ITEM NO. CA4

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: February 21, 2017

REGULAR ____ **CONSENT** X **EFFECTIVE DATE** N/A

DATE: February 10, 2017

TO: Public Utility Commission

FROM: Matt Muldoon MM

THROUGH: Jason Eisdorfer and Marc Hellman

SUBJECT: CASCADE NATURAL GAS: (Docket No. UF 4300) Requests authority to enter into a revolving credit agreement for a term of up to five years in an amount up to $100 million.

STAFF RECOMMENDATION:

Staff recommends the Commission approve Cascade Natural Gas Corporation's (Cascade Natural Gas or Company) application subject to Staff's following Conditions:

1. The sum of borrowing principal and Letters of Credit (LC) under the Revolving Credit and Loan Agreement (Credit Agreement) shall not exceed $100 million at any one time.

   Note: Simultaneous borrowing may not exceed an initial $75 million Credit Agreement expandable with an accordion feature of up to a $25 million for a maximum size of $100 million.

2. The term of the Credit Agreement will be for up to five years with the option of exercising two one-year extensions for a maximum of a seven-year term.

   Note: Each extension of the Credit Agreement is at the Company's discretion. This is a usual and customary feature supportive of credit ratings.

3. One-time arrangement fees at the closing of the Credit Agreement will not exceed $75,000 to U.S. Bank National Association as Lead Agent, and $25,000 to a Syndication Agent to be determined. Annual bank administration and agency fees will not exceed $15,000.

4. A one-time upfront fee to U.S. Bank may not exceed the higher of $131,250 or 17.5 basis points (bps) of the initial commitment. The one-time upfront fee for all other participating banks may not exceed 20 bps of that bank's initial commitment amount.

5. Up to $25 million of LCs may be issued and outstanding under the Credit Agreement at any one time. Bank LC fronting fees will not exceed 20 bps.
6. Bank annual facility and borrowing fees and spreads will not exceed those shown in Attachment A, except as otherwise specifically provided in the Conditions listed herein.
7. Authority for the $50 million credit facility authorized in Docket No. UF 4280 by Commission Order No. 13-247 (Existing Credit Facility) will terminate upon close of the new Credit Agreement.
8. The Company will file a copy of the executed Credit Agreement with the Commission within 30 calendar days after closing, accompanied by a report demonstrating all fees, margins over underlying securities, interest rates, and expenses are consistent with contemporaneous competitive market prices for such credit agreements.

   No quarterly or annual reporting is required, but the Company must maintain a quarterly activity log, inclusive of any Commercial Paper (CP), LCs, short term borrowings, other commitments and draw-downs with detailed descriptions, and cost data, breaking out execution cost for accordion features. This log must be maintained and available for review by the Commission for the life of the credit facility.
9. Amendments to LCs will not exceed $150 per amendment.
10. Aggregate Company and participating bank legal fees will not exceed $250,000.
11. The Commission reserves the right to determine the reasonableness of usage, risks and costs in future rate proceedings.

DISCUSSION:

<u>Issue</u>

Whether the Commission should approve the Company's request for authority to enter into a revolving credit agreement for a term of up to seven years, in an amount up to $100 million, inclusive of all accordion features and optional extensions.

<u>Applicable Law</u>

Under ORS 757.415(1), a public utility may issue stocks and bonds, notes and other evidences of indebtedness, certificates of beneficial interests in a trust and securities for the following purposes:

"(a) The acquisition of property, or the construction, completion, extension or improvement of its facilities.

(b) The improvement or maintenance of its service.

(c) The discharge or lawful refunding of its obligations.

(d) The reimbursement of money actually expended from income or from any other money in the treasury of the public utility not secured by or obtained from the issue of stocks or bonds, notes or other evidences of indebtedness, or securities of such public utility . . .

(e) The compliance with terms and conditions of options granted to its employees to purchase its stock, if the commission first finds that such terms and conditions are reasonable and in the public interest.

(f) The finance or refinance of bondable conservation investment as described in ORS 757.455 . . . ."

However, an order of the Commission is required before a public utility may issue stocks and long-term bonds (of duration more than one year), notes or other evidences of indebtedness, and any security. *See* ORS 757.410. The Commission may grant permission for the amount requested by the public utility, for a lesser amount, or for none at all. Further, the Commission may include in its order such conditions to approval that it deems reasonable and necessary. *See* ORS 757.430.

Application requirements and the exhibits that must be attached are set forth in OAR 860-027-0030.

<u>Analysis</u>

Background
On January 19, 2017, the Company filed a request for authority to enter into a revolving credit agreement for a term of up to five years in an amount up to $75 million with an ability to increase that amount by $25 million up to a total of $100 million. On January 30, 2017, the Company filed supplemental information in support of its request. The primary use of the Credit Agreement is to provide working capital, operational liquidity, and transactional guarantees. LC issued under the Credit Agreement will provide collateral in construction and in market transactions, and reclamation guarantees where necessary.

Staff reviewed the Company's filing and is satisfied that all requirements of OAR 860-027-0030 have been met. Staff recommends that the Commission grant the Company's request in full because it will be used for authorized purposes. These purposes include guarantee of necessary utility market transactions, and construction and maintenance contracts. Approval is appropriate with the adoption of the Conditions provided herein.

Use of Proceeds

The Credit Agreement and associated LCs purposes listed on pages 4-5 of the Company's application are usual and necessary utility purposes. For example, MDU gas utilities plan to continue to upgrade and expand facilities to meet customer demand while improving safety and reliability.[1]

The Company may issue notes to banks participating in the Credit Agreement for amounts equal to the individual bank's commitment level. The Company may also use the Credit Agreement for any utility purpose authorized by ORS 757.415; e.g., the low cost credit and liquidity enhancement of:

- Construction, operations and maintenance, and other contracts;
- Pollution control revenue bond remarketing;
- Issuance and guarantee of commercial paper and other short-term debt;
- Low cost trading collateral in lieu of maintaining cash deposits or balances; and
- Replacement of other financing vehicles in adverse market conditions.

Use of this credit facility bolsters access to markets, reduces financing costs, and avoids cash deposits that could be at risk in the event of counterparty bankruptcy.

Expenses

In subsequent rate cases, the Company has the burden to demonstrate that the form of borrowing used for each pertinent utility purpose was the best combination of expense and risk of borrowing options available to the Company. Consideration of alternatives then will include secured first mortgage bonds (FMB) within a program designed to provide adequate cash flow and interest metrics, and an appropriate pool of qualified utility assets.

The Company represents in its Application that fees and margins incurred will be market-based costs typical for this type of facility. Cascade Natural Gas is not required to subject the Credit Agreement or related LCs to competitive bidding. However, the Company must still demonstrate in subsequent general rate cases that fees and margins, including those after any execution of accordion features and extensions, reflect competitive contemporaneous market conditions.

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1 See "Regulated Energy Delivery Section" of MDU Resourced Group, Inc. (MDU) Form 8-K Current Report filed with the U.S. Securities and Exchange Commission (SEC) on February 1, 2017.

Restrictions
Cascade Natural Gas must observe some covenants and restrictions as it draws down on the requested Credit Agreement. The Company's debt may not exceed 65 percent of its capital structure. Swing-line Loans may not exceed $10 million. Further, Cascade Natural Gas may not use over $25 million to support the issuance of LCs. Portions of the up to $100 million requested Credit Facility devoted to a given use will not simultaneously be available to support other financing activity or to meet other commitments. These restrictions are usual, customary, and unlikely to be restrictive.

The proposed Credit Facility may contain an accordion feature that allows the Company to increase its borrowing capacity by up to $25 million. Prevailing market conditions may restrict any enlargement to increments or multiples of $5 million. The costs for such increase in borrowing capacity must be commensurate with the market conditions at the time the accordion feature is executed. Accordion features generally allow for better control of cost and risk. The Company only pays for the cost of a smaller credit facility while that is adequate to meet its utility needs, but retains the flexibility to enlarge the facility as needed. This prevents ratepayers from supporting a larger facility if it is not yet needed.

Consistent with Federal Energy Regulatory Commission (FERC) Regulation:
Cascade Natural Gas represents that, as a natural gas local distribution company, it is not FERC jurisdictional with respect to credit facilities and short-term borrowing. This treatment differs from FERC regulation of electric utilities.

Extensions Authorized Beyond an Initial Five Year Term:
The term of the Credit Agreement is for up to five years. At the Company's discretion, the facility may be extended twice for an additional year. The Company has the flexibility to use these extensions when they are cost and risk effective. Conversely, these extensions may never be used. The presence of the extensions and the accordion feature are considered credit positive by the rating agencies.

One rating agency concern is that a firm will refresh its credit facility very close to expiration. In that circumstance, the firm may have fewer options and be under pressures that could restrict its decisions or increase the costs in a credit agreement. By including usual and customary flexibilities, the Commission's authorization allows the Company to negotiate from a stronger position and to assure rating agencies that the Company can access competitive credit facility rates.

For example, the Company could arrange for a shorter three-year Credit Agreement if that is attractively priced. Alternatively, the Company may arrange a longer low cost Credit Agreement that Cascade Natural Gas might like to keep active and not refresh closer to a five-year renewal date than rating agencies would prefer absent authorized extensions. Historically, these flexibilities have reduced cost across jurisdictional utilities to the ratepayers' advantage.

Outstanding Authorization
The Company expects to close the new credit agreement before the Existing Credit Facility is scheduled to expire. This is usual, customary, and expected by credit rating agencies. At close, Cascade Natural Gas will have a 50 percent larger Credit Agreement than it has currently — the $75 million proposed Credit Agreement with the ability to further increase this to $100 million:

Order No. 13-247	Docket No. UF 4280	$50 million (Expiring)
Pending	Docket No. UF 4300	$75 million (Requested)
(Total including optional $25 million expansion)		$100 million

Note: $25 million of the requested Credit Agreement is available for LCs.
The Company has no other Reimbursement Agreements supporting LCs.

Authorized expenses will be limited to customary and usual fees provided in the Conditions herein.

Credit Ratings
Because the requested Credit Agreement is integral to the Company's financial liquidity, authorization to borrow is not terminated based on any particular credit rating. The Credit Agreement itself will not require a rating. Cascade Natural Gas's unsecured debt ratings from Moody's and Fitch will affect both bank annual commitment fees and borrowing spreads, each of which is capped for the applicable credit rating as shown in Attachment A.

Cascade Natural Gas's Unsecured Long-Term Debt is currently rated as:
Moody's: BBB+ **Fitch**: A-

Reporting Requirements
The Company's reporting requirements are relatively light as proposed in this filing in comparison to like prior Commission authorizations. However, Staff does not foresee any harm that would result from the proposed reduction in reporting because the Company must still capture and keep operation data that is to be available at any time upon Commission request. Should the Company fail to comply with a Commission request, Staff would recommend regular periodic filings in future applications to assure compliance.

Credit Agreement Size
Reviewing the Company's financing applications over the past ten years; the Company has made do with a $50 million credit agreement.[2] In this filing, the Company looks to enlarge its Credit Agreement to $75 million with an option to increase it up to $100 million. Staff notes that in 2006, the Company served approximately 49,744 customers, while by 2015 the Company served 58,875 customers.[3] Staff believes that the larger credit facility is consistent with the Company's larger utility obligations as of year 2015. Further, incorporating the accordion feature into the Credit Agreement controls cost, and provides certainty that the Company could enlarge its Credit Agreement if necessary. However, until greater financial guarantees and greater short term cash flows are needed, the Company and its ratepayers avoid paying for a $100 million capability when a $75 million Credit Agreement is sufficient.

Conclusion

After thorough review of Cascade Natural Gas's application and supplemental filing, Staff finds that the Company's proposed Credit Agreement inclusive of the Conditions herein is reasonable and should be beneficial to ratepayers. As noted above, reporting requirements are less complex in this application than those in like prior Commission authorizations, but the Company agrees that it will capture and keep operation data that will be made available to the Commission upon request.

This requested authorization would also allow the Company to execute an accordion feature enlarging the requested facility to $100 million without requiring further Commission authorization. Staff supports the accordion feature because it may bolster the Company's credit ratings, and may help insulate it from financial market disruptions. Staff finds that the restrictions, costs, and flexibilities of the requested Credit Facility are usual, similar to the Existing Credit Facility, do no harm, and control costs of performing necessary utility business. The Company has reviewed this memo and agrees with its explanations and Conditions.

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2 See Docket Nos. UF 4242 and UF 4280.

3 See Cascade "Ten-Year Summary Selected Statistics" on page 44 of the Commission's "2015 Oregon Utility Statistics" book.

PROPOSED COMMISSION MOTION:

Authorize Cascade Natural Gas to enter into a revolving credit agreement for a term of up to five years in an amount up to $100 million, subject to Staff Conditions 1 to 11.

Attachment A
Other Limitations on Fees and Spreads

A. A bank's annual facility fee may not exceed the following bps of average commitment amounts based on the higher of Standard and Poor's (S&P) or Fitch (F) rating on the Company's unsecured debt[4] in effect in the relevant period:

S&P F	S&P F	S&P F	S&P F	S&P F
A+	A	A–	BBB+	Other
Level 1	Level 2	Level 3	Level 4	Level 5
8 bps	10 bps	12.5 bps	17.5 bps	22.5 bps

B. The rate associated with fixed-rate borrowing (LIBOR Rate Advances) under the Credit Agreement will not exceed the applicable 1-, 2-, 3-, or 6-month maturity Eurodollar Rate plus the following spread based on the higher of S&P or Fitch rating on the Company's unsecured debt in effect on the day of borrowing:

S&P F	S&P F	S&P F	S&P F	S&P F
A+	A	A–	BBB+	Other
Level 1	Level 2	Level 3	Level 4	Level 5
87.5 bps	100 bps	112.5 bps	125 bps	150 bps

C. The Alternate Base Rate (ABR) associated with floating-rate borrowing (Prime Rate Advances) under the Credit Agreement will not exceed the highest of:

a. Federal Funds Rate plus 50 bps;

b. One-Month Eurodollar Rate plus 150 bps; or

c. Prime Rate plus the following spread based on S&P or Fitch rating:

S&P F	S&P F	S&P F	S&P F	S&P F
A+	A	A–	BBB+	Other
Level 1	Level 2	Level 3	Level 4	Level 5
0 bps	0 bps	0 bps	7.5 bps	27.5 bps

[4] Company is at Pricing Level 3. When split-rated, the factor for the higher S&P/Fitch rating applies.