

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: October 25, 2016**

REGULAR _____ CONSENT X EFFECTIVE DATE _____ N/A _____

DATE: October 14, 2016

TO: Public Utility Commission

FROM: Matthew Muldoon *mm*

THROUGH: *I* Jason Eisdorfer and *K* Marc Hellman

SUBJECT: NORTHWEST NATURAL: (Docket No. UF 4299) Requests authority to issue and sell up to 1,700,000 shares of common stock.

STAFF RECOMMENDATION:

The Public Utility Commission of Oregon (Commission) should authorize Northwest Natural Gas Company (Northwest Natural, NWN, or Company) to issue and sell up to 1,700,000 shares of common stock, inclusive of any over-allocation options, subject to the following conditions:

1. The Company may sell common stock using any mix of three methods: (1) through underwriters or dealers; (2) through agents; or (3) direct to a limited number of purchasers, provided aggregate sales do not exceed 1,700,000 shares. Staff will collectively refer to these three methods as "Market Flotation".
2. Authorization requested would remain in effect until depleted or withdrawn by a subsequent Commission order.
3. Upon issuance of an order pursuant to Docket No. UF 4299, all like prior stock Market Flotation authorization¹ is withdrawn. Separate authorizations to issue stock under other methods, such as pursuant to the Company's Dividend Reinvestment and Direct Stock Purchase Plan, Employee Stock Purchase Plan, Restated Stock Option Plan, and Long Term Incentive Plan, (as described in the body of this report) are unchanged.
4. No equity forward² is authorized.

¹ As an example, see Commission Order No. 04-171 entered March 23, 2004, in Docket No. 04-171.

² The Company has not requested and Staff has not analyzed an equity forward, such as a contract guaranteeing a market or other certain price with carrying costs on future draw-downs.

5. No pro-rata issuance of common stock to existing holders of the Company's securities is authorized.³
6. The Company will obtain and retain itemized invoices for underwriting agent discounts and commissions, counsel's fees, accountant's fees, miscellaneous expenses and other shelf registration, and allocated expenses making this information available to Staff upon request until the Commission has issued a final order in the second general rate case after issuance.⁴ For each itemized fee the Company will capture the specific role of the entity and the specific service provided in accordance with industry custom.⁵
7. Northwest Natural shall file the usual Report of Securities Issued and Disposition of Net Proceeds statements within 60 days after each issuance is completed. This reporting shall include component issuance costs,⁶ the total amount, per unit price, total expenses, and net proceeds of the issuance.
8. The Commission reserves the right to review for reasonableness all financial aspects of this Market Flotation in any rate proceeding, audit, or earnings review under an alternate form of regulation.

DISCUSSION:

Issue

Whether the Commission should authorize, or as applicable exempt, Northwest Natural to issue and sell up to 1,700,000 shares of common stock, inclusive of all over-allotment options, in one or more Market Flotation offerings.

Applicable Law

Under ORS 757.410, 757.412, and 757.415, and OAR 860-027-0030, NW Natural proposes to issue common stock with no par value for ongoing and usual utility purposes described in ORS 757.415 (a) through (f) which are materially the same as, for example, authorization under Commission Order No. 04-171 entered

³ See pages 4 and 9 of the Company's application.

⁴ This requirement ensures availability of issuance cost data without undue burden upon the Company.

⁵ Costs for financial entities having primary roles should be broken out from other costs. Similarly itemized legal costs should be sufficiently detailed to conform to common industry practices.

⁶ Northwest Natural's reporting will update Figure 2 with actual costs, by type such as counsel's fees. See Condition 3 regarding capture and retention of more granular costs.

March 23, 2004. The Company does not propose new or different purposes at this time.⁷

Consistent with the requirements of OAR 860-027-0030, the Company's application and Staff's review show that the requested authority would be: A) used for the lawful object of ongoing utility purposes, B) compatible with the public interest, C) necessary to continue to provide reliable utility service, D) without impairment of Northwest Natural's ability to perform said utility service, E) appropriate for said purposes, and F) fair, reasonable, and not contrary to the public interest. Northwest Natural in its filing as summarized by Staff herein shows that the authority requested is both consistent with the public interest, and without harm to ratepayers or to the public.

