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June 14, 2017

Via Electronic Filing and US Mail

OREGON PUBLIC UTILITY COMMISSION
ATTENTION: FILING CENTER
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**RE: Docket No. UM 1804–In the Matter of
NORTHWEST NATURAL GAS COMPANY dba NW NATURAL,
Application for Approval of Corporate Reorganization to Create a
Holding Company**

Enclosed for filing is Staff Reply Testimony in UM 1804, together with a Certificate of Service and UM 1804 Service List.

Exhibit 100 redacted, confidential pages are: 24, 28, 29, 31, 58, and 59 – 61

Exhibit 102 is highly confidential

Exhibit 103 and 104 are non-confidential

Exhibit 105: pages 1-20 are non-confidential, pages 21-25 are confidential and pages 26-44 are highly confidential

Exhibit 106 is non-confidential

Confidential and highly-confidential pages and exhibits will be mailed to parties who have signed Protective Order No 17-052 and Modified Protective Order No 17-135 respectively.

/s/ Kay Barnes

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CASE: UM 1804
WITNESS: MATT MULDOON

**PUBLIC UTILITY COMMISSION
OF
OREGON**

STAFF EXHIBIT 100

Reply Testimony

REDACTED
June 14, 2017

1 **Q. Please state your name, occupation, and business address.**

2 A. My name is Matt Muldoon. I am a Senior Economist for the Public Utility
3 Commission of Oregon (Commission or OPUC). My business address is
4 201 High Street SE, Salem, OR 97301.

5 **Q. Please describe your educational background and employment
6 experience.**

7 A. My educational background and employment experience are set forth in my
8 Witness Qualification Statement, which is provided as Exhibit Staff/101.

9 **Q. How is your testimony organized?**

10 A. My testimony is organized as follows:

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Q. Did you prepare exhibits in support of your reply testimony?

- 18 A. Yes. I prepared the following exhibits:
19 Exhibit Staff/101 – Witness Qualification Statement
20 Exhibit Staff/102 – Staff’s Highly Confidential Assessment
21 Exhibit Staff/103 – Staff’s Proposed Ring-Fencing Conditions
22 Exhibit Staff/104 – Staff’s Proposed Ring-Fencing Conditions inclusive
23 of NW Natural’s Conditions for Comparison and Past Docket
24 References
25 Exhibit Staff/105 – Company Responses to Staff Data Requests
26 Exhibit Staff/106 – Reference Materials

I. EXECUTIVE SUMMARY

Q. What is the purpose of your testimony?

- 31 A. The purpose of my testimony is to evaluate NW Natural Gas Company’s (NW
32 Natural or Company)¹ request to reorganize into a holding company structure.

¹ Staff uses “NW Natural” throughout testimony, and “NWN-U” in its list of conditions at Exhibit Staff/103, to refer to the regulated public utility.

1 The yet-to-be-formed holding company (given the name “HoldCo”) would
2 wholly-own and control NW Natural, but would exist beyond the
3 Commission’s regulatory jurisdiction but for the conditions adopted in this
4 proceeding. To evaluate NW Natural’s proposal, I have analyzed the need for
5 a holding company structure, and the attendant risks and benefits, to
6 determine if this permanent decision results in a net benefit to NW Natural
7 customers and causes no harm to Oregon citizens as a whole, as required by
8 Oregon law.

9 **Q. What is your conclusion as to NW Natural’s application?**

10 A. I conclude that the application *as filed does not* provide net benefits to NW
11 Natural customers, nor are NW Natural’s proposed ring-fencing conditions
12 adequate to protect utility customers. Therefore, I recommend that the
13 Commission not approve the application as filed.

14 **Q. Are there circumstances under which you would recommend the**
15 **Commission approve NW Natural’s request to form a holding**
16 **company?**

17 A. Yes. I can recommend approval of NW Natural’s request to form a holding
18 company if Staff’s recommend conditions, or a similarly robust variant thereof,
19 are adopted by the Commission as set forth in Exhibit Staff/103. Staff offers
20 superior ring-fencing conditions that aim to preserve the financial health of the
21 utility, mitigate the risks associated with holding company ownership, and
22 provide a net benefit to NW Natural ratepayers.

23 **Q. Can you please provide an executive summary of your testimony?**

1 A. Yes. NW Natural has asked the Commission to approve a corporate
2 reorganization under which NW Natural will become a wholly-owned
3 subsidiary of a holding company (HoldCo) that will be formed for the primary
4 purpose of providing a better platform for the consolidated organization to
5 pursue acquisitions and finance growth opportunities through HoldCo, without
6 the regulatory burden of Commission approval and oversight.

7 After restructure, HoldCo will own 100 percent of NW Natural's common
8 stock and wield complete control over NW Natural operations. Thereafter,
9 HoldCo will be able to make ongoing future acquisitions that are rarely subject
10 to the Commission's jurisdiction.² This proposition concerns Staff because
11 poor credit ratings at HoldCo, or the bankruptcy of HoldCo (as seen with
12 Enron), could cause serious harm to NW Natural customers if adequate
13 separation is not achieved between HoldCo and the utility. Additionally,
14 HoldCo could draw equity out of NW Natural to support HoldCo's non-
15 regulated investments, or HoldCo's heavy borrowing could "leak" through to
16 the utility, damaging NW Natural's currently immaculate A+ credit³ and raising
17 its cost of long-term debt and credit facilities.

18 Staff emphasizes that Commission approval of NW Natural's
19 restructuring application is not an end point. Rather, it is a *starting point* for
20 persistent future HoldCo mergers and acquisitions of any nature that do not

² Acquisition of an Oregon public utility by HoldCo would require Commission approval.

³ Please see <https://www.moody.com/page/lookuprating.aspx> for Moody's ratings and https://www.standardandpoors.com/en_US/web/guest/home for S&P ratings. In each case, the rating agency may ask that you create a free account to log in and look up ratings.

1 require Commission approval. This brings us to the importance of the
2 decision in this docket—if the Commission approves the application but does
3 not adopt adequate ring-fencing conditions *in this docket* that protect Oregon
4 ratepayers from future HoldCo acquisitions, there is no second opportunity to
5 insulate NW Natural from HoldCo decisions that may not be in the best
6 interest of utility customers.

7 Moreover, to be approved by the Commission, Oregon law requires that
8 NW Natural’s formation of a holding company result in a “net benefit” to the
9 utility’s customers and no harm to Oregon citizens as a whole. Conditions (or
10 commitments) proposed by parties to mitigate or offset the risks arising from
11 the restructuring itself are generally not viewed as benefits, but are support
12 for the conclusion that no harm will result from the restructuring. Thus, NW
13 Natural must carry its burden of demonstrating to the Commission that the
14 restructuring provides a net benefit to its customers, not simply no harm.

15 In my testimony I examine the need for, and the risks and benefits of,
16 NW Natural’s holding company proposal. Staff generally agrees that the
17 reorganization *could* benefit customers by further insulating the utility from its
18 current unregulated subsidiaries. However, on the other hand, the holding
19 company structure itself brings with it new potential risks not present today,
20 namely:

- 21 • Financial stability of NW Natural credit ratings and capital structure
22 due to HoldCo’s heavy leveraging to fund mergers and acquisitions
23 (M&A);
24

- 1 • Proper allocation of costs between HoldCo, the regulated utility,
2 and affiliates;
- 3
- 4 • Commission access to information in a complex corporate
5 structure;
- 6
- 7 • Prioritization of management attention to new, non-regulated
8 business and growth opportunities at the expense of attention to
9 reliable delivery of utility services and affordable access to capital
10 markets; and
- 11
- 12 • Failure to capture, for utility customers, the cost savings associated
13 with the restructuring and ongoing efficiencies and economies of
14 scale resulting from future HoldCo M&As.
- 15

16 The Company's proposed ring-fencing conditions do not adequately protect
17 customers from the above-listed risks, let alone provide a net benefit to
18 customers.

19 However, the Company's supplemental testimony on its growth strategy,
20 filed at the request of the parties to help fill in the record concerning HoldCo's
21 likely trajectory, provided Staff with a better understanding of HoldCo's near-
22 term acquisitions and the due diligence conducted by NW Natural
23 management.⁴ Nonetheless, Staff notes that the actual breadth of acquisition
24 possibilities is vast, limited only by what HoldCo can finance post-approval.
25 Despite limited knowledge of HoldCo's characteristics, investment goals, and
26 acquisitions post-approval, Staff believes it is able to design effective ring-
27 fencing conditions for HoldCo by looking to past decisions where the
28 Commission adopted ring-fencing conditions that sufficiently protected the
29 acquired-utility from harm when the parent encountered financial distress.

⁴ See Exhibit Staff/105, Muldoon/26-44 (Company Highly Confidential Response to Staff DR 63).

1 Staff has modified the Company's proposed ring-fencing conditions and
2 added additional common and ordinary conditions found at Exhibit Staff/103.

3 The predominant modifications and additions by Staff include:

- 4 • NW Natural will become a wholly-owned subsidiary of a Special
5 Purpose Entity (SPE) established for the purpose of ring-fencing
6 NW Natural;
- 7 • NW Natural's credit ratings shall not drop more than two notches
8 from prevailing April 1, 2017 S&P and Moody's credit ratings;
- 9 • NW Natural Common Equity must be no less than 46 percent of its
10 total Capital Structure;
- 11 • No dividends or like payments (special, one-time, or otherwise)
12 may be drawn from NW Natural if any of the following conditions
13 are present: (a) NW Natural Common Equity falls below 46 percent
14 of Capital Structure; (b) one of the Rating Agencies finds such
15 payment to be credit-negative for NW Natural, or (c) either S&P or
16 Moody's LT local-currency long-term corporate credit ratings drop
17 more than one notch below A+;
- 18 • NW Natural must notify the Commission no less than seven
19 calendar days before dividending or otherwise transferring five
20 percent or more of its retained earnings;
- 21 • A voluntary petition for bankruptcy by NW Natural would require the
22 affirmative consent of the holder of the "Golden Share," the
23 unanimous vote of the SPE Board of Directors, and the unanimous
24 vote of the NW Natural Board of Directors, where both SPE and
25 NW Natural Board of Director votes are inclusive of the vote of at
26 least one independent director;
- 27 • Conditions related to access to records, information, and people
28 have been re-drafted to allow access to information that may lead
29 to relevant evidence;
- 30 • A deferred credit to customers of at least \$500,000 annually based
31 upon the cost savings incurred from shared Board of Directors and
32 management with HoldCo, and a requirement to update this value
33 to better reflect actual cost savings in the Company's second
34 general rate case post entry of a Commission order in this docket.

- A condition to credit to NW Natural customers all future costs savings that result from future HoldCo acquisitions.

Staff believes its recommended conditions found at Exhibit Staff/103 help ensure that NW Natural's holding company structure results in net benefits to NW Natural ratepayers and no harm to Oregon citizens as a whole. Therefore, Staff recommends the Commission approve the reorganization, subject to Staff's conditions. However, without Staff's conditions, NW Natural's application does not result in net benefits as required by Oregon law.

II. CONTEXT FOR REVIEW

Q. What does NW Natural propose in its application and opening testimony?

A. NW Natural has asked the Commission to approve a holding company structure under which NW Natural would shift from the position of "parent company" with 12 subsidiary companies beneath it to become a "wholly-owned subsidiary company" controlled by a holding company not yet formed, but given the name "HoldCo." Under the proposed new structure, NW Natural's current subsidiaries would no longer be subsidiaries of NW Natural,⁵ but would shift to become subsidiaries of HoldCo. As time goes on, HoldCo may or may not be the "Parent" company at the top of the organizational chain, whose stock is publicly traded.

⁵ The exception is Northwest Energy Corporation, which will continue to hold NWN Gas Reserves LLC; both companies will remain subsidiaries of NW Natural post-restructuring.

1 The corporate reorganization as requested in this application would be
2 accomplished through an exchange of stock shares on a one-to-one basis
3 such that the shareholders of NW Natural would hold the same percentage of
4 the newly formed HoldCo shares immediately after the reorganization as they
5 held in NW Natural immediately prior to the reorganization. Importantly,
6 HoldCo would directly or indirectly own 100 percent of NW Natural's newly
7 floated regulated utility common stock shares, meaning that HoldCo would
8 have direct financial control over NW Natural. However, NW Natural would
9 not transfer any of its utility assets or property to HoldCo or to any other
10 affiliate.⁶

11 **Q. Has NW Natural filed supplemental testimony in this docket?**

12 A. Yes. NW Natural filed supplemental testimony by Justin Palfreyman, the
13 Company's Vice President of Strategy and Business Development. Parties to
14 this docket expressed concern over the lack of access to information about
15 HoldCo's characteristics, growth strategy, and likely future acquisitions so that
16 Staff, intervenors, and the Commission could identify the attendant risks of
17 HoldCo and propose appropriate ring-fencing conditions. The Company
18 hosted a workshop for the parties to discuss highly confidential information
19 regarding its growth strategy and HoldCo's anticipated future acquisitions.
20 Staff's evaluation of this information is discussed in highly confidential Exhibit
21 Staff/102.

⁶ Application of Northwest Natural Gas Company (hereinafter NW Natural Application) at 6 (filed Feb. 10, 2017); Company Response to Staff DR No. 9.

1 structures.⁸ The applicant bears the burden of showing that Commission
2 approval of the application will “serve the public utility’s customers and is in
3 the public interest.”⁹

4 **1. ORS 757.511 requires net benefits to customers and no harm to**
5 **Oregon citizens**

6 **Q. What is the legal standard under ORS 757.511 required for approval of**
7 **NW Natural’s holding company application?**

8 A. In 2001, the Commission opened Docket No. UM 1011 to determine the legal
9 interpretation of ORS 757.511’s requirement that the transaction “serve the
10 public utility’s customers” and be “in the public interest.”¹⁰ Parties to the
11 docket disagreed as to whether the statute simply required a “no harm”
12 standard or a “net benefit” standard. The Commission determined that “to
13 serve the public utility’s customers” requires a higher standard than no harm,
14 and articulated a two-step analysis for the approval of future transactions
15 under ORS 757.511:

- 16 • First, the Commission must make the assessment that the utility’s
17 customers will be served, which means that the transaction will
18 provide *a net benefit to the utility’s customers*.¹¹

⁸ See Order No. 98-056 (order approving Idaho Power’s request to form a holding company); Order No. UM 1021 (PacifiCorp’s application to be held under PacifiCorp Holdings Inc., however, Staff explained that this was purely a technical filing because the merger of PacifiCorp with Scottish Power had already been approved in UM 918); and UM 1250 (Avista’s application to form a holding company that was withdrawn before reaching the Commission).

⁹ ORS 757.511(4)(a).

¹⁰ Prior to Order No. 01-778, the Commission had not interpreted the ORS 757.511 legal requirement that the transaction “serve the public utility’s customers” because the applicants of prior approved transactions, such as the acquisitions of Enron/PGE in UM 814, Scottish Power/PacifiCorp in UM 918, and Sierra Pacific/PGE in UM 967, had sufficiently demonstrated that the transaction would meet the more stringent net benefit standard.

¹¹ *In the Matter of a Legal Standard for Approval of Mergers*, Docket No. UM 1011, Order No. 01-778 at 11 (Sept. 4, 2001).

- 1 • Second, the Commission must also find that granting the
2 application is in the public interest, meaning that it will cause no-
3 harm to the public at large, specifically, “the proposed transaction
4 may *not impose a detriment to Oregon citizens as a whole*.”¹²

5 The Commission explained that the net benefit determination is not a
6 rigid standard based solely on economic considerations. Rather, the
7 legislature gave the Commission discretion in its assessment of whether a net
8 benefit will result—such a decision is flexible, and depends on the facts and
9 total set of concerns of each case.¹³ Additionally, the Commission need not
10 always require monetary credits to demonstrate that customers will receive a
11 net benefit, although past orders have generally required such terms. Staff
12 agrees that the Commission has discretion in its decision-making, but would
13 note that conditions proposed by an applicant solely to mitigate the new risks
14 or harms from the corporate restructuring should not be seen as benefits.

15 **2. Appropriate comparator: the prudent and well-managed NW**

16 **Natural**

17 **Q. What is the appropriate “comparator” in this case?**

18 A. To determine whether a utility’s application satisfies the two requirements of a
19 net benefit to the utility’s customers and no harm to Oregon citizens, a
20 “comparator” is used. The Commission explained that it will measure the
21 benefits by comparing the application to *the continued prudent and well-*
22 *managed operation of the utility today*.¹⁴ By way of example, in the

¹² *Id.* at 11 (emphasis added).

¹³ *Id.* at 11.

¹⁴ *In the Matter of MidAmerican Energy Holdings Company Application for Authorization to Acquire Pacific Power & Light*, Order No. UM 1209, Order No. 06-082 at 3 (Feb. 24, 2006).

1 MidAmerican Energy Holding Company (MEHC)-PacifiCorp merger docket,
2 the Commission explained that the merger benefits would be compared
3 against “the continued prudent and well-managed operation of PacifiCorp,
4 [which] under Scottish Power, has maintained PacifiCorp’s system; provides
5 good customer service; and ready access to capital at relatively favorable
6 rates.”¹⁵

7 Therefore, in the application before us, we are to measure the benefits of
8 NW Natural’s holding company proposal against the continued prudent and
9 well-managed NW Natural utility, which Staff notes is a very high standard for
10 comparison. NW Natural is a well-run company that provides good customer
11 service, maintains an excellent safety record within a strict safety program,
12 and has ready access to capital at exceptionally favorable rates.

13 In sum, to gain approval of this application, NW Natural bears the burden
14 of showing that: (1) net benefits result from the proposed restructuring and (2)
15 there will be no harm to Oregon citizens as a whole, based on a comparison
16 to the continued well-run and prudently managed NW Natural. The statute
17 also requires that the Commission examine the effect on income taxes paid
18 by the utility, which is addressed later in my testimony.¹⁶

19 **B. Holding Companies**

20 **1. Holding company background**

21 **Q. What is a holding company and what is its general purpose?**
22

¹⁵ *Id.* at 3.

¹⁶ See ORS 757.511(4)(b).

1 A. Broadly speaking, a holding company is a company that doesn't have any
2 operations, activities, or active businesses *itself*. Instead, it *owns assets*,
3 namely shares of stock in other companies or businesses. When a single
4 company controls the majority share of the outstanding stock of other
5 companies, it is called the "Parent Company" (Parent). The general purpose
6 of the Parent is to earn profits for its shareholders through its acquisitions and
7 management of subsidiary companies. In NW Natural's proposal, the new
8 HoldCo, which as currently proposed is the Parent (this could change as
9 other entities are added to the corporate family over time), would not produce
10 goods or services itself; rather, the Parent would hold (own) shares of
11 numerous other companies below it to form a group of affiliated companies
12 (affiliates).

13 This structure allows the Parent to buy and control, and at times sell, a
14 number of different companies. There can also be tax benefits associated
15 with a holding company structure. Assuming the Parent is a public company,
16 the Parent could be the sole holder of affiliates' common stock. Further, the
17 Parent could form partnerships and own varying amounts of subsidiaries
18 common stock. Over time, the Parent may buy more or sell parts of its
19 holdings. These decisions would be made in the best interest of the
20 shareholders of the Parent (HoldCo), which in our case, may conflict with
21 optimization of the NW Natural utility as the highest corporate goal.

22 **Q. Are there any stand-alone Oregon local gas distribution companies**
23 **(LDCs) that have chosen holding company corporate structures?**

1 A. Yes and no. Cascade Natural Gas Corporation is owned by MDU Resources
2 Group, Inc. in a complex holding company structure, which was approved by
3 this Commission in UM 1283. However, Avista Corp's application to form a
4 holding company in UM 1250 was withdrawn by the utility prior to a
5 Commission decision on the proposal. In analyzing Avista's holding company
6 request, Staff came to the same conclusion that Texas PUC staff came to in
7 the NextEra-Oncor proceeding last month—approval of the utility's application
8 would bring increased risks to utility customers and the state, with such
9 minimal benefits, that the transaction should not be approved.¹⁷

10 **Q. But aren't holding company structures common for gas utilities?**

11 A. Yes, they are common but not exclusive. Staff would not go so far as to
12 agree with the statement in NW Natural's application that "[t]he
13 Commission has long recognized the benefits of a holding company in
14 insulating a utility from risks that may be posed by a utility's non-regulated
15 businesses."¹⁸ As support for this claim, NW Natural cites to the
16 Commission order adopting Idaho Power's request to form a holding
17 company, which states: "Staff concurs that the proposal *may* insulate the
18 company, by corporate separation of regulated from non-regulated
19 businesses . . . However, to ensure that customers indeed are not harmed
20 and are in a position to benefit from the formation of the holding company,

¹⁷ See Exhibit Staff/106 for a brief news synopsis of the current day NextEra-Oncor decisions.

¹⁸ NW Natural Application at 1.

1 Staff proposed several ordering conditions,” all of which the Commission
2 adopted.¹⁹

3 Staff indicated that a holding company *may* provide better insulation,
4 but the Commission never opined on this statement. Further, unlike the
5 proposal before us, not a single party expressed concern with Idaho
6 Power’s application.²⁰ Second, NW Natural referred to the Commission
7 order approving PacifiCorp’s application to be held under PacifiCorp
8 Holdings, Inc., which Staff explained was a simple filing required to meet
9 the “technical/legal requirements of ORS 757.511.” This was because the
10 acquisition of PacifiCorp by Scottish Power had already been vetted and
11 approved in a prior docket.²¹ Staff agrees that holding company structures
12 do have certain benefits, but emphasizes that they also come with risks to
13 the utility. As a result, the Commission has not always approved mergers
14 or restructurings requested by the utility.

15 **Q. Could you explain what corporate structure regulation is and what**
16 **concerns it addresses?**

17 A. Yes. The objective of corporate structure regulation is to encourage
18 transactions (mergers and acquisitions) and restructurings (holding
19 companies) that serve the public interest and increase utility performance,
20 and discourage ones that do not. Importantly, the regulated utility must

¹⁹ Docket No. UM 877, Order No. 98-056 at 2 (emphasis added).

²⁰ Docket No. UM 877, Order No. 98-056 at 1.

²¹ See Order No. 01-573 (July 10, 2001).

1 remain financially healthy, both in terms of credit ratings and in control of its
2 utility assets and resources.

3 Likewise, utility management must remain undistracted by investment
4 activity at the Parent-level and operations unrelated to its first and foremost
5 priority—its obligation to serve utility customers. Said another way, the
6 Parent management should be focused on the long-term financial
7 performance of the utility and not seek opportunities or cost-avoidance for the
8 Parent at the expense of greater long-term costs to the utility. The short-term
9 gain perspective was a major concern for this Commission in prior
10 ORS 757.511 dockets such as Texas Pacific Group's (TPG) proposal to
11 purchase Portland General Electric (PGE) in UM 1121, which the
12 Commission denied.²²

13 Finally, should new business ventures pursued by the Parent of the
14 holding company fail, the utility must be protected from the possibility of being
15 dragged into the bankruptcy proceeding of its Parent or affiliates.

16 **Q. Are federal laws, including the Public Utility Holding Company Act of**
17 **1935 (PUHCA) controls that addressed holding company transfer**
18 **pricing abuses and over-leveraging of utility companies that gave rise**
19 **to bankruptcy, still in effect?**

20 A. No. The federal regulatory boundaries on utility holding companies were
21 largely eliminated with the 1992 amendments to PUHCA and the repeal of

²² Order No. 05-114.

1 PUCHA in 2005. Therefore, Staff looks to the Commission's ring-fencing
2 controls, rather than federal regulations, to protect ratepayers in this context.

3 **Q. So what tools do we have to ensure that utility customers are**
4 **protected from the actions of its holding company Parent?**

5 A. First, we cannot ensure that customers are *100 percent* protected from all
6 possible negative, future events and the actions of their holding company
7 Parent, but *ring-fencing* is the most common regulatory approach to providing
8 protection from the risks associated with the creation of holding company
9 structures and are reasonably effective, *if properly designed*. For example, in
10 UM 814, approval of the Enron-PGE merger was contingent upon
11 Commission-adopted ring-fencing provisions that mandated PGE be held by
12 Enron in a bankruptcy-remote structure. The Commission ring-fencing
13 conditions successfully protected PGE from the bankruptcy proceedings of its
14 Parent, Enron. Specifically, PGE was able to maintain investment grade
15 ratings during and after Enron's bankruptcy. Of particular note, claimants and
16 creditors against Enron were unable to attach PGE assets to be transferred to
17 or sold for the benefit of said creditors. As a result, the Commission's ring-
18 fencing conditions in that case have been cited in numerous articles as an
19 example of successful ring-fencing of a utility under very challenging
20 conditions.²³

²³ Public Utilities Fortnightly, "The Constellation Experience" Aug. 2010 available at <https://www.fortnightly.com/fortnightly/2010/08/constellation-experience?page=0%2C4> ("Acting with a caution out of step with the free-market spirit of the 1990s, the Oregon Public Utility Commission conditioned Enron's acquisition of PGE on the imposition of significant ring-fencing measures, which were intended to insulate PGE from potential financial calamities involving other

1 **Q. Could you please elaborate further on the purpose of “ring-fencing”?**

2 A. Yes. The primary purposes of ring-fencing are:

- 3 1. To maintain separation of the utility from the Parent in order to isolate the
4 utility from negative legal and financial impacts of the Parent’s
5 investment activity;
- 6 2. To make the utility bankruptcy remote (i.e., protect the utility from being
7 involuntarily brought into bankruptcy for the benefit of the Parent);
- 8 3. To ensure that the utility can operate on a stand-alone basis; and
- 9 4. To protect utility customers from abuse by affiliates, such as cross-
10 subsidization.²⁴

11 **Q. How does Standard and Poor’s view ring-fencing?**

12 A. With regard to the purchase of PacifiCorp by MEHC (a division of Berkshire
13 Hathaway), Standard and Poor’s stated: “Any action that state regulators
14 take that provides support (whether legal, regulatory, financial or operational)
15 to the utility and/or isolates the utility (most importantly financial obligations)
16 from its parent company will be positive for credit.” Parent risk can be
17 mitigated through the follow categories of ring-fencing:

- 18 1. Restricting Parent access to utility dividends;
19 2. Restricting degradation of the utility’s credit ratings;
20 3. Restricting utility loans to affiliates;
21 4. Setting standards for pricing of transactions with affiliates; and
22 5. Ensuring utility management is focused on its utility operations.

23

parts of Enron’s operations. PGE subsequently was spared consolidation into the Enron bankruptcy, an outcome that numerous commentators, including Standard & Poor’s, stated was the result of the commission-imposed ring-fencing measures. Among the important restrictions were the maintenance of a 48-percent equity level at PGE and advance notification of special or large dividends to Enron.”).

²⁴ Steven Schwartz, “Ring-Fencing” Southern California Law Review available at http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5531&context=faculty_scholarship.

1 **2. Past Commission decisions under ORS 757.511**

2 **Q. What past examples of application for mergers and acquisitions, or**
3 **holding companies, can serve as a reference?**

4 A. The following is a partial list of five applications just to acquire PGE:

- | | | | | |
|---|---|---------|----------------|----------------------------|
| 5 | • | UM 814 | Enron | Approved |
| 6 | • | UM 967 | Sierra Pacific | Approved But Not Completed |
| 7 | • | UM 1045 | NW Natural | Application Withdrawn |
| 8 | • | UM 1121 | TPG | Denied |
| 9 | • | UM 1206 | PGE Stock | Distribution Approved |

10

11

A more comprehensive list includes:

- | | | | | |
|----|---|---------|------------------------|-----------------------|
| 12 | • | UM 814 | Enron-PGE | Order No. 97-196 |
| 13 | • | UM 887 | Idaho Power-IPHC | Order No. 98-056 |
| 14 | • | UM 918 | Scottish Power-PAC | Order No. 99-196 |
| 15 | • | UM 968 | Sierra Pacific-PGE | Order No. 00-702 |
| 16 | • | UM 1101 | Legal Standard | Order No. 01-778 |
| 17 | • | UM 1121 | TPG-PGE | Order No. 05-114 |
| 18 | • | UM 1209 | MEHC-PAC | Order No. 06-082 |
| 19 | • | UM 1283 | MDU-Cascade | Order No. 06-081 |
| 20 | • | UM 1250 | Avista-Avista Holdings | Application withdrawn |

21

22

Q. Has our Commission ever had reason to deny a merger and acquisition
23 **or holding company structure in the past?**

24

A. Yes. When TPG tried to acquire PGE in 2004, the Commission denied the
25 application based on concerns related to harm to customers that could result
26 from TPG's excessive consolidated long-term debt and business risks
27 associated with TPG's short-term ownership plan.

28

In 2006, Avista filed an application to form a holding company, but a

29

Commission decision was never reached because Avista withdrew its

1 application on the grounds that the conditions and commitments proposed in
2 in the proceeding were not agreeable.²⁵

3 **3. Current decisions by other state commissions**

4 **Q. Are there current-day examples where concerns similar to those in**
5 **this docket have been addressed by other commissions?**

6 A. Yes. The Texas Public Utility Commission (TX-PUC) recently rejected a
7 similar “minimally informative” merger application.²⁶ Just this month, TX-PUC
8 rejected a petition for rehearing on its decision to deny NextEra’s application
9 to acquire Oncor, Texas’s largest transmission and distribution electric utility.
10 The current day example is relevant for two reasons. First, Oncor survived
11 the bankruptcy of its parent, Energy Future Holdings Corp. (EFH), due to
12 Oncor’s ring-fencing. EFH was once known as TXU Corp. before its \$45
13 billion leveraged buyout, however, “special” dividends were paid to its
14 investors outside of routine quarterly and slowly-increasing dividends. To pay
15 the special dividends, EFH had to borrow more money which impaired its
16 credit ratings and made it much less resilient to economic shocks.

17 Second, NextEra sought to purchase Oncor and submitted a minimally
18 informative application to the TX-PUC that failed to identify specific benefits
19 and also asked for removal of the ring-fencing conditions that enabled Oncor
20 to survive its Parent’s bankruptcy. Texas PUC staff advised their Texas
21 commissioners of the increased risks and minimal benefits of a NextEra-

²⁵ See Docket No. UM 1250.

²⁶ See Exhibit Staff/106.

1 Oncor merger, emphasizing that NextEra had the burden of proof to identify
2 clearly why such a transaction would do no harm and why it would benefit the
3 ratepayers of Oncor and Texans in general. Texas PUC staff did not
4 presume mitigation of risks and presume benefits. The TX-PUC concluded
5 that the acquisition would increase risks for the regulated utility with no
6 discernable benefits for Texans. NextEra might have had fabulous benefits to
7 offer, but it never articulated them. NextEra also made the mistake of calling
8 ring-fencing a “deal killer,” rather than thinking through what conditions would
9 not actually restrict the aggregate corporation in its actual operations and
10 therefore could be agreeable.

11 Now comes NW Natural before the Commission, offering 15 basic
12 commitments and minimal detail in its application and opening testimony as to
13 the possible risks and benefits the restructuring will bring to ratepayers. For
14 this reason, the Company’s supplemental testimony and associated highly
15 confidential materials were doubly important to Staff. It is not enough to have
16 a great executive team and a great plan; the Company must carry its burden
17 of showing that net benefits will result for customers, and that it has
18 adequately considered the potential harms to its customers and proposed
19 ring-fencing conditions to mitigate risks identified.

20 **C. Why Does this Decision Matter?**

21 **Q. What are the consequences of this decision?**

22 A. If approved, the proposed restructuring will permanently attach NW Natural to
23 HoldCo’s currently uncertain corporate positioning trajectory that includes

1 ongoing future mergers and acquisitions not subject to Commission review.
2 The Commission should be concerned because without adequate ring-
3 fencing conditions, NW Natural customers can be directly and adversely
4 affected by the investment decisions of HoldCo. Therefore, prior to handing
5 HoldCo the keys to invest in enterprises that will grow NW Natural's corporate
6 family primarily for the benefit of shareholders and executives—with the utility
7 along for the ride—the Commission should contemplate whether such a
8 trajectory is in the best interest of Oregon utility customers.

9 **Q. Are you saying that this application requires as much scrutiny as a**
10 **merger application under the same statute, ORS 757.511?**

11 A. Yes. This application is no less important than a merger-acquisition
12 application under ORS 757.511. With this application, the Commission is not
13 just approving the formation of HoldCo; it is also authorizing deference to
14 HoldCo's unknown future acquisitions. It would be very difficult for the
15 Commission to protect NW Natural through intervention at the SEC or some
16 other forum. That said, holding companies can provide benefits if the utility is
17 properly ring-fenced from potentially riskier HoldCo operations.

18 **Q. Can you provide more detail to support the restructuring concern you**
19 **have flagged?**

20 A. Yes. Corporate structure—in this case a holding company—provides the
21 organizational skeleton of the corporate family. How the corporation's
22 functions are divided and how those divisions are organized defines what the
23 corporation can do well and what it can do quickly. Currently, NW Natural is

1 organized around its core utility functions. The Company is highly regulated
2 and its structure is consistent with prioritizing efficient, safe delivery of reliable
3 utility service at minimal financial risk and with maximum long-term utility
4 success. **[BEGIN CONFIDENTIAL]** [REDACTED]

5 [REDACTED]

6 [REDACTED]

7 [REDACTED] **[END CONFIDENTIAL]** NW Natural ratepayers benefit
8 from this type of management concentration, focused on delivering excellent
9 service into the future at reasonable prices.

10 By contrast, approval of HoldCo would result in less external oversight,
11 allowing for streamlined acquisition of both regulated and unregulated
12 companies. As a result, the aggregate corporation will become diversified in
13 nature with the consolidated company no longer being primarily a regulated
14 local gas distribution company (LDC). For example, Berkshire Hathaway has
15 ownership in everything from PacifiCorp to insurance to ketchup. Two
16 decades post Commission approval, HoldCo's organizational chart could be
17 quite complex.

18 Moreover, such acquisitions, and the decision-making process leading
19 up to those acquisitions, will undoubtedly require management attention and
20 resources which, in NW Natural's proposal, will be provided by the exact
21 people—NW Natural's management and Board will also be HoldCo's
22 management and Board. Even with the best of intentions, time and attention
23 will inevitably be diverted away from the utility. It is Staff's position that

1 ratepayers should pay just for the time and expertise actually consumed on
2 behalf of the regulated utility.

3 Finally, holding companies are often interested in high-risk endeavors,
4 such as natural gas exploration and development or construction
5 opportunities because they offer the potential for higher or faster returns.²⁷
6 Unlike the regulated utility business that is relatively steady and low risk, the
7 opportunities noted above have boom and bust cycles that without adequate
8 ring-fencing could cause direct harm to the NW Natural utility and its
9 customers.

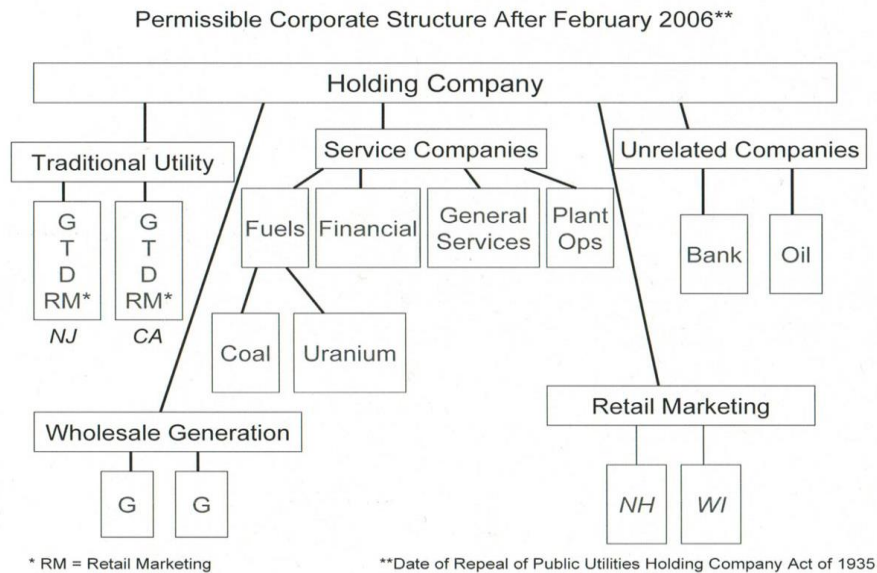
10 **Q. What, if anything, is different in this application than in other**
11 **ORS 757.511 applications?**

12 A. Unlike the MEHC-PacifiCorp merger, where Staff thoroughly researched the
13 ins and outs of MEHC to gain an understanding of the likely benefits and risks
14 that MEHC and BEHC would bring based on the companies' past practices,
15 Staff knows little of HoldCo's future plans for investment. More importantly, it
16 is impossible to judge the effectiveness and efficiency of HoldCo in acquiring
17 and managing other companies and new ventures other than natural gas. It
18 can be difficult for a company to successfully transform its business strategy
19 and operational expertise outside of what it does well.

20 **Q. Do you have a diagram of a holding company structure that might help**
21 **us visualize NW Natural's future corporate family?**

²⁷ See Exhibit Staff/105, Muldoon 26-44 (Company's Highly Confidential Response to Staff DR 63).

1 A. Yes. Below is just one example of how a holding company might be
 2 structured post-PUHCA repeal, but it is not necessarily indicative of HoldCo's
 3 corporate structure. HoldCo has yet to be formed or make any acquisitions,
 4 so we do not know its specific characteristics as we have in past ORS
 5 757.511 dockets.



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D. Changes in Commission Control

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Q. What changes in Commission control will occur if HoldCo is approved?

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A. This question is best reserved for briefing as it involves the legal

10

interpretation of Commission statutes. However, there are some common

11

statutes and past examples that Staff can speak to.

12

Any future transfer of control over NW Natural, beyond the restructuring,

13

would need to be approved by the Commission under

14

ORS 757.511.²⁸ In other words, Staff's understanding is that, because

²⁸ ORS 757.511; Docket No. UM 1209, Order No. 06-121 at 2 (Mar. 14, 2006).

1 HoldCo will own 100 percent of NW Natural (a regulated public utility)
2 common stock, if an entity tried to acquire HoldCo, or exercise “substantial
3 influence” over HoldCo, it must be approved under ORS 757.511. Affiliate
4 interest transactions will continue to be subject to Commission approval and
5 “[a]ll sales, exchanges, or other transfer of [NW Natural] assets are currently,
6 and would be after the Reorganization, subject to Commission approval.”²⁹
7 For example, the sale of public utility property under ORS 757.480 would
8 continue to apply, and if NW Natural were to seek to issue stocks, bonds,
9 notes, or other securities (like Avista did in its 2014 acquisition of AERC),
10 such issuance would be subject to Commission approval under ORS
11 757.415.

12 Importantly, what *does change* with approval of HoldCo is the
13 Commission’s authority to approve acquisitions that may directly affect NW
14 Natural customers because those acquisitions will now be executed at the
15 HoldCo-level, rather than at the NW Natural-level, over which the
16 Commission has jurisdiction. Unless HoldCo targets an Oregon utility, the
17 Commission will likely have no jurisdiction to review or approve a future
18 HoldCo acquisition. Therefore, ring-fencing conditions adopted in this docket
19 are essential, because HoldCo will be able to draw equity out of NW Natural
20 to fund future M&As subject only to the conditions imposed by the
21 Commission.

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²⁹ NW Natural Application at 22.

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III. STAFF'S ANALYSIS

A. Need For Holding Company Structure

Q. Has NW Natural indicated why it wants a holding company structure?

A. Yes. Throughout its application and supporting testimony NW Natural has expressed that a holding company structure will:

1. "Better support the effective growth of the consolidated organization"³⁰
2. "provide a better, and more efficient, platform upon which the Company may pursue, finance, and oversee new business opportunities,"³¹ specifically, the ability to **[BEGIN CONFIDENTIAL]**
[REDACTED]
[REDACTED]
[REDACTED]³² **[END CONFIDENTIAL]**
3. "Provide a better structure for the consolidated entity to pursue business opportunities separate and apart from NW Natural's utility operations"³³

Q. Does Staff find merit in any of NW Natural's reasons listed above?

A. Yes, but with the caveat that the application as filed does not provide a net benefit to customers. Investors and market analysts expect NW Natural to

³⁰ NW Natural Opening Testimony, NWN/100, Filippi/9.
³¹ NW Natural Opening Testimony, NWN/100, Filippi/8.
³² Exhibit Staff/105, Muldoon/23-24 (Company Response to CUB DR 2 Supplemental Attachment 3).
³³ NW Natural Opening Testimony, NWN/100, Filippi/2.

1 grow through capital expenditures on infrastructure projects, organic growth
2 from new customers, and acquisition of other companies. Overall, HoldCo
3 would better satisfy *investor* expectations. Please see Staff's discussion of
4 the Company's growth strategy in Highly Confidential Exhibit Staff/102.

5 **[BEGIN CONFIDENTIAL]** [REDACTED]

6 [REDACTED]

7 [REDACTED]

8 [REDACTED] **[END CONFIDENTIAL]**

9 Staff agrees that as NW Natural remains a streamlined local gas
10 distribution company (LDC), it remains an acquisition target. Large electric
11 utilities and conglomerates across the United States and Canada are buying
12 companies like NW Natural that perform utility functions very efficiently to use
13 the free-cash flow from the natural gas company to fund riskier investments.
14 Ratepayers and Oregonians benefit from NW Natural remaining an Oregon
15 headquartered company with deep community roots, and keeping skilled
16 trade and managerial jobs in Oregon. Staff can't fully value the benefit of
17 being local without knowing the specifics of any proposal to acquire NW
18 Natural. However, a diversified company resulting from Commission approval
19 of HoldCo could make NW Natural a less attractive acquisition target because
20 of its likely diversified complexity. Further, Staff sees a potential need to

1 diversity operational cash flows as Portland and Multnomah County recently
2 set a 100 percent renewables goal to meet future energy needs.³⁴

3 In sum, *if* HoldCo can grow the aggregate corporate family while
4 retaining a cautious, Oregon-centric perspective, utility ratepayers *could*
5 *potentially* benefit from being part of a larger aggregate-capitalization
6 corporation.

7 When evaluating the top level of an aggregate corporation, credit rating
8 agencies and investors often see reduced regulatory risk and nimbler
9 decision-making as a result of the holding company structure. Said another
10 way, if HoldCo is successful at maintaining revenues at strong multiples of
11 interest coverage for borrowings, then the rating agencies see a larger size as
12 analogous to a larger ship less impacted by financial swells. However, to be
13 clear, such an outcome is *highly uncertain* absent ring-fencing conditions that
14 support a cautious and prudent approach to management. By contrast, high-
15 risk, high-reward ventures absent adequate ring-fencing could mean
16 unsuccessful investments or bankruptcy of HoldCo that could harm the
17 ratepayers of a utility that is performing exceptionally well as it is structured
18 today.

19 Further, Staff is not convinced that the *only* solution is formation of a
20 holding company to pursue subsequent acquisitions. There could be other
21 options as discussed in Exhibit Staff/102. However, the application to

³⁴ See Exhibit Staff/102, Muldoon/17 ("Portland, Multnomah County Set 100% Renewable Energy Goal" in The Oregonian by Ted Sickinger (June 1, 2017)).

1 restructure is the decision of NW Natural's management and is the application
2 currently before the Commission to be evaluated for a net benefit.

3 **Q. Although there can be benefits in principle to forming a holding**
4 **company structure, does doing so in this case "serve the public"?**

5 A. Not as filed by NW Natural. However, Staff thinks that with adequate ring-
6 fencing proposed by Staff, a holding company structure has potential to serve
7 to public. **[BEGIN CONFIDENTIAL]** [REDACTED]

8 [REDACTED]

9 [REDACTED]

10 [REDACTED]

11 [REDACTED]

12 [REDACTED]

13 [REDACTED]

14 [REDACTED]

15 [REDACTED]

16 [REDACTED]

17 [REDACTED]

18 [REDACTED]

19 [REDACTED] **[END**

20 **CONFIDENTIAL]** These kinds of arrangements can be beneficial to
21 ratepayers. In addition, positive newsworthiness increases the desirability of
22 the Parent stock in bundled dividend paying equity as an alternative to fixed
23 income components of conservative portfolios. But, as Staff noted earlier,

1 NW Natural's performance today is excellent and the utility would likely
2 continue to provide utility service in substantially the same way without
3 HoldCo.

4 Staff acknowledges that better legal and financial separation between
5 NW Natural and its current subsidiaries could be a benefit for the utility, and
6 believes this benefit and the costs savings that should result as HoldCo
7 makes acquisitions are the primary benefits of the application. On the other
8 hand, these benefits are being exchanged for new risks associated with
9 HoldCo, absent the higher certainties of Staff's proposed ring-fencing.

10 **Q. What is Staff's understanding as to how HoldCo will finance its**
11 **acquisitions?**

12 A. The Company has explained that without the holding company structure, new
13 investments would "likely be funded using NW Natural retained earnings . . .
14 or non-utility debt incurred by a Non-Utility Subsidiary."³⁵ By contrast, with
15 approval of HoldCo, the HoldCo is not restricted to relying on NW Natural
16 retained earnings but rather can use "equity and/or debt issuances at the
17 holding company level, capitalizing on the efficiencies of scale afforded by a
18 holding company."³⁶

19 While HoldCo could issue debt, one of the Staff conditions is that HoldCo
20 cannot pledge NW Natural assets. Therefore HoldCo debt issuances would
21 likely be unsecured until HoldCo has acquired enough qualified non-NW

³⁵ NW Natural Opening Testimony, NWN/100, Filippi/9.

³⁶ NW Natural Opening Testimony, NWN/100, Filippi/10.

1 Natural assets to issue HoldCo secured debt. Unsecured debt will carry
2 higher coupon rates than secured debt. Without Staff's conditions, there
3 would be substantial pressure to guarantee HoldCo debt with utility assets.
4 But such a guarantee would impair the regulated utility's ability to maintain its
5 pool of qualified assets supporting the utility's low cost first mortgage bond
6 (FMB) program. This is another example of how absent Staff's ring-fencing
7 conditions, the HoldCo and the regulated utility could compete for the same
8 resources.

9 **Q. What would happen to NW Natural and its customers if HoldCo were not**
10 **approved?**

11 A. That is unclear. Staff provides a highly confidential financial assessment in
12 Exhibit Staff/102. As NW Natural likes to emphasize, there are very few pure-
13 play natural gas regulated utilities left. However, if NW Natural were to be an
14 acquisition target, such an acquisition would require Commission approval
15 under ORS 757.511 and a showing of net benefits to customers.

16 Similarly, without a holding company structure, NW Natural would need
17 to come before the Commission if financing is required to make an
18 acquisition. By contrast, HoldCo provides a platform to make acquisitions
19 more quickly without Oregon regulatory oversight. However, Staff notes that
20 in UF 4283 and UI 343, Avista Corp. successfully completed the timely
21 acquisition of Alaska Energy and Resources Company (AERC) without a
22 holding company structure.

23 **B. Attendant Risks of NW Natural's HoldCo**

1 **Q. What risks are common to holding companies that we should keep in**
2 **mind?**

3 A. For starters, transactions and restructurings that serve the public interest
4 require that the regulated utility remain financially healthy and unaffected from
5 the parent's investments, undistracted by investment or management
6 activities unrelated to serving customers of the utility, and that management
7 decisions remain independent and do not divert resources away from the
8 utility or damage its financial stability.

9 NW Natural states that the reorganization will provide benefits to NW
10 Natural's customers "without any change in the Commission's ability to
11 regulate NW Natural, without any change in customer rates, without any
12 change in the level or quality of service, and with shareholders bearing the
13 costs of the Reorganization."³⁷ However, Staff feels that this assertion
14 oversimplifies the issues in this application.

15 First, the Commission's ability to regulate NW Natural the natural gas
16 utility does remain unchanged. However, the Parent Company (HoldCo) that
17 wholly-owns NW Natural cannot be regulated by the Commission but for the
18 conditions it agrees to in this docket. This is a change from the status quo
19 where the Commission has jurisdiction over the Parent Company (NW
20 Natural).

21 Second, there will be no change in customer rates only if HoldCo-related
22 costs and HoldCo-subsidary costs are properly allocated (away from NW

³⁷ NW Natural Application at 14.

1 Natural), there is no cross subsidization between affiliates, and effective ring-
2 fencing prohibits leak-through of HoldCo credit ratings or Hold Co BOD
3 demands to pull excessive amounts of equity out of NW Natural through
4 dividend issuance.

5 Third, Staff questions whether the level and quality of service will remain
6 unchanged when NW Natural's management and Board will now also be
7 taking on a second role as management and Board of HoldCo. Staff raises
8 this concern because HoldCo will likely be seeking to make substantial
9 investments and engaging in multiple acquisition opportunities with the same
10 people now taking on two jobs instead of one, the amount of time and focus
11 currently dedicated to NW Natural cannot be the same post-reorganization.

12 Fourth, it is a given that shareholders should bear the costs of the
13 reorganization, so Staff is not sure why the Company may be resistant to
14 effective tracking mechanisms to identify and capture reorganization costs
15 and associated future benefits.

16 **1. Risk to Financial Stability**

17 **Q. Before discussing how NW Natural's credit ratings and capital structure**
18 **could be affected by the reorganization, please provide a snapshot of**
19 **NW Natural's current financial condition.**

20 A. As of May 10, 2017, NW Natural's Long-Term (LT) Local general credit
21 ratings (not for a particular purpose) are A+ for both S&P and Moody's. NW
22 Natural is the highest rated "Natural Gas Utility" as followed by Value Line.
23 This reflects careful care and focus by the Company, namely many years of

1 steady and conservative management. Maintaining top notch ratings as NW
2 Natural has achieved has a cost in terms of time, money, and management
3 attention that will now have to be shared with HoldCo. It is significantly
4 harder to increase and maintain credit ratings, than it is to cause them to fall.
5 Therefore, ring-fencing conditions must be adopted that protect NW Natural's
6 hard-earned credit ratings that customers have paid for through costs of
7 management, capital structure, and foregone alternatives.

8 **Q. How might NW Natural's credit ratings and capital structure be harmed**
9 **by the reorganization?**

10 A. Rating agencies sometimes apply similar credit ratings for the Parent as well
11 as its subsidiaries. The risk to NW Natural and its customers is that the ring-
12 fencing is not sufficient to warrant different ratings, causing NW Natural to
13 suffer a downgrade as the Parent (HoldCo) enters and engages in the M&A
14 arena. When strong ring-fencing conditions are adopted, a subsidiary could
15 have very different credit ratings than its Parent. For example, when Enron
16 was in bankruptcy and thus had the lowest credit rating, PGE still had
17 investment grade ratings.

18 Similarly, absent strong ring-fencing conditions, the capital structure of
19 NW Natural could be comprised of more debt as cash is withdrawn from NW
20 Natural by the Parent (HoldCo) to fund growth activities. The rating agencies
21 consider stress scenarios under which a large amount of debt at the Parent
22 causes creditors to become less certain of timely repayment of Parent loans.
23 The rating agencies then examine what access or control the Parent can

1 exert on subsidiaries to increase the Parent's ability to repay debt. Increasing
2 the debt capitalization of the Parent could increase the cost of future NW
3 Natural debt issuances, credit facilities, letters of credit, and the cost of
4 guarantees in market transactions and contracts.

5 **Q. How will NW Natural stock be affected by the reorganization?**

6 A. NW Natural stock will become HoldCo stock (the trade stock), meaning that
7 funds from sales of such stock would go to HoldCo. Any new issue of NW
8 Natural stock would be held by HoldCo. NW Natural could issue additional
9 stock to HoldCo in order to infuse cash down to NW Natural.

10 **Q. Did NW Natural seek an advisory opinion from any rating agency on**
11 **how the utility could be affected by the reorganization?**

12 A. No. Staff requested information on the various financial ratio limitations and
13 parameters that were assumed or calculated by the rating agencies in
14 providing any advisory opinion regarding the proposed reorganization. NW
15 Natural was not in possession of such information because "NW Natural did
16 not receive any advisory opinions regarding the proposed reorganization from
17 any rating agency."³⁸

18 **Q. Did NW Natural address the financial risks posed to the utility as a**
19 **result of the holding company structure?**

20 A. No, not to Staff's satisfaction. NW Natural proposes to allow the utility's credit
21 ratings to fall to an impermissible level based upon past practice and

³⁸ Exhibit Staff/105 (Company Response to Staff DR No. 10 and 13).

1 historical ratings, and allows for a capital structure that is overleveraged and
2 inconsistent with NW Natural's stated target capital structure of 50/50.

3 **Q. Has Staff performed any other assessment of NW Natural finances and**
4 **financial market conditions?**

5 A. Yes. Staff provides further assessment in Highly Confidential Exhibit
6 Staff/102, namely an analysis of the NW Natural's growth strategy, likely
7 HoldCo acquisitions, and structural changes. Staff requested pro forma
8 financial statements before and after the restructure. Staff analyzed NW
9 Natural's response and found that NW Natural projects perfect continuity in
10 cash flows to the NW Natural utility post-reorganization. However, Staff
11 cannot rely on this projection because it is a snapshot of HoldCo before
12 HoldCo has acquired anything, which is only a temporary state.

13 **2. Risk Concerning Cost Allocation and Affiliate Transactions**

14 **Q. What risks has Staff identified with regard to cost allocations under**
15 **HoldCo?**

16 A. Staff is concerned that cost allocations will be proposed that may over-
17 allocate costs to NW Natural. After all, NW Natural is the regulated utility with
18 captive customers. The Commission would need to stay vigilant to ensure
19 cost allocations are reasonable. For example, the Commission would want to
20 ensure controls are in place that do not result in executive and expert
21 employee compensation being allocated to NW Natural when the executive's
22 time is being spent analyzing acquisition targets. Staff has proposed usual
23 and customary conditions to address this concern.

1 **3. Risk of HoldCo Distracting from Obligation to Serve**

2 **Q. Does Staff have concerns about a reduction in service quality due to**
3 **management time being directed away from the utility to HoldCo?**

4 A. Staff does not have concerns regarding safety because NW Natural has
5 strong safety records within continuing strict programs, but Staff does have
6 concerns regarding the utility no longer being the core focus of management.
7 Management attention is very important. However superb, managers have
8 finite time and attention to spend on all the business of a company.

9 Invariably, new ventures require substantial benefit, cost, risk, and
10 alternatives analyses. Conflicts and failures, which are more common in new
11 efforts than in familiar ones, may require unique new solutions and additional
12 management time and resources. For example, when one buys a company,
13 its computer systems may not mesh with the buyer's; corporate cultures can
14 clash; the selling company may have booked business forward; and so on.

15 Staff's concern centers around the fact that management and director
16 time will be directed away from utility management, but ratepayers will be
17 paying, until the Company's next general rate case (absent Staff's
18 recommended condition on deferral of cost savings) for management and
19 director time now spent on HoldCo formation and target acquisitions
20 unrelated to providing utility service to its gas customers.

21 NW Natural explains in its application that "[a]ll current NW Natural
22 officers will remain NW Natural officers. Similarly, the Board of Directors will
23 continue to serve in the same capacity. Members of the NW Natural Board of

1 Directors will also serve on the HoldCo Board of Directors, but the two boards
2 will exercise separate and independent functions and duties.”³⁹ NW Natural
3 highlights that the same corporate governance will exist after reorganization
4 to indicate that there will be no change to the utility after reorganization.

5 But this is the very crux of Staff’s concern. Given that the NW Natural
6 Board and the HoldCo Board will be comprised of the exact same individuals,
7 Staff questions how reorganization will not result in less time and resources
8 devoted to routine and well proven utility operations and more time to HoldCo
9 and new affiliate companies. When the same people, with the same amount
10 of time in a day, face on the one hand, regulated utility processes with proven
11 internal solutions that long-term employees know well, and on the other hand,
12 all nature of problems at every stage of identifying, acquiring, and integrating
13 new companies, management and skilled flexible employee time must by
14 logic go to putting out new fires. Staff’s conditions recognize these basic
15 realities. As key managers and executives address new opportunities, the
16 cost impact of that shift of focus should be captured (even if minimal) and
17 deferred to benefit ratepayers in the next general rate case.

18 Similarly, in a situation where a decision is beneficial to HoldCo but not
19 NW Natural, how do we ensure the Board acts in NW Natural’s best interest?
20 NW Natural explains that this is not a concern because: “As a technical
21 matter, and by virtue of corporate law, a Board of Directors owes its fiduciary
22 duty to the entity on which Board it serves. So, the Board of Directors of

³⁹ NW Natural Application at 6-7.

1 Northwest Natural Gas Company, an Oregon Corporation (NW Natural),
2 would, under corporate law be obligated to act in the best interests of NW
3 Natural's businesses."⁴⁰ But this is the very problem Staff noted earlier—the
4 same fiduciary duty would apply for HoldCo—meaning the same individuals
5 would be legally obligated to act in the best interests of HoldCo when a
6 decision arises that might compromise NW Natural. Because nascent
7 HoldCo acquisitions could fail absent management attention and infusions of
8 resources, and because a well-seasoned, effective utility team can be
9 expected to handle routine challenges, absent Staff's conditions there would
10 logically be risk of HoldCo and Affiliates leaning financially on NW Natural.

11 **4. Risk Concerning Commission Access to Information**

12 **Q. Is Staff concerned about Commission access to information?**

13 **A.** Yes, if Staff's conditions are not adopted. Staff is concerned that it may be
14 more difficult to obtain records from a growing set of companies and Parent
15 for information that may reasonably lead to relevant information. As HoldCo
16 shareholder value is derived from a greater set of companies, and not so
17 reliant on NW Natural, executive management may be less responsive to
18 Oregon-regulatory requests. Staff has experienced this issue with other
19 utilities when trying to evaluate affiliate interest filings—Staff would have
20 limited to no information on affiliates' costs but for the conditions agreed to in
21 prior merger dockets that require that the Commission have access to all
22 books of account of parents and affiliates.
23

⁴⁰ Exhibit Staff/105 (Company Response to Staff DR No. 55).

1 **5. Risk Due to HoldCo's Unknown Trajectory**

2 **Q. Please explain how HoldCo's relatively unknown corporate trajectory**
3 **complicates the Commission's assessment of whether this**
4 **restructuring results in a net benefit to customers and whether risk-**
5 **mitigating conditions are adequate.**

6 A. In this case, the proposed restructuring starts NW Natural on a HoldCo
7 corporate positioning trajectory. This new direction is less bounded by
8 Oregon's public interest and largely outside of Commission oversight.
9 Therefore, this application is no less important than past merger cases.

10 By comparison, it is different from past ORS 757.511 applications
11 because we are considering approving a company (HoldCo) to exercise
12 substantial influence over a regulated utility without the benefit of predicting
13 its future trajectory and behavior based on evidence from past practices.
14 This makes it more difficult to determine the appropriate conditions to
15 recommend. By way of example, in MEHC's acquisition of PacifiCorp, Staff
16 thoroughly investigated the business platform and characteristics of MEHC
17 and BEHC. After reviewing voluminous discovery related to MEHC and
18 BEHC's history, Staff was able to identify the concerns it should protect
19 against with ring-fencing, including MEHC's short-term financial obligations
20 that would cause MEHC to put pressure on PacifiCorp to produce funds to
21 meet those obligations.

22 Staff was also concerned that MEHC's debt would negatively impact
23 PacifiCorp's credit rating and therefore increase PacifiCorp's cost of debt.

1 Further, unlike in MEHC-PacifiCorp, where the acquiring company brought
2 benefits to PacifiCorp such as access to capital, management expertise, and
3 cost savings and efficiencies, HoldCo cannot offer such benefits at this time.
4 As another example, Avista performed very extensive research and risk
5 assessments both internally and by utilizing directly retained expert
6 consultants who exhaustively investigated and modeled risks of the proposed
7 acquisition of AERC. In this case, Staff must assess whether the Company's
8 executive team, when working on behalf of HoldCo, will perform like due
9 diligence in future M&A opportunities evaluations. This is not to say HoldCo
10 cannot offer benefits in the future, but the net benefits test is lacking in the
11 application as filed.

12 **Q. Is it reasonable to foresee the abovementioned harms, or are these a**
13 **“parade of horrors” as the Company has indicated to Staff?**

14 A. It is reasonable to consider these potential harms and is consistent with past
15 Staff evaluations in ORS 757.511 dockets. The Commission has explained
16 that “using evidence in the record, [the Commission is] permitted to draw
17 rational inference of possible or actual harms that could affect [the utility] and
18 its customers.”⁴¹

19 **Q. Are there any other issues Staff and the Commission must to consider**
20 **in this application?**

21 A. Yes. ORS 757.511 also requires that the Commission “must consider the
22 effect of the acquisition or merger on the amount of income taxes paid by the

⁴¹ Order No. 05-114 at 21.

1 utility or its affiliated group and make any necessary adjustments to the rates
2 of the utility, including the establishment of a balancing account to track
3 income tax expense, to ensure that the acquisition or merger serves the
4 utility's customers and is in the public interest."⁴²

5 The Company notes it does not anticipate that the reorganization will
6 result in a taxable event, under either Oregon law or the Internal Revenue
7 Code.⁴³ Staff asked discovery questions related to the tax consequences of
8 the reorganization. NW Natural explained that the "formation of a new
9 corporate parent entity (i.e. a holding company) is not anticipated to result in
10 the creation of any tax benefits or tax liabilities that do not already exist. This
11 includes consideration of income taxes, property taxes, sales taxes, and
12 franchise taxes."⁴⁴ However, NW Natural currently does not have any records
13 or private letter rulings, from the IRS or an accounting firm, regarding the tax
14 consequences of the proposed reorganization.⁴⁵

15 The Company has indicated that because the restructuring is not
16 anticipated to result in any new tax benefits or liabilities, it is not necessary to
17 create a new tracking or balancing account. Staff understands this response
18 to mean that the legal restructuring—creation of HoldCo itself—most likely will
19 not have tax implications. However, HoldCo *creates the framework* to make

⁴² ORS 757.511(4)(b).

⁴³ NW Natural Gas Application at 5, fn 4 (explaining that the Internal Revenue Service ("IRS") previously recognized events of this nature as tax-free reorganizations).

⁴⁴ Exhibit Staff/105 (Company Response to Staff DR No. 7).

⁴⁵ *Id.* Staff notes that one of the conditions listed the Company's Exhibit A: Agreement and Plan of Merger is that "NW Natural receives an opinion of Stoel Rives LLP confirming the United States federal income tax consequences of the Merger contemplated by this Agreement."

1 future acquisitions which may have tax implications for the utility that will
2 depend on (a) Company-driven tax management or (b) state and/or federal
3 tax changes. Therefore, Staff recommends a condition to establish a tracking
4 mechanism to capture tax benefits from future HoldCo M&As for the benefit of
5 NW Natural customers. Notably, if not made a condition in this proceeding,
6 any future tax benefits that result from subsequent M&As made possible by
7 approval of HoldCo will not be required to be returned for the benefit of NW
8 Natural and its ratepayers. Given that the Company's application as filed has
9 no net benefit, this is one way to help produce a benefit from the restructuring
10 that would accrue to customers.

11 **C. Benefits of NW Natural's Proposed HoldCo**

12 **1. NW Natural-identified benefits**

13 **Q. What benefits has the Company identified?**

14 **A.** The Company has identified the following benefits in its application and
15 Opening Testimony:⁴⁶

- 16 • The holding company structure in and of itself is a benefit because:
 - 17 ○ It results in stronger legal and financial separation between NW
18 Natural and its current subsidiaries "by ensuing legal and financial
19 separation of NW Natural from HoldCo and other affiliates"
 - 20 ○ Protects NW Natural's debt rating and investment profile
 - 21 ○ Positions HoldCo to grow which will likely keep NW Natural
22 independent and local
 - 23

⁴⁶ NW Natural Application at 3; see NW Natural Opening Testimony, NWN/100, Filippi/3,12-13, NWN/200, Wilson/4, 6.

- 1 • Offers benefits from the commitments that customers would not have but
2 for the reorganization, namely:
- 3 ○ A non-consolidation opinion
- 4 ○ Access to records of NW Natural, HoldCo, and HoldCo
5 subsidiaries, which gives the Commission extended authority
6 because “the Commission does not have the right to access
7 information for a utility’s unregulated affiliates”
- 8 ○ Access to audit the accounting records of HoldCo and its
9 subsidiaries or affiliates, insofar as such records are the bases for
10 charges to NW Natural
- 11 ○ Financial commitments that go beyond existing regulatory controls
12 over NW Natural’s financial distributions to its shareholders,
13 including conditions prohibiting issuance of dividends that would
14 reduce equity below 40% or cause credit ratings to fall below
15 investment grade.

16

17 **Q. Please summarize Staff’s analysis of the benefit of the holding**
18 **company structure in and of itself by creating stronger legal and**
19 **financial separation between NW Natural and its current subsidiaries.**

20 A. The Company indicates throughout its application and testimony that the
21 holding company structure in and of itself will “further insulate NW Natural as
22 a public utility from non-public-utility businesses.”⁴⁷ Staff agrees that there
23 will likely be better legal separation shielding NW Natural from its current
24 subsidiaries under HoldCo’s structure as compared to its current structure.

25 However, the extent to which the separation is actually increased (or
26 better for customers) is unclear given the current legally separate nature of
27 the subsidiaries (they are not subdivisions of NW Natural), and the interplay
28 of bankruptcy law and corporate veil piercing. For example, the Commission

⁴⁷ NW Natural Application at 1.

1 has required that Gill Ranch Storage make its own borrowing guaranteed by
2 its own natural gas storage facilities rather than by the regulated NW Natural
3 utility or its assets. Further, NW Natural explained in responses to Staff's
4 data requests that it observes the appropriate requirements to maintain
5 corporate separation from its subsidiaries.

6 The Company has explained that: "As is the case within the consolidated
7 organization currently, in a holding company structure, each corporate entity
8 is legally separate. The reorganization simply changes the manner in which
9 those entities are organized within the consolidated entity" and "the [current]
10 Non-Utility Subsidiaries, which are separate and distinct legal entities,
11 conduct other businesses."⁴⁸ These statements seem to indicate that NW
12 Natural is currently separated from its subsidiaries, leaving Staff uncertain
13 about the additional incremental legal separation a holding company structure
14 would bring "in and of itself."

15 To try to get better clarity about what risks NW Natural's current
16 subsidiaries pose to the utility, Staff asked data requests to which the
17 Company responded: "Gill Ranch Storage, LLC, NW Natural Gas Storage,
18 LLC, and other of our non-utility subsidiaries are not subdivisions. They are
19 separate and distinct corporate entities"⁴⁹ and the "impact of NW Natural's
20 non-utility activity currently has no material impact on NW Natural's current

⁴⁸ NW Natural Opening Testimony, NWN/100, Filippi/3-4.

⁴⁹ Exhibit Staff/105 (Company Response to Staff DR. No. 9 and 59).

1 debt or corporate credit ratings . . . [a]fter the Reorganization, NW Natural will
2 continue to maintain a stand-alone credit profile”⁵⁰

3 However, in other sections of testimony, NW Natural offers a
4 comparison, stating that under its current corporate structure, if a non-utility
5 subsidiary were to experience financial distress, or were to be impaired, that
6 would be reflected in the consolidated financial statements of NW Natural and
7 could affect the debt and corporate credit ratings and shareholder valuation of
8 NW Natural.⁵¹ By contrast, NW Natural states that under the holding
9 company structure, such an impairment would roll-up the consolidated
10 financial statements of HoldCo, leaving NW Natural’s secured debt rating
11 unaffected.⁵² Staff agrees that after the Company’s proposed restructure
12 subject to the Staff’s proposed conditions, there would be stronger protection
13 against an affiliate claim reaching NW Natural assets. However, this is only
14 true if adequate ring-fencing is constructed so other HoldCo liabilities do not
15 roll-down to NW Natural.

16 **Q. Did Staff consider whether there could be a loss of benefits from**
17 **shifting NW Natural’s current subsidiaries from under NW Natural to be**
18 **held under HoldCo?**

19 A. Yes, Staff considered this. In its application, NW Natural provides a diagram
20 of its existing structure with NW Natural at the parent company level.⁵³ Staff

⁵⁰ Exhibit Staff/105 (Company Response to Staff DR No. 11).

⁵¹ NW Natural Opening Testimony, NWN/100, Filippi/10.

⁵² NW Natural Opening Testimony, NWN/100, Filippi/10-11.

⁵³ NW Natural Application at 3-4.

1 investigated whether there actually may be a loss of benefits from moving the
2 subsidiaries out from under NW Natural given that “HoldCo will acquire all of
3 NW Natural’s interest in the Non-Utility Subsidiaries that are currently NW
4 Natural subsidiaries” except for NWN Gas Reserves, which is held under NW
5 Energy Corporation and will remain under NW Natural.⁵⁴

6 Staff inquired as to what equity currently available to the utility from its
7 direct or indirect subsidiaries would no longer be available to the utility after
8 the reorganization. The Company explained that it does not expect the
9 reorganization to affect any equity that is currently available to the utility from
10 its current subsidiaries because, under the current structure, the utility only
11 receives equity from NWN Gas Reserves LLC (through NW Energy
12 Corporation) which will continue to be available after the reorganization given
13 that those two subsidiaries will remain subsidiaries of the utility.⁵⁵

14 Additionally, the Company explained that NW Natural’s non-utility subsidiaries
15 were formed with equity contributions through NW Natural’s retained earnings
16 (shareholder dollars) and are not utility assets; meaning when there is a
17 return on the subsidiary investments through an equity distribution, it is
18 returned to NW Natural retained earnings, not to NW Natural the utility.

⁵⁴ NW Natural Opening Testimony, NWN/100, Filippi/5. Staff notes that NWN Gas Reserves, LLC, “which is operated for the benefit of utility customers,” will remain under NW Natural after the reorganization.

⁵⁵ Exhibit Staff/105 (Company Response to Staff DR No. 4) (emphasis added) (the Company further explained that “equity distributions from the remainder of NW Natural’s current subsidiaries (Non-Utility Subsidiaries), which are currently available to NW Natural, but generally not the Utility, to remain unavailable to the Utility.”).

1 Staff is satisfied that the movement of existing non-regulated
2 subsidiaries out from under NW Natural to be held by HoldCo does not result
3 in a loss of equity from NW Natural, although it does change the entity that
4 gets to decide how to use such equity—it will be HoldCo, not NW Natural.
5 Overall, increasing the financial separation of NW Natural from its current
6 non-regulated affiliates is more likely positive than negative with proper ring-
7 fencing to mitigate HoldCo risks.

8 **Q. What is Staff's view on the importance of remaining an independent and**
9 **local company?**

10 A. Being a local company with long-term roots in Oregon implies that NW
11 Natural is committed to its focus of serving Oregon customers.
12 Additionally, locating and retaining its headquarters in Oregon supports
13 employees, payroll, and associated tax payments. Staff notes that it is
14 common practice in past cases for the Company to commit to remaining
15 locally headquartered in Oregon for the reasons identified by Staff above,
16 therefore, Staff proposes this be a condition in this proceeding. Staff views
17 the commitment to remain local not so much as a benefit, but as an
18 example of no harm to Oregon citizens because there will be no loss of
19 local jobs due to a relocation of the Company.

20 If HoldCo is successful, then it is possible that there is an increased
21 likelihood that NW Natural will remain headquartered in Portland and remain
22 independent, while Oregon benefits from increased jobs, net migration of

1 people to the state, and increased cash flows from beyond the region into the
2 region.

3 **Q. Please summarize the benefits arising from the Company's proposed**
4 **conditions.**

5 A. The Company proposed fifteen conditions in the five categories of: Access to
6 Records; Cost Allocation; Financial Commitments; Holding Company
7 Subsidiaries/Affiliated Interests; and Non-Consolidation Opinion. A few of the
8 Company-proposed conditions are satisfactory to Staff, but on the whole, the
9 conditions are not sufficient to protect ratepayers from the risks associated
10 with the reorganization. Staff does not view the Company's access to records
11 conditions as a benefit based on how they are drafted regarding access to
12 relevant information; the Cost Allocation conditions must be slightly modified
13 to reflect standard cost allocation conditions in prior dockets; the financial
14 protections are certainly not benefits due to the low thresholds set by the
15 Company that are inconsistent with the Company's historical credit ratings
16 and capital structure; and the non-consolidation opinion is a way to mitigate
17 new risks of HoldCo, so it weighs little in favor of an incremental benefit.

18 Staff explains the deficiencies in the Company's proposed conditions, as
19 well as the modifications and additions Staff made to protect against harm to
20 Oregonians and to create a net benefit to customers, at "IV. Staff's Proposed
21 Conditions."

22 **2. Staff-identified benefits**

1 **Q. What benefits did Staff identify as resulting from a holding company**
2 **structure and NW Natural's proposed application as filed?**

3 A. Staff feels that the primary benefit of the application as filed by NW Natural is
4 the likely greater separation between NW Natural and its current affiliates and
5 greater access to information of non-regulated affiliates. However, the extent
6 of that benefit is likely minimal and not an incremental benefit when the risks
7 brought on by HoldCo are considered.

8 **Q. Did Staff identify any other potential benefits through discovery**
9 **requests?**

10 A. No. Staff pressed the Company for specific examples of cost-savings or
11 synergies that the HoldCo would provide for NW Natural ratepayers. The
12 Company has yet to provide any examples of clear benefits to ratepayers,
13 and responded that "we currently do not intend to formally move any
14 employees, services or functions to HoldCo," making it appear that NW
15 Natural-identified cost-savings are very limited, not proposed to be identified
16 and captured for ratepayer benefit, or highly uncertain and dependent on the
17 success of future acquisitions and ventures. When Staff sought further clarity
18 as to any "quantitative, financial, legal/structural, qualitative, or other
19 benefits," the Company responded that Staff should look to the Direct
20 Testimony filed in this docket.⁵⁶

21 **3. Past Commission-identified benefits**

22 **Q. What are examples of benefits from past Commission decisions?**

⁵⁶ Exhibit/Staff 105 (Company Response to Staff DR No. 37).

1 A. The Commission has not defined what constitutes a net benefit—it is a
2 flexible process involving the specific facts of each case. However, in past
3 cases, the benefits resulting from the ORS 757.511 transaction were clearer
4 and might include cost savings to customers through rate credits, service
5 quality improvement obligations, low income bill payment assistance,
6 environmental or renewable energy commitments, and other incremental
7 benefits.

8 For example, in the MEHC-PAC merger, MEHC agreed to four years of
9 rate credits and other customer benefits including low-income bill payment
10 assistance, protecting PacifiCorp's financial health by maintaining over 48.25
11 percent equity ratio and credit ratings over BBB-, and a plan to add 1.4 GW of
12 renewable generation by 2015, among other benefits.

13 Additionally, because NW Natural is forward-looking, well-managed, and
14 top-credit-rated, there is less immediate financial benefit from restructure or
15 merger than for example when Berkshire Hathaway indirectly acquired
16 PacifiCorp and pledged one billion dollars to bolster and guarantee
17 PacifiCorp's credit quality.

18 **D. Staff Conclusion: No Net Benefit as Currently Filed**

19
20 **Q. Does the Company's application satisfy the ORS 757.511 requirement**
21 **that the restructuring result in a net benefit to NW Natural customers?**

22 A. No. Staff has identified reasonable risks associated with a HoldCo growth
23 strategy, further complicated by no past performance to rely on. Corporate
24 restructure, even when modified and ring-fenced, involves tradeoffs. Oregon

1 ratepayers could experience a small net benefit from slightly reduced
2 overhead and management costs or tax benefits arising from future HoldCo
3 acquisitions, but the Company did not propose to capture those efficiencies
4 for ratepayers, and although greater legal separation as compared to its
5 current structure may result, Staff concludes that the risks discussed in this
6 testimony outweigh any minimal benefits. Moreover, it is the burden of the
7 Company to show a net benefit will result from the restructuring.

8 Nevertheless, Staff has developed a set of conditions below that include
9 stronger financial restrictions to preserve the utility's capital structure and
10 credit ratings, protect against bankruptcy, and capture (through deferred
11 credits) cost savings resulting from the restructure. The credits can be seen
12 as a way to provide certainty that a minimum amount of cost savings will be
13 identified and captured for ratepayer benefit.

14 **IV. STAFF'S PROPOSED CONDITIONS**

15 **A. Staff's Conditions**

16 **Q. Has Staff designed new or modified conditions for this application?**

17 A. Yes. Please see Exhibit Staff/103. Exhibit Staff/104 also contains Staff's
18 proposed conditions but includes NW Natural's proposed conditions and
19 references to past adopted conditions for convenience.

20 **B. Discussion of NW Natural's Conditions and**

21 **Staff's Rationale for Modifications and Additional Conditions**

22 **Q. Please briefly restate the purpose of ring-fencing in this docket.**

1 A. NW Natural is looking for ways to grow and one option is an acquisition
2 strategy facilitated by formation of HoldCo. If HoldCo is approved, customers
3 must be protected from risks associated with this strategy. Ring-fencing
4 should be designed to address the unique characteristics of each case and its
5 impact on utility customers. In this case, ring-fencing should ensure:

- 6 1. NW Natural corporate governance is structured so as to prevent
7 reductions in capital investment, operational expense, and the transfer of
8 strategic control of NW Natural to an out-of-state Parent whose interests
9 may not be aligned with that of ratepayers specifically and Oregonians
10 generally.
- 11 2. NW Natural's dividends, both quarterly and special or extra-ordinary are
12 reasonably limited to prevent stripping of equity from NW Natural.
13
- 14 3. NW Natural's hard-earned credit ratings are reasonably preserved.
- 15 4. NW Natural is sufficiently protected to prevent a voluntary or involuntary
16 filing of NW Natural into bankruptcy for the benefit of Parent, HoldCo, or
17 Affiliates.
- 18 5. Oregon corporate presence and focus is retained, management remains
19 focused on the utility and the culture of NW Natural fiscal excellence
20 providing low cost access to capital for utility purposes.
21

22 **Q. Is there merit to the argument that the Company is merely proposing**
23 **a restructuring (not engaging in a merger), so its limited conditions**
24 **are adequate?**

25 A. No. Approval of this application is approval of all future HoldCo acquisitions.
26 There is no later to this process. The right time, and appropriate time, to
27 develop strong conditions to protect ratepayers is now.

28 **Q. How did Staff organize its proposed conditions?**

1 A. Staff proposes common conditions found across past ORS 757.511
2 merger/holding company dockets filed at this Commission. Staff organized its
3 recommended conditions into the following categories:

4 1. Financial Protections

- 5 • Credit and capital structure
- 6 • Dividends
- 7 • Bankruptcy protection

8 2. Accounting and Cost Allocation

- 9 • Accounting generally
- 10 • HoldCo formation costs
- 11 • Allocations between NW Natural and HoldCo
- 12 • Prevention of cross subsidization of affiliates

13 3. Access to Records and Information

14 4. Reorganization Continuity

- 15 • Service quality
- 16 • Miscellaneous

17 5. Cost Savings

- 18 • Credits to customers
- 19 • Future mergers and acquisitions

20 **1. Financial Protections**

22 **Q. Please summarize the Company's proposed "Financial Commitments"**
23 **and "Non-Consolidation Opinion" commitment.**

24 A. The Company's "Financial Commitments"⁵⁷ allow the Company to issue
25 equity out of NW Natural up to HoldCo if its secured debt rating is at
26 investment grade or higher and its common equity is not less than 40 percent

⁵⁷ See NW Natural Application at 10-11.

1 of NW Natural's total capital structure. Staff disagrees with NW Natural's
2 assessment that these are "reasonable levels" given that NW Natural's
3 current (and historically) near perfect credit ratings would be allowed to fall,
4 under NW Natural's proposal, from A+ to BBB- (the lowest investment grade
5 rating), and its capital structure could fall to the floor of 40/60. NW Natural
6 also offers a non-consolidation opinion from the law firm of Stoel Rives within
7 60 days of HoldCo's formation.

8 **Q. What financial protection conditions does Staff propose?**

9 A. Staff Conditions 4-16 serve to protect NW Natural from experiencing
10 weakened or damaged financial conditions as a result of HoldCo decisions
11 and investments. All conditions are common and ordinary to past
12 merger/holding company dockets, and if they vary slightly from past dockets,
13 they do so to reflect NW Natural's specific financial characteristics, given that
14 to produce a net benefit under ORS 757.511, the reorganization must be
15 compared to the continued prudent and well-managed NW Natural.

16 Staff's predominant financial protection conditions require that NW
17 Natural maintain separate corporate credit and Long-Term (LT) debt and
18 preferred stock (if any) ratings from HoldCo (or Parent if different); maintain
19 the common equity portion of its capital structure at 46 percent or higher;
20 maintain investment ratings at no less than two notches below current levels;
21 and restrict dividends or like-payments to HoldCo (or Parent if different) if NW
22 Natural's common equity would fall below 46 percent, its credit ratings as
23 determined by S&P or Moody's would drop more than one notch below its

1 current level of A+, or S&P or Moody's would find the dividend or like-
2 payment to be credit-negative for NW Natural.

3 Staff recommends additional common conditions, such as Staff
4 Condition 8, which ensures that NW Natural customers will be held harmless
5 if the reorganization results in a higher revenue requirement for NW Natural
6 than had the reorganization not occurred.⁵⁸ Staff has proposed additional
7 financial protection conditions found in Exhibit Staff/103.

8 **Q. Please explain Staff's rationale for its proposed equity floor.**

9 A. Staff disagrees that a capital structure of 40 percent equity is "a reasonable
10 level" to allow equity extraction from the utility. **[BEGIN CONFIDENTIAL]**

11 [REDACTED]

12 [REDACTED]

13 [REDACTED] **[END CONFIDENTIAL]** Again, our comparator is
14 a continued well-managed NW Natural, making it reasonable to rely on the
15 Company's past and projected financial performance.

16 By way of comparison, when PGE was acquired by Enron, the
17 Commission required that PGE not issue any dividends to Enron if the
18 common equity portion of its capital structure was below 48 percent.

19 Likewise, in the MEHC acquisition of PacifiCorp, the Commission adopted

⁵⁸ Enron/PGE, Order No. 97-196 (Condition 10); see Order No. 97-196 at 7 where the Commission states: "The Tenth condition of the Stipulation is common to merger orders. It is a guarantee that PGE's customers will be held harmless if the PGE and Enron merger results in a higher revenue requirement for PGE than if the merger had not occurred."

1 conditions requiring PacifiCorp to maintain the common equity portion of its
2 capital structure at 48.25 percent with declining percentages over time.⁵⁹

3 **Q. Would Staff’s proposed floor of 46 percent common equity (CE) after**
4 **removal of good will and equity associated with non-regulatory assets**
5 **create any challenges for the Company under its current corporate**
6 **structure looking back to 2007 or as projected forward by Value Line to**
7 **2022?**

8 A. No. Staff reviewed annual information developed by Value Line (VL),
9 summarized in the following table and highlighted in yellow.

Year	CE	LT Debt	Total	Year	CE	LT Debt	Total
2007	53.7%	46.3%	100.0%	2017	57.0%	43.0%	100.0%
2008	55.1%	44.9%	100.0%	2018	57.0%	43.0%	100.0%
2009	52.3%	47.7%	100.0%	2019	57.0%	43.0%	100.0%
2010	53.9%	46.1%	100.0%	2020	57.0%	43.0%	100.0%
2011	52.7%	47.3%	100.0%	2021	57.0%	43.0%	100.0%
2012	51.5%	48.5%	100.0%	2022	57.0%	43.0%	100.0%
2013	52.4%	47.6%	100.0%				
2014	55.2%	44.8%	100.0%				
2015	57.5%	42.5%	100.0%				
2016	57.0%	43.0%	100.0%				

10

11 **Q. Did Staff ask the Company to provide forward-looking information to**
12 **confirm that Staff’s proposed Common Equity floor is more than**
13 **reasonable on a quarterly basis for the Company?**

14 A. Yes. In response to a Staff data request, the Company provided Confidential
15 Attachment 1,⁶⁰ showing that [BEGIN CONFIDENTIAL] [REDACTED]

16 [REDACTED]

⁵⁹ Order No. 06-082 at 6 (see GC 18(a) and O 15).

⁶⁰ Exhibit Staff/105, Muldoon/21-22)(Company Response to Staff DR No. 64 – Confidential UM 1804 OPUC DR 64 Attachment 1).

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[REDACTED]

[REDACTED]

[REDACTED]

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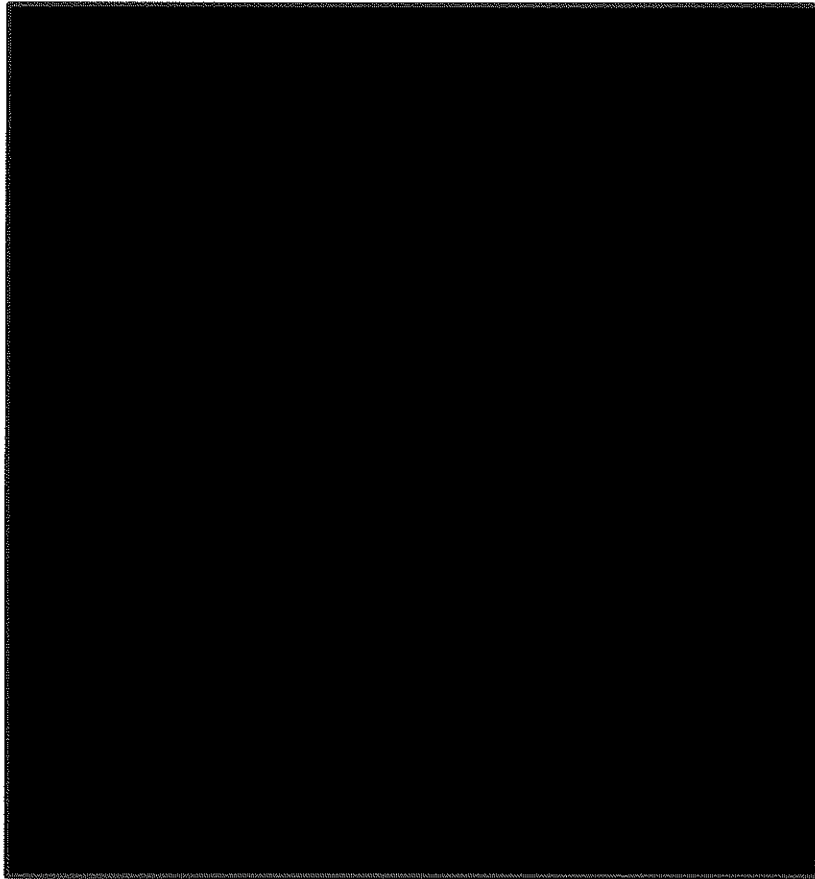
[REDACTED]

[END CONFIDENTIAL] Given that the appropriate comparator for the net benefit determination is the continued prudent and well-managed NW Natural absent reorganization, it is more than reasonable to recommend a 46 percent equity floor going forward.⁶² Please see the table below containing NW Natural's projections for illustration.

[BEGIN CONFIDENTIAL]

⁶¹ *Id.* **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]**

⁶² See also Exhibit Staff/105 (Company Response to Staff DR No. 66).



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[END CONFIDENTIAL]

Q. Please explain Staff's proposed debt rating floor and supporting rationale.

A. As of May 10, 2017, NW Natural's general credit ratings are as follows:

<u>NWN Current Credit Ratings</u>	S & P⁶³	Moody's
Corporate LT Local Credit Rating	A+	A+
Rating outlook	Stable	Stable

⁶³ S&P refers to Standard & Poor's Rating Service, a division of The McGraw-Hill Companies, Inc., while Moody's refers to Moody's Investors Service, Inc.

1 Staff's conditions are designed to preserve NW Natural's ability to borrow
 2 reflective of the above ratings, meaning that Staff's conditions limit
 3 dividends that can be paid out from NW Natural to HoldCo (or Parent if
 4 different). The following figure illustrates the differences between NW
 5 Natural's current ratings (green), NW Natural's proposed floor (red), and
 6 Staff's proposed floor (blue). A drop of a *single notch* in ratings would
 7 currently be seen by Staff, the Company, and investors as a major setback
 8 for NW Natural. NW Natural proposes allowing *six to seven* notches.

Moody's		S&P				
Long-term	Short-term	Long-term	Short-term			
Aaa	P-1	AAA	A-1+		High Grade	
Aa1		AA+			High grade	
Aa2		AA				
Aa3		AA-				
A1	P-2	A+	A-1		Staff	
A2		A		Upper medium grade		
A3		A-	A-2			
Baa1	P-3	BBB+	A-3		Co.	
Baa2		BBB				Lower medium grade
Baa3		BBB-				

9
 10 As displayed above, NW Natural proposes to allow a fall of *six to*
 11 *seven* rating notches, from the top of upper medium grade all the way
 12 down to investment grade, before HoldCo would be prohibited from
 13 drawing equity out of NW Natural the utility. This is inconsistent with the
 14 Company's historic practice and what Staff would expect of a prudent and
 15 well-managed NW Natural. The Company explained that "NW Natural's
 16 secured debt ratings have not been below investment grade from 1982 to

1 the current date. Existing officers of the Company believe that the secured
 2 debt ratings have not been below investment grade prior to that time.”⁶⁴ To
 3 be clear, dropping six to seven rating notches is not equivalent to a “bad
 4 quarter” or a “bad year.” The severity in the level of change is analogous
 5 to the level of health maintained by a professional athlete plummeting to
 6 that of someone on life support. Staff cannot accept that such a level of
 7 wealth transfer from NW Natural up to HoldCo, or leveraging HoldCo to the
 8 extent that NW Natural’s credit ratings teeter on investment grade, would
 9 be considered reasonable or justifiable. For example, a primary cause for
 10 a company to experience such a precipitous rating drop is when special
 11 dividends are issued after corporate raiders acquire a company.

12 **Q. Please explain Staff restrictions on dividend issuance and rationale in**
 13 **conjunction with the table immediately below.**

		Value Line Estimated Near Future Dividends											VL Avg	Div. Growth	
Abbreviated Utility	Ticker	2012 Yr	2013 Yr	2014 Yr	2015 Yr	2016 Yr	2014-16 Average	2017 Yr	2018 Yr	2019 Yr	2020 Yr	2021 Yr	2022 Yr	2020- 22 / Yr	2020-22 vs. 2014-16
Atmos	ATO	1.04	1.42	1.50	1.59	1.71	1.60	1.80	1.92	2.04	2.17	2.30	2.43	2.30	6.2%
Laclede (Spire)	SR / LG	1.66	1.70	1.76	1.84	1.96	1.85	2.10	2.20	2.30	2.40	2.50	2.60	2.50	5.1%
New Jersey	NJR	0.97	0.60	0.86	0.93	0.98	0.92	1.02	1.04	1.07	1.09	1.12	1.15	1.12	3.3%
Northwest Natural	NWN	1.79	1.83	1.85	1.86	1.87	1.86	1.88	1.92	1.96	2.01	2.05	2.09	2.05	1.6%
South Jersey	SJI	0.83	0.90	0.96	1.02	1.06	1.01	1.10	1.15	1.20	1.25	1.30	1.35	1.30	4.2%
Southwest Gas	SWX	1.15	1.29	1.43	1.58	1.76	1.59	1.90	2.05	2.19	2.34	2.50	2.66	2.50	7.9%
WGL	WGL	1.59	1.66	1.74	1.83	1.93	1.83	2.02	2.08	2.12	2.16	2.20	2.24	2.20	3.1%
TOTAL														Northwest Natural	4.2%
														Co Gas Screen	4.5%

14
 15 A. Looking at 10-years of combined history and Value Line (VL)⁶⁵ Projection,
 16 NW Natural, absent restructure, is expected to issue only quarterly dividends
 17 gradually growing year-over-year by 4.2 percent. This is typical of natural gas
 18 utilities followed by VL. The table above shows that a screen of seven

⁶⁴ Exhibit Staff/105 (Company Response to Staff DR No. 27).

⁶⁵ See Value Line analysis by John E. Seibert III on June 2, 2017.

1 companies like NW Natural can be expected to issue only quarterly dividends
2 which investors expect to grow at 4.5 percent year-over-year. Please take
3 note of the total absence of special dividends or large extra one-time cash
4 distributions. This steady, predictably increasing dividend is what attracts and
5 retains current NW Natural investors. No other large special payments are
6 necessary to satisfy *current* NW Natural investors. In other words, HoldCo
7 does not need to be compensated for the risk of holding NW Natural stock
8 more than investors who currently hold this type of regulated utility stock.
9 And so, a quarterly dividend increasing at no more than 5 percent year-over-
10 year should be sufficient alone to satisfy HoldCo as a reasonable return for
11 holding the regulated utility's stock.⁶⁶

12 In sum, absent ring-fencing, NW Natural could be forced to make large
13 payments to HoldCo investors. Therefore, Staff has proposed Condition 10 to
14 restrict dividend and like distributions up to HoldCo. Specifically, dividends
15 can only be issued if NW Natural has a 46 percent equity structure; the rating
16 agencies do not find a that a distribution would be credit negative;⁶⁷ or the
17 credit rating agencies would directly drop ratings more than one notch below
18 A+ (NW Natural's current long-term local corporate credit rating).

⁶⁶ As an example, see "Fortis CEO Says His Eyes are Still on US M&A, But Being Patient for Now" by Stephanie Tsao of SNL Financial LC published Jun. 8, 2017. Fortis CEO Barry Perry's aspirational target for multiple acquisitions in the U.S. and Canada was a 5 percent per year earnings per share growth rate. This indicates that earnings supporting dividend growth, or otherwise used to fund HoldCo growth, need be no higher than if the dividend growth were the recipient NW Natural investors now, rather than a single holder of the regulated utility's stock (HoldCo). Otherwise, payout to the Parent need be no higher than payout to current investors.

⁶⁷ "Credit negative" essentially means that the rating agencies place a negative "flag" or "watch" on the company while they determine whether the company's credit ratings should be downgraded. This is a position that NW Natural currently would take great pains to avoid.

1 **Q. Please explain the significance of the condition requiring Commission**
2 **notification before dividending 5 percent or more of retained earnings.**

3 A. Staff includes this common and ordinary condition to alert the Commission
4 that the utility plans to permit the Parent (HoldCo) to extract substantial
5 wealth (a large cash payment) from the regulated utility's retained earnings
6 that would otherwise be used to meet future utility purposes. In other words,
7 this is the pool of money that NW Natural uses to attract and retain its
8 executives, grow the regulated utility, and buffer the utility against any future
9 financial problems that would now be transferred up to the HoldCo, becoming
10 HoldCo money for non-utility-related investments and acquisitions.

11 **Q. Please explain the need for Staff Conditions 6, 7, and 8.**

12 A. From a customer perspective, it would only be reasonable to form HoldCo if
13 the regulated utility would be at least as well off as it would have been without
14 the reorganization. However, Oregon's statute requires more—NW Natural
15 customers must benefit from the restructuring. In short, if NW Natural's cost
16 of capital increases requiring more money from ratepayers to cover its costs,
17 it becomes the burden of *the Company* to show that this increase is not due
18 to the restructure. And if the increase is due to the restructure, ratepayers will
19 be held harmless as a result of Staff's ring-fencing conditions.

20 **Q. Please explain Staff's view of the non-consolidation opinion**
21 **commitment.**

22 A. The Company offers the non-consolidation opinion as a benefit assuring legal
23 and financial separation of NW Natural from HoldCo and other affiliates that it

1 does not have today, specifically, protection from the effects of bankruptcy or
2 major liability of HoldCo or one of its affiliates or subsidiaries.⁶⁸ In sum, Staff
3 understands NW Natural to be saying that currently NW Natural is exposed to
4 potential volatility from the financial performance of its affiliates and the claims
5 of creditors and affiliates because it does not have a non-consolidation
6 opinion under its current structure.⁶⁹

7 Staff supports NW Natural's commitment to obtaining a non-
8 consolidation opinion from the law firm of Stoel Rives. However, Staff makes
9 two observations. First, non-consolidation opinions are common in ORS
10 757.511 cases.⁷⁰ Additionally, NW Natural is currently a healthy utility not in
11 any obvious financial danger from which it needs protection. Thus, Staff
12 views the non-consolidation opinion as a common way to mitigate the harm of
13 the proposed reorganization, but not necessarily as an incremental benefit.
14 Additionally, non-consolidation opinions are fact specific, limited in scope and
15 highly qualified, so the opinion does not absolutely guarantee that NW Natural
16 would not be pulled into the bankruptcy of its Parent. This reality leads Staff
17 to recommend issuance of a "golden share" and independent director
18 conditions to strengthen the ring-fencing protection for the NW Natural utility.

⁶⁸ NW Natural Application at 13; NW Natural Opening Testimony, NWN/200, Wilson/12. A non-consolidation opinion is a formal legal opinion that states that the ring-fencing provisions are sufficient to prevent a bankruptcy court from "pulling" NW Natural into a HoldCo bankruptcy.

⁶⁹ NW Natural Application at 13; NW Natural Opening Testimony, NWN/100, Filippi/11.

⁷⁰ Order No. 06-082 at 6 (MidAmerican committed to providing a non-consolidation opinion that PacifiCorp would not get pulled into bankruptcy proceedings if MidAmerican ever filed for bankruptcy, see O 17).

1 Second, NW Natural's non-consolidation opinion commitment states that
2 NW Natural will consult with the parties to this docket and the Commission if it
3 can't obtain the non-consolidation opinion based on the final conditions
4 adopted by the Commission.⁷¹ Staff believes a non-consolidation opinion
5 should be required and conditions its recommendation for approval of this
6 filing on NW Natural actually obtaining a non-consolidation opinion based on
7 the final conditions adopted by the Commission.

8 **Q. Does Staff propose other conditions to make NW Natural bankruptcy**
9 **remote, and for what reasons?**

10 A. Yes. Staff recommends additional protections above what the Company
11 offered in its application to protect against NW Natural exposure to HoldCo
12 bankruptcy proceedings given the largely unknown trajectory of HoldCo,
13 inability of the Commission to place additional ring-fencing conditions to
14 protect NW Natural after this proceeding, and common conditions used in the
15 past that have proven to be successful in the worst of scenarios.

16 Notably, "[a]s holding companies increasingly have diversified their
17 investments to riskier (nonutility) assets, failures have increased. The
18 resulting parent-company bankruptcies have exposed the utility-subsidaries
19 to bankruptcy. To mitigate this risk, utilities typically are operated as
20 bankruptcy-remote subsidiaries of their holding companies. The terms of
21 such bankruptcy remoteness, including the contractual means for achieving it,

⁷¹ NW Natural Application at 11-12.

1 are usually mandated by the utility's regulator—in the United States, state
2 public utility commissions.”⁷²

3 Therefore, Staff proposes a “Golden Share” to be held by an
4 independent director, similar to that used in the Enron-PGE acquisition and
5 the MEHC-PacifiCorp “independent director” condition.

6 **Q. Why does Staff propose a golden share condition and what is it?**

7 A. Staff's Condition 15 calls for a “Golden Share,” which is the sole Commission-
8 authorized (\$1.00 par) share of Preferred Stock. This “golden share” can
9 outvote all other outstanding shares of all types, or all classes, of stock with
10 regard to (a) dividends and like distributions and (b) bankruptcy. Staff
11 proposes that the golden share be held by an independent director(s) at the
12 NW Natural-level of the chain, as opposed to a person with a tie or
13 relationship to the parent (HoldCo currently), its affiliates, NW Natural, or any
14 lender. Alternatively, the Commission could hold the share.

15 Staff does not believe that requiring the golden share be held by an
16 independent director is redundant because they work in harmony to protect
17 ratepayers. First, the share itself is a mechanism to prevent dividend abuse
18 and protect against the parent or creditors dragging the utility into bankruptcy.
19 Second, an independent director better ensures that the holder of the golden
20 share acts in the utility's best interest even when HoldCo is under duress.

21 In fact, Standard & Poor's has confirmed the efficacy of such ring-
22 fencing structures when it reaffirmed a strong credit rating for PGE,

⁷² Steven Schwartz “Ring-Fencing” at 76.

1 notwithstanding that the utility's parent (Enron) was in bankruptcy. The credit
2 rating survived because Enron had set up a ring-fence around PGE through
3 the issuance of a \$1.00 Par Junior Preferred Stock and creating an
4 "independent director." The Commission adopted a similar protection in
5 MEHC-PAC, with a condition requiring an independent director. Staff expects
6 its conditions would allow NW Natural to maintain investment grade credit
7 ratings even if the remainder of the Parent's holdings were liquidated in
8 bankruptcy. However, Staff notes that while the golden share or independent
9 director may prevent a voluntary bankruptcy petition, the risk that creditors will
10 pursue an involuntary filing still exists.

11 **Q. Please explain what a special purpose entity (SPE) is and why Staff**
12 **thinks it is beneficial in this case.**

13 A. Staff recommends making NW Natural a subsidiary of a special purpose
14 entity (SPE) to keep the regulated utility at arm's length from HoldCo. The
15 SPE is an additional company that sits in the corporate structure between NW
16 Natural and HoldCo (please see the diagram in Exhibit Staff/103, Muldoon/2).
17 The SPE's only purpose is to hold the regulated utility's stock shares and
18 keep accounts for quarterly dividends paid up to HoldCo and cash infusions
19 paid down to the utility; the SPE does not borrow money or conduct any
20 business activity. Thus, the simple and limited financial transactions of the
21 SPE are very hard to mischaracterize. This is important because the SPE
22 creates a clear separation between the regulated utility and HoldCo's cash
23 flows and assets, showing that the utility's cash flows are not commingled in

1 any way with HoldCo or non-utility subsidiaries which protects NW Natural
2 assets in the event of a HoldCo bankruptcy proceeding.

3 Past examples support deploying conditions like Staff now recommends.
4 In the MEHC-PacifiCorp acquisition, MEHC agreed to hold the stock of
5 PacifiCorp as a “special purpose entity” (SPE) to further fence it from the
6 activities of conducted by MidAmerican.⁷³ If all of Staff’s other ring-fencing
7 conditions are adopted, the SPE “fire wall” from HoldCo is less critical. But
8 several integrated conditions working together are more effective and
9 preferable to one.

10 **2. Accounting and Cost Allocation**

11 **Q. Please summarize the Company’s “Cost Allocation” and “Holding 12 Company Subsidiaries/Affiliated Interests” commitments.**

13 A. Regarding the Company’s “Cost Allocation” conditions, Staff found that
14 certain subsections needed to be more specific. For example, the Company
15 indicated that costs will be allocated based on “primary cost-driving factors”⁷⁴
16 and HoldCo will have an “accounting system adequate to support
17 allocation.”⁷⁵ Staff recommends that time spent on HoldCo be tracked hourly,
18 and has proposed modified cost allocation conditions to reflect the language
19 used in past Commission M&A and holding company dockets.

20 Additionally, the Company only proposed two conditions regarding
21 transactions with “Affiliated Interests,” which Staff views as an important issue

⁷³ Order No. 06-082 at 6.

⁷⁴ NW Natural Application at 10 (Company’s Cost Allocation condition (5)(b)).

⁷⁵ NW Natural Application at 10 (Company’s Cost Allocation condition ((5)(c)).

1 of the reorganization. Most M&A and holding company dockets have
2 comprehensive conditions in this area to prevent cross-subsidization or abuse
3 by affiliates. Please see Exhibit Staff/103.

4 **Q. Please explain the rationale for Staff's modifications and additions**
5 **regarding accounting and cost allocation.**

6 A. Staff's "Accounting and Cost Allocation" conditions include conditions
7 pertaining to accounting generally, HoldCo formation costs, allocations
8 between NW Natural and HoldCo, and prevention of cross subsidization,
9 namely though the maintenance of separate books and accounts, and access
10 to records to review transactions between affiliates. However, Staff's
11 conditions further ensure that costs are tracked with sufficient granularity and
12 descriptions as to exclude: 1) HoldCo planning and formation costs, 2) future
13 M&A planning, execution, and integration costs, and 3) management time and
14 resources refocused to HoldCo investors at the expense of the utility.

15 Conversely, Staff conditions in the "Cost Savings" section of Exhibit
16 Staff/103 provide for customary accounting and tracking frameworks to
17 identify and capture cost savings and tax benefits for utility ratepayers.

18 **3. Access to Records and Information**

19 **Q. Please summarize the Company's proposed "Access to Records"**
20 **commitments.**

21 A. The Company's proposed conditions on "Access to Records" are too narrow
22 to protect customers. NW Natural proposes to limit Commission access to
23 information in ways that former approved M&A and holding company dockets

1 do not. For example, the Company's conditions appear to provide NW
2 Natural, HoldCo, and Affiliates discretion to decide what constitutes relevant
3 information before producing records for Commission review.⁷⁶ Information
4 that the Company determines is relevant to "matters within the jurisdiction of
5 the Commission" will be produced. But many HoldCo matters that can
6 directly affect the utility will be outside the Commission's jurisdiction. Staff
7 issued data requests seeking clarity on the level of access to information the
8 Commission would have under the Company's proposed condition, to which
9 the Company responded: "NW Natural and its affiliates will perform a review
10 of all record(s) to determine the information that is relevant to the business of
11 NW Natural, and provide that information."⁷⁷

12 **Q. Please explain the rationale for Staff's modifications and additions to**
13 **access to record, information, and people.**

14 A. By contrast, the "access to records" conditions that the Commission has
15 approved and other regulated utilities have agreed to in past dockets allow
16 Staff and the Commission to review and determine the relevancy of such
17 information. Staff's proposed modifications ensure that Staff will have access
18 to necessary records for the utility, affiliates, and HoldCo for costs that are
19 discoverable and likely to lead to relevant information. The wording of Staff's
20 proposed conditions is consistent with past Commission precedent.

21 **4. Reorganization Continuity**

⁷⁶ Exhibit Staff/105 (Company Response to Staff DR No. 24).

⁷⁷ *Id.*

1 **Q. Please summarize the Company's proposed commitments in this area.**

2 A. The Company provided no commitments in this area. Staff's proposed

3 conditions below are additions rather than modifications.

4 **Q. Please explain the rationale for Staff's conditions on regulatory**
5 **continuity, namely maintaining service quality and current benefits.**

6 A. Non-regulated activities will take more management time and attention in the

7 future if HoldCo is approved. Because NW Natural service quality and safety

8 records are currently strong within ongoing programs, Staff's proposed

9 conditions primarily address two points. First, utility ratepayers should bear

10 the cost of the management time and attention they consume. Second,

11 federal funding may be cut for low-income assistance, community support

12 and "green" innovation, so Staff proposes that community and low-income

13 support currently provided by NW Natural should not drop from its highest

14 levels in the past five years.

15 Staff also proposes conditions related to ensuring that service quality is

16 maintained. Frequently, the Commission has required service quality

17 measures to maintain or improve the current quality and/or prevent reduced

18 service quality as a result of a merger. The measure can include service

19 quality measures, other customer guarantees, commitment to continued

20 assistance to low-income customers, or public purpose funding.⁷⁸

⁷⁸ In the Enron-PGE merger, Enron committed to various public purposes, including development of renewable resources, continued mitigation of the fish and wildlife impacts of PGE's hydroelectric facilities, the filing of a systems benefit charge, and charitable donations for low-income bill assistance. See Order No. 97-196 (condition 18).

1 Staff's conditions support continued safe and reliable utility services in
2 Oregon by requiring that NW Natural not diminish delivery of safe and reliable
3 service in Oregon. NW Natural must continue to fully comply with CFR Title
4 49 Parts 190 to 199 and remains subject to the same exacting safety and
5 reliability standards as now enforced.⁷⁹

6 **5. Cost Savings**

7 **Q. Please explain the Company's proposed cost savings conditions.**

8 A. The Company proposed none. In the Company's filing, they note that with
9 the formation of HoldCo and growth activities through acquiring other
10 businesses, NW Natural may have reduced allocations that will benefit
11 customers. One concern that Staff has, besides the lack of any Company
12 commitment to timely pass through cost savings, is that customers will not
13 see those benefits in full until the Company incorporates the cost savings into
14 rates through a general rate filing. Even then, the cost savings could be
15 estimates.

16 **Q. Please explain the rationale for Staff's modifications and additions**
17 **regarding credits to customers and cost savings relating to future**
18 **HoldCo M&As.**

⁷⁹ Staff's conditions in the area of safety and service quality are minimal. In merger cases, the Commission often imposes significant service quality measures. For example, in the Enron-PGE merger, to ensure a continued PGE commitment to safety and reliability, the Commission adopted a condition requiring a service quality program under which PGE was subject to revenue requirement reductions if it did not meet certain performance targets established annually. See Order No. 97-196 (condition 11).

1 A. This is a category created by Staff to capture the cost savings and efficiencies
2 that should be achieved with NW Natural Board and management time being
3 redirected to HoldCo issues, and the assumption of investor relations by
4 HoldCo. Said another way, the full cost for current management time is
5 embedded in customers rates until the Company's next general rate case,
6 thus a credit should be deferred for customers.⁸⁰ Staff proposes Condition 48
7 that includes a minimum level of cost savings to be passed through to
8 customers equal to \$500,000 per year beginning in 2018. Staff recommends
9 this condition be applicable until NW Natural has rates effective from a
10 second general rate case (subsequent to a Commission decision in this
11 docket) because the timing of acquisitions in relation to general rate filings is
12 undetermined and Staff believes that the period between NW Natural's next
13 general rate case and the second following general rate case would give a
14 better sample of the amount of director and management time re-allocated to
15 HoldCo. In other words, the \$500,000 credit would be increased or
16 decreased in the second general rate case to more accurately reflect the time
17 re-allocated to HoldCo, and then Condition 48 would terminate.

18 Staff also proposes Condition 49 to capture cost savings and economies
19 of scale as more work is done at HoldCo level and the corporate family grows
20 with HoldCo M&As. For example, should HoldCo acquire several utilities,
21 cost savings from economies of scale or other savings must be passed

⁸⁰ The Company has been tracking, but not deferring, all costs associated with the application to form a holding company. See Exhibit Staff/105 (Company Response to Staff DR No. 57).

1 through to NW Natural customers. Staff recommends this condition be
2 applicable until NW Natural has rates effective from a second general rate
3 case subsequent to Commission approval in this docket. After that point, the
4 condition would terminate and any savings would be addressed through cost
5 allocation manuals and in subsequent rate cases.

6 **Q. The conditions Staff proposes in this case appear *less voluminous***
7 **than the ring-fencing provisions in MEHC's purchase of PacifiCorp; is**
8 **this reasonable?**

9 A. Yes. In the MEHC-PacifiCorp case, the Commission adopted 53 multi-part
10 commitments applicable to all states including Oregon, and 34 multi-part
11 Oregon-specific conditions, for a total of 87 commitments by the acquiring
12 company. Staff's conditions are more streamlined and less burdensome on
13 NW Natural that was the case in MEHC's purchase of PacifiCorp. NW
14 Natural should have no trouble meeting Staff's proposed conditions absent
15 departure from current company practices.

16 **Q. Why are Staff's conditions more appropriate to the facts and**
17 **circumstances of NW Natural forming a HoldCo to those proposed by**
18 **NW Natural?**

19 A. Staff's conditions are more consistent with past Commission practice,
20 including the wording of such conditions. In addition, Staff's proposed
21 conditions recognize that substantial value is stored in NW Natural's current
22 credit ratings. Staff's conditions better fit the context of this specific

1 application than do the Company's. Further, Staff's conditions address the
2 risks posed by the holding company structure by:

- 3 • Preserving NW Natural's exceptional credit ratings and common
4 equity portion of its capital structure at levels supported by historical
5 data and future projections;
- 6 • Preventing HoldCo from drawing dividends or like payments
7 (special, one-time, or otherwise) from NW Natural if any of three
8 circumstances are present that would compromise the utility;
- 9 • Protecting NW Natural from being affected by a HoldCo or
10 subsidiary bankruptcy through the use of a golden share held by an
11 independent director, separation through a SPE, and a non-
12 consolidation opinion;
- 13 • Allowing for ready Commission access to records, information, and
14 people of HoldCo, Affiliates, and NW Natural that may lead to
15 relevant evidence; and
- 16 • Providing a deferred credit to customers of at least \$500,000
17 annually, as well as other deferred cost savings and tax benefits for
18 ratepayers.

19 Staff's conditions also provide benefits in the form of access to affiliate
20 information not currently available to the Commission, establishing an equity
21 floor of 46 percent and credit ratings no less than one notch below A+,
22 providing a \$500,000 credit (possibly increasing) to customers and future
23 credits that capture cost savings and tax benefits, and ensuring that
24 community commitments remain at current levels.

25 **Q. Do prior Commission orders support the ring-fencing provisions**
26 **proposed by Staff?**

27 A. Yes. Staff's recommendation is grounded upon common and ordinary
28 conditions that have been approved by the Commission in past ORS 757.511

1 docket. Please see Staff Exhibit/104 for Staff's conditions, including a
2 comparison to NW Natural's, with references to conditions from past dockets.

3 Staff's proposed conditions must be sufficiently robust to work effectively
4 to shield the regulated utility and ratepayers from a broad set of potential
5 future circumstances, as opposed to one single merger application. Despite
6 lacking much of the traditional information provided in ORS 757.511 dockets,
7 Staff has designed a ring-fencing framework that is intended to be functional
8 and effective through a broad spectrum of market conditions and ongoing
9 merger targets post HoldCo-approval.

10 V. CONCLUSION

11 Q. What is Staff's conclusion regarding NW Natural's application to 12 reorganize into a holding company structure?

13 A. NW Natural's request to form a holding company seeks authorization to
14 engage in persistent future mergers and acquisitions absent Commission
15 oversight. As currently filed, NW Natural's proposal offers insufficient benefits
16 to offset substantial new risks to ratepayers. Approval under Oregon law is
17 predicated upon NW Natural meeting its burden of demonstrating net benefits
18 to its ratepayers and no harm to Oregonians as a whole. Therefore, NW
19 Natural's application cannot be approved as filed. Moreover, Staff
20 emphasizes that the comparator in this case is a thriving NW Natural, where
21 customers are served by dedicated management and exceptionally low-cost
22 access to capital.

1 Without dynamic ring-fencing conditions, NW Natural customers are not
2 protected from the inherent risks associated with HoldCo acquisitions. Staff
3 has proposed customary ring-fencing remedies to shield ratepayers and help
4 ensure that reliable utility service is provided at continued just and reasonable
5 rates. Further, Staff's conditions provide clarity of expectations and capture
6 credits and cost savings for customers, resulting in a net benefit to NW
7 Natural ratepayers.

8 **Q. What is your final recommendation for the Commission in this**
9 **matter?**

10 A. Staff recommends the Commission issue an order approving NW Natural's
11 application to form a holding company, subject to the adoption of Staff's
12 proposed ring-fencing conditions.

13 **Q. Does this conclude your testimony?**

14 A. Yes.

CASE: UM 1804
WITNESS: MATT MULDOON

**PUBLIC UTILITY COMMISSION
OF
OREGON**

STAFF EXHIBIT 101

Witness Qualifications Statement

June 14, 2017

WITNESS QUALIFICATION STATEMENT

NAME: Matthew (Matt) J. Muldoon

EMPLOYER: Public Utility Commission of Oregon

TITLE: Senior Economist
Energy – Rates Finance and Audit Division

ADDRESS: 201 High Street SE, Suite 100
Salem, OR 97301

EDUCATION: In 1981, I received a Bachelor of Arts Degree in Political Science from the University of Chicago. In 2007, I received a Masters of Business Administration from Portland State University with a certificate in Finance.

EXPERIENCE: From April of 2008 to the present, I have been employed by the OPUC. My current responsibilities include financial and rate analysis with an emphasis on Cost of Capital. I have worked on Cost of Capital in the following general rate case dockets: AVA UG 186; UG 201, UG 246, UG 284, UG 288, and UG 325 current; NWN UG 221; PAC UE 246, and UE 263; PGE UE 262, UE 283, and UE 294; and CNG UG 287 and UG 305..

From 2002 to 2008 I was Executive Director of the Acceleration Transportation Rate Bureau, Inc. where I developed new rate structures for surface transportation and created metrics to insure program success within regulated processes.

I was the Vice President of Operations for Willamette Traffic Bureau, Inc. from 1993 to 2002. There I managed tariff rate compilation and analysis. I also developed new information systems and did sensitivity analysis for rate modeling.

OTHER: I have prepared, and defended formal testimony in contested hearings before the OPUC, ICC, STB, WUTC and ODOT. I have also prepared OPUC Staff testimony in BPA rate cases.

CASE: UM 1804
WITNESS: MATT MULDOON

**PUBLIC UTILITY COMMISSION
OF
OREGON**

STAFF EXHIBIT 102

**Exhibits in Support
Of Reply Testimony**

June 14, 2017

Staff Exhibit 102 is Highly Confidential and

Is subject to Modified Protective Order No.17-135

CASE: UM 1804
WITNESS: MATT MULDOON

**PUBLIC UTILITY COMMISSION
OF
OREGON**

STAFF EXHIBIT 103

**Exhibits in Support
Of Reply Testimony**

June 14, 2017

Docket No. UM 1804
Staff's Proposed Ring-Fencing Conditions

DEFINITIONS

Affiliate shall refer to any component company of the family of companies owned or invested in by Parent.

Beneficial Ownership shall mean control of five (5) percent or more of the Common Equity of a company or corporation.

Capital Structure shall mean proportions of Common Equity and LT Debt (with maturities exceeding 1 year) adding up to 100 percent for a named (or place-holder) corporation, wherein Common Equity does not include "Goodwill" and equity associated with non-regulated assets. In Oregon, LT Debt does not include imputed debt or debt-like lease obligations.

Commission means the Public Utility Commission of Oregon.

Credit Ratings shall mean both Standard and Poor's (S&P) and Moody's Corporate and Long-Term (LT) Debt credit ratings.

Golden Share shall mean the sole (\$1 Par) share of Preferred Stock authorized by the Commission. This share of Preferred Stock must be in the custody of an independent director(s) at the NWN-U-level. In matters of dividends and like distributions, and of bankruptcy, this share will override all other outstanding shares of all types or all classes of stock.

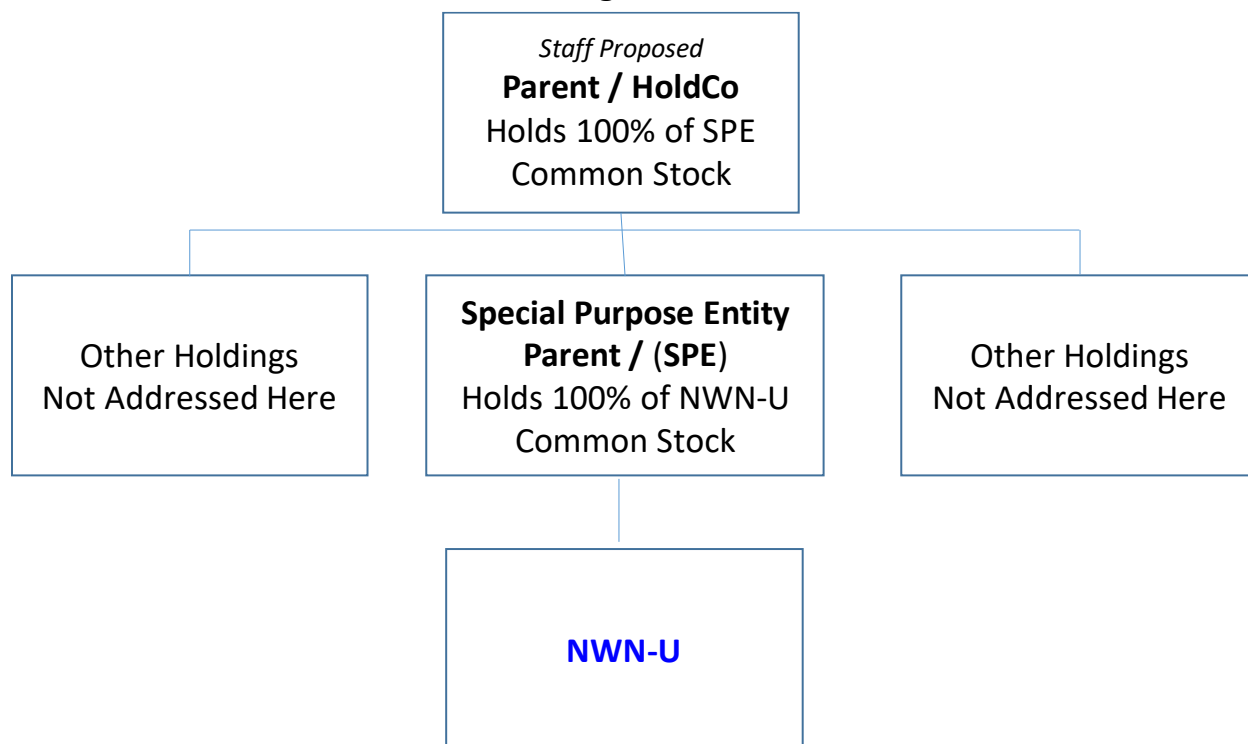
NWN-U shall refer to NW Natural, the regulated utility company.

Parent shall include any parent company or corporation whether privately held or publicly traded, any holding company (HoldCo) holding NWN-U common stock, and any intermediate corporation between the top level corporation and NWN-U.

Rating Agencies shall mean S&P's and Moody's.

SUMMARY

Staff conditions its recommendation to approve NW Natural's request to reorganize into a holding company structure (HoldCo) on adoption of Staff's ring-fencing conditions listed below. Additionally, Staff proposes that a Special Purpose Entity (SPE) be inserted between NWN-U and HoldCo. The SPE would hold 100 percent of NWN-U's common stock. All of the SPE's common stock would be held by the Parent (as defined above) or by an intermediate holding company. This structure keeps the regulated utility operations of NWN-U clearly separated from Parent investment activity.

Figure-1

Staff's proposed conditions are common and ordinary to ORS 757.511 merger/holding company proceedings before this Commission. They are intended to preserve the current financial integrity of NWN-U by restricting dividend issuance and Board of Director (BOD) actions that facilitate parental extra-organic growth by impairing NWN-U's financial security and performance. Staff's proposed conditions also attempt to ensure that NWN-U does not bear costs unrelated to the provision of natural gas service and NWN-U management remains focused on its obligation to provide safe and reliable service to its utility customers. The fifteen conditions proposed by NWN-U in its application are included below in *[bracketed italics]* for comparison and convenience.

CONDITIONS/COMMITMENTS

GENERAL

1. NWN-U and Parent agree that these conditions may be modified as a result of regulatory decisions or settlements in other states. For example, the Commission may add any condition imposed by the Washington Utilities and Transportation Commission (WUTC), the California Public Utilities Commission (CUPC), or any other regulator, with respect to the proposed reorganization.
2. NWN-U and Parent will enter into an agreement that incorporates the ring-fencing provisions set forth herein. This agreement will be binding on NWN-U and Parent (and HoldCo and SPE if different from Parent), and their respective Boards of

Directors. This agreement will be filed with the Commission within 90 days of the transaction's closing. NWN-U and Parent commit that they will comply with Commission-approved ring-fencing conditions and will make no amendments, revisions, or modifications to this agreement or any ring-fencing provisions without prior Commission approval.

3. Staff accepts NW Natural's proposed condition 4 without modification: Nothing in these Reorganization commitments will be interpreted as a waiver of NW Natural's or HoldCo's rights to request confidential treatment for information that is the subject of any of these commitments.

FINANCIAL PROTECTIONS

Credit and Capital Structure

4. The Parent and NWN-U will maintain separate corporate credit and Long-Term (LT) Debt and preferred stock (if any) ratings, and make these credit ratings available to the Commission and Staff upon request. NWN-U will also maintain adequate: (a) interest coverage and (b) pool of qualified NWN-U assets to maintain the ability to issue First Mortgage Bonds (FMB). Parent agrees to take any necessary action to ensure that NWN-U's Credit ratings do not drop more than two notches from prevailing April 1, 2017, S&P and Moody's credit ratings.
5. NWN-U Common Equity must be maintained at a level no less than 46 percent of total NWN-U Capital Structure.
6. NWN-U Cost of Capital including each of: Rate of Return (ROR), Common Equity, and LT Debt may not be more costly after the restructuring than they would be had NWN-U not reorganized. NWN-U bears the burden of showing that: (a) any increase in NWN-U's Cost of LT Debt for which rate recovery is sought did not result from factors associated with either the reorganization or any subsequent HoldCo or Parent M&As, or (b) that the increase has been eliminated by positive changes (from a ratepayer perspective) in other Cost of Capital elements.
7. Customers of NWN-U will be held harmless from adverse rate impacts due to any increase in the Parent's or NWN-U's cost of LT Debt that is caused by the reorganization.
8. Parent and NWN-U guarantee that NWN-U customers shall be held harmless if the reorganization results in a higher revenue requirement for NWN-U than if the reorganization had not occurred.

9. Parent and NWN-U commit that neither NWN-U nor NWN-U's subsidiaries will, without the approval of the Commission:
 - A. Make loans or transfer funds (other than dividends and payments pursuant to the MSA) to Parent or Affiliates;
 - B. Assume any obligation or liability as guarantor, endorser, surety, or otherwise for Parent or Affiliates;
 - C. Transfer any of its utility assets or property to Parent or Affiliates;
 - D. Seek to pledge utility assets or securities backing for any hedging, indebtedness, or securities of Parent or Affiliates;
 - E. Enter into cross-default provisions involving Parent or Affiliates; and
 - F. Refrain from participating in a money pool.

Dividends

10. No dividends or like payments or distribution (special, one-time, or otherwise) may be drawn from NWN-U if any of the following conditions are present:
 - A. NWN-U Common Equity would fall below 46 percent of NWN-U Capital Structure;
 - B. Either S&P or Moody's finds such payment to be credit-negative for NWN-U; or
 - C. Either S&P or Moody's LT local unsecured corporate credit ratings drop more than one notch below A+.
11. NWN-U must notify the Commission no less than 7 calendar days before dividending¹ or otherwise transferring 5 percent or more of its retained earnings.
12. SPE will notify Commission within 30 days prior to SPE issuing debt² and Commission may amend this order to strengthen ring-fencing measures at that time.

Bankruptcy Protection

13. In order for NWN-U's proposed restructuring to proceed, within 60 days of the formation of HoldCo, NW Natural will provide a non-consolidation opinion to the Commission which concludes that the ring-fencing provisions (final conditions

¹ Dividing could be labeled as dividend, distribution, cash payment, etc.

² The SPE should not be issuing its own debt. Issuance of debt by the SPE would indicate inadequate ring-fencing. In such an event, the Commission reserves the right to amend ring-fencing conditions to preclude this activity.

adopted by the Commission) are sufficient such that a bankruptcy court would not order the substantive consolidation of the assets and liabilities of NWN-U with those of HoldCo, its affiliates or subsidiaries; in other words, approval of the reorganization is contingent upon timely filing of said non-consolidation opinion.

14. NWN-U will become a wholly-owned subsidiary of a Special Purpose Entity (SPE) established for the purpose of ring-fencing NWN-U, with the intention of removing NWN-U from the bankruptcy estate of Parent and its affiliates.
15. A voluntary petition for bankruptcy by NWN-U would require the affirmative consent of the holder of the "Golden Share," the unanimous vote of the SPE BOD, and the unanimous vote of the NWN-U BOD, where both SPE and NWN-U BOD votes are inclusive of the vote of at least one independent director.
16. SPE subsidiaries, NWN-U and NWN-U's two subsidiaries (NW Energy Corp. and NWN Gas Reserves), will not hold Parent investments without prior Commission approval.

ACCOUNTING & COST ALLOCATION

Accounting Generally

17. NWN-U will maintain its own NWN-U accounting system (accounts and subaccounts, books, computers, data, documents, software, and audit trails with supporting records) separate from Parent's accounting system, with such accounting information and financial books and records kept at NWN-U headquarters in Oregon. NWN-U's financial books and records and state and federal regulatory filings and documents will continue to be available to the Commission, upon request, at NWN-U's headquarters in Oregon.
18. NWN-U assets, cash flows, and financial accounts may not be co-mingled with existing affiliates, or with any new affiliates or operations resulting after the creation of HoldCo.
19. NWN-U will maintain separate financial statements and filings with the U.S. Securities and Exchange Commission (SEC).

HoldCo Formation Costs

20. No organizational, start-up, or other costs associated with the creation of HoldCo will be appear on NWN-U accounts or be allocated to NWN-U customers. NWN-U shall furnish the Commission with journal entries and supporting detail showing the nature and cost of all organizational, start-up, and other costs for HoldCo (including

but not limited to management time, BOD time, in-house and outside counsel time, any consultants engaged, etc.) since the reorganization was first contemplated, as well as the accounts charged, within 90 days of a Commission order in this docket.

21. NWN-U will exclude from NWN-U general rate cases, or any other method of cost recovery, all costs related to reorganization and all of HoldCo's costs related to future business endeavors and M&As including but not limited to all legal work from in-house counsel and outside counsel; NWN-U BOD time; costs related to M&A consulting and advice; preparation of and materials for HoldCo-related presentations; and other reorganization and expansion costs.
22. Taxes and assessments paid to the federal government, to states, and to political subdivisions thereof shall be no greater than they would be had the Company not restructured. Tax benefits that would not exist had the Company not restructured may be addressed in proceedings before the Commission; however, until that time, NWN-U shall set up a tracking mechanism to account for income tax expense and potential benefits for NWN-U.

Allocations between NWN-U and HoldCo

23. The Commission may audit the accounting records of Parent and Affiliates that are the bases for charges to NWN-U, to determine the reasonableness of the costs and the allocation factors used by the Parent or its subdivisions to assign costs to NWN-U and amounts subject to allocation or direct charges. Parent, Affiliates and SPE will cooperate fully with such Commission audits.
24. Parent and NWN-U will maintain robust systems to track employee, officer, director, agent, and attorney time, identifying within an hour, time not spent for NWN-U utility purposes that shall not be allocated to NWN-U.
25. NWN-U bears the burden of showing that a particular expense may be allocated to NWN-U ratepayers.

Prevention of Cross-Subsidization

26. Parent and NWN-U will comply with all applicable Commission statutes and regulations regarding affiliated interest transactions, including timely filing of applications and reports.
27. NWN-U will file on an annual basis an affiliated interest report including an organizational chart, narrative description of each Affiliate, revenue for each Affiliate and transactions with each Affiliate.

28. NWN-U will not cross-subsidize between the regulated and non-regulated businesses or between any regulated businesses, and shall comply with the Commission's applicable orders and rules with respect to such matters.
29. Any allocation of costs, corporate and Affiliate investments, expenses, or overheads between NWN-U and Parent or an affiliate will comply with the following principles:
- A. Cost allocations to NWN-U will be directly charged whenever possible, and shared or indirect costs will be allocated based upon primary, demonstrable, and transparent cost-driving factors.
 - B. Parent and all subsidiaries and affiliates will maintain accounting systems adequate to support the allocation and assignment of costs of executives and other relevant personnel to or from NWN-U. See Condition 24 above for further detail.
 - C. All costs subject to allocation will be auditable and flagged by origin, so as to be specifically identified, tracked, and trended. Failure to adequately support any allocated cost may result in denial of its recovery in rates.
 - D. Any corporate cost allocation methodology used for rate setting, and subsequent changes thereto, will be submitted to the Commission for approval.
 - E. The Company's Master Services Agreement (MSA), itemizing and explaining corporate cost allocation methods used for rate setting, will be updated to include the corporate and affiliate cost allocation methodologies between Parent, HoldCo, NWN-U, and Affiliates and filed with the Commission no later than 90 days after execution of the reorganization. Thereafter, the MSA will be appended to the annual June affiliated interest report filed with the Commission. This annual filing will capture, highlight and explain all changes from the prior year. The entirety of the MSA and its components are subject to review by Staff in subsequent proceedings before the Commission to confirm that cost drivers, accounting methods, assumptions, and practices result in fair, just and reasonable utility rates. The Company will update, and re-file for approval, the MSA and AI Reporting reflecting HoldCo organizational detail and the outcome of docket no. UM 1804.³

³ On June 1, 2017, NW Natural filed its Updated Master Service Agreement (MSA) with the Commission, docketed UI 385. Staff Condition 30 requires that the MSA be updated and refiled with the Commission for approval subsequent to a Commission order in this docket.

- F. Costs which could have been denied recovery in rates had they been incurred by NWN-U will likewise be denied recovery whether they are allocated directly or indirectly through subsidiaries of Parent (or HoldCo).
 - G. Parent, SPE, and NWN-U commit to using asymmetrical pricing as required by OAR 860-027-0048(4).
 - H. NWN-U will file timely applications and reports in compliance with ORS 757.015 through 757.495 and OAR 860-027-0040 through 860-027-0042.
30. Parent and NWN-U commit that they will interpret ORS 757.015 and 757.495 to require Commission approval of any contract between NWN-U and (1) any affiliate of HoldCo or (2) any affiliate of Parent. This shall include the MSA discussed in Condition 29.

ACCESS TO RECORDS & INFORMATION

31. Parent, NWN-U, and all Affiliates shall provide the Commission access to:
- A. All books of account, budgets, integrated resource planning, documents, data, records, accounting, and financial information which pertain to transactions between Parent, NWN-U, and Affiliates.
 - B. Unrestricted access to the written information inclusive of accounting and financial metrics that the Parent or any subdivision thereof provide to the Rating Agencies.
 - C. Parent and NWN-U Board of Director (BOD) meeting minutes and presentations for BOD meetings, committees and subcommittees thereof, as well as investor presentations and transcripts.

Parent, NWN-U, and Affiliates will not contest Commission access to books and records that may lead to relevant information for Oregon regulatory purposes. In other words, the “relevancy” of discovery is not pre-determined by Parent, NWN-U, and/or Affiliates.

32. Parent and NWN-U shall provide the Commission with complete and unrestricted access to all information provided by and to common stock, bond, or bond rating analysts, which directly or indirectly pertains to NWN-U or any Affiliate that exercises influence or control over NWN-U. Such information includes, but is not limited to, opinions, reports and presentations made to or provided by common stock analysts and bond rating analysts.

33. Parent, NWN-U, and Affiliates will make their employees, officers, directors and agents available to testify before the Commission at the Commission's request.
34. Pursuant to OAR 860-027-0175(2), Parent agrees to report all Beneficial Ownership as of the last calendar day of each year to the Commission to be received by March 31 of each year. All beneficial owners must stand ready to appear before the Commission to explain their holding, whether passive or otherwise, upon Commission request.
35. For the first five calendar years after reorganization, as part of its affiliated interest filings, Parent and NWN-U will report on how the company complied with each of the conditions listed herein no later than June 15th of each year. This report will require an officer attestation of compliance with the conditions. If any of the conditions are not being met, the report shall include proposed corrective measures relative to the specific condition, subject to Commission revision and penalty. Annual affiliated interest reports will enduringly contain a complete Parental-view corporate organizational chart and a second listing of contact telephone number, email, and titles for Parent (HoldCo), SPE, and NWN-U corporate officers.
36. Annual affiliated interest reports must itemize all Parent M&A and divestiture activity. The Parent will also notify the Commission within 30-days whenever it completes a merger, acquisition, or divestiture with capitalization in excess of \$1 million.
37. On or before December 31 of each year, Parent shall make available to the Commission a final copy of its annual budget(s) for the succeeding year.
38. NW Natural shall notify the Commission of:
 - A. Its intention to transfer more than five (5) percent of its retained earnings out of NWN-U over a six-month period;
 - B. Its intention to declare a special cash dividend payment at least 30 days before declaring the dividend;
 - C. Its most recent quarterly cash dividend payment 30 days after declaring each dividend.

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REORGANIZATION CONTINUITY**Service Quality**

39. Parent and NWN-U will maintain safety standards and policies substantially comparable to or better than the NWN-U currently maintained standards and policies. Neither HoldCo formation nor future acquisitions may diminish delivery of safe and reliable utility service in Oregon. NWN-U will continue to fully comply with CFR Title 49 Parts 190 to 199.

Miscellaneous

40. Both Parent and NWN-U commit that their corporate headquarters will remain in Oregon.
41. Legal disputes pertaining to Parent (HoldCo), SPE, and NWN-U shall be resolved in Oregon.
42. NWN-U shall maintain its current pension funding policy, until informed by a Commission Order regarding revised best practices. Thereafter, NWN-U will look to Commission accounting orders for further guidance.
43. For each calendar year 2018 through 2022 inclusive, Parent and NWN-U commit to maintain a minimum of the highest annual contribution level from 2012 through 2016 inclusive for Oregon low income bill payment assistance. The contributions may be comprised of contributions from corporate, employee, other sources, and customer donations. The corporate contribution will be recorded in non-utility accounts. Before the end of the five-year period, Parent and NWN-U commit to working with low-income advocates and customer groups to evaluate additional contributions.
44. NWN-U, and Parent where applicable, will honor all existing collective bargaining agreements for two years after the execution of the restructure. For that same period, employee's compensation and benefits packages will be at least as favorable in the aggregate as existing benefit packages.
45. In addition, NWN-U will maintain current support levels for two years after execution of the restructure for energy efficiency and renewable natural gas.
46. Within 60 days of the effective date of a Commission order approving HoldCo, NW Natural shall file with the Commission a complete copy of the minutes of the Board of Director's meeting at which the formation of HoldCo was approved.

47. If the Commission believes that NWN-U or Parent have violated any of the conditions listed herein, or any conditions included in the Commission's final order approving the application, the Commission shall give Parent and NWN-U written notice of the violation. If Parent or NWN-U is found to have committed a violation after Commission investigation (or a hearing if requested), the Commission will issue an order stating the penalty it shall seek.

**COST SAVINGS
(FROM HOLDCO AND FUTURE M&A)**

Credits to Customers

48. Until such time as rates in NWN-U's next general rate case are effective, a credit to customers in the amount of at least \$500,000 annually must be deferred for later return to customers. This credit is based upon the cost savings incurred from a shared Board of Directors and management with HoldCo. Following NW Natural's next general rate case, the Board of Director and management time, and other costs related to HoldCo, will be tracked until NW Natural's second general rate case following the Commission's order in this docket, at which time the amount removed from base rates will be adjusted to reflect more accurate tracking of time spent on HoldCo.
49. Cost savings achieved as a result of Parent's future Mergers and Acquisitions (M&A) or as a result of Parent-assumed shared functions (such as investor relations), however modest, will be deferred and later credited to customers until NW Natural's second general rate case following the Commission's order in this docket.

Future Mergers & Acquisitions

50. Parent and NWN-U agree to interpret ORS 757.480 to require Commission approval of any transaction which results in a merger or acquisition of NWN-U with any other company whether or not that company provides service in Oregon.
51. Approval of HoldCo formation does not relieve recipients of NWN-U stock from requirements of ORS 757.511. Parent or NWN-U will notify the Commission subsequent to a public announcement of any acquisition of any business that represents five percent or more of the Parent, SPE, or NWN-U capitalization or change in control of Parent, SPE, or NWN-U.
52. HoldCo or NWN-U will notify the Commission in writing subsequent to HoldCo's board approval and as soon as practicable following any public announcement of:

(1) any acquisition of any business that represents five percent or more of HoldCo's capitalization, or (2) change in effective control or acquisition of any material part of NWN-U by any means.

53. NWN-U will not ask for rate recovery in Oregon of future acquisition transaction costs or acquisition period incremental executive bonuses or otherwise allow these costs to affect Oregon customers by including them in any filings to the OPUC.
54. Parent and NWN-U will refrain from seeking recovery through NWN-U rates any acquisition premiums or goodwill associated with the reorganization or any subsequent M&A activity.
55. Within 90 days after HoldCo acquires or creates a new subsidiary entity, HoldCo shall file with the Commission a statement that provides the name of the subsidiary, the total value of its assets the nature of the subsidiary's business and whether it will do business with NW Natural.
56. NWN-U ratepayers will be held harmless for any currency exchange or related mitigation or hedging costs pertaining to activities beyond NWN-U utility operations.
57. Any diversified holdings and investments (i.e., non-utility businesses or foreign utilities) of Parent following approval of the transaction will not be held by NWN-U or a subsidiary of NWN-U. This condition will not prohibit Parent or its affiliates other than NWN-U from holding diversified businesses.

CASE: UM 1804
WITNESS: MATT MULDOON

**PUBLIC UTILITY COMMISSION
OF
OREGON**

STAFF EXHIBIT 104

**Exhibits in Support
Of Reply Testimony**

June 14, 2017

Docket No. UM 1804
Staff's Proposed Ring-Fencing Conditions
With NW Natural's Proposed Conditions and References to Past Dockets

DEFINITIONS

Affiliate shall refer to any component company of the family of companies owned or invested in by Parent.

Beneficial Ownership shall mean control of five (5) percent or more of the Common Equity of a company or corporation.

Capital Structure shall mean proportions of Common Equity and LT Debt (with maturities exceeding 1 year) adding up to 100 percent for a named (or place-holder) corporation, wherein Common Equity does not include "Goodwill" and equity associated with non-regulated assets. In Oregon, LT Debt does not include imputed debt or debt-like lease obligations.¹

Commission means the Public Utility Commission of Oregon.

Credit Ratings shall mean both Standard and Poor's (S&P) and Moody's Corporate and Long-Term (LT) Debt credit ratings.

Golden Share shall mean the sole (\$1 Par) share of Preferred Stock authorized by the Commission. This share of Preferred Stock must be in the custody of an independent director(s) at the NWN-U-level. In matters of dividends and like distributions, and of bankruptcy, this share will override all other outstanding shares of all types or all classes of stock.

NWN-U shall refer to NW Natural, the regulated utility company.

Parent shall include any parent company or corporation whether privately held or publicly traded, any holding company (HoldCo) holding NWN-U common stock, and any intermediate corporation between the top level corporation and NWN-U.

Rating Agencies shall mean S&P's and Moody's.

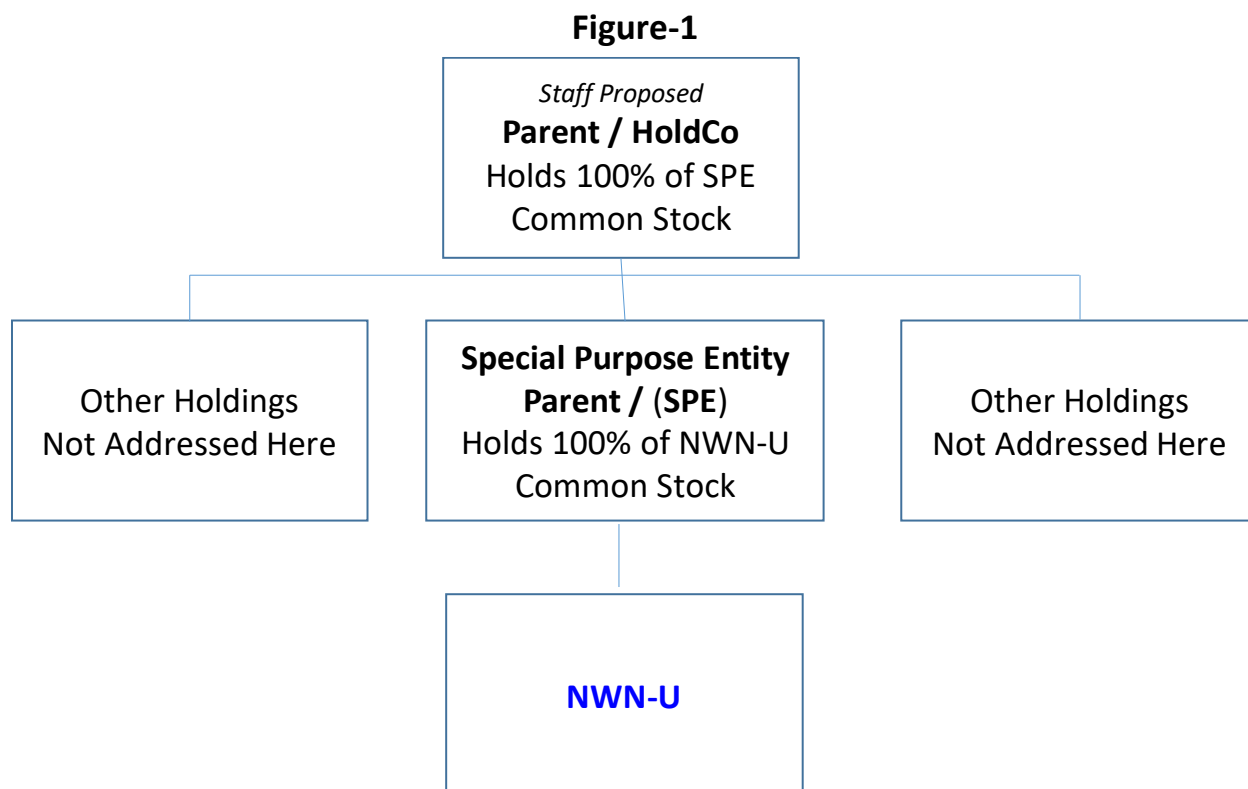
SUMMARY

Staff conditions its recommendation to approve NW Natural's request to reorganize into a holding company structure (HoldCo) on adoption of Staff's ring-fencing conditions listed below. Additionally, Staff proposes that a Special Purpose Entity (SPE) be inserted between NWN-U and HoldCo.² The SPE would hold 100 percent of NWN-U's common stock. All of the SPE's common stock would be held by the Parent (as defined

¹ See ORS 757.415(3).

² NWN-U did not include a SPE in its application.

above) or by an intermediate holding company. This structure keeps the regulated utility operations of NWN-U clearly separated from Parent investment activity.



Staff's proposed conditions are common and ordinary to ORS 757.511 merger/holding company proceedings before this Commission. They are intended to preserve the current financial integrity of NWN-U by restricting dividend issuance and Board of Director (BOD) actions that facilitate parental extra-organic growth by impairing NWN-U's financial security and performance. Staff's proposed conditions also attempt to ensure that NWN-U does not bear costs unrelated to the provision of natural gas service and NWN-U management remains focused on its obligation to provide safe and reliable service to its utility customers. The fifteen conditions proposed by NWN-U in its application are included below in *[bracketed italics]* for comparison and convenience.

CONDITIONS/COMMITMENTS

GENERAL

1. NWN-U and Parent agree that these conditions may be modified as a result of regulatory decisions or settlements in other states. For example, the Commission may add any condition imposed by the Washington Utilities and Transportation Commission (WUTC), the California Public Utilities Commission (CUPC), or any other regulator, with respect to the proposed reorganization.

*[NW Natural and HoldCo will enter into an agreement that incorporates the ring-fencing provisions set forth herein. This agreement will be binding on NW Natural and HoldCo, and their respective Boards of Directors. This agreement will be filed with the Commission within 90 days of the transaction's closing. NW Natural and HoldCo commit that no amendments, revisions, or modifications will be made to this agreement or any ring-fencing provisions without prior Commission approval.]*³

2. NWN-U and Parent will enter into an agreement that incorporates the ring-fencing provisions set forth herein. This agreement will be binding on NWN-U and Parent (and HoldCo and SPE if different from Parent), and their respective Boards of Directors. This agreement will be filed with the Commission within 90 days of the transaction's closing. NWN-U and Parent commit that they will comply with Commission-approved ring-fencing conditions and will make no amendments, revisions, or modifications to this agreement or any ring-fencing provisions without prior Commission approval.
3. Staff accepts NW Natural's proposed condition without modification: *[Nothing in these Reorganization commitments will be interpreted as a waiver of NW Natural's or HoldCo's rights to request confidential treatment for information that is the subject of any of these commitments.]*⁴

FINANCIAL PROTECTIONS

Credit and Capital Structure

*[NW Natural will maintain separate debt, and if outstanding, preferred stock ratings. NW Natural will maintain its own corporate credit rating, as well as ratings for each long-term debt (and preferred stock (if any)) issuance that would otherwise be rated.]*⁵

4. The Parent and NWN-U will maintain separate corporate credit and Long-Term (LT) Debt and preferred stock (if any) ratings, and make these credit ratings available to the Commission and Staff upon request. NWN-U will also maintain adequate: (a) interest coverage and (b) pool of qualified NWN-U assets to maintain the ability to issue First Mortgage Bonds (FMB). Parent agrees to take any necessary action to ensure that NWN-U's Credit ratings do not drop more than two notches from prevailing April 1, 2017, S&P and Moody's credit ratings.⁶

³ NW Natural Application for Approval of Corporate reorganization to Create a Holding Company (hereinafter NW Natural Application) at 11 (proposed commitment 14).

⁴ NW Natural Application at 9 (proposed commitment 4).

⁵ NW Natural Application at 11 (proposed commitment 9).

⁶ See MEHC/PAC, Order No. 06-121 (GC 15); Enron/PGE, Order No. 97-196 (condition 5).

5. NWN-U Common Equity must be maintained at a level no less than 46 percent of total NWN-U Capital Structure.
6. NWN-U Cost of Capital including each of: Rate of Return (ROR), Common Equity, and LT Debt may not be more costly after the restructuring than they would be had NWN-U not reorganized. NWN-U bears the burden of showing that: (a) any increase in NWN-U's Cost of LT Debt for which rate recovery is sought did not result from factors associated with either the reorganization or any subsequent HoldCo or Parent M&As, or (b) that the increase has been eliminated by positive changes (from a ratepayer perspective) in other Cost of Capital elements.⁷
7. Customers of NWN-U will be held harmless from adverse rate impacts due to any increase in the Parent's or NWN-U's cost of LT Debt that is caused by the reorganization.
8. Parent and NWN-U guarantee that NWN-U customers shall be held harmless if the reorganization results in a higher revenue requirement for NWN-U than if the reorganization had not occurred.⁸
9. Parent and NWN-U commit that neither NWN-U nor NWN-U's subsidiaries will, without the approval of the Commission:
 - A. Make loans or transfer funds (other than dividends and payments pursuant to the MSA) to Parent or Affiliates;
 - B. Assume any obligation or liability as guarantor, endorser, surety, or otherwise for Parent or Affiliates;
 - C. Transfer any of its utility assets or property to Parent or Affiliates;⁹
 - D. Seek to pledge utility assets or securities backing for any hedging, indebtedness, or securities of Parent or Affiliates;¹⁰
 - E. Enter into cross-default provisions involving Parent or Affiliates; and
 - F. Refrain from participating in a money pool.

⁷ Enron/PGE, Order No. 97-196 (condition 7: the allowed return on common equity and other costs of capital will not rise as a result of the merger. These capital costs refer to the costs of capital used for purposes of rate setting, avoided cost calculations, affiliated interest transactions, least cost planning, and other regulatory purposes.).

⁸ Enron/PGE, Order No. 97-196 (condition 10); see Order No. 97-196 at 7 where Commission states: "The Tenth condition of the Stipulation is common to merger orders. It is a guarantee that PGE's customers will be held harmless if the PGE and Enron merger results in a higher revenue requirement for PGE than if the merger had not occurred."

⁹ NW Natural Application at 11 (proposed commitment 10).

¹⁰ MEHC/PAC, Order No. 06-121 (GC 20).

Dividends

[NW Natural shall not be permitted to declare or make any distributions unless, on the date of such distribution, the NW Natural common equity ratio after giving effect to such distribution is not less than 40 percent of total NW Natural capital, except to the extent a lower equity ratio is established for ratemaking purposes by the Commission, or unless otherwise ordered by the Commission.]¹¹

[NW Natural and HoldCo commit that NW Natural will not make any dividends to HoldCo if NW Natural's secured debt rating falls below investment grade, or unless otherwise ordered by the Commission.]¹²

10. No dividends or like payments or distribution (special, one-time, or otherwise) may be drawn from NWN-U if any of the following conditions are present:
 - A. NWN-U Common Equity would fall below 46 percent of NWN-U Capital Structure;
 - B. Either S&P or Moody's finds such payment to be credit-negative for NWN-U; or
 - C. Either S&P or Moody's LT local unsecured corporate credit ratings drop more than one notch below A+.¹³
11. NWN-U must notify the Commission no less than 7 calendar days before dividending¹⁴ or otherwise transferring 5 percent or more of its retained earnings.
12. SPE will notify Commission within 30 days prior to SPE issuing debt¹⁵ and Commission may amend this order to strengthen ring-fencing measures at that time.

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¹¹ NW Natural Application at 11 (proposed commitment 10).

¹² NW Natural Application at 11 (proposed commitment 11).

¹³ MEHC/PAC, Order No. 06-121 (GC 18(a): PacifiCorp common equity not to fall below 48.25 percent through Dec. 31, 2008, and specific declining percentages thereafter.); Enron/PGE, Order No. 97-196 (condition 6: PGE shall not make any distribution to Enron that would cause PGE's equity capital to fall below 48 percent of the total PGE capital without Commission approval. The Commission Staff, PGE and Enron may re-examine this minimum common equity percentage as financial conditions change, and may request that it be adjusted.).

¹⁴ Dividing could be labeled as dividend, distribution, cash payment, etc.

¹⁵ The SPE should not be issuing its own debt. Issuance of debt by the SPE would indicate inadequate ring-fencing. In such an event, the Commission reserves the right to amend ring-fencing conditions to preclude this activity.

Bankruptcy Protection

[Within 60 days of the formation of HoldCo, NW Natural will provide a non-consolidation opinion to the Commission which concludes that the ring-fencing provisions and other provisions of the Reorganization are sufficient such that a bankruptcy court would not order the substantive consolidation of the assets and liabilities of NW Natural with those of HoldCo, its affiliates or subsidiaries. In the event that NW Natural is unable, for any reason, to obtain such an opinion, it will consult with parties to this docket and the Commission regarding this topic.]¹⁶

13. In order for NWN-U's proposed restructuring to proceed, within 60 days of the formation of HoldCo, NW Natural will provide a non-consolidation opinion to the Commission which concludes that the ring-fencing provisions (final conditions adopted by the Commission) are sufficient such that a bankruptcy court would not order the substantive consolidation of the assets and liabilities of NWN-U with those of HoldCo, its affiliates or subsidiaries; in other words, approval of the reorganization is contingent upon timely filing of said non-consolidation opinion.¹⁷
14. NWN-U will become a wholly-owned subsidiary of a Special Purpose Entity (SPE) established for the purpose of ring-fencing NWN-U, with the intention of removing NWN-U from the bankruptcy estate of Parent and its affiliates.
15. A voluntary petition for bankruptcy by NWN-U would require the affirmative consent of the holder of the "Golden Share," the unanimous vote of the SPE BOD, and the unanimous vote of the NWN-U BOD, where both SPE and NWN-U BOD votes are inclusive of the vote of at least one independent director.¹⁸

[The assets of NW Natural and HoldCo and its subsidiaries or affiliates will be accounted for separately].¹⁹

16. SPE subsidiaries, NWN-U and NWN-U's two subsidiaries (NW Energy Corp. and NWN Gas Reserves), will not hold Parent investments without prior Commission approval.²⁰

¹⁶ NW Natural Application at 11-12 (proposed commitment 15).

¹⁷ See MEHC/PAC, Order No. 06-121 (O 17).

¹⁸ Enron/PGE involved the issuance of a \$1.00 Par Junior Preferred Stock and created an independent director; MEHC/PAC required an independent director.

¹⁹ NW Natural Application at 11 (proposed commitment 12).

²⁰ Avista/AVA, Staff/102, Morgan/8 (Staff proposed condition 26(b): no AVA holding shall be conveyed to Avista Utilities or a subsidiary of Avista Utilities without prior Commission approval).

ACCOUNTING & COST ALLOCATION**Accounting Generally**

[NW Natural will maintain its own books and records, separate from the books and records of HoldCo. NW Natural's financial books and records and state and federal regulatory filings and documents will continue to be available to the Commission, upon request.]²¹

17. NWN-U will maintain its own NWN-U accounting system (accounts and subaccounts, books, computers, data, documents, software, and audit trails with supporting records) separate from Parent's accounting system, with such accounting information and financial books and records kept at NWN-U headquarters in Oregon.²² NWN-U's financial books and records and state and federal regulatory filings and documents will continue to be available to the Commission, upon request, at NWN-U's headquarters in Oregon.²³
18. NWN-U assets, cash flows, and financial accounts may not be co-mingled with existing affiliates, or with any new affiliates or operations resulting after the creation of HoldCo.
19. NWN-U will maintain separate financial statements and filings with the U.S. Securities and Exchange Commission (SEC).

HoldCo Formation Costs

[No organizational and start-up costs associated with the creation of HoldCo will be allocated to NW Natural's customers.]²⁴

20. No organizational, start-up, or other costs associated with the creation of HoldCo will appear on NWN-U accounts or be allocated to NWN-U customers.²⁵ NWN-U shall furnish the Commission with journal entries and supporting detail showing the nature and cost of all organizational, start-up, and other costs for HoldCo (including but not limited to management time, BOD time, in-house and outside counsel time, any consultants engaged, etc.) since the reorganization was first

²¹ NW Natural Application at 10-11 (proposed commitment 8).

²² MEHC/PAC, Order No. 06-121 (GC 3).

²³ *Id.*

²⁴ NW Natural Application at 10 (proposed commitment 7).

²⁵ IPHC/IPC, Docket No. UM 877, Order No. 98-056 (condition 3).

contemplated, as well as the accounts charged, within 90 days of a Commission order in this docket.²⁶

21. NWN-U will exclude from NWN-U general rate cases, or any other method of cost recovery, all costs related to reorganization and all of HoldCo's costs related to future business endeavors and M&As including but not limited to all legal work from in-house counsel and outside counsel; NWN-U BOD time; costs related to M&A consulting and advice; preparation of and materials for HoldCo-related presentations; and other reorganization and expansion costs.²⁷
22. Taxes and assessments paid to the federal government, to states, and to political subdivisions thereof shall be no greater than they would be had the Company not restructured. Tax benefits that would not exist had the Company not restructured may be addressed in proceedings before the Commission; however, until that time, NWN-U shall set up a tracking mechanism to account for income tax expense and potential benefits for NWN-U.

Allocations between NWN-U and HoldCo

*[The Commission may audit the accounting records of HoldCo and its subsidiaries or affiliates that are the bases for charges to NW Natural to determine the reasonableness of allocation factors used by HoldCo to assign costs to NW Natural and amounts subject to allocation or direct charges. HoldCo will cooperate fully with such Commission audits.]*²⁸

23. The Commission may audit the accounting records of Parent and Affiliates that are the bases for charges to NWN-U, to determine the reasonableness of the costs and the allocation factors used by the Parent or its subdivisions to assign costs to NWN-U and amounts subject to allocation or direct charges. Parent, Affiliates and SPE will cooperate fully with such Commission audits.²⁹
24. Parent and NWN-U will maintain robust systems to track employee, officer, director, agent, and attorney time, identifying within an hour, time not spent for NWN-U utility purposes that shall not be allocated to NWN-U.³⁰

²⁶ IPHC/IPC, Order No. 98-056 (condition 3); see MEHC/PAC, Order No. 06-121 (GC 16).

²⁷ See IPHC/IPC, Order No. 98-056 (condition 4: "No future holding company costs shall be borne by IPC Oregon ratepayers, except those costs explicitly authorized by the Commission.")

²⁸ NW Natural Application at 10 (proposed commitment 6).

²⁹ MEHC/PAC, Order No. 06-121 (GC 6).

³⁰ See IPHC/IPC, Order No. 98-056, where the Commission adopted Staff's condition 2 requiring establishment of necessary time and expense reporting mechanisms to ensure IPHC costs are appropriated changed.

25. NWN-U bears the burden of showing that a particular expense may be allocated to NWN-U ratepayers.

Prevention of Cross-Subsidization

[NW Natural and HoldCo will comply with all applicable Commission statutes and regulations regarding affiliated interest transactions, including timely filing of applications and reports.]³¹

26. Parent and NWN-U will comply with all applicable Commission statutes and regulations regarding affiliated interest transactions, including timely filing of applications and reports.
27. NWN-U will file on an annual basis an affiliated interest report including an organizational chart, narrative description of each Affiliate, revenue for each Affiliate and transactions with each Affiliate.³²
28. NWN-U will not cross-subsidize between the regulated and non-regulated businesses or between any regulated businesses, and shall comply with the Commission's applicable orders and rules with respect to such matters.³³

[Any allocation of costs, corporate and affiliate investments, expenses, or overheads between NW Natural and HoldCo or an affiliate of Holdco will comply with the following principles:

- A. *For services rendered to NW Natural or each cost category subject to allocation to NW Natural by HoldCo or any of its affiliates, NW Natural must be able to demonstrate that such service or cost category is: i) necessary to NW Natural for the reasonable performance of its regulated operations, ii) is not duplicative of services already being performed within NW Natural, and iii) is reasonable and prudent.*
- B. *Cost allocations to NW Natural will be directly charged whenever possible, and shared or indirect costs will be allocated based upon the primary cost-driving factors.*
- C. *HoldCo and its subsidiaries will have in place an accounting system adequate to support the allocation and assignment of costs of executives and other relevant personnel to or from NW Natural.*

³¹ NW Natural Application at 11 (proposed commitment 13); MEHC/PAC, Order No. 06-121 (GC 7).

³² MEHC/PAC, Order No. 06-121 (GC 8).

³³ MEHC/PAC, Order No. 06-121 (GC 9).

- D. *All costs subject to allocation will be auditable, such that they can be specifically identified, particularly with respect to their origin.*
- E. *Any corporate cost allocation methodology used for rate setting, and subsequent changes thereto, will be submitted to the Commission for approval. The Company's Master Services Agreement will be updated to include the corporate and affiliate cost allocation methodologies between HoldCo, NW Natural and their affiliates. The Master Services Agreement will be filed with the Commission for review, no later than 90 days after close of the transaction. Approval of the Master Service Agreement will be requested, but approval for ratemaking purposes will not be requested in such filing. Amendments to the Master Service Agreement will also be filed with the Commission.*
- F. *NW Natural and HoldCo commit to using asymmetrical pricing as required by OAR 860-027-0048(4).³⁴*
29. Any allocation of costs, corporate and Affiliate investments, expenses, or overheads between NWN-U and Parent or an affiliate will comply with the following principles:
- A. Cost allocations to NWN-U will be directly charged whenever possible, and shared or indirect costs will be allocated based upon primary, demonstrable, and transparent cost-driving factors.³⁵
- B. Parent and all subsidiaries and affiliates will maintain accounting systems adequate to support the allocation and assignment of costs of executives and other relevant personnel to or from NWN-U.³⁶ See Condition 24 above for further detail.
- C. All costs subject to allocation will be auditable and flagged by origin, so as to be specifically identified, tracked, and trended. Failure to adequately support any allocated cost may result in denial of its recovery in rates.³⁷
- D. Any corporate cost allocation methodology used for rate setting, and subsequent changes thereto, will be submitted to the Commission for approval.³⁸
- E. The Company's Master Services Agreement (MSA), itemizing and explaining corporate cost allocation methods used for rate setting, will be updated to

³⁴ NW Natural Application at 9-10 (proposed commitment 5).

³⁵ MEHC/PAC, Order No. 06-121 (GC 14).

³⁶ MEHC/PAC, Order No. 06-121 (GC 14).

³⁷ See MEHC/PAC, Order No. 06-121 (GC 14).

³⁸ See MEHC/PAC, Order No. 06-121 (GC 14).

include the corporate and affiliate cost allocation methodologies between Parent, HoldCo, NWN-U, and Affiliates and filed with the Commission no later than 90 days after execution of the reorganization. Thereafter, the MSA will be appended to the annual June affiliated interest report filed with the Commission. This annual filing will capture, highlight and explain all changes from the prior year. The entirety of the MSA and its components are subject to review by Staff in subsequent proceedings before the Commission to confirm that cost drivers, accounting methods, assumptions, and practices result in fair, just and reasonable utility rates.³⁹ The Company will update, and re-file for approval, the MSA and AI Reporting reflecting HoldCo organizational detail and the outcome of docket no. UM 1804.⁴⁰

- F. Costs which could have been denied recovery in rates had they been incurred by NWN-U will likewise be denied recovery whether they are allocated directly or indirectly through subsidiaries of Parent (or HoldCo).⁴¹
 - G. Parent, SPE, and NWN-U commit to using asymmetrical pricing as required by OAR 860-027-0048(4).
 - H. NWN-U will file timely applications and reports in compliance with ORS 757.015 through 757.495 and OAR 860-027-0040 through 860-027-0042.
30. Parent and NWN-U commit that they will interpret ORS 757.015 and 757.495 to require Commission approval of any contract between NWN-U and (1) any affiliate of HoldCo or (2) any affiliate of Parent. This shall include the MSA discussed in Condition 29.⁴²

ACCESS TO RECORDS & INFORMATION

[NW Natural will provide the Commission with access to all books of account as well as all documents, data, and records of NW Natural, HoldCo, and its affiliated interests, which pertain to transactions between NW Natural and its affiliated interests or which are otherwise relevant to the business of NW Natural.]⁴³

³⁹ See MEHC/PAC, Order No. 06-121 (GC 13).

⁴⁰ On June 1, 2017, NW Natural filed its Updated Master Service Agreement (MSA) with the Commission, docketed UI 385. Staff Condition 30 requires that the MSA be updated and refiled with the Commission for approval subsequent to a Commission order in this docket.

⁴¹ MEHC/PAC, Order No. 06-121 (GC 14).

⁴² MEHC/PAC, Order No. 06-121 (O 3).

⁴³ NW Natural Application at 9 (proposed commitment 1).

*[NW Natural and HoldCo will provide the Commission access to corporate minutes, including Board of Director's minutes and all committee minutes with relevant information regarding NW Natural.]*⁴⁴

31. Parent, NWN-U, and all Affiliates shall provide the Commission access to:
- A. All books of account, budgets, integrated resource planning, documents, data, records, accounting, and financial information which pertain to transactions between Parent, NWN-U, and Affiliates.⁴⁵
 - B. Unrestricted access to the written information inclusive of accounting and financial metrics that the Parent or any subdivision thereof provide to the Rating Agencies.⁴⁶
 - C. Parent and NWN-U Board of Director (BOD) meeting minutes and presentations for BOD meetings, committees and subcommittees thereof, as well as investor presentations and transcripts.

Parent, NWN-U, and Affiliates will not contest Commission access to books and records that may lead to relevant information for Oregon regulatory purposes. In other words, the “relevancy” of discovery is not pre-determined by Parent, NWN-U, and/or Affiliates.

32. Parent and NWN-U shall provide the Commission with complete and unrestricted access to all information provided by and to common stock, bond, or bond rating analysts, which directly or indirectly pertains to NWN-U or any Affiliate that exercises influence or control over NWN-U. Such information includes, but is not limited to, opinions, reports and presentations made to or provided by common stock analysts and bond rating analysts.⁴⁷

⁴⁴ NW Natural Application at 9 (proposed commitment 3).

⁴⁵ Enron-PGE, Order No. 97-196 (Appendix A, Condition 2); Idaho Power Application, Docket No. UM 877, Order No. 98-056 (condition 1: no limitation as to “relevancy” of information: “(IPC) shall provide the Commission with access to all books of account as well as all documents, data and records of IPC, the holding company, IPHC and its non-regulated subsidiaries which involve transactions related to the application.”); MEHC/PAC, Docket No. 1209, Order No. 06-121, Appendix A at 16 (GC 4)(noting that this commitment is not only applicable to MECH, but to Berkshire Hathaway as well).

⁴⁶ See MEHC/PAC, Order No. (GC 4 and 17).

⁴⁷ Enron-PGE, Order No. 97-196 (Appendix A, Condition 8); see MEHC/PAC, Order No. 06-121 (GC 17).

*[NW Natural, HoldCo, and any Affiliates will make their employees, officers, directors and agents available to testify before the Commission to provide information relevant to matters within the jurisdiction of the Commission.]*⁴⁸

33. Parent, NWN-U, and Affiliates will make their employees, officers, directors and agents available to testify before the Commission at the Commission's request.
34. Pursuant to OAR 860-027-0175(2), Parent agrees to report all Beneficial Ownership as of the last calendar day of each year to the Commission to be received by March 31 of each year.⁴⁹ All beneficial owners must stand ready to appear before the Commission to explain their holding, whether passive or otherwise, upon Commission request.
35. For the first five calendar years after reorganization, as part of its affiliated interest filings, Parent and NWN-U will report on how the company complied with each of the conditions listed herein no later than June 15th of each year. This report will require an officer attestation of compliance with the conditions. If any of the conditions are not being met, the report shall include proposed corrective measures relative to the specific condition, subject to Commission revision and penalty. Annual affiliated interest reports will enduringly contain a complete Parental-view corporate organizational chart and a second listing of contact telephone number, email, and titles for Parent (HoldCo), SPE, and NWN-U corporate officers.⁵⁰
36. Annual affiliated interest reports must itemize all Parent M&A and divestiture activity. The Parent will also notify the Commission within 30-days whenever it completes a merger, acquisition, or divestiture with capitalization in excess of \$1 million.
37. On or before December 31 of each year, Parent shall make available to the Commission a final copy of its annual budget(s) for the succeeding year.⁵¹
38. NW Natural shall notify the Commission of:⁵²
 - A. Its intention to transfer more than five (5) percent of its retained earnings out of NWN-U over a six-month period;

⁴⁸ NW Natural Application at 9 (proposed commitment 2); MEHC/PAC, Order No. 06-121 (GC 5).

⁴⁹ This is a current NW Natural requirement, carried forward to the reorganized firm, mirroring PacifiCorp and Berkshire Hathaway filings with the Commission.

⁵⁰ See MEHC/PAC, Order No. 06-121 (GC 49).

⁵¹ IPHC/IPC, Docket No. UM 877, Order No. 98-056 (condition 5).

⁵² IPHC/IPC, Docket No. UM 877, Order No. 98-056 (condition 8).

- B. Its intention to declare a special cash dividend payment at least 30 days before declaring the dividend;
- C. Its most recent quarterly cash dividend payment 30 days after declaring each dividend.

REORGANIZATION CONTINUITY

Service Quality

- 39. Parent and NWN-U will maintain safety standards and policies substantially comparable to or better than the NWN-U currently maintained standards and policies. Neither HoldCo formation nor future acquisitions may diminish delivery of safe and reliable utility service in Oregon.⁵³ NWN-U will continue to fully comply with CFR Title 49 Parts 190 to 199.

Miscellaneous

- 40. Both Parent and NWN-U commit that their corporate headquarters will remain in Oregon.⁵⁴
- 41. Legal disputes pertaining to Parent (HoldCo), SPE, and NWN-U shall be resolved in Oregon.
- 42. NWN-U shall maintain its current pension funding policy, until informed by a Commission Order regarding revised best practices. Thereafter, NWN-U will look to Commission accounting orders for further guidance.⁵⁵
- 43. For each calendar year 2018 through 2022 inclusive, Parent and NWN-U commit to maintain a minimum of the highest annual contribution level from 2012 through 2016 inclusive for Oregon low income bill payment assistance. The contributions may be comprised of contributions from corporate, employee, other sources, and customer donations. The corporate contribution will be recorded in non-utility accounts. Before the end of the five-year period, Parent and NWN-U commit to working with low-income advocates and customer groups to evaluate additional contributions.⁵⁶

⁵³ See Enron/PGE, Order No. 97-197 (condition 11: re service quality measures).

⁵⁴ See MEHC/PAC, Order No. 06-121 (O 2(a)).

⁵⁵ MEHC/PAC, Order No. 06-121 (GC 50).

⁵⁶ MEHC/PAC, Order No. 06-121 (O 22).

44. NWN-U, and Parent where applicable, will honor all existing collective bargaining agreements for two years after the execution of the restructure. For that same period, employee's compensation and benefits packages will be at least as favorable in the aggregate as existing benefit packages.
45. In addition, NWN-U will maintain current support levels for two years after execution of the restructure for energy efficiency and renewable natural gas.
46. Within 60 days of the effective date of a Commission order approving HoldCo, NW Natural shall file with the Commission a complete copy of the minutes of the Board of Director's meeting at which the formation of HoldCo was approved.⁵⁷
47. If the Commission believes that NWN-U or Parent have violated any of the conditions listed herein, or any conditions included in the Commission's final order approving the application, the Commission shall give Parent and NWN-U written notice of the violation. If Parent or NWN-U is found to have committed a violation after Commission investigation (or a hearing if requested), the Commission will issue an order stating the penalty it shall seek.⁵⁸

COST SAVINGS (FROM HOLDCO AND FUTURE M&A)

Credits to Customers

48. Until such time as rates in NWN-U's next general rate case are effective, a credit to customers in the amount of at least \$500,000 annually must be deferred for later return to customers. This credit is based upon the cost savings incurred from a shared Board of Directors and management with HoldCo. Following NW Natural's next general rate case, the Board of Director and management time, and other costs related to HoldCo, will be tracked until NW Natural's second general rate case following the Commission's order in this docket, at which time the amount removed from base rates will be adjusted to reflect more accurate tracking of time spent on HoldCo.⁵⁹
49. Cost savings achieved as a result of Parent's future Mergers and Acquisitions (M&A) or as a result of Parent-assumed shared functions (such as investor

⁵⁷ See IPHC/IPC, Docket No. UM 877, Order No. 98-056 (condition 10).

⁵⁸ See MEHC/PAC, Order No. 06-121 (O 1(a)).

⁵⁹ A common condition is the offering of a rate credit to customers to show a net benefit or capital cost savings from the merger; See Enron/PGE Order No. 97-196 (condition 19: Enron and PGE guarantee, through a customer credit, merger-related cost of service reductions of \$9 million per year for four years, for a total of \$36 million credited to customers; Sierra/PGE Order No. 00-702 (condition 3: customers shall receive a monthly rate credit).

relations), however modest, will be deferred and later credited to customers until NW Natural's second general rate case following the Commission's order in this docket.

Future Mergers & Acquisitions

50. Parent and NWN-U agree to interpret ORS 757.480 to require Commission approval of any transaction which results in a merger or acquisition of NWN-U with any other company whether or not that company provides service in Oregon.⁶⁰
51. Approval of HoldCo formation does not relieve recipients of NWN-U stock from requirements of ORS 757.511. Parent or NWN-U will notify the Commission subsequent to a public announcement of any acquisition of any business that represents five percent or more of the Parent, SPE, or NWN-U capitalization or change in control of Parent, SPE, or NWN-U.
52. HoldCo or NWN-U will notify the Commission in writing subsequent to HoldCo's board approval and as soon as practicable following any public announcement of: (1) any acquisition of any business that represents five percent or more of HoldCo's capitalization, or (2) change in effective control or acquisition of any material part of NWN-U by any means.⁶¹
53. NWN-U will not ask for rate recovery in Oregon of future acquisition transaction costs or acquisition period incremental executive bonuses or otherwise allow these costs to affect Oregon customers by including them in any filings to the OPUC.
54. Parent and NWN-U will refrain from seeking recovery through NWN-U rates any acquisition premiums or goodwill associated with the reorganization or any subsequent M&A activity.⁶²
55. Within 90 days after HoldCo acquires or creates a new subsidiary entity, HoldCo shall file with the Commission a statement that provides the name of the subsidiary, the total value of its assets the nature of the subsidiary's business and whether it will do business with NW Natural.⁶³
56. NWN-U ratepayers will be held harmless for any currency exchange or related mitigation or hedging costs pertaining to activities beyond NWN-U utility operations.

⁶⁰ MEHC/PAC, Order No. 06-121 (O 4).

⁶¹ MEHC/PAC, Order No. 06-121 (GC 12).

⁶² See MEHC/PAC, Order No. 06-121 (O 13).

⁶³ PHC/IPC, Docket No. UM 877, Order No. 98-056 (condition 9).

57. Any diversified holdings and investments (i.e., non-utility businesses or foreign utilities) of Parent following approval of the transaction will not be held by NWN-U or a subsidiary of NWN-U. This condition will not prohibit Parent or its affiliates other than NWN-U from holding diversified businesses.⁶⁴

⁶⁴ MEHC/PAC, Order No. 06-121 (GC 11(a)); Avista/AVA, Staff/102, Morgan/8 (Staff proposed condition 26(a)).

CASE: UM 1804
WITNESS: MATT MULDOON

**PUBLIC UTILITY COMMISSION
OF
OREGON**

STAFF EXHIBIT 105

**Exhibits in Support
Of Reply Testimony**

June 14, 2017



Rates & Regulatory Affairs
UM 1804
Data Request Response

Request No. UM 1804-OPUC-DR 4:

What equity currently available to the utility will no longer be available to the utility because an affiliate is no longer a direct or indirect subsidiary of the utility in the proposed reorganization?

Response:

We assume this question is focused on equity of subsidiaries that is currently available to the utility portion (Utility) of NW Natural Gas Company (NW Natural), and that would not be available under the proposed reorganization. We would not expect there to be any change in the equity that is currently available to the Utility as compared to the equity that would be available under the proposed reorganization. We would expect the equity from NWN Gas Reserves LLC via Northwest Energy Corporation, which is currently available to the Utility would continue to be available to the Utility after the proposed reorganization. We would expect equity distributions from the remainder of NW Natural's current subsidiaries (Non-Utility Subsidiaries), which are currently available to NW Natural, but generally not the Utility, to remain unavailable to the Utility, except through possible re-contribution via the newly formed holding company.

NW Natural's Non-Utility Subsidiaries were formed with equity contributions through NW Natural's retained earnings (commonly referred to as shareholder dollars) and are not a Utility asset. When there is return on these investments through an equity distribution, it is returned to NW Natural's retained earnings (shareholder dollars) and not to the Utility. The Utility is not used to subsidize Non-Utility Subsidiaries, and the Utility is not subsidized by the Non-Utility Subsidiaries.



Rates & Regulatory Affairs
UM 1804
Data Request Response

Request No. UM 1804-OPUC-DR 7:

Please detail any tax impact of the reorganization. Provide a description of any records pertaining to any private letter rulings or any other communication that has been made to the Internal Revenue Service or any independent accounting firms that may related to the tax consequences of the proposed reorganization.

Response:

The formation of a new corporate parent entity (i.e., a holding company) is not anticipated to result in the creation of any tax benefits or tax liabilities that do not already exist. This includes consideration of income taxes, property taxes, sales taxes, and franchise taxes.

The reorganization itself is not anticipated to result in a taxable event, under either Oregon state law or the U.S. Internal Revenue Code. The Internal Revenue Service has previously recognized events of this nature as tax-free reorganizations.

There are currently no records pertaining to communications, private letter rulings, or similar, with the IRS or any independent accounting firm, related to the tax consequences of the proposed reorganization.



Rates & Regulatory Affairs
UM 1804
Data Request Response

Request No. UM 1804-OPUC-DR 9:

Please describe all forms of collateral that will support the financial integrity of each NW Natural subdivision either directly or indirectly.

Response:

Northwest Natural Gas Company, the corporate entity within which the utility operates, (NW Natural) does not operate in formal subdivisions. We expect the collateral that is available to support the financial integrity of NW Natural to be the same before and after the reorganization. The reorganization as proposed does not contemplate moving any assets out of NW Natural. For example, NW Natural's 1946 Mortgage, with respect to which most utility assets are collateral, would remain at NW Natural and continue to be collateralized by utility assets.

Please note Gill Ranch Storage, LLC, NW Natural Gas Storage, LLC, and other of our non-utility subsidiaries are not subdivisions. They are separate and distinct corporate entities.



Rates & Regulatory Affairs
UM 1804
Data Request Response

Request No. UM 1804-OPUC-DR 10:

At the holding company level, provide a table reflecting the various financial ratio limitations and/or parameters that were assumed or calculated by the rating agencies in providing any advisory opinions regarding the proposed reorganization.

Response:

NW Natural did not receive any advisory opinions regarding the proposed reorganization from any rating agency, and therefore, NW Natural is not in possession of the requested information.



Rates & Regulatory Affairs
UM 1804
Data Request Response

Request No. UM 1804-OPUC-DR 11:

What is the expected or potential impact on debt ratings for the utility company as a result of this reorganization? Please provide a narrative explanation supporting the expected impact.

Response:

Northwest Natural Gas Company, an Oregon corporation, and the corporate entity within which the utility sits (NW Natural) expects no material impact or change to NW Natural's debt ratings as a result of this reorganization. NW Natural's current debt ratings are primarily driven by NW Natural's utility operations' risk profile and on-going performance of the utility operations. The impact of NW Natural's non-utility activity currently has no material impact on NW Natural's current debt or corporate credit ratings, and is not expected to have any material impact on NW Natural's debt or corporate credit ratings after the reorganization as contemplated in our application. After the reorganization, NW Natural will continue to maintain a stand-alone credit profile separate and apart from its parent/holding company.



Rates & Regulatory Affairs
UM 1804
Application to Create a Holding Company
Data Request Response

Request No. UM 1804-OPUC-DR 13:

Please describe, in detail, how the reorganization will provide additional protection for ratepayers by 'ring fencing' utility operations from the non-regulated businesses. Has NW Natural received guidance from any debt-rating agency that supports the position that the reorganization will effectively reduce the risk of default for the prospective utility company's securities?

Response:

Several of the ring-fencing provisions proposed in the Application are commitments NW Natural will make to protect and benefit customers that are not currently required by law, rule, or OPUC Order. In this sense, these commitments provide additional protections for ratepayers. NW Natural discussed in more detail in the Application how these commitments are designed to protect and benefit customers.

NW Natural reserves its right to provide additional evidence in the record, as the breadth of this data request requires the Company to provide a narrative response and legal argument that may more appropriately be developed throughout the record in this docket, in response to positions taken by, or evidence provided by parties.

In response to the second part of this data request, NW Natural has not formally requested any advisory ratings for NW Natural or the Holding Company giving effect to the reorganization. We have had informal conversations regarding credit and debt ratings for NW Natural giving effect to the reorganization, and those discussions are reflected in our response to DR 11.



Rates & Regulatory Affairs
UM 1804
Application to Create a Holding Company
Data Request Response

Request No. UM 1804-OPUC-DR 23:

Please identify all of the services and functions currently carried out at NW Natural (e.g., shareholder services) that will now be carried out by Holdco. For each of these services, please identify:

- a. The costs NW Natural incurred in providing each of these services in calendar years 2012 through 2016 inclusive.
- b. The costs the Commission allowed NW Natural to include in rates in UG 221.
- c. The amount of each of such costs that would be allocated back to NW Natural and the basis/justification for such allocation.

Response:

We expect the holding company (Holdco) to be a non-operating holding company. As such, we currently do not intend to formally move any employees, services or functions to Holdco. At the same time, as described in our application, we do not intend for the utility portion (Utility) of Northwest Natural Gas Company, an Oregon corporation and the entity within which the utility resides (NW Natural) to in any way subsidize non-utility or Holdco costs. To achieve our objective, we intend for NW Natural employees who perform services and functions for Holdco and other non-utility subsidiaries to charge their time for performing such services in accordance with NW Natural's Shared Services Agreement and Cost Allocation Manual, as would be revised to give effect to the reorganization. This approach is consistent with the manner in which NW Natural employees currently charge time to non-utility activities. Under our approach, the Utility does not bear costs of non-utility, non-rate based, or affiliate activities. Wages and salaries of NW Natural and affiliate employees are charged to non-utility or utility affiliate activities by a direct charge through the payroll system (SAP-CATS). The costs of direct services to the holding company and other affiliates include the hours worked by the employees providing those services, adjusted to include payroll loadings (for benefits, taxes, etc.).

Currently, and after the reorganization, the services and functions performed by NW Natural employees for non-utility subsidiaries (which after the reorganization will include Holdco), will be described in the annual Affiliated Interest Report filed by NW Natural with the OPUC. This approach may change if Holdco eventually holds other

businesses in a manner that justified Holdco taking on primary services and functions roles.

Staff/105
Muldoon/8



Rates & Regulatory Affairs
UM 1804
Data Request Response

Request No. UM 1804-OPUC-DR 24:

Regarding access to records, as explained in the application, is NW Natural proposing to provide the Commission access to all records that Staff argues are relevant to the business of NW Natural? Or, is NW Natural or any of its affiliates deciding for the Commission what records are relevant and will produce only those records for Staff's review?

Response:

As stated in the Company's application, NW Natural is willing to commit to provide access to all books of account as well as all documents, data, and records of NW Natural, HoldCo, and its affiliate interests that pertain to transactions between NW Natural and its affiliated interests or which are otherwise relevant to the business of NW Natural. Additionally, NW Natural, HoldCo, and any affiliates will make their employees, officers, directors and agents available to testify before the Commission to provide information relevant to matters within the jurisdiction of the Commission. Also, NW Natural and HoldCo will provide the Commission access to corporate minutes, including Board of Directors' minutes and all committee minutes with relevant information regarding NW Natural.

If the Commission requests access to records pursuant to the proposed commitments in the application, NW Natural or its affiliates will perform a review of all record(s) to determine the information that is relevant to the business of NW Natural, and provide that information. If any dispute were to arise relating to whether any record(s) was withheld that is relevant to the business of NW Natural, the Company proposes following the discovery resolution process set forth in OAR 860-001-0500.



Rates & Regulatory Affairs
UM 1804
Data Request Response

Request No. UM 1804-OPUC-DR 27:

How many notches do NW Natural's current secured debt ratings need to fall to become non-investment grade? Please provide the most recent date at which NW Natural's secured debt rating was not investment grade?

Response:

How many notches do NW Natural's current secured debt ratings need to fall to become non-investment grade?


Moody's:

Senior secured long-term rating debt rating is "A1", 6 notches above non-investment grade.

S&P:

Senior secured long-term rating debt rating is "AA-", 7 notches above non-investment grade.

Moody's	S&P	Rating Description
Aaa	AAA	Prime
Aa1	AA+	High Grade
Aa2	AA	
Aa3	AA-	
A1	A+	Upper Medium Grade
A2	A	
A3	A-	
Baa1	BBB+	Lower Medium Grade
Baa2	BBB	
Baa3	BBB-	
		Non-Investment Grades

 Current Senior Secured LT Ratings
 Non-Investment Ratings

Please provide the most recent date at which NW Natural's secured debt rating was not investment grade?

A Bloomberg database search indicates NW Natural's secured debt ratings have not been below investment grade from 1982 to the current date. Existing officers of the Company believe that the secured debt ratings have not been below investment grade prior to that time, but the Bloomberg database is not available prior to 1982 to confirm.



Rates & Regulatory Affairs