity of interest their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousnesses, but one. They are not unlike a multiple team of horses drawing a vehicle under the control of a single driver. With or without a formal "agreement," the subsidiary acts for the benefit of the parent, its sole shareholder.[33]

How can hierarchical control be exercised? It can be exercised directly (such as by handing down orders from upper board to lower board and on to local management), and indirectly (such as by selecting as "local" managers individuals likely to follow such orders). Suppose Cleco Power develops a budget that exceeds its available capital. If the Acquirers were committed to local management (as CLECO Corp. is today), they would promise to provide Cleco Power the necessary capital. But one finds no promise in this opaque language offered by the Acquirers:

> [T]he planning process is designed to result in a financial plan for the company that balances the expected performance of the operating

[33] *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").

> business, its capital needs, distributions to shareholders, and availability of financing proceeds, subject to the need for each company to have a sufficiently strong balance sheet to support the desired rating outcomes. Management will maintain a financial model that will forecast these cash flow elements and calculate the required credit metrics. To the extent that preliminary projections show that cash needs exceed available sources from operations and financing, management and the board will adjust the inputs of the plan such that a viable forecast that meets the operating and capital needs of the business is developed.[34]

In sum: The Commission cannot know today what will be the effects of the Acquirers' hierarchical presence. That new presence means a new risk—the risk that the Acquirers' (and their controllers') priorities will supersede Cleco Power's priorities. That risk does not exist today.

D. The Acquirers' business activities—current and future, known and unknown—cause risk to Cleco's customers

Q. How will you address concerns over the Acquirers' business activities?

A. I will begin by describing the regulatory gap that states face, due to the 2005 repeal of the federal Public Utility Holding Company Act of 1935. I then will cover the following topics:

The acquisition will increase Cleco Power's exposure to risks.

"Ring-fencing" leaves Cleco Power exposed to three risks.

Additional, unknown risks exist because the Acquirers are free to buy unlimited additional businesses, regardless of their fit with Louisiana's priorities.

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

Experience, logic and economic theory show that the risks to Cleco Power are not "speculative."

[34] Response to LPSC 7-32.

I then will offer solutions and conclusions concerning the Acquirers' business activities.

1. Louisiana faces a regulatory gap in holding company oversight

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

A. Yes. Until its repeal in 2005, the federal Public Utility Holding Company Act of 1935 (PUHCA) required, subject to certain exceptions, that each utility holding company constitute a "single integrated public-utility system."[35] The purpose of this mandate was to align each utility's corporate form with its public service obligations. While the Act had many provisions, the key tools were these:

> Section 11(b)(1) required the SEC to break up holding company systems that owned scattered utility companies and unrelated businesses, so that after the break-ups, each system would be confined to a single "integrated public-utility system," subject to certain exceptions.
>
> Section 10(b)(1) required the SEC to disapprove any acquisition by a utility holding company, if the acquisition would "tend towards ... concentration of

[35] 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.

> control of public-utility companies, of a kind or to an extent detrimental to the public interest or the interest of investors, or consumers."
>
> Section 10(c)(2) allowed only those acquisitions that "tended towards the economic and efficient development of an integrated public-utility system."
>
> Section 7(d) prohibited utility holding companies from issuing securities that, among other things, involved an "improper risk" or were "detrimental to the public interest or the interest of investors or consumers."

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

To enforce the "integrated system" principle, the Securities and Exchange Commission, beginning in 1935, broke up the then-existing 13 holding companies into several hundred relatively local systems. (Some multi-state systems remained, in a form called "registered holding companies" that were subject to extra regulatory oversight.) Once the SEC completed this work, utility mergers in the electric and gas industries were relatively rare until the mid-1980s.

Beginning in the mid-1980s, today's merger trend began. The initial mergers involved the joining of utilities with adjacent or near-adjacent service territories.

Examples were the mergers of Toledo Edison and Cleveland Electric Illuminating; Kansas Power and Light and Kansas Gas & Electric; Northeast Utilities and Public Service of New Hampshire; Delmarva and Atlantic City Electric; and Pepco, Delmarva and Atlantic City Electric. In these transactions, still bound by PUHCA's "integrated system" requirement, the main regulatory efforts were these: to identify and allocate costs and benefits associated with savings likely to arise from real operational economies of scale and scope (this being prior to the era of regional transmission organizations, whose operations now can provide much of the scale and scope economies that those early merger proposals claimed to create); to protect against horizontal or vertical market power; and to ensure that the larger, post-merger entity devoted sufficient attention to local quality of service. These initial mergers, for the most part, did not involve the joining of remote electric facilities, or the mixing of previously separate utility and non-utility businesses.

Additional complexity occurred in 1992. Amendments to PUHCA[36] permitted utility holding companies to acquire, exempt from the integrated system principle, geographically dispersed generating companies whose exclusive business was selling electricity at wholesale. Holding companies could own these "exempt wholesale generators" located anywhere in the U.S., while still owning traditional state-regulated retail utilities.

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

Q. What changes did the 2005 repeal bring?

A. The Energy Policy Act of 2005 repealed the entire 1935 Act—all its limits and reviews of utility holding company acquisitions. As a result, there is no federal limit on holding company arrangements involving geographically dispersed utilities, mixtures of utility and non-utility businesses, debt leveraging or complex corporate family structures.[37] Corporate family structures prohibited for 70 years are now possible, unless states act on their own. As a result, acquisitions of dispersed utility companies can occur for reasons other than operational efficiencies. No longer does federal law require corporate structure to align with public service obligation. What our grandparents understood as "utilities"—the traditional safe investment—has changed its character.

Q. Why are these federal statutory changes relevant to this proceeding?

A. While PUHCA was in place, and enforced properly by the SEC, a state commission could be relatively certain that its utility, on being acquired by some other entity, would not—

1. become an affiliate of utility businesses that were not part of the same integrated public utility system;

2. become an affiliate of substantial non-utility businesses—at least not without federal regulatory review;

3. become part of a corporate family in which interaffiliate transactions (including transactions anywhere in the family, not just transactions to which

[37] 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.

the utility was a party) were unbounded by rules on interaffiliate prices aimed at preventing cross-subsidies;

4. become part of a corporate family whose financial structures went unreviewed by regulators obligated to protect consumers; or

5. become part of a holding company system free to acquire any kind of company, anywhere, in any industry, without advance review by some regulator for the effects on consumers.

Since PUHCA permitted none of these circumstances (with limited exceptions), a state commission could reasonably expect the acquirer to make high quality, local utility service its priority. But with PUHCA's repeal, commissions now need to develop their own ways to screen acquisitions, to ensure that the entities that own or influence utility infrastructure remain accountable to regulators, consumers, investors and the public—and make customer service their priority.

To summarize: Acquisitions of utilities are no longer confined to local, integrating acquisitions—acquisitions that must "tend[] toward the economical and efficient development of an integrated public-utility system" (from old PUHCA Section 10(c)(2)). In addressing the proposed acquisition, therefore, the Commission should ask this question: "What corporate family characteristics will produce the best performance?" Without answering this question, there is no objective context for judging this transaction, no clear way to align the Acquirers' business aspirations with Louisiana's priorities. Instead, the Commission will be receiving proposals like this one—proposals in which the Acquirers, after acquiring Cleco Power, then make additional acquisitions without limit, as discussed next.

2. The acquisition will increase Cleco Power's exposure to risks

Q. How will this acquisition change the risk picture in CLECO's corporate family?

A. The change will be immediate. As noted in Part III.B, Cleco Power today contributes 95 percent of CLECO Corp's revenue. Trouble elsewhere in CLECO Corp. is unlikely to affect Cleco Power because any trouble would be small. But after this acquisition, the Acquirers' numerous other businesses investments—the ones we know of plus the ones we don't (because with PUHCA's repeal, there is no legal limit on acquisitions)—expose Cleco Power to all their risks.

Q. Is the Acquirers' self-portrait an accurate guide to the risks CLECO's customers could face?

A. No. The Acquirers present themselves as stable and low-risk. They do so by emphasizing their current businesses and finances. But they are not static companies; nor are the companies in which they invest. Because all these companies are free to acquire additional companies without geographic or type-of-business limit, the Commission has no idea what risks will arise. With CLECO Corp. the only owner of Cleco Power, this problem does not exist today.

It is true that the Acquirers focus on infrastructure companies, particularly ones protected by government from competition. But these companies still face risk. Financial outcomes can be adversely affected if regulations affecting those utilities change. Some of these ventures are huge public construction projects that face risk of cost overruns, environmental damage and work injuries. Some of these ventures, the

Acquirers insist on keeping secret.[38] Since CLECO Corp.'s business focuses on Louisiana, the Commission can both know and influence, and in most respects control, Cleco Power's regulatory risks. But for regulatory events affecting the Acquirers' s other activities, the Commission will have neither knowledge nor influence, let alone control.

Exacerbating the knowledge gap will be the reduction in public information about CLECO Corp., Cleco Power and their hundreds of newly-joined affiliates. In his study of private equity buyouts, financial analyst Stephen G. Hill wrote:

> Federal statutes require that the financial structure of the firms before and after the merger, and the business organization, subsidiaries, and operational details of each of the companies be published in Securities and Exchange Commission (S.E.C.) documents, reports to shareholders, and proxy statements, all according to strict time schedules and specified standards of accuracy. The S.E.C. reporting requirements exist to inform investors the value and risks of the companies in which they invest.
>
> . . .
>
> In addition to publishing information on securities issuances, publicly traded companies must file at the S.E.C. a series of annual and quarterly reports. Those reports contain information about a company's revenues and expenses, accounting practices, its business platforms, corporate inter-relationships, operational details, potential risks, (including pending legal actions), as well as full financial statements (income statement, balance sheet and cash flow statement) and notes to the financial statements. The S.E.C. also requires corporate insiders to file monthly reports regarding changes in their stock holdings in the company. Finally, the S.E.C. regulates a company's proxy statement and the manner in which the company uses it to solicit votes.
>
> . . .

[38] See, *e.g.*, Response to LPSC 7-6, treating confidentially its answer to a request for "any and all other companies in which MIP III will hold an ownership stake."

This wealth of information made public through S.E.C. requirements reporting is only for publicly-traded companies. *A privately-held company does not have those public reporting requirements*. Without sufficient information regarding the financial structure of a buyout deal, it is difficult for a regulator to gauge the risk to the utility arising from the buyout.[39]

3. "Ring-fencing" leaves Cleco Power exposed to three risks

Q. The Acquirers have proposed "ring-fencing" as a solution to concerns about risk to Cleco Power. What is your response?

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

1. Prohibitions against the utility paying dividends to the holding company if the payment reduces the utility's equity level below some specified level.[40]

2. Corporate separation measures that (a) prevent the utility from being pulled into the bankruptcy filing of its parent or affiliate, and (b) protect the utility's credit ratings from business risks elsewhere in the corporate family.

3. Prohibitions against the utility loaning money to, or guaranteeing loans to or otherwise supporting the debt of, or otherwise investing in, any holding company affiliate.

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[39] Stephen G. Hill, *Private Equity Buyouts of Public Utilities: Preparation for Regulators* 29-30 (National Regulatory Research Institute Dec. 2007), available at http://www.naruc.org/Publications/NRRI%2007-11%20private%20equity%20buyouts.pdf (hereinafter cited as "Hill Study") (emphasis added).

[40] As the Hill Study explains (at 32): "Regulators need, at a minimum, authority to limit the utility's ability to transmit cash to the parent or acquirer, where such cash flows conflict with the utility's public service obligations. The ability of the regulator to prevent the parent/acquiring firm unlimited access to the cash flow stream of the regulated utility can lower the risk and shore up the financial health of the utility."

4. Limits on internal reorganizations that would weaken the above-mentioned measures.

5. Preservation of the regulator's authority to order the utility divested from the holding company should the ring-fencing conditions be violated or become inadequate.

Some ring-fencing is better than no ring-fencing. But given this transaction's complexity, ring-fencing does not protect against the three risks discussed next.

a. Increases in Cleco Power's cost of, and decreases in its access to, debt financing

Q. Does ring-fencing protect against increases in Cleco Power's cost of debt arising from its affiliation with the Acquirers?

A. Not fully. Cleco Power's credit reputation will be influenced by the Acquirers' financial condition. Cleco Power's own debt ratings can be affected by downgrades of its owners' debt. And, to the extent some of Cleco Power's equity capital comes from its owners' debt, a downgrade of that debt can make equity more costly for Cleco Power. These problems are not addressed by ring-fencing.

Q. Won't the utilities have their own access to debt capital?

A. Legally speaking, yes. But Cleco Power's prospective lenders will care about pressures placed on Cleco Power by its owners. A utility's ability to earn and retain income gives lenders confidence that the utility will repay its loans. Rational lenders will worry that the Acquirers' own risks and needs for capital will cause them to pressure Cleco Power to pay dividends, cut spending (thereby risking regulatory penalties) or take other actions that an unaffiliated utility would not take. That worry can cause those lenders to raise the cost of loans to the utilities. Nothing about ring-fencing prevents this rational lender reaction. Similarly, while the utility will have its own credit ratings, those ratings can still be influenced by the Acquirers' access to and cost of capital, since the utility's ability

to pay off their loans may depend in part on the availability of that capital. An owner's bankruptcy, and owner financial stress generally, will not be a matter of indifference to the utility or its creditors, even if ring-fencing protects Cleco Power from being pulled into an owner's bankruptcy.

The Applicants say that "Cleco Power is ... committing to hold ratepayers harmless from any increase in the cost of debt to Cleco Power caused by any potential credit downgrades resulting from the Transaction." App. at 16. This is the standard "no harm" language. But it is only language. The owners' financial difficulties, if large enough, can lead to downgrades large enough that Cleco Power will need a rate increase to pay the increase in cost of debt.

b. Cleco Power's bankruptcy

Q. Does ring-fencing remove the risk that the Acquirers' business failures cause Cleco Power to enter bankruptcy?

A. No. If an Acquirer fails and enters bankruptcy, a typical ring-fencing measure would prevent that Acquirer from itself pulling Cleco Power involuntarily into bankruptcy with the Acquirer. Ring-fencing achieves this protection by interposing between the holding company and the utility a "special purpose entity" (SPE). The SPE is controlled by an independent director whose affirmative vote is required for the utility to enter bankruptcy. But this measure does nothing to protect Cleco Power from its own bankruptcy, should it suffer a cash or capital shortage due to its Acquirers' financial stresses. If an Acquirer is in bankruptcy, the bankruptcy court could limit the Acquirer's capital flows, thereby reducing the financial support to Cleco Power. The SPE cannot prevent that result. While I understand that CLECO Corp. can still raise equity on its

own, I would expect prospective equity investors to raise the cost of that equity, or limit its availability, if a major owner of CLECO Corp. is in bankruptcy.

c. The Acquirers' interference in Cleco Power's business decisions

Q. Does ring-fencing prevent the Acquirers from controlling or otherwise interfering with Cleco Power's (and the Commission's) decisions on how Cleco Power should carry out its service obligations?

A. No. As I will explain in Part III.F, the Acquirers have business goals that are not compatible with CLECO's public service obligations, or the Commission's array of options for the future. But the Acquirers have made no commitment not to divert Cleco Power's priorities away from the Commission's priorities. Nor do the Acquirers commit to finding the best people and the best practices, giving them the necessary resources and then "ring-fencing" those resources from diversion or distraction. If the Acquirers use their hierarchical control to limit Cleco Power's spending, or to cause it to erect entry barriers to new competitors (the problem I discuss in Part III.F), ring-fencing does not help.

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

A. They would be correct. Eliminating all risk is not practical—not if the Acquirers insist on the right to engage in risky ventures without Commission approval:

> In Fitch's view, ring-fencing techniques rarely provide total insulation of a U.S. utility from problems relating to an insolvent parent. Furthermore, even if affiliates are segregated in numerous ways, the presence of a single important unifier, such as a large intercompany loan or an intercompany supply contract critical to continuing operations, may nullify all other ring-fencing efforts.[41]

[41] Hill Study at 41 (quoting Fitch Ratings, *Corporate Finance, Rating Linkage Within U.S. Utility Groups: Ring-Fencing Mechanisms, Utilities, Holding Companies*

And that is the point. For the Acquirers to object that we cannot eliminate all risk implies some right to engage in behaviors that cause risk—behaviors that CLECO does not engage in. The Acquirers do not have that right—unless the Commission allows it.

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

Q. Can't the Commission protect the utility customers by excluding from Cleco Power's rates any increases in their cost of capital caused by the Acquirers' activities?

A. Only if the medicine is not worse than the disease. The larger the problem faced by the holding company, the more limited the regulator's options. Rate disallowances exclude from the utility's revenue requirement costs not properly attributable to utility service. Fines disgorge the wrongdoer's ill-gotten gains. But both types of financial penalties share a vulnerability: The larger the penalty, the weaker the post-penalty company; and so the greater the regulatory hesitance to impose the penalty.[42] And unless there is some alternative company ready, willing and able to replace the incumbent, the public interest in a viable supplier competes with the public interest in assigning full financial consequences for misbehavior. This moral dilemma is inherent in every too-big-to-fail setting.

Furthermore, regulatory resources must keep up with regulatory complexity. But the Acquirers have made no promise to help fund the increase in staff necessary to

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and Affiliates at 1 (April 8, 2003). This Fitch comment addressed ring-fencing techniques in use in 2003. It is possible that since then, the techniques have become stronger. But I am unaware of any ring-fencing techniques that protect against the three concerns raised here.

[42] As the Louisiana and California Commissions have acknowledged. See note 22.

anticipate and address the post-acquisition complexities. Charitable contributions yes, regulatory strengthening no. Relying on financial penalties for structural abuse is less effective than preventing risky structures to begin with.

5. Experience, logic and economic theory show that the risks to Cleco Power are not "speculative"

Q. Anticipating Applicant arguments, are your concerns about risks speculative?

A. No, they are factual:

1. The Commission does not know what additional acquisitions CLECO's new owners will undertake, because due to the repeal of PUHCA 1935 there is no legal limit on those activities' geographic or type-of-business scope. That is a fact.

2. The Acquirers' post-acquisition activities will occur outside the Commission's jurisdiction and control. That is a fact.

3. The Acquirers' business goals (as I will discuss in Part III.F) are in tension with Cleco Power's public service obligations. That is a fact.

4. The Commission does not know how small Cleco Power will become relative to its Acquirers (although as explained at Part III.B, we start at 0.63% and head downward from there). Nor does the Commission know how small is too small, or how many unrelated affiliates are too many unrelated affiliates, before Cleco Power's welfare becomes too small to matter to its owners and the family system too complex for the regulators. That is a fact.

Those who call these concerns speculative are the ones who speculate. They speculate that (a) shrinking CLECO's contribution to its holding company's financial well-being will not reduce the holding company's commitment to the utilities' well-being; (b) the Acquirers' non-Louisiana business activities will not conflict with the utilities' service obligations; (c) business failures within the Acquirers' corporate families will not occur—and if they do, they will have no adverse effect on the utilities; and (d) magnifying the complexity of the regulatory task will not strain the Commission's limited regulatory

resources. The Acquirers cannot prove these negatives. It is speculation to assume them away.

The Acquirers want their pre-status picture, that of successful owners of infrastructure companies, to fill the Commission's eye-space, and then to be copied into an order approving the transaction. But the Acquirers are not static; they buy companies continuously. Indeed, their next moves remain undisclosed to the Commission, just as this acquisition was not disclosed to the Commission before it was announced. The post-acquisition entity will be the classic black box.

6. Solutions and conclusions on the Acquirers' business activities

Q. On the subject of the Acquirers' business activities, what do you recommend?

A. The correct solution is to disapprove the transaction. Louisiana does not need this additional complexity and risk. If the Commission chooses to approve the transaction, it should establish a condition requiring the Commission's permission before any of the Acquirers makes any acquisition of a size or type that the Commission determines could harm Cleco Power. I will present this condition in Part VI.A.1.a.

Q. What if the Applicants resist this condition?

A. Resisting this condition is equivalent to insisting on the right to make unilateral decisions, unchecked by the Commission, on what future risk-adding investments to make. That is not a public interest attitude.

E. The investment goals of CLECO's new owners, and the pressures they put on CLECO, will change in unknown ways

Q. How will the acquisition change the characteristics of the ultimate shareholders of CLECO Corp.?

A. No one knows. That means the Commission cannot know if the new set of shareholders ultimately owning Cleco—Macquarie, British Columbia, John Hancock and *their* owners—will create pressures inconsistent with Louisiana's goals.

CLECO's current shareholders were content to own shares in a company whose main holding was a small, non-acquisitive utility serving entirely in one state. The proposed transaction replaces them with investment management companies that bet on growth from more acquisitions. Whether the dominant shareholder voice will be buy-and-holders or risk-takers, pension funds or hedge funds, entities that buy long or entities that buy short, those that focus on this year's profits or those that focus on the next decade's viability, and how that dominant shareholder voice will change over time (changes the Commission cannot control) the Commission today has no idea. Different types of shareholders pressure management for different types of decisions, including decisions that affect the cost and quality of service (such as what to build vs. what to buy, when to seek rate increases, and when to pay dividends). This uncertainty over who will pressure CLECO, in what direction, is not in the interest of Louisiana or its electricity customers.

F. The Acquirers' "business model"—buying regulated monopolies and protecting their revenue stream—can impede the Commission's future policies and limit its options

Q. Is there potential for conflict between the Acquirers' business model and the Commission's need for flexibility?

A. Yes. State commissions and legislatures are exploring ways to help consumers reduce their costs by serving themselves, rather than depending solely on government-protected monopolies. But the Acquirers' business model is inconsistent with this trend, because it calls for owning monopoly assets in markets where customers are captive. In this subpart I will describe some of the alternative market structures the Commission can encourage, then explain how the proposed acquisition is inconsistent with encouragement. My purpose is not to advocate for any one of the options, but to emphasize that by rejecting this acquisition the Commission keeps its options open, while approving this acquisition now creates the likelihood of tension and conflict later.

1. The Commission should preserve the option of giving customers more choices

Q. Describe the possibilities for new market structure options that the Commission should keep open.

A. Cleco Power is a vertically integrated retail monopoly. Every Cleco Power customer has little choice but to buy the same "plain vanilla" service that every other customer buys. That market structure stands in contrast to structures that new technologies are making possible. I will discuss two such structures now, in generation and in distribution services. To reiterate: I am not suggesting that the Commission should pick any of these paths, in this proceeding or some future one. I do argue that approving this acquisition will make it harder for each of these future market structures to display their merits,

thereby making it harder for the Commission to put Cleco Power and its customers on the paths the Commission eventually chooses.

a. The potential for generation competition

Q. What is the potential for generation competition in Louisiana?

A. The potential for generation competition in Louisiana is embodied in the Commission's 2002 General Order on Market-Based Mechanisms.[43] That order requires electric utilities to "employ a market-based mechanism to support the acquisition of generating capacity or purchase power contracts." Subject to certain exceptions, utilities must use a "Request for Proposal (RFP) competitive solicitation process." The General Order thus seeks to ensure that generation competition is based on merit.

It is reasonable to assume that the Acquirers have offered a 14.8% premium because they expect Cleco Power's earnings to be largely protected by government. That expectation is inconsistent with generation competition based on merit. This inconsistency should concern the Commission. Cleco Power cannot readily commit wholeheartedly to vigorous generation competition if its new owners will expect stable earnings from owning a vertically integrated monopoly. It is true that the Commission's 2004 General order requires oversight of the generation competitive process by an independent monitor, the Commission staff and the Commission itself.[44] That oversight can reduce the risk that the new owners' incentives will skew generation decisions, but

[43] General Order, Docket No. R-26172 (Mar. 21, 2002).

[44] As required by the General Order, Docket No. R-26172 Sub Docket A at p.13 (Jan. 14, 2004).

the risk remains: The acquisition creates conflict between the acquirers' incentives and the Commission's policies.

b. The potential for competition and choice in distribution services

Q. What is the potential for competition in distribution services?

A. After a century of choicelessness, of buying a uniform electricity product from a vertically integrated monopoly supplier, electricity and gas customers now are gaining access to new distribution technologies. These technologies can lower their costs while raising their comfort. New companies are offering thermostat controls, time-of-use pricing and renewable energy packages, among other products. Consumers are self-supplying with solar panels. (I recognize that the Commission is debating what level of compensation these solar-generating consumers should receive, but I assume the Commission still wants customers to have the choice of buying only from a monopoly or becoming more self-sufficient.) Aggregators of demand response are offering to pay consumers to use less, creating load-shifting behaviors that can avoid construction of new generation.

These technological, behavioral and market forces are causing policymakers to debate one of regulation's most important questions: What market structures—what mixes of competition, monopoly and regulation—will produce the most customer-responsive array of distribution services at reasonable cost? Approving this acquisition means having a utility whose owners will be uncomfortable having this debate, for the reasons discussed next.

2. The Acquirers' business model—earning returns by owning monopoly assets—depends on limiting customers' choices

Q. Why are these generation-level and distribution-level developments relevant to the proposed acquisition of Cleco Power?

A. Today's Cleco Power might be content to play the role of a small utility providing its vertically integrated electric service to those who want that service, while providing distribution, transmission and backup services to those who want to self-generate (provided that the costs of those services are allocated appropriately). But the Acquirers have a different goal. They are paying a $435 million premium (along with the rest of the purchase price) to get "growth"—growth in revenue and profit. That is a natural desire in a competitive world. But Cleco Power does not operate in a competitive world. The Acquirers want to own Cleco Power monopoly so that they can receive the stable earnings from its monopoly. They are buying a company that has captive customers, and they expect that company to continue to have captive customers.

Each of the Acquirers is like a private mutual fund that invests in incumbent monopolies. The predictable returns from these monopolies are what makes these funds attractive to particular types of investors.[45] Efforts by the Commission to give customers more options will make returns less predictable. That is what competition does—it makes returns less predictable, more dependent on beating competitors than on persuading regulators. But unpredictable returns is not what the Acquirers seek. That means executives outside Louisiana could be instructing CLECO executives inside

[45] See, e.g., Leslie Direct Testimony at 6 (MIRA seeks investments that are "financially stable and predictable over the long term").

Louisiana to oppose Commission efforts even to consider the new, customer-empowering opportunities. I see no reason why Louisiana would benefit from introducing tensions and frictions into what will already be a complex set of questions. Indeed, if after the acquisition, the Commission tries to give customers opportunities to self-supply or shop competitively, those who control Cleco Power will argue that the Commission is weakening the very company it has selected and now depends on.

Approving this acquisition thus narrows the Commission's options. But the Commission should be preserving its options: not just its legal authority (which the Acquirers say will not change—but that was never in doubt), but its practical ability, to guide Louisiana's electric industry toward a diverse, cost-effective future. Preserving that ability means not creating a situation where the dominant actor has goals that conflict with the Commission's.

If the Commission does approve the acquisition, it should make clear that its approval does not create any right in Cleco Power to (a) continue owning and controlling the poles-and-wires business, (b) become the provider of any new "distribution platform services," or (c) compete in any of the new distributed services markets.[46] This three-part condition does no more than preserve the Commission's existing powers. But by stating the condition explicitly, the Commission will alert all affected parties that approval of the acquisition makes no promises about the future. It does not grant any preferred position

[46] These questions are at the heart of the New York Commission's investigation into "reforming the energy vision." *Order Adopting Regulatory Policy Framework and Implementation Plan*, Case 14-M-0101 (N.Y. Pub. Serv. Comm. Apr. 24, 2014).

in new markets; nor does it guarantee continued control of the franchise which Cleco Power currently controls. The Commission will have signaled to prospective distribution service providers that what will matter is merit, not incumbency.

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The Applicants have stated (App. at 42): "The Transaction would not result in the combination of utilities that are competing against each other in any relevant electric market; therefore, the Transaction would have no effect, whatsoever, on competition." It should now be clear that this statement misses the point. The question is not who is competing today, but who might be competing tomorrow. The Commission should err on the side of preserving, not limiting, its options.

G. The five harms all flow from a single source: CLECO's decision to put acquisition price before customer interest

Q. You have explained how this transaction will cause Louisiana consumers five types of harm. Do these harms have a common source?

A. Yes. The common source is the actions of CLECO Corp.'s Board, both in choosing the Acquirers and negotiating the transaction's terms. In this Part III.G I will establish factually that CLECO's goal was highest return for its shareholders, not best performance for the utility's customers. I then will explain that by seeking the highest return for its shareholders, CLECO undermined Cleco Power's obligations to its customers. The $435 million control premium extracted by the CLECO Board overcompensates CLECO shareholders, denies customers benefits proportionate to their burdens, and distorts the market for utility mergers and acquisitions.

1. CLECO's goal was highest return for its shareholders, not best performance for its customers

Q. Describe the control premium CLECO's shareholders will receive.

A. This transaction involves a cash buyout of CLECO Corp.'s current shareholders. It reflects a control premium of 14.8% above the closing stock price on the last trading day before the announcement.[47] It is worth $435 million to CLECO Corp.'s shareholders. Since Cleco Power represents 95% of CLECO Corp.'s revenues, it is reasonable to assume that most of this control premium is attributable to the Acquirers' wish to control, and derive earnings from, Cleco Power.

Q. What role did CLECO play in influencing the size of the premium?

A. The undisputed facts lead to two indisputable conclusions. First, CLECO's Board took the actions it deemed necessary to get its shareholders the highest price possible. Second, in ultimately choosing the Acquirers and negotiating terms, CLECO's Board placed no visible value on its customers' interest.

Exhibit SH-1 presents excerpts from CLECO's own narrative of its efforts to find the buyers and negotiate the terms that maximized gain to shareholders. The Board was concerned about flat earnings:

> As part of its ongoing consideration of strategic alternatives, the board considered, among other things, that Cleco (1) recently completed a multi-year generation construction and acquisition effort that left it with excess generating capacity; (2) is unlikely to grow its rate base significantly in the near term; (3) faces pressure to reduce its rates, which at the time were the highest rates charged by an electric utility in Louisiana; and (4) was *entering a phase of limited growth* over the next five years before

[47] See Proxy Statement at 19.

> additional generation would offer material new investment opportunities, which opportunities would depend upon the success of a wholesale electric marketing initiative. The Board also considered that Cleco's *remaining as an independent standalone company would leave Cleco shareholders exposed to various risks and uncertainties,* including, among others, utility industry risks, risks related to economic conditions in Louisiana, *the potential for downward pressure on industry P/E multiples* in light of current market valuations and other risks related to regulatory and legislative matters.
>
> . . .
>
> The Board determined that Cleco's long-term strategic plan was viable, but that a business combination transaction might enhance shareholder value, particularly in light of the high P/E multiples at which Cleco's Common Stock was trading at the time and Cleco's limited growth prospects in the near-term.[48]

The Board first sought offers, then tried to persuade the offerors to increase their offers. The goal was an outcome that was "in the best interests of Cleco and its shareholders."[49] After ten months of strategizing, soliciting and negotiating, and after selecting the Acquirers, the Board concluded "that it was unlikely that any other buyer would be willing to pay more than the per share Merger Consideration payable in the Merger...."[50]

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

A. Yes. There are two types of evidence— affirmative and negative. The affirmative evidence is what I just noted: The CLECO Board sought and received assurance that it

[48] Proxy Statement at 33.

[49] Proxy Statement at 39.

[50] Proxy Statement at 40.

could not get a better price from any other suitor. The second type of evidence is the absence of evidence. In their negotiations, as summarized by CLECO's Proxy Statement, the parties never bargained over consumer benefits. At no point did anyone from CLECO make any demand for customer benefits—real benefits, as opposed to mere continuation of the status quo.[51] Customer benefits were, literally, besides the point.

Evidence also lies in documents that begot this transaction. The Merger Agreement (Exhibit 3 to the Application) has 77 pages of single-spaced prose. More pages flow from the two "fairness opinions"—each side having bought its own so as to be certain it was receiving maximum value. Thousands of words typed, billions of dollars negotiated, all this effort—solely to ensure that both sets of shareholders receive benefits in appropriate relation to cost, and to protect them from transactional disappointment. But for the utility customers, these documents calculate nothing, say nothing, promise nothing, protect nothing. If the motivation for this transaction had anything to do with customers, one would expect CLECO to have extracted *something* from the Acquirers. The record shows nothing.

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

A. Almost. I am not suggesting that CLECO decisionmaking process ignored the customers completely. I will assume that CLECO did enough inquiry to make an educated guess that its chosen acquirer would at least not make CLECO's performance worse. But the central factor, the dominant factor, the determinative factor according to the Proxy

[51] As explained in Part IV below.

Statement, was value to shareholders, not performance for customers. CLECO could have—and, as I will explain in Part III.G.2, due to its utilities' obligation to serve should have—done the opposite: It should have caused prospective acquirers to compete first based on customer performance, and only then on offer price. CLECO had it backwards.

The parties of course recognized that the Commission had certain expectations, and that the transaction would need to meet those expectations.[52] But that is no different from saying "the acquisition cannot take place without Commission approval"—which is a tautology. "What do we need to do to satisfy the Commission?" is a very different question from "What actions will bring the most benefits to our customers?"

2. By seeking highest return for its shareholders, CLECO undermined its obligations to the customers

Q. By placing shareholders ahead of customer service, how did the CLECO Board's behavior square with Cleco Power's obligation to serve?

A. It didn't. A public utility has an obligation to serve its customers using the most cost-effective practices, and at the lowest feasible cost. Consider these precedents:

1. A utility must "operate with all reasonable economies."[53]

2. A utility has an obligation to serve at "lowest feasible cost."[54]

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[52] See Proxy Statement at 36 (stating that "[t]he LPSC commissioners provided extensive guidance on the regulatory commitments that a potential buyer would be expected to accept in connection with a business combination transaction with Cleco").

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

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

3. A utility must use "all available cost savings opportunities...as well as general economies of management."[55]

Had CLECO'S Board viewed the customers as its primary obligation, it would first have sought and screened prospective acquirers based on ability and willingness to meet the above-quoted standards. Then, having selected the best performers based on merit, it would have caused those performers to compete for CLECO's favor by offering performance commitments to the customers. And then, and only then, having obtained real commitments through competition, the Board could have induced the surviving competitors to compete on price. By making customer benefits irrelevant, CLECO failed to consider companies whose acquisition price bids would be lower but whose effectiveness in serving customers would be higher.

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

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

A. Nothing, if all parties affected by the transaction are subject to effective competition, or by a regulatory rule that replicates effective competition. Consider the sale of an

[55] *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).

apartment building, in a city with plenty of apartment vacancies. The interests of the building seller, building buyer and renters are aligned. The building seller will demand the highest possible price, but the buyer will resist paying a price above what he predicts he can recover as he competes for tenants in the rental market. So the building buyer will pay a premium no greater than the new economic value he believes he can create as the new owner. That new economic value is a public interest benefit. In a market where there is competition for the ultimate product (in this example, apartment rentals), an acquisition contest run by the acquiree, based on highest possible price, can produce a public interest result.

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

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

A. I assume so. But a board's fiduciary duty to maximize shareholder wealth is always subject to other obligations imposed by federal and state law. Otherwise, companies could, without legal consequence, emit toxic waste and pay their workers sub-minimum wages. Whatever fiduciary duty the CLECO Board has to maximize its shareholders' wealth is constrained by its utilities' franchise obligation to provide the most cost-effective service to their customers. That is the obligation that the CLECO Board

violated when it bid out its franchise based on highest possible price rather than best possible performance. By rejecting this acquisition, the Commission will signal that the franchise is a privilege to be earned through performance, not an asset to be bought with dollars.

Q. The Commission has never conditioned a merger or acquisition approval on the target company proving it selected its acquirer based on performance for customers. Are you asking the Commission to "change the rules mid-game"?

A. No, because my position does not change the rules; it applies the rules. Regulatory law requires that a utility provide service cost-effectively. It also requires that regulators give shareholders an opportunity to earn a reasonable return on investment in assets used and useful in serving the public. These two principles ensure that shareholder return is aligned with service to customers. The rule has never been that what commissions owe shareholders is an opportunity to earn a return *at the expense of* customers. Would it have been better for all had the Commission made this point more explicitly and prior to this transaction? Yes. But the rule has existed implicitly.

Those who argue otherwise confuse, or blur, the distinction between investing dollars in public utility assets and betting dollars in the stock market. The Applicants' proposal is not a situation in which a utility invested dollars in utility assets based on some Commission policy, and then the Commission changed that policy to the shareholders' detriment. Cleco Power's rates are lawful rates because they authorize a return consistent with the just and reasonable standard (and if the authorized return falls below what the utilities consider lawful, they have a right to seek an increase, unless they voluntarily waived that right). If the Commission rejects this acquisition, the utilities' rates still will be lawful, for the same reason. The shareholders will still be earning the

return to which they are legally entitled. The Commission has never promised more than an opportunity to earn the authorized return investment in utility assets; nor has the Commission ever promised shareholders any particular return on their investment in utility stock.

So to require the utility, in searching for acquirers, to find the best performer for consumers does not conflict with any regulatory obligation to shareholders. It changes no rules mid-game—at least not for any game relevant to public utility regulation. What would "change the rules of the game" would be to allow a board, whose franchise obligation requires putting customers first, to get $435 million for putting its customers second.

3. The control premium overcompensates CLECO shareholders, denies customers benefits proportionate to their burdens, and distorts the market for utility acquisitions

Q. Explain your concerns about the control premium.

A. The 14.8% control premium overcompensates CLECO shareholders for their investment in a government-regulated utility. This conclusion flows from a basic understanding of a commission's constitutional obligation to utility shareholders.

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

> 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

> capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return.[56]

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…It would, when once made in respect to any utility, be fixed, for all time, subject only to increases to represent additions to plant, after allowance for the depreciation included in the annual operating charges.[57]

This Commission has made the same point. Cleco Power paid an acquisition premium to acquire Teche Electric Cooperative, then sought recovery of the premium in rates. The Commission said no, explaining: "The United States Supreme Court has recognized that the legally protected interest of an utility investment, such as the investment in CLECO, resides in the capital invested in the utility, and not the sale value of the utility's property."[58]

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

[57] 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).

[58] *In Re: Institution of Investigation Into Proposed Acquisition of Central Louisiana Electric Company Inc., Joint Application of Teche Electric Cooperative, Inc.* and *Central Louisiana Electric Company Inc. for Approval of Acquisition*, Order No. 21128 at 25 (Sept. 9, 1997) (citing, among other authorities, the Brandeis concurrence quoted above).

When a commission sets cost-based rates, utility shareholders receive this constitutionally required compensation. The control premium is extra compensation—overcompensation. It does not represent "capital embarked in the [public utility] enterprise"; *i.e.,* funds invested in assets used to provide public utility service. In the current transaction, the control premium represents funds the Acquirers were willing to pay CLECO shareholders to get control of the Cleco Power's franchise.[59] Because the control premium does not represent investment in utility service assets, CLECO shareholders have no legally protected expectation to receive it.

Applicants state (App. at 25) that Cleco Power will not seek to recover the acquisition premium in rates. But that statement diverts attention from the real question. The real question is not whether Cleco Power should recover the premium; the real question is whether CLECO's shareholders should receive the premium. The premium reflects new value Acquirers seek to gain by buying CLECO Corp. There is no clear reason why CLECO's shareholders should receive that value. There is no evidence that this value was created by CLECO shareholders' risk-taking or its executives' managerial merit. The value, rather, reflects the Acquirers' desire to control Cleco Power's franchise. But that franchise has value because of its government-created uniqueness: It is granted by the government and protected by the government, which government then requires ratepayers then to pay government-mandated rates calculated to give the utility a

[59] That is why I use the term "control premium" to refer to the 14.8% or $435 million. That amount is only the upper layer of the full purchase price. Part of the remainder of the purchase price recovers for shareholders their contribution to Justice Brandeis's rate base—the unrecovered book cost of the utility's investments devoted to public service.

reasonable opportunity to earn a fair return. Since the value to the Acquirers of controlling the franchise results from the combination of the government-granted franchise and government-mandated rates, there is no clear reason why the premium value should go to CLECO shareholders. At least some portion of the control premium is logically deserved by the ratepayers, whose captive role and loyal monthly payments produce the stream of earnings that create the value represented by the control premium. Yet this Application assumes that 100% of the control premium goes to the CLECO shareholders.

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

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

Here is another way to understand the control premium. When the Acquirers buy 100% of CLECO stockholders' shares, they are actually buying two things: Cleco Power's assets and its franchise (along with CLECO Corp.'s other businesses). The assets were at book value on CLECO's books, and they will remain at book value after the acquisition (that it is the necessary result of the commitment not to recover the control

premium in rates). So if the Acquirers are paying only book value for the assets, the control premium must be attributable to the franchise.

But *the franchise is not the CLECO shareholders' asset to sell.* The franchise is a government-granted right—the right to be the sole provider of a government-defined service in a government-defined service territory. The franchise was not created by the shareholders; it was created by government; it is not owned by the shareholders; it is owned by the government. The value the Acquirers see in the franchise is not value created by shareholders through skill, risk or any other means. It is value created by government actions; specifically, the actions of granting Cleco Power the right to serve and of compelling customers to pay rates that comply with constitutional standards. And that is why allowing the CLECO shareholders to keep the control premium is illogical: It reflects the franchise being auctioned by shareholders to the bidder offering the largest financial payment, not the one offering the best service.

That is also why proper treatment of the premium in the regulated monopoly context differs from treatment in unregulated markets. In regulated markets, if corporate acquisition decisions are driven by effective competition, paying and receiving a premium is routine and legitimate. (Take careful note of the "if," because the preceding sentence does not work if competition is not effective, such as if the acquirer is paying the premium to gain market power—the ability to exclude competitors and then charge prices above competitive levels.) In markets subject to effective competition, paying and receiving a premium is routine and legitimate because the shareholder and customer interests are aligned. (Recall the apartment building hypothetical: An acquirer facing effective competition in its ultimate product market will pay no more for the target

company than what it predicts it can recover by pricing competitively, setting prices high enough to cover costs and reasonable profit but not so high as to lose customers to competitors.) In the context of regulated monopolies, the shareholder and customer interests are not aligned. They are not aligned because the acquirer sells its products in a monopoly market, where there is little risk of losing customers. CLECO resolved the shareholder-customer conflict by placing shareholder benefit ahead of customer benefit. In doing so, CLECO violated its utility's duty to serve the interests of the utility's customers.

There are two ways to fix this error. The Commission can either disapprove acquisitions that are rooted in shareholder-customer conflict, or it can eliminate the conflict by allocating to ratepayers the portion of the control premium attributable to their contribution to its value. Either solution will disappoint those CLECO shareholders who bet on the Commission approving the transaction and allowing them to keep the control premium. But the Commission's obligation is not to honor bets made in the stock market; it is to enforce the utility's obligation to serve—an obligation that, as in a competitive market, puts customers first.

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

A. Since shareholders are not constitutionally entitled to the control premium, the Commission is free to allocate it according to whatever principle satisfies the public interest standard. I recommend this principle: The control premium should be allocated between shareholders and ratepayers according to their relative contribution to the value represented by the premium. Commissions apply this same principle when they allocate the gain on sale of an asset used for utility service. That is, when a generating asset has

been in a utility's rate base, and the utility then sells that asset at a gain above net book value, the gain goes (or should go) to ratepayers. The gain goes to ratepayers because through their historic rate payments (reflecting the asset's presence in rate base), they have borne the economic burden associated with the asset. Benefit follows burden. And when an asset is not in rate base and then is sold at a gain, the gain belongs to the shareholders because they have borne the economic burden associated with the asset. Benefit follows burden. [60]

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[60] In *Democratic Central Comm. of the District of Columbia v. Washington Metropolitan Area Transit Comm'n*, the court stated:

> 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

(I caution readers that the gain-on-sale-of-asset analogy works only up to that point: as an example of the principle that value goes to those whose economic contribution produced the value. I am not saying that the ratepayer's burden-bearing in the context of a generating asset sold at a gain is itself analogous to the ratepayer's contribution to the control premium.)

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

1. The Acquirers are paying the control premium to get control of the Cleco Power franchise.

2. The value of this franchise is due to its stable source of revenue.

3. That source of revenue is stable because of the government decision to grant the utility a franchise.

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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); *Application of Connecticut Natural Gas Corp. for a Rate Increase—Phase 1—Gain on Condemnation*, Docket No. 99-09-03RE02 (Mar. 14, 2001) *(*referring to "the Department's clear and consistent treatment of gains or losses on disposed rate base property supported by revenue requirements").

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.").

4. Where the franchise is, as a legal or practical matter, a monopoly franchise, the ratepayers have no choice but to be the source of revenue that creates the value the Acquirers see.

That is the argument for the ratepayers' contribution. What about the CLECO shareholders' contribution? CLECO might argue that but for its shareholders' investment, there would be no service for which ratepayers contributed revenue. Looking at the various arguments, the Commission might even decide that the control premium is, technically, a windfall—a value to which no one actually contributed. Given the likely existence of arguments on both sides, and to give both sides a chance to bring forward facts, I recommend that the Commission rebuttably presume that the relative contribution to the franchises' value, as between shareholders and ratepayers, is 50-50. Then the logic of rebuttable presumptions does the work. If facts rebutting the presumption do not emerge, the presumption determines the result. My Condition VI.B.2 reflects this approach.

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

A. No. As to shareholder risk, it is necessary to distinguish the utility's investment in public utility assets from a shareholder's investment in stock purchases. Regulatory law, embodied in the Constitution's Fifth Amendment Takings Clause and the just and reasonable standard, is concerned only with the former: compensating the utility for its investment in public utility assets. As I explained above, the "private property" protected by the Fifth Amendment is the utility's investment in utility assets, not the shareholder's investment in utility stock. Justice Brandeis again: "The thing devoted by the investor to the public use is capital embarked in the enterprise", *i.e.*, "rate base."). In the public utility context, shareholder risk-taking on stock purchases lies outside the constitutional

analysis. And while a utility's investment in public utility assets involves some risk, ratepayers already compensate investors for that risk through the authorized return on equity included in the utility's annual revenue requirement.

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

Since the control premium is justified by neither CLECO shareholder risk-taking nor the utilities' operational effectiveness, we must infer that the Acquirers are paying the premium to get the utilities' franchises—those government-granted rights to provide an essential service in return for monthly customer payments mandated by constitutional standards. (Consider this: If the Commission, prior to the Acquirers committing to pay a premium, had declared that Cleco Power's franchises would be subjected to a nationwide competition, with the Commission selecting the best performer to replace the incumbent, would the Acquirers have offered the same control premium? Unlikely. And given the Acquirers' preference for companies that have guaranteed customers, their even considering such an acquisition would be unlikely.)

Q. Doesn't the control premium necessarily belong to CLECO's shareholders because they are the utility's legal owners?

A. No. This assertion assumes that the franchise is a private good to which the shareholders have "title;" then it incorrectly equates "title" with "entitlement." This assumption incorrectly transplants concepts from unregulated markets into a regulated utility market. In an unregulated market, one with no government intervention, buyers and sellers trade freely. They are entitled to the value of that to which they have title. If you want what I

own, you must pay me what I want for it—its full value. But in regulation, and utility regulation in particular, legal ownership does not always entitle the owner to the full value they could extract absent regulation. Otherwise, utilities with monopolies could charge whatever price the market could bear. That is not how regulation works. When utility shareholders volunteer to enter a government-regulated market, they necessarily accept that regulators can take action to limit their ability to extract value. That has been the law since medieval times, memorialized today in the landmark case of *Munn v. Illinois*, 94 U.S. 113, 126 (1877) (reasoning that 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.")

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

In particular cases, there might be a factual basis for dividing up the premium between shareholders and customers. But to argue that all of it goes to the shareholders, merely because they are the "owners," conflates what they own (the company and its

assets) with what they do not own (the government-granted franchise). Under this mistaken reasoning, were the government to exercise its power to revoke the incumbent's franchise and award it to some other company, the government would have to pay the incumbent not only the unrecovered book value of the assets, but also some value associated with the franchise, *i.e.*, a premium. That makes no sense, because the incumbent did not create the franchise. The same result holds if the incumbent were to seek permission to withdraw from the franchise; if, say, the company wanted to depart from the utility business. We would not award the shareholders a special payment on top of their unrecovered prudent investment. And if the incumbent's shareholders have no right to a premium when their utility's franchise is revoked or when their company chooses to exit the utility business, then they have no right to a premium when they "sell" it voluntarily. The franchise is not theirs to sell.

Q. What about the Acquirers' commitment not to recover the premium from ratepayers?

A. If the Acquires commit not to recover the premium through rates, one might then argue that the premium causes no problem; that is, one might say, if the Acquirers want to pay more for CLECO than Cleco Power can recover, that is their business; the Commission need not care.

But the Commission should care. By approving a transaction involving a control premium, absent evidence that the recipients created the value associated with that premium, the Commission would be validating and stimulating a market for acquisitions that operates inconsistently with economic efficiency. The acquisitions market would embody a mismatch between risk and reward, between performance and compensation. Acquisitions would be based on who is willing and able to pay the most for the target

company, rather than on who is willing and able to offer the most to customers. Allowing such results denies utility customers what they pay for: service at a quality and cost that replicates competitive market outcomes. For this reason, the control premium is a cost to ratepayers, even if it never enters the rates.

* * *

This Part III has explained that the acquisition of Cleco Power's monopoly conflicts with Louisiana's needs in multiple ways. Each harm described in this Part causes a distinct risk to customers: business risk, diminution-of-Cleco-Power-risk, type-of-shareholder risk, loss-of-local-control risk, competition risk, and shareholder-customer conflict risk. Each of these risks has a probability of occurrence above zero and a cost of occurrence above zero. In hundreds of pages of submissions—Application, exhibits, testimony, discovery—the Applicants make no effort to quantify these costs. Nowhere do they identify possible negative events, estimate their probabilities and apply those probabilities to the likely costs. Even if they had made that effort, they could have addressed only the risks that are known—the risks from the Acquirers' current holdings. We still would face the risks that are unknown: the risks associated with all the future acquisitions that the Acquirers can make without this Commission's approval.

If the motivation behind this acquisition had the public interest as its purpose, the Application would present specific ideas for improving Cleco Power service or reducing its costs, along with binding commitments to do so. As discussed next, on the topic of real benefits the Applicants are silent again.

IV.
Merely Complying With the Law is not a Benefit

A. "Maintaining" the status quo is not a benefit

Q. Do you see any benefits from this transaction?

A. No. The Applicants state they "do not anticipate material savings to result from the Transaction...." Application at 16. In a competitive market, an acquirer that fails to improve risks its shirt. But the Acquirers are buying a utility in a monopoly market, so they are not risking their shirts. And so they commit merely to—

> *maintain* Cleco Power's total number of transmission and distribution field personnel through June 30, 2018;
>
> *maintain* a complement of 160 field personnel for the duration of the SQP;
>
> *continue* its on-site Lineman Training School and Apprentice Lineman training program;
>
> *maintain* average annual spending on vegetation management;
>
> *maintain* system average interruption duration index ("SAIDI") and system average interruption frequency index ("SAIFI") values consistent with Cleco Power's 10-year rolling average values;
>
> *continue* Cleco Power's 10-year cycle of pole inspections (with replacements or repairs as deemed necessary during inspection);
>
> *continue* to address the lowest-performing 5% of distribution feeders;
>
> *maintain* Cleco Power's customer call center in Pineville, Louisiana;
>
> *maintain* transmission and distribution centers in Louisiana; [and]
>
> *maintain* its currently existing customer service offices.[61]

[61] Crump Direct Testimony at 10-11 (emphasis added). See also App. at 16.

"Maintain" and "continue" means doing nothing more than what Cleco Power was doing already. These are not benefits. Under competition, sellers must continuously improve. But competition is not the Acquirers' ambition. Their ambition is to buy monopoly assets and collect stable earnings—doing nothing more than "maintaining" and "continuing."

What if, for example, Cleco Power wants to improve, but needs more equity to do so. The Acquirers are making no commitment:

> The members of Cleco Partners are not obligated to fund operations or expansion of Cleco Power. However, the members have a responsibility and an incentive to take *commercially reasonable steps* to protect and enhance the value of their portfolio company investments. Therefore, if Cleco Power were to need additional capital, the members *would evaluate options* to provide such funding and *take the appropriate action*.[62]

It's all about "commercially reasonable steps," and "protecting and enhancing value of their ... investments." It's not about excelling for the consumer. And if the Commission tries to order the Acquirers to inject equity into Cleco Power, the Acquirers will oppose: "The LSPC does not now have review authority over issuances of equity of ... Cleco Corporation."[63] So if Cleco Power faces a capital shortage, it will have to compete with the hundreds of other companies in the Acquirers' portfolio, along with the thousands of other companies in the external equity markets. The Acquirers will only "evaluate options .... and take the appropriate action"—as they see it.

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[62] Response to LPSC 8-18(a) (emphasis added).

[63] Response to LPSC 7-10. The Acquirers do commit not to let the utility's equity level fall below 40%, but there is no obligation to raise it if necessary.

Q. Are you forgetting the $1,211,000 in savings they promise (Proposed Regulatory Commitment 17)?

A. No, but I thought it was a joke. Cleco Power's electric sales in 2014 were $1.226 billion.[64] So the offer amounts to 1/1000 of the utility's annual revenue requirement, $4.23 per customer per year, 35 cents a month.[65]

Q. What about the $50 million added to Cleco Power's credit facility?

A. Mr. Olagues (Direct Testimony at 11) states that "the lenders [to the transaction] have committed to a $350 million revolving credit facility to replace the $300 million revolving credit facility currently in place, which would increase available liquidity by $50 million." There is no evidence that Cleco Power needs this increase. Nor is there reason to think it would not be available to Cleco Power without the transaction. As long as the Commission sets rates calculated to produce for Cleco Power recovery of reasonable costs plus a reasonable return, there is no reason to assume that the utility will not have access to the financing it needs. And given that the utility is in a "phase of limited growth,"[66] there is no evidence that the utility has an unusual need for more credit.

[64] See CLECO's 2014 10-K Report at 54.

[65] Cleco Power has about 286,000 customers. See CLECO's 2014 10-K Report at 12. 1.221 million divided by 286,000 is 4.23.

[66] Proxy Statement at 41.

B. The "Service Quality Program" offers no improvement

Q. What are your comments on the proposed "Service Quality Program"?

A. Mr. Crump's Service Quality Program (Exh. KDC-2) contains nothing more than normal prudent behavior—behavior which is the obligation of any franchised utility. Merely avoiding reductions in personnel and training (SQP I, II); maintaining reliability spending (SQP III); making "all reasonable efforts" to maintain SAIDI and SAIFI values (SQP IV—and this is not even a commitment to maintain the values, just a commitment to make "all reasonable efforts"); maintaining pole inspection procedures (SQP V); continuing current policy on poorly performing distribution feeders (SQP VI); and maintaining call centers, dispatch centers and customer service offices (SQP VII, VIII and IX)—these are ordinary activities, all utterly unambitious.

Keeping the status quo from sliding—that is our Acquirers' ambition. Their attitude is "buy and hold," not "buy and excel." Furthermore, the costs of all these efforts will be charged to ratepayers, and any capital expenditures will enter rate base and earn a profit. So they win without competing. There is no commitment to achieve anything above the ordinary, and no commitment to bear costs if performance is below the ordinary. The Service Quality Program adds nothing to current obligations.

C. The "Proposed Regulatory Commitments" merely restate existing obligations

Q. What are your comments on the "Proposed Regulatory Commitments"?

A. The same. The Application (at 20-34) offers 41 proposed commitments, divided into eight areas: (A) enforcement and compliance; (B) organizational and operational continuities; (C) officers and directors; (D) economic and financial; (E) ring fencing, interaffiliate accounting and conduct; (F) capital structure and dividends; (G) changes of

control; and (H) reporting. These commitments are all illusory because they do no more than comply with the law or do what any responsible corporation does. Here are the relevant items from the list, with comments:

A-1 (Cleco Power remains jurisdictional): They have no legal authority to become non-jurisdictional.

A-2 (Cleco Power will obey existing PSC orders): Already obligatory.

A-3 (Cleco Power will not contest PSC jurisdiction over retail rates and service): There would be no chance of approval otherwise. And there is no basis to contest the PSC's jurisdiction over retail rates and service.

A-4 (Cleco Power commits to comply with various rate orders): Already obligatory.

B-5 (Cleco Power will remain a Louisiana entity): There would be no chance of approval otherwise. Mere status quo.

B-6 (Cleco Power will maintain safe and reliable service): Obligatory.

B-7 (Cleco Power will maintain current or higher employment for two years): A utility needs to have the employees it needs to carry out its obligatory service activities, no more and no less. If this commitment means it will keep more employees than it needs, it is violating its duty to be efficient, thereby abusing its customers and insulting its employees.

B-8 (Cleco Power will retain current management): Same as above. Managers either deserve to stay or they do not, based on their performance.

B-9 (no adverse change to pensions for "at least two years"): One would hope not. And after two years?

B-10, B-11 (charitable contributions and economic development funding, at $600,00 and $500,000 per year): Compared to the 14.8 percent, $435 million control premium CLECO shareholders would receive, and compared to the $1.2 billion in Cleco Power's annual revenues, this amount is small. In any event, we expect good citizenship from companies that receive government-protected franchises from the state.

B-12 (commitment to maintain reliability): Obligatory. No commitment to improve reliability.

B-13 (commitment to maintain voluntary low-income assistance program): Credit deserved.

C-14, C-15 (location of officers and directors in Louisiana): Mere maintenance of status quo, with no traceable effect on performance. The addition of a few local officers and directors does not change the fact that, as noted in *Copperweld* (see footnote 33 above) the utility will be controlled from the top.

D-16 (no recovery of transaction costs, fees or acquisition premium): Obligatory.

D-17: (allocation to ratepayers of $1.2 million in savings): 35 cents per customer per month.

D-18 (Cleco maintains its own debt): Mere continuation of status quo.

D-19 (Cleco Power committing to maintain investment credit ratings, and holding customers harmless from downgrades): See explanation in Part III.D.3.a; also unenforceable for reasons explained shortly.

D-20 (Cleco Power is not requesting a determination of prudence of its commitments; parties can contest them later): This "commitment" makes no sense. If the Commission later decides that commitments that were a condition of this transaction were not prudent, what does the Commission do—unscramble the transaction?

E-21, E-22 (access to books and records): Merely maintains current Commission authority, but denies access to books and records of post-acquisition entity affiliates not engaged in interaffiliate transactions with Cleco Power, even if their activities could harm Cleco Power. See Part VI.A.1.

E-23 (access to information provided to credit rating agencies "that pertains to Cleco Power"): Failure to define "pertains to Cleco Power" means that the Commission and intervenors would have to fight to gain information about affiliates whose business risks could affect Cleco Power.

E-24 (promise not to engage in cross-subsidization, and to provide cost allocation methodologies to enforce same): Obligatory. Illusory commitment not to abuse consumers. Lacks commitment of funding so that Commission can enforce its rules in this newly complex structure.

E-25 ("Cleco Power will not loan or pledge utility assets to Cleco Corporation, or any of its other subsidiaries or affiliates, without prior LPSC approval; there will be no recourse to Cleco Power assets as collateral or security for debt issued by Cleco Corporation, without LPSC prior authorization."). (!) Actually creates a right in Cleco Power to seek permission to loan or pledge assets to the Macquarie-controlled CLECO Corp, and anticipates the option—with Commission

authorization—for CLECO Corp. lenders to have recourse to Cleco Power assets). I know of no circumstance in which such actions would be consistent with the public interest.

E-26 (no change in cost allocation methods without PSC approval): Illusory, as Commission controls these methods anyway.

E-27 (Cleco Power has burden of proof in rate cases, won't contest Commission authority to disallow imprudent or unrelated costs): Illusory, since Commission has this authority already.

E-28 (will adopt measures to separate accounting for non-regulated activities): Illusory, because it is a current obligation. No offer to fund new staff that will be necessary to trace interaffiliate transactions.

E-29, 30 (independent director who has power to prevent entry into bankruptcy, non-consolidation opinion, no bankruptcy without unanimous board vote): Garden variety ring-fencing provisions. And there is no protection against Cleco Power bankruptcy arising from failures in Acquirers' other businesses. See Part III.D.3.

E-31 (no transfer of Cleco Power assets to an affiliate without PSC permission): One would hope not.

F-32, 33 (Cleco Power to maintain common equity ratio of at least 40 percent, including limiting dividends to satisfy that 40 percent requirement): Garden variety capitalization commitment. And with rates set based on a much higher equity ratio, this provision actually seeks permission to overcharge ratepayers for more equity than is assumed for rate purposes.

F-34 (no reduction in PSC ratemaking authority): This is not a "commitment." Only a state constitutional amendment could reduce the PSC's ratemaking authority.

G-35 (preserves PSC authority over changes in control): Illusory, because PSC already has this authority.

H-36 (commitment to file reports on compliance; noncompliance will be followed by "corrective measures"): Illusory, because PSC could and should order such reports. Statement that noncompliance will be followed with proposals for corrections omits any notion of punishment for noncompliance. Effect is to invite noncompliance until detected, followed by mere "corrective measures."

H-37 (no waiver of right to request confidentiality treatment): This is not an offer of something positive; it's a reservation of the opportunity to argue for secrecy in matters of public import.

H-38, 39, 40 (commitment to file and provide legally required reports): The definition of illusory commitments, since all are required by law.

H-41 (purports to dictate the PSC's schedule for revisiting its approval in light of any FERC order): The PSC determines its own schedule.

Q. What about the commitment to maintain investment grade ratings?

A. The Application states (at 17): "Cleco Power commits to maintain investment grade ratings for its senior unsecured debt from two nationally-recognized rating agencies, which will ensure that Cleco Power has access to financing necessary to support the needs of the business." This statement is only an aspiration. Cleco Power cannot legally or practically make this commitment, because bond ratings are controlled by the rating agencies, not by Cleco Power. If the Acquirers do not provide the capital Cleco Power needs, its lenders will worry, leading to lower ratings and higher interest cost.

This commitment would have more meaning if it came from the Acquirers rather than from Cleco Power, in the form of a promise that they will always provide enough equity or other forms of financial backing, such that Cleco Power maintains investment grade ratings for its debt; and that failure by the Acquirers to do so will lead to disaffiliation. But the Acquirers have made no such commitment; as noted above, they have expressly avoided any responsibility to inject equity into CLECO Corp. or Cleco Power.

Q. What about "enhanced" regulatory powers for the Commission?

A. The Application (at 2) states: "The LPSC would retain all regulatory powers over Cleco Power that it has today, and those powers would be enhanced by the proposed regulatory commitments discussed below." App. at 2. I assume "enhanced" means that Cleco Power would make commitments that don't exist today. But the transaction would bring

risks that don't exist today, while the enhancements fall short of the risks. In asserting that consumers will be better off, the Application hides the fact that consumers will be worse off.

V.
Rather Than Let CLECO Sell Out to the Acquirers, the Commission Should See What Skills and Services Others Can Offer

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 transaction. If the purpose of regulation is to improve performance, the logical path is not to accept the first acquirer that walks in the door, based on a secret selection process run by a utility holding company seeking acquirers who want to buy a utility monopoly.

But rejecting the transaction without doing more risks repeating this process with other prospective acquirers. Instead, the Commission should consider creating multiple paths to Louisiana's electricity future—paths that can be compared based on rigorous criteria and information requirements. This approach, rooted in an obligation to improve service for the customers, contrasts with the Acquirers' unambitious intent to "maintain" and "continue."

In Part II I recommended that the Commission develop a vision for the types of companies it wishes to have in Louisiana. It would do so by defining its desired mix of products and services, then considering the types of companies—in terms of business mix, corporate structure, financial structure and market structure—most likely to excel in providing those products and services. We can fashion that vision only after studying and answering these questions:

1. What are the products and services that offer the diversity of supply, and the democratizing of demand, that Louisiana most needs?

2. For providers of essential services, what should be the corporate structure, in terms of the mix of utility and non-utility businesses, and layers of affiliates between the utility and the board that ultimately controls it?

3. What should be the relationship of debt to equity in the corporate family's various levels?

4. Which markets should be monopoly markets and which should be competitive markets?

5. What rules will be necessary to prevent temptations that misalign executive decisions with consumer needs?

6. What regulatory resources will the Commission need to prevent inappropriate behavior and induce performance excellence?

7. What consequences must the Commission be prepared to impose on those who fail to get the message that consumers come first?

8. Finally, what procedure should we expect a Louisiana utility to follow, so that the acquirer it picks is the one that offers consumers the best services rather than the one that offers shareholders the highest price?

With that clear vision in place, the Commission will be positioned to open Louisiana's doors wide to all those willing to offer their skills and services, and then to cause them to compete on the merits. It can issue requests for proposals to find the best companies, and design a procedure for comparing, assessing and selecting those proposals. That is how businesses find the best employees, how government agencies find the best consultants, and how customers find the best home improvement contractors. To look only at this acquisition, giving it only an up or down vote, is to judge it in isolation from all other possibilities.

By inviting alternative applicants to offer diverse services and structures, the Commission also will improve the quality of the applications. Had the Acquirers thought they were competing for the Commission's favor rather than competing for CLECO's favor, they would have offered the customer benefits it thought were necessary to win. They would have offered commitments they believed would exceed those offered by its competitors. But because the Acquirers saw their sole objective as winning over

CLECO's Board, they offered what the CLECO Board wanted—a premium over market price high enough to satisfy the Board's desire to get the best possible price. And because the Board asked nothing for consumers, they offered nearly nothing to customers (except the 35 cents a month). A transaction in which the shareholders get $435 million while the customers get $1.2 million is not a public interest transaction.

To prevent such lopsidedness in the future, and to get for Louisiana the service excellence it deserves, I recommend the Commission require each future acquisition applicant to show why it, above any other company, deserves the extraordinary privilege of controlling a government-granted franchise to serve the state's citizens. See Condition VI.A.6.

VI.
If the Commission Does Approve this Takeover, Conditions Will be Necessary—But Not Sufficient—To Reduce the Risk of Harm and Increase the Probability of Benefit

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. See Part VI.A., B. and C. But as I will explain in Part VI.D, 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 harm and benefit, and between private and public interests.

For all these conditions, any reference to "Acquirer" includes all affiliates of and successors to such Acquirer.

A. Eliminate harms

1. Protect Cleco Power from Acquirers' business risks

a. No member of the Acquirers' corporate families shall acquire any interest in any business, where such interest exceeds a dollar level established by the Commission to eliminate the possibility of harm to Cleco Power, unless the Commission has determined that the acquisition and continued ownership of such interest will cause no harm to Cleco Power or its customers, or increase the cost of the Commission oversight. The Commission will determine the dollar level prior to the acquisition's consummation. The Commission could create safe harbors (no Commission review necessary), advance notice (after which the transaction may proceed unless the Commission determines that review is necessary), and express decisions granting or denying approval, all as necessary to distinguish, expeditiously, acquisitions that pose risks to consumers from those that do not.

b. The Commission shall have access, in Louisiana, to the books and records of any of Acquirers' affiliates whose business activities the Commission reasonably believes could affect Cleco Power adversely.

Comment: Commitments 21 and 22 (App. at 27-28) appears to offer access only to books and records of affiliates engaged in interaffiliate transactions with Cleco Power. And Applicants will not grant access to the books of Cleco Partners, the entity that will own the Cleco Group, saying it is "merely an aggregation of shareholder interests" whose activities "will be limited to shareholder matters."[67] Given the risks to the Louisiana utilities of affiliate ventures, as described in Part III.D above, regulatory access to the books and records of affiliates engaged in those ventures is necessary.

2. Prevent inappropriate movement of capital away from Cleco Power

a. Cleco Power shall maintain a capital structure within the ranges established by the Commission from time to time. Accordingly:

   i. The Acquirers shall inject equity into the CLECO utilities consistent with Commission policies.

   ii. Cleco Power shall not pay dividends except to the extent consistent with the Commission policies.

   iii. Cleco Power shall not incur debt except to the extent consistent with Commission policies.

   iv. Cleco Power shall not provide financial support of any type to any affiliated business venture, other than through the purchase of goods or services consistent with the Commission's rules in interaffiliate transactions.

b. Consistent with the Application (at 31), Applicants shall confirm that CLECO Corporation will not be prohibited from issuing new equity to third parties (including through public markets).

[67] Response to LPSC 7-12.

3. Prohibit inappropriate interaffiliate transactions

a. The parties shall not consummate this transaction until they have submitted to the Commission, and the Commission has approved, internal procedures at CLECO Corp. and Cleco Power, and at all companies with influence over Cleco Power, designed to ensure that all employees of such companies will comply with the Commission's rules and conditions. Such procedures shall include not merely rules and training, but procedures for monitoring, detecting and penalizing inappropriate actions.

b. Cleco Power shall not become a party to any interaffiliate agreement, including any agreement for the allocation of overhead costs, unless the Commission first has found that such agreement is in the best interest of the customers and is otherwise consistent with the Commission requirements.

c. A Cleco Power decision to use its own employees or services, rather than using corporate shared services, shall not be overruled or influenced by the Acquirers or any affiliate thereof.

4. Prevent interference with Cleco Power's management

a. Subject to paragraph (b) below, Applicants shall guarantee that (i) Cleco Power's management will create its own budgets unconstrained by any affiliate, and (ii) such budgets will be approved by Acquirers as submitted by Cleco Power. The Acquirers shall provide Cleco Power with all funds required by such utility to carry out its budget.

b. In the event that any Acquirer (or affiliate thereof) wishes to modify a budget originally submitted by Cleco Power, such Acquirer shall submit to the Commission the original budget and the Acquirer'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.

c. Acquirers shall guarantee that if the Commission orders Cleco Power to make any expenditure, or comply with any standard, that causes it to exceed its budget, no Acquirer or other affiliate will prevent Cleco Power from carrying out such order. This condition does not preclude the utility from acting on its own to contest such order.

d. Prior to consummation of this acquisition, the CEO of each Acquirer shall certify, under penalty of perjury, and in a manner that binds all

successors, that no one outside Cleco Power has authority to overrule any decision made by the utility, except under the circumstances described in paragraph (b) of this condition.

e. Without advance Commission approval, the Acquirers shall make no corporate governance rules affecting the Cleco Power's decisionmaking autonomy.

5. Clarify Cleco Power's franchise privilege

Approval of this transaction creates no expectation that Cleco Power has any right, beyond what it had prior to this transaction, to provide any service within Louisiana for any time period.

6. Protect against strategic sale of CLECO

No Acquirer shall begin any effort to sell Cleco Power except according to competitive procedures that the Commission has determined will result in the selection of that acquirer able and willing to provide the most cost-effective, responsive and innovative service for the utility customers.

7. Fund necessary regulatory staff

Acquirers shall pay to the Commission an annual fee, not recoverable from utility customers, to cover the Commission's incremental cost, as determined by the Commission, associated with ensuring that as a result of this acquisition there will be no harm to Cleco Power's customers, or to any market for electricity services that affect the well-being of those customers.

B. Create benefits

1. Improve operations

Prior to consummating the proposed acquisition, the Applicants shall jointly submit a plan that identifies each improvement the acquisition will make in Cleco Power's performance, and the schedule for such improvements, along with specific metrics by which the Commission can determine whether such improvement occurs. The parties shall not consummate the proposed acquisition until the Commission has approved such plan, along with any conditions.

2. Allocate control premium between shareholders and customers

The Commission shall allocate the control premium (defined as the excess of purchase price over market value as of a day determined by the

Commission) between CLECO Corp.'s shareholders and Cleco Power's ratepayers according to each group's relative contribution to the premium's value. There shall be a rebuttable presumption that each group's relative contribution is 50-50. Upon the Commission's final determination of the contribution by ratepayers, the post-acquisition entity shall pay that amount to Cleco Power's customers according to terms determined by the Commission.

C. Ensure compliance

1. Ensure internal procedures for compliance

Prior to consummation of the acquisition, all Applicants shall demonstrate to the Commission's satisfaction that (a) they have all instituted internal procedures, with consequences for violations, sufficient to prevent or detect all violations of these conditions; and (b) no employee of any Applicant faces incentives to violate these conditions.

2. Preserve Commission authority to order disaffiliation by Cleco Power

By accepting these conditions the Applicants recognize, and commit not to contest, the Commission's authority to order any entities that own Cleco Power to cause Cleco Power to disaffiliate from them, in whatever manner the Commission deems appropriate and consistent with law, should the Commission find that (a) there is any violation of any of these conditions or (b) Cleco Power's affiliation with the Acquirers can cause harm to Louisiana ratepayers.

Comment: Some marriages end up in divorces. Some marriages have "pre-nups." It is a matter of simple symmetry. If this transaction does not work out for the Acquirers, they have clear paths for departure, such as selling Cleco Power to a third party or spinning it off to ultimate shareholders. If the transaction does not work out for the Commission, it needs similarly clear off-ramps.

D. Problems with the conditions: Practicality and enforceability

Q. Do you have concerns about the practicality and enforceability of your conditions?

A. Yes. Some of these conditions apply not to Cleco Power but to the Acquirers. They might argue that they, and their actions, are outside the Commission's current legal

powers. Indeed, Their Commitment A-1 states: "Nothing herein, however, will serve to create LPSC jurisdiction over Cleco Corporation, Cleco Group, or the new owners of Cleco Group." And Mr. Murphy (Direct Testimony at 27) states that the regulatory commitments "would be legally binding on the regulated entity, Cleco Power" (meaning, I assume, not on any other entity). But if a condition directed to the Acquirers themselves is necessary to protect the public interest, the Acquirers have a choice: Accept the condition or lose the transaction.

That statement leads to the next problem: It is not clear whether the Acquirers' acceptance of the conditions can vest in the Commission the power to enforce the conditions if the Commission does not otherwise have that power. The Commission therefore must assure itself of these conditions' lawfulness and enforceability before relying on them. If a particular condition is necessary to the public interest but it is not clear that the Commission has the authority to impose it, the acquisition should not go forward.

Q. Under what circumstances might the Commission need to order disaffiliation?

A. The Commission would consider this option whenever it determines that a utility's affiliation with the Acquirers has become, or is likely to become, detrimental to the utility's ability to carry out its public service obligations at cost and quality levels that meet the Commission's standards. A non-exhaustive list of such situations would include the following:

1. An Acquirer has blocked Cleco Power's initiatives required or approved by the Commission.

2. An Acquirer has declined to provide capital to Cleco Power in amounts and types the Commission deems necessary.

3. The cost to Cleco Power of equity or debt is higher than it would have been absent its affiliation with the Acquirers.

4. The magnitude or nature of the business activities in which the Acquirers are engaged has exceeded some level determined by the Commission to cause a risk of harm to Cleco Power.

5. A rating agency has downgraded, or has indicated the possibility of downgrading, Cleco Power's debt due to its affiliation with the Acquirers.

6. The Commission discovers an interaffiliate transaction that violates appropriate interaffiliate transaction standards to the possible detriment of Cleco Power.

7. An Acquirer or affiliate thereof resists reasonable requests, by the Commission or others, for information about business activities that could affect Cleco Power's well-being.

8. The Commission determines that an Acquirer has intervened in a utility's (or an affiliate's) decision-making in a manner potentially detrimental to the utility or its customers.

9. An event external to any Acquirer changes the risk level of Macquarie's business activities negatively, so as to affect Cleco Power detrimentally.

If one of these events occurred, the Commission would have the option of initiating a proceeding to determine whether third-party sale, disaffiliation, or franchise revocation is necessary. In that proceeding, the Commission would take into account any possible advantages accruing to Cleco Power from the affiliation that would be lost with a disaffiliation. I am not suggesting that disaffiliation is a necessary response to a violation of a condition. Penalties must be proportionate to violations. I am saying that because there can be violations that justify spin-off or franchise revocation, the public interest requires that the Commission have this option available, and be willing and ready to invoke it when necessary.

Q. Do you have concerns about the feasibility of the disaffiliation option?

A. Yes. Even if the Applicants accept such a condition now, some interested party (*e.g.,* a shareholder, bondholder, vendor or contract partner) could later challenge the Commission's authority to order a disaffiliation. If that possibility is real, the Commission should pause, because if a condition necessary to the public interest is not clearly enforceable, then the acquisition itself cannot be in the public interest.

Another concern is practical: There is no way to know now whether there will be an alternative provider willing to take over Cleco Power; or whether in that situation Cleco Power, having endured whatever costs, risks or other changes were caused by the Acquirers, will be able to serve effectively on its own. That fact too must give the Commission pause. If the Commission lacks the legal and practical means to undo an affiliation it has approved, then it must avoid that affiliation to begin with. A plane without landing gear should not be allowed to leave the runway.

Q. If the Acquirers object to these conditions, what does that say about its priorities?

A. The Acquirers will likely object that these condition impede their plans for its future. But the relevant concern is not their future; it is Cleco Power's future.

VII.
Conclusion: The Acquisition Fails Most of the 18 Factors

Q. What is your recommendation to the Commission?

A. The Commission should reject this transaction, because it fails most of the 18 factors in the 1994 General Order, as explained next:

1. Whether the transfer is in the public interest.

The transaction is not in the public interest, for all the reasons discussed in this testimony and in the items below. Its origins are in the buyers' and seller's private interests, the negotiation of which occurred without regard for the public interest. It brings risks and no benefits (except 35 cents a customer-month).

2. Whether the purchaser is ready, willing and able to continue providing safe, reliable and adequate service to the utility's ratepayers.

The technical purchasers have no assets and no employees.[68] It therefore has no capacity to be "ready, willing and able" to do anything other than own 100% of the stock in CLECO Corp. If a shell company can satisfy this factor then the factor loses its meaning.

3. Whether the transfer will maintain or improve the financial condition of the resulting public utility or common carrier ratepayers.

There is no evidence that the transfer "will maintain or improve" Cleco Power's financial condition, or that of its ratepayers. There is no evidence of a legally binding commitment to do so. There are only words, from a corporation lacking any personnel or assets, delivered by individuals who work for companies whose owners will benefit from the transaction. Those individuals, in their personal capacity, have no ability to maintain or improve anything. All that we are told is that the Acquirers have money. But because those Acquirers are in the risky business of making acquisitions, they can lose money as well as make

[68] The corporations that will own CLECO Corp.'s stock are "newly formed entities with essentially no assets other than the equity commitments of the Investors...." Definitive Proxy Statement at 41.

money. There is no record evidence of the differential in probability between risking money and making money.

4. *Whether the proposed transfer will maintain or improve the quality of service to public utility or common carrier ratepayers.*

Same comment. The witnesses parrot this language but they have no ability to satisfy it. Even if they had that ability, the Acquirers make no guarantee that those individuals will remain with their present companies.

5. *Whether the transfer will provide net benefits to ratepayers in both the short term and the long term and provide a rate making method that will ensure, to the fullest extent possible, that ratepayers will receive the forecasted short and long term benefit.*

There is no evidence of "net benefits"—other than the 35 cents per customer-month. The most frequently used term, in the proposed conditions, is "maintain." To maintain is not to create.

6. *Whether the transfer will adversely affect competition.*

As explained in Part III.F.2, the Acquirers' business model is to own infrastructure that sells services on a monopoly basis—markets in which customers have no choice. That business model is inherently hostile to markets in which customers have choice. While it is not possible to identify in the Application specific actions that a Macquarie et al.-controlled Cleco will take to deny customers choices, approving this transaction will set up a situation where the Commission must regulate a company whose every incentive is contrary to options the Commission is certain to investigate. That in itself is harm.

7. *Whether the transfer will maintain or improve the quality of management of the resulting public utility or common carrier doing business in the state.*

Again, no supporting evidence. The new owner is a shell.

8. *Whether the transfer will be fair and reasonable to the affected public utility or common carrier employees.*

Same comment.

9. *Whether the transfer would be fair and reasonable to the majority of all affected public utility or common carrier shareholders.*

As explained in Part III.G.3, the gain received by CLECO shareholders is not "fair"; relative to their legally protected expectations, it is excessive.

10. *Whether the transfer will be beneficial on an overall basis to State and local economies and to the communities in the area served by the public utility or common carrier.*

See comment on Factor 5. Other than the 35 cents per month, there are no benefits.

11. *Whether the transfer will preserve the jurisdiction of the Commission and the ability of the Commission to effectively regulate and audit public utility's or common carrier's operations in the State.*

As explained in Part VI.D, the Commission's legal jurisdiction will be unaffected; but its practical ability to exercise that jurisdiction will be adversely affected. Instead of watching over a single small utility with several similarly small affiliates, all largely operating in Louisiana, the Commission will have to watch over a holding company system with dozens of affiliates, operating in multiple states and nations, owned by a small number of private investment companies that have no limits on what they can buy or sell (although a sale of CLECO Corp. would trigger Commission review).

12. *Whether conditions are necessary to prevent adverse consequences which may result from the transfer.*

Yes, but as explained in Part VI.D, the necessary conditions are not sufficient conditions. And if the Acquirers oppose the conditions, the Commission should look closely at the reasons why.

13. *The history of compliance or noncompliance of the proposed acquiring entity or principals or affiliates have had with regulatory authorities in this State or other jurisdictions.*

I did not offer testimony on this factor.

14. *Whether the acquiring entity, persons, or corporations have the financial ability to operate the public utility or common carrier system and maintain or upgrade the quality of the physical system.*

As explained in Part III.D, "financial ability" depends on the risks Acquirers have taken and will take. If they have trouble with their investments, rendering them less able to finance Cleco Power's needs (or rendering Cleco Power less able to finance its own needs), this factor is

violated. Because of the dramatic change in financial and ownership structure of the holding company system, and its ability to expand without Commission review (unless the Commission adopts my Condition VI.A.1), there is no way to know if this factor will be honored.

15. *Whether any repairs and/or improvements are required and the ability of acquiring entity to make those repairs and/or improvements.*

I did not offer testimony on this factor. But the Application and testimony say no improvements are planned. In any event, as noted above under Factor 2 the acquiring entity is a shell company. That company's owners, in turn, appear to be financial managers, not repair experts.

16. *The ability of the acquiring entity to obtain all necessary health, safety and other permits.*

I did not offer testimony on this factor.

17. *The manner of financing the transfer and any impact that may have on encumbering the assets of the entity and the potential impact on rates.*

The Applicants say they will not force the utility to financially support other ventures in the holding company family. But the "potential impact on rates" is unknown. There is no basis in the record for finding that the acquisition will lower rates. There is a basis, explained in Part III.D, for finding that the acquisition will raise rates—if, for example, trouble somewhere in the Acquirers' many ventures causes Cleco Power's lenders to worry about being repaid; and then due to that worry, to raise the interest on loans.

18. *Whether there are any conditions which should be attached to the proposed acquisitions.*

See Part VI of this testimony.

The 1994 General Order states that Applicants have the burden of proof. That burden cannot be met by merely repeating Commission factors. 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. The Acquirers have made no effort to do so. Implicitly, they treat 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 Order requires proof—even if we define "harm" as only status quo harm and exclude opportunity cost harm (concepts discussed in Part III.A). And even if Applicants 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 the Acquirers will make, all without the Commission approval, all without geographic or type-of-business limit, all without any customer-benefitting rationale.

Q. Does this conclude your Direct Testimony?

A. Yes.

Exhibit SH-1

Resume of Scott Hempling

Scott Hempling is an attorney, expert witness and teacher. As an attorney, he has assisted clients from all industry sectors—regulators, utilities, consumer organizations, independent competitors and environmental organizations. As an expert witness, he has testified numerous times before state commissions and before committees of the United States Congress and the legislatures of Arkansas, California, Maryland, Minnesota, Nevada, North Carolina, South Carolina, Vermont, and Virginia. As a teacher and seminar presenter, he has taught public utility law and policy to a generation of regulators and practitioners, appearing throughout the United States and in Canada, Central America, Germany, India, Italy, Jamaica, Mexico, New Zealand, Nigeria and Peru.

The first volume of his legal treatise, *Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction*, was published by the American Bar Association in 2013. It has been described as a "comprehensive regulatory treatise [that] warrants comparison with Kahn and Phillips." The second volume will address the law of corporate structure, mergers and acquisitions. His book of essays, *Preside or Lead? The Attributes and Actions of Effective Regulators*, has been described as "matchless" and "timeless"; a Spanish translation will be widely circulated throughout Latin America, through the auspices of the Asociación Iberoamericana de Entidades Reguladoras de la Energía and REGULATEL (an association of telecommunications regulators from Europe and Latin America). The essays continue monthly at www.scotthemplinglaw.com.

His articles have appeared in *The Electricity Journal*, *Public Utilities Fortnightly*, *ElectricityPolicy.com*, publications of the American Bar Association, and other professional publications, covering such topics as mergers and acquisitions, the introduction of competition into formerly monopolistic markets, corporate restructuring, ratemaking, utility investments in nonutility businesses, transmission planning, renewable energy and state–federal jurisdictional issues. From 2006 to 2011, he was the Executive Director of the National Regulatory Research Institute.

Hempling is an adjunct professor at the Georgetown University Law Center, where he teaches courses on public utility law and regulatory litigation. He received a B.A. *cum laude* in (1) Economics and Political Science and (2) Music from Yale University, where he was awarded a Continental Grain Fellowship and a Patterson research grant. He received a J.D. *magna cum laude* from Georgetown University Law Center, where he was the recipient of an *American Jurisprudence* award for Constitutional Law. Hempling is a member of the U.S. Department of Energy's Future Electric Utility Regulation Advisory Group. More detail is available at www.scotthemplinglaw.com.

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, 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, 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; American Public Power Association.

Public Interest Organizations

Alliance for Affordable Energy, American Association of Retired Persons, Consumer Federation of America, Energy Foundation, Environmental Action Foundation, GRID2.0 (Washington, D.C.), Illinois Citizens Utility Board, Union of Concerned Scientists.

Regulatory Commissions and Consumer Agencies

Arkansas Public Service Commission, Arizona Corporation Commission, Connecticut Department of Public Utility Control, Connecticut Office of Consumer Counsel, Delaware Public Service Commission, Hawaii Public Utilities Commission, State of Hawaii Office of Planning, Indiana Utility Regulatory Commission, Kansas Corporation Commission, State of Maryland, Maryland Energy Administration, Maryland Attorney General, Massachusetts Attorney General, Massachusetts Department of Public Utilities, Mexico's Comisión Reguladora de Energía, Minnesota Public Utilities Commission, Mississippi Public Service Commission, Mississippi Public Utilities Staff, Missouri Public Service Commission, Montana Public Service Commission, National Association of Regulatory Utility Commissioners, Nevada Consumer Advocate, Nevada Public Service Commission, New Hampshire Public Utilities Commission, New Jersey Division of Ratepayer Advocate, North Carolina Utilities Commission, Ohio Public Utilities Commission, Oklahoma Corporation Commission, Pennsylvania Office of Consumer Advocate, Puerto Rico Energy Commission, South Carolina Public Service Commission, Texas Office of Public Utility Counsel, Vermont Department of Public Service, Virginia State Corporation Commission, Wisconsin Attorney General.

Testimony Before Legislative Bodies

United States Senate

Committee on Energy and Natural Resources, May 2008 (addressing the adequacy of state and federal regulation of electric utility holding company structures).

Committee on Energy and Natural Resources, Feb. 2002 (analyzing bill to amend the Public Utility Holding Company Act) (PUHCA).

Committee on Energy and Natural Resources, May 1993 (analyzing bill to transfer PUHCA functions from SEC to FERC).

Committee on Banking and Urban Affairs, Sept. 1991 (analyzing proposed amendment to PUHCA).

Committee on Energy and Natural Resources, March 1991 (analyzing proposed amendment to PUHCA).

Committee on Energy and Natural Resources, Nov. 1989 (analyzing proposed amendment to PUHCA).

United States House of Representatives

Subcommittees on Energy and Power and Telecommunications and Finance, Commerce Committee, Oct. 1995 (regulation of public utility holding companies).

Subcommittee on Energy and Power, Energy and Commerce Committee, July 1994 (analyzing future of the electric industry).

Subcommittee on Energy and Power, Energy and Commerce Committee, May 1991 (analyzing proposed amendment to PUHCA).

Subcommittee on Environment, Energy and Natural Resources, Government Operations Committee, Oct. 1990 (assessing electric utility policies of FERC).

Appropriations Subcommittee on Commerce, Justice, State and the Judiciary, Apr. 1989 (discussing proposals to increase staff administering PUHCA).

Subcommittee on Energy and Power, Sept. 1988 (discussing "independent power producers" and PUHCA).

State Legislatures

Committee on Energy and Public Utilities, California Senate (December 1989) (discussing relationships between electric utilities and their non-regulated affiliates).

Interim Committee on Electric Restructuring, Nevada Legislature (1995-97) (discussing options for structuring the electric industry).

Committees on General Affairs, Finance, Vermont Senate (February-March 1997) (discussing options for structuring the electric industry).

Task Force to Study Retail Electric Competition, Maryland General Assembly (1997).

Electricity Restructuring Task Force, Virginia General Assembly (1999).

Judiciary Committee, South Carolina Senate (Fall 2000).

Testimony Before Commissions, Courts and Arbitration Panels

Louisiana Public Service Commission: Holding company acquisition of utility holding company (2015).

Hawaii Public Utilities Commission: Holding company acquisition of utility holding company (2015).

Connecticut Public Utilities Regulatory Authority: Holding company acquisition of utility holding company (2015).

District of Columbia Public Service Commission: Holding company acquisition of utility holding company (2014-15).

Maryland Public Service Commission: Holding company acquisition of utility holding company (2014-15).

Mississippi Public Service Commission: Utility's divestiture of transmission assets (2013).

U.S. District Court for Minnesota: Effects of Minnesota statute limiting reliance on fossil fuels (2013).

Tobacco Arbitration Panel: Principles for regulating cigarette manufacturers (on behalf of State of Maryland) (2012).

Illinois Commerce Commission: Performance-based ratemaking (2012).

Maryland Public Service Commission: Holding company acquisition of utility holding company (2011).

California Public Utilities Commission: Performance-based ratemaking (2011).

Superior Court of Justice, Ontario, Canada: Renewable energy contractual relations under the Public Utility Regulatory Policies Act (2007).

Florida arbitration panel: Financial responsibility for stranded investment arising from municipalization (2003).

Minnesota Public Utilities Commission: Transmission expansion for renewable power producers (2002).

U.S. District Court for Wisconsin: State corporate structure regulation in relation to the Commerce Clause of the U.S. Constitution (2002).

New Jersey Board of Public Utilities: Conditions for provider of last resort service (2001).

Indiana Utility Regulatory Commission: Risks of overcharging ratepayers using "fair value" rate base (2001).

North Carolina Utilities Commission: Effect of merger on state regulatory powers (2000).

Wisconsin Public Service Commission: Effect of merger on state regulatory powers (2000).

New Jersey Board of Public Utilities: Affiliate relations in telecommunications sector (1999).

Illinois Commerce Commission: Affiliate relations and mixing of utility and non-utility businesses (1998).

Texas Public Utilities Commission: "Incentive" ratemaking, introduction of competition (1996).

Vermont Public Service Board: Cost allocation and interaffiliate pricing among service company and utility affiliates (1990).

Publications

Books

Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction (American Bar Association 2013).

Preside or Lead? The Attributes and Actions of Effective Regulators (2d edition 2013).

Articles, Papers and Book Chapters

"Certifying Regulatory Professionals: Why Not?", *ElectricityPolicy.com* (June 2015).

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"How Order 1000's Regional Transmission Planning Can Accommodate State Policies and Planning," *ElectricityPolicy.com* (September 2012).

"Renewable Energy: Can States Influence Federal Power Act Prices Without Being Preempted?" *Energy and Natural Resources Market Regulation Committee Newsletter* (American Bar Association, June 2012).

"Can We Make Order 1000's Transmission Providers' Obligations Effective and Enforceable?" *ElectricityPolicy.com* (May 2012).

"Riders, Trackers, Surcharges, Pre-Approvals, and Decoupling: How Do They Affect the Cost of Equity?" *ElectricityPolicy.com* (March 2012).

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Renewable Energy Prices in State-Level Feed-in Tariffs: Federal Law Constraints and Possible Solutions (lead author, with C. Elefant, K. Cory, and K. Porter), Technical Report NREL//TP-6A2-47408 (January 2010).

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"Joint Demonstration Projects: Options for Regulatory Treatment," *The Electricity Journal* (June 2008).

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Is Competition Here? An Evaluation of Defects in the Market for Generation (National Independent Energy Producers 1995) (co-author).

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Reducing Ratepayer Risk: State Regulation of Electric Utility Expansion. (American Association of Retired Persons 1993).

"'Incentives' for Purchased Power: Compensation for Risk or Reward for Inefficiency?" *The Electricity Journal* (Sept. 1993).

"Making Competition Work," *The Electricity Journal* (June 1993).

"Confusing 'Competitors' With 'Competition.'" *Public Utilities Fortnightly* (March 15, 1991).

"The Retail Ratepayer's Stake in Wholesale Transmission Access," *Public Utilities Fortnightly* (July 19, 1990).

"Preserving Fair Competition: The Case for the Public Utility Holding Company Act," *The Electricity Journal* (Jan./Feb. 1990).

"Opportunity Cost Pricing." *Wheeling and Transmission Monthly* (Oct. 1989).

"Corporate Restructuring and Consumer Risk: Is the SEC Enforcing the Public Utility Holding Company Act?" *The Electricity Journal* (July 1988).

"The Legal Standard of 'Prudent Utility Practices' in the Context of Joint Construction Projects," *NRECA/APPA Newsletter Legal Reporting Service* (Dec. 1984/Jan. 1985) (co-author).

Speaker and Lecturer

United States: American Antitrust Institute; American Association of Retired Persons; American Bar Association; American Power Conference; American Public Power Association; American Wind Energy Association; Chicago Bar Association (Energy Section); Columbia University Institute for Tele-Information; Columbia University Institute for Tele-Information; Electric Cooperatives of South Carolina; Electric Power Research Institute; *Electric Utility Week;* Electricity Consumers Resource Council; *Energy Daily;* Executive Enterprises; Exnet; Federal Energy Bar Association; Federal Energy Bar Association; Harvard Electricity Policy Group; Infocast; Louisiana Energy Bar; Management Development Institute at Gurgaon, India; Management Exchange; Maryland Resiliency Through MicrogridsTask Force; Mid-America Association of Regulatory Commissioners; MidAtlantic Demand Resources Initiative; Mid-Atlantic Conference of Regulatory Utility Commissioners; National Association of Regulatory Utility Commissioners; National Association of State Utility Consumer Advocates; National Conference of Regulatory Attorneys; National Governors Association; National Independent Energy Producers; New England Conference of Public Utility Commissioners; New England Public Power Association; New York Bar Association (Energy Section); North Carolina Electric Membership Corporation; Pennsylvania Bar Institute; Puerto Rico Energy Policies Forum; Regulatory Studies programs at Michigan State University, New Mexico State University and University of Idaho; Society of American Military Engineers; Society of Utility and Regulatory Financial Analysts; Southeastern Association of Regulatory Utility Commissioners; U.S. Department of Energy Forum on Electricity Issues; U.S. Environmental Protection Agency; World Regulatory Forum; Yale Alumni in Energy.

International: Canadian Association of Members of Utility Tribunals; Canadian Energy Law Forum; Central Electric Regulatory Commission (India); Comisión Reguladora de Energía (Mexico); Independent Power Producers Association of India; India Institute of Technology-Kanpur; Ludwig-Maximilians-Universitat (Munich, Germany); National Association of Water Utility Regulators (Italy); New Zealand Electricity Authority; New Zealand Commerce Commission; Nigeria Electric Regulatory Commission; Office of Utility Regulation of Jamaica; OSIPTEL (the Peruvian Telecom Regulator) Training Program on Regulation for University Students; Regulatel (an international forum of telecommunications regulators); Regulatory Policy Institute (Cambridge, England); The Energy and Resources Institute (India).

Community Activities

Member, PEPCO Work Group, appointed by County Executive of Montgomery County, Maryland (2010–2011).

Sunday School Teacher, Temple Emanuel, Kensington, Maryland (2002–2006, 2008).

Board of Trustees, Temple Emanuel (2005–2006).

Musical performer (cello), Riderwood Village Retirement Community (2003–present).

Exhibit SH-2

Excerpts from CLECO Corp.'s Definitive Proxy Statement (Jan. 13, 2015)

(all emphases added)

January 31, 2014	At this meeting, the Board considered a variety of strategic alternatives, including remaining as an independent, standalone company, possible business combination transactions and potential acquisitions of third parties. *The Board concluded that while an acquisition of a third party was unlikely to enhance shareholder value, a cash-based business combination transaction might present an interesting alternative for Cleco and its shareholders*. … In the spring of 2014, several parties (including MIP III) contacted Mr. Williamson concerning the possibility of exploring a business combination transaction...
April 24, 2014	During this meeting, and as part of the Board's ongoing consideration of Cleco's strategic alternatives, the Board discussed the valuation of Cleco's Common Stock and *whether Cleco might be able to capture a premium valuation for its shareholders* through a business combination transaction. The Board considered data prepared by the financial advisors showing that Cleco's projected price to earnings multiple, which we refer to as a P/E multiple, for 2014, 2015 and 2016 exceeded the projected P/E multiples of its peers and that an *acquisition premium might already be reflected in Cleco's current stock price based on market speculation.* The representatives of Goldman Sachs and TPH discussed certain recent transactions in the gas and electric utility industry... Mr. Williamson discussed with the Board *various inquiries made by parties in prior months expressing interest* in a potential business combination transaction. After discussion of potential business combination transactions, the Board determined to defer any exploration of such opportunities until Cleco had obtained the LPSC's approval of the extension of Cleco Power's formula rate plan. At this meeting, the independent directors of the Board also decided to hire legal counsel *to assist them in evaluating Cleco's strategic alternatives* alongside Cleco's outside counsel..
May 27, 2014	… During this meeting, the Board discussed a tentative settlement of the extension of Cleco Power's existing formula rate plan. Mr. Williamson then *recounted the inquiries made by various parties in late 2013 and the spring of 2014* expressing interest in a potential business combination transaction with Cleco. He noted that with news of the settlement of the extension of Cleco Power's formula rate plan expected to become public soon, at least some of these parties would likely contact Cleco again as they had generally been informed that Cleco would not consider such a transaction until that time...

June 6-10, 2014	Cleco received written, nonbinding preliminary indications of interest from two parties, which we refer to as Party C and Party D, respectively, and MIP III, on behalf of itself and a consortium of investors, which we refer to as the MIP III consortium, expressing interest in a potential business combination transaction with Cleco. *As part of its ongoing consideration of strategic alternatives, the Board considered, among other things, that Cleco (1) recently completed a multi-year generation construction and acquisition effort that left it with excess generating capacity; (2) is unlikely to grow its rate base significantly in the near term; (3) faces pressure to reduce its rates, which at the time were the highest rates charged by an electric utility in Louisiana; and (4) was entering a phase of limited growth over the next five years before additional generation would offer material new investment opportunities, which opportunities would depend upon the success of a wholesale electric marketing initiative. The Board also considered that Cleco's remaining as an independent standalone company would leave Cleco shareholders exposed to various risks and uncertainties, including, among others, utility industry risks, risks related to economic conditions in Louisiana, the potential for downward pressure on industry P/E multiples in light of current market valuations and other risks related to regulatory and legislative matters.* The Board also considered the extent to which Cleco could enhance shareholder value through dividends and stock repurchases. …
	The Board then discussed the written indications of interest received from Party C, Party D and the MIP III consortium. During this discussion, the Board *considered Cleco's prospects as an independent standalone company under its long-term strategic plan and the value that might be realized in a business combination transaction. The Board determined that Cleco's long-term strategic plan was viable, but that a business combination transaction might enhance shareholder value*, particularly in light of the high P/E multiples at which Cleco's Common Stock was trading at the time and Cleco's limited growth prospects in the near-term. The Board discussed with senior management and its outside advisors various matters regarding how to respond to the indications of interest, including *whether to solicit interest from additional counterparties...*
June 22, 2014	[T]he Board directed senior management and representatives of the financial advisors to *contact nine potential counterparties on the list (which consisted of five industry and four financial counterparties)* ….
June 23, 2014	Cleco issued a press release stating that it had received indications of interest with respect to a potential business combination transaction and

	that it would work with its financial and legal advisors to review and *evaluate any proposals and compare them to Cleco's standalone strategic plan*. In the wake of the market rumors and following Cleco's press release, certain LPSC commissioners made public statements expressing concern about a business combination transaction involving Cleco and noting various regulatory issues that any potential buyer would need to address in connection with seeking approval from the LPSC for such a transaction.
June 24, 2014	Of the nine potential counterparties contacted, six of them (including Party A and Party B) indicated they were not interested in exploring a business combination transaction with Cleco. The other three potential counterparties selected by the Board (consisting of Party C, Party D and MIP III), as well as the four additional counterparties that had contacted Cleco or representatives of Goldman Sachs or TPH regarding a possible business combination transaction involving Cleco, signed confidentiality and standstill agreements… The standstill provision included in each draft contained a provision stating that a potential counterparty was not permitted to ask for a waiver of the standstill (a "no-ask, no-waiver" provision). This provision was intended to *incentivize potential counterparties to put forth their best and highest offer* for Cleco as part of Cleco's strategic review process by seeking to negate their ability to make such an offer outside of the process or after Cleco announced an alternative transaction. Five of the seven potential counterparties negotiated modifications to the standstill provisions to permit them to submit proposals to the Board in the event Cleco were to enter into a definitive transaction agreement with a third party.
On July 1, 2014	The Board also discussed concerns expressed by certain LPSC commissioners regarding a business combination transaction involving Cleco and how to address those concerns.
On July 22, 2014	The proposal from the MIP III consortium provided for an acquisition of Cleco in an *all cash transaction at an indicative price of $55.25 per share*. The proposal from Party C provided for an acquisition of Cleco in an all cash transaction at an indicative price of $59.25 per share. Party C also described in general terms an alternative proposal in which Cleco would be merged with a newly formed public company that would also hold certain of Party C's assets and in which Cleco shareholders would receive stock of the surviving corporation in the merger. The proposal from Party E and its potential co-investors provided for an acquisition of Cleco in an all cash transaction at an indicative price between $57.00 and $59.00 per share.
July 24-25, 2014	In reviewing the proposals, the Board considered that various interested counterparties had noted Cleco's Common Stock was trading at

	a high P/E multiple relative to its peers and had also expressed concern about the impact of the recent settlement of the extension of Cleco Power's existing formula rate plan on Cleco's projected financial performance. On August 6, 2014, the LPSC held its regularly scheduled Business & Executive meeting which Mr. Williamson, Mr. Marks (Cleco's lead independent director) and three other outside directors of Cleco attended at the LPSC's request. Mr. Williamson and the independent directors responded to questions from the LPSC commissioners regarding any potential business combination transaction involving Cleco. During this meeting, the LPSC commissioners expressed concerns about the consequences of a business combination transaction involving Cleco, including with respect to whether such a transaction would result in a change in customer rates and whether a counterparty would maintain Cleco's employee headcount, headquarters location and charitable contribution practices, among other things. The LPSC commissioners also expressed concern about the implications of foreign investors acquiring Cleco. The LPSC commissioners provided extensive guidance on the regulatory commitments that a potential buyer would be expected to accept in connection with a business combination transaction with Cleco.
August 22, 2014	Cleco received updated written proposals from the MIP III consortium and Party C, including a markup of the merger agreement and a *description of commitments that each party would be willing to make to obtain the LPSC's approval* of the proposed business combination transaction. The MIP III consortium proposed to acquire Cleco in *an all cash transaction at an indicative price of $55.25 per share*, which was the same as its previous indication of interest. MIP III also requested that Cleco enter into an exclusivity agreement. Party C proposed to acquire Cleco in an all cash transaction at *an indicative price of $58.75* per share, which was lower than its previous indication of interest.
August 25, 2014	[T]he Board held a meeting…The representatives of Goldman Sachs and TPH then reviewed the proposals submitted by the MIP III consortium and Party C. Locke Lord reviewed the terms and conditions in the initial markups of the merger agreement by the MIP III consortium and Party C, including (i) the scope of the parties' required efforts to obtain regulatory authorizations (particularly from the LPSC) and the commitments each party would be willing to accept to obtain the LPSC's approval, (ii) various deal protection provisions, particularly the terms of the non-solicitation provision and the amount and conditions for payment by Cleco of a termination fee and (iii) in the case of the MIP III consortium, the amount and conditions for payment of a reverse termination fee and provisions relating to its proposed debt and equity financing… [T]he Board instructed senior management and Locke Lord to *seek to negotiate more favorable terms in the draft merger agreements with respect to,*

	among other things, various deal protection provisions and the covenant regarding the parties' respective obligations to obtain required regulatory approvals. …MIP III informed them that the MIP III consortium would only be willing to continue negotiations if Cleco entered into an exclusivity agreement, which the Board had rejected.
August 29, 2014	The Board again considered MIP III's request for an exclusivity agreement and determined again that it should be rejected. Also on September 5, 2014, Senior management updated the Board on its discussions with Party C. Specifically, senior management informed the Board that *Party C was unwilling to obligate itself in the merger agreement to various regulatory commitments that senior management believed were necessary to obtain the LPSC's approval* of a business combination transaction, based on, among other things, the regulatory commitments identified by the LPSC commissioners at the August 6, 2014 Business & Executive meeting of the LPSC.
September 16, 2014	After the Board meeting, senior management of Cleco, Mr. Marks (Cleco's lead independent director) and a representative of Phelps Dunbar met with representatives of the MIP III consortium and its outside regulatory counsel to discuss the likely requirements to obtain the LPSC's approval of a business combination, including those previously communicated by the LPSC. After this meeting and *in response to Mr. Williamson's request for an increase in the MIP III consortium's price*, representatives of MIP III informed Mr. Williamson that the MIP III consortium *would consider increasing its indicative price to acquire Cleco, but it was not willing to do so unless Cleco entered into an exclusivity agreement.* During that same week, Party C's outside advisors contacted a representative of Goldman Sachs and communicated that *Party C and its outside advisors had ceased their due diligence review of Cleco and stopped pursuing a business combination transaction with Cleco*.
September 19, 2014	The Board determined that Party C was not likely to re-engage in discussions with Cleco. The Board then considered the status of the MIP III consortium's due diligence review and its request for exclusivity. The Board decided that it was in the best interest of Cleco and its shareholders to continue exploring a potential business combination transaction with the MIP III consortium, but *that senior management should continue to seek an increase in the MIP III consortium's price*
September 30, 2014	Following discussion, the Board instructed Locke Lord and senior management to *seek more favorable terms with respect to the terms and conditions of the transaction and to reiterate Cleco's request for a price increase from the MIP III consortium*. The Board was also informed that neither Party C nor any other party had contacted Cleco or its financial advisors with respect to a potential business combination transaction since

the Board meeting on September 19th.

October 6, 2014 — Representatives from MIP III and bcIMC attended for a portion of the meeting to discuss, among other things, their proposed financing of the transaction, their approach to the regulatory approval process and the commitments they would be willing to make to obtain the approval of the LPSC. … The Board also reviewed with senior management Cleco's *standalone business plan compared to the value that would be realized by shareholders in the business combination transaction with the MIP III consortium.* The Board also considered *the extent to which the trading price of Cleco's Common Stock might decline and trade at a lower P/E multiple if Cleco did not enter into a business combination transaction.* … By the end of the day on October 15, 2014, the remaining issues between the MIP III consortium and Cleco relating to the merger agreement had been resolved other than the MIP III consortium's final proposed purchase price and the amount of the termination fee, the reverse termination fee and the expense reimbursement cap.

October 16, 2014 — Mr. Williamson and the chief executive officer of MIP III discussed the remaining issues in the merger agreement. The MIP III consortium *agreed to increase its purchase price from $55.25 to $55.37 per share.* The MIP III consortium also agreed to increase the amount of the reverse termination fee to $180 million (or approximately 5.4% of the proposed transaction's equity value) and to cap its expense reimbursement at $18 million (or approximately 0.5% of the proposed transaction's equity value) with a termination fee equal to $120 million (or approximately 3.6% of the proposed transaction's equity value.

October 17, 2014 — [T]he Board unanimously determined that the Merger *is fair to and in the best interests of Cleco and its shareholders* and approved and declared advisable the Merger Agreement, the Merger and the other transactions contemplated thereby, and resolved that the Merger Agreement be submitted for consideration by the holders of Cleco's Common Stock at a special meeting of shareholders, and recommended that such shareholders of Cleco vote to approve the Merger Agreement.

October 20, 2014 — Parent and Cleco issued a press release announcing the execution of the Merger Agreement prior to the commencement of trading on the NYSE.

REASONS FOR THE MERGER; RECOMMENDATION OF OUR BOARD: … [T]he Merger Consideration of $55.37 per share of Common Stock *represents a premium of 14.8%* to the closing price of Common Stock of $48.22 on October 16, 2014, the last trading day before the date Cleco entered into the Merger Agreement; the Board's belief, following discussions with Goldman Sachs and TPH and based on knowledge of the industry and the operations of Cleco, that *it was unlikely that any other*

buyer would be willing to pay more than the per share Merger Consideration payable in the Merger; the Board's belief that Parent will continue Cleco's strategy of providing safe and reliable electric service to Cleco's utility customers and has the platform and expertise required to maintain Cleco's existing relationships with regulators, employees and customers.

RISKS: the fact that Parent and Merger Sub *are newly formed entities with essentially no assets other than the equity commitments of the Investors;* the risk that the financing contemplated by the Debt Commitment for the consummation of the Merger might not be obtained; the possibility that if the Merger is not consummated, Cleco would have incurred significant risks and transaction and opportunity costs, including the diversion of management and employee attention and the potential effect of such diversion and restrictions on Cleco's business and its relations with regulators;