The Commission has reserved the right to ensure that detailed documentation is captured and preserved, and to review any or all financial aspects of this authorization in a general rate case or other proceeding.

Discussion and Analysis

On October 10, 2016, NW Natural filed an application with the Commission with respect to NW Natural's proposed offering, issuance, and sale, through one or more offerings, of up to 1,700,000 authorized but unissued shares of the Company's Common Stock.

At issue is whether this authorization is in the public interest, and whether these Market Flotations can be accomplished cost effectively and preferably to the benefit of ratepayers.

Estimated Proceeds

Northwest Natural expects that the requested authority would be used in one or more negotiated public offerings within the next 24 months to generate gross proceeds of about \$97 million. After estimated fees and expenses, the Company expects to realize about \$90.5 million as shown in Figure 2 below under "Estimated Costs".⁸

Market Flotations are "Lumpy"

The costs and coordination required for public offerings tend to make Market Flotation stock issuances infrequent. As a result, a utility is likely to go to markets more often to issue and sell bonds than to sell common stock. As a mental exercise, were Northwest Natural to sell all shares at about the current market price, generating the Company's estimated net proceeds, without issuing any new long-term debt, its capital structure would be weighted in Oregon toward Common Stock as shown in Figure 1 on the next page:

⁷ See the Company's Application page 12, "Purposes for the Securities".

⁸ See NWN Application page 12.

Figure 1

	\$M Outstanding		Pro Forma Pro Forma	
	12/31/2015	Ratios	\$M	Ratios
Long-Term Debt	601.7	43%	601.7	41%
Common Stock	782.4	57%	873.1	59%
Total	1,384.1	100%	1,474.8	100%

Focused Application

Northwest Natural’s Employee Stock Purchase Plan, its Dividend Reinvestment and Direct Stock Purchase Plan, the Company’s Restated Stock Option Plan, and its Long Term Incentive Plan (LTIP) (collectively, Company Plans) are addressed separately and not affected by the requested authority. The Market Flotation authority provided under this order is separate and in addition to any authorization in effect to issue Common Stock under the Company Plans. Further, Northwest Natural does not now seek authority for equity forwards or hedging in conjunction with securities issuance. Staff appreciates the Company addressing a single topic in its financing application, improving clarity and allowing certainty regarding this application.

Favorable Market

While no one can time or project markets perfectly, one can plot market statistics against long-run historical trends. The authority requested would provide the Company with necessary flexibility to issue stock in conditions consistent with metrics favorable to ratepayers.⁹ Numerous international shocks and historically low bond yields have made utility stocks attractive relative to alternative investments.

Target Capital Structure

Though the Company Board of Directors (Board) has authorized 3.5 million shares of preferred stock, none is outstanding. As shown on page 10 of its application, Northwest Natural targets a capital structure with 50 percent common equity and 50 percent long-term debt. This capital structure balances liquidity and other risks to the firm and helps ensure ongoing access to capital markets at favorable rates.

The Company’s measured approach is strongly supportive of the Company’s long-term credit ratings. Ratepayers benefit from lower interest costs and minimal counterparty trading requirements diminishing ongoing operational costs of service. As the Company issues new debt, its capital structure will move toward target.

⁹ The Wall Street Journal (WSJ) chart of October 11, 2016, by James Mackintosh, “A Great Market Rotation” showed utility stock prices in aggregate were up 21 percent for the first half of the year and were still substantially up for the year at the start of October.

Flexibility

As described on page 8 of the Company's application, the requested authority would allow Northwest Natural to work through underwriters, agents, or directly with purchasers. This allows the Company the flexibility to select a method that in the Company's estimation best controls cost and risk at given times. Where appropriate opportunity arises, this flexibility may allow the Company to negotiate with more options and from a stronger position than were the Commission to authorize a single approach.

The authority to sell 1.7 million shares includes all over-allotment options should underwriters or other agents see greater than expected demand for shares, and helps ensure price stability otherwise.¹⁰ Northwest Natural may not need to issue and sell the entire authorized quantity of stock requested to meet net proceeds targets. Repeatedly in the last two years investors have fled to safer investments like U.S. utility stock that pays dividends in U.S. dollars when fearful about everything from commodity consumption in China to a British exit from the European Union.

Alternatives Considered

The Board has authorized issuance of 100 million shares¹¹ of common stock providing more than adequate head room for the requested authority. Management also evaluated the costs and benefits of issuing preferred stock. However, preferred stock would not achieve the capital structure and credit rating goals of common stock. In addition, under current and near projected market conditions, Northwest Natural could issue additional long-term debt at a lower price than preferred stock.

Alternatives listed under the topic, "Focused Application" above are better suited for low-cost issuance of small amounts of stock over an extended period of time. None of those alternate methods was viable in lieu of Market Flotation of common stock.

Use of Proceeds

Northwest Natural intends to use projected proceeds to fund improvement and maintenance of its facilities and processes to continue to meet the Company's ongoing utility obligations. This purpose is consistent with 757.415(a), (b), and (c). For clarity, the Company will address any needed refreshment of other stock programs such as the Company Plans in a separate future application.

¹⁰ This option is often referred to as a "Green Shoe". Stride Rite Corporation, formerly Green Shoe Manufacturing was the first company to allow underwriters to use this option to provide stability and liquidity in a public stock offering.

¹¹ See Page 1 of Application Exhibit A, "Amended and Restated Articles of Incorporation".

Estimated Costs

Northwest Natural estimates Market Flotation costs at levels approximately those provided in Figure 2 below:

Figure 2
Northwest Natural's

Estimation of Fees and Expenses	\$US
1 <u>Gross Proceeds / Price to Public</u>	97,000,000
2 Underwriting Agent Discounts & Commissions	6,200,000
3 SEC Registration Fee	11,200
4 NYSE Fee	8,160
5 Printing & Engraving Expense	5,000
6 Counsel's Fees	50,000
7 Accountants' Fees	30,000
8 Miscellaneous Expenses	25,000
9 <u>Allocation of Other Shelf Registration Expenses</u>	100,000
<u>Total Estimated Commissions and Expenses</u>	<u>6,429,360</u>
Net Estimated Amount to be Realized	90,570,640

NYSE — New York Stock Exchange

SEC — U.S. Securities and Exchange Commission

In compliance with Condition 6, the Company will obtain and maintain more granular cost detail than shown in summary in Figure 2 or as customarily captured by the Company's accounting system. To minimize the reporting burden the Company's reporting in compliance with Condition 7 will update Figure 2 with actual costs but will not replicate or attach subordinate itemized costs, held available for Staff review upon request.

Benefits of Capturing Market Flotation Cost Detail

Commission jurisdictional utilities differ in size and geography from textbook examples of flotation costs. These utilities have benefited in recent rate cases from recognition of flotation costs specific to the Northwestern U.S. for similarly situated and sized utilities within required return on equity modeling.

Ratepayers benefit from a pre-announced spotlight on Market Flotation costs by seeing various costs including legal fees more closely track market benchmarks for like complexity of legal work performed. This approach recognizes actual market costs of issuance while curtailing some historical cost escalation trends.

Other Regulatory Requirements

The Company is now making filings with the Washington Utilities and Transportation Commission (WUTC). In addition, Northwest Natural will update its shelf registration with the SEC as necessary.

Conclusion

No Harm

Staff finds that the authority requested is timely, usual and customary. Northwest Natural's purpose in issuing and selling common stock is ongoing utility operations similar to like prior authorizations.

This stock issuance provides both flexibility and the means to retire any unneeded authorization. Authorization requested helps to maintain the Company's target capital structure, credit ratings and access to markets at favorable rates for the Company, its investors and ratepayers.

Controls beneficial to both Northwest Natural and its ratepayers, help to ensure costs are reasonable, while recognizing actual Market Flotation costs appropriate for services rendered.

The Company has reviewed this memo and agrees with Staff's findings.

PROPOSED COMMISSION MOTION:

Authorize Northwest Natural to issue and sell up to 1,700,000 shares of common stock, subject to Staff's Conditions 1 through 8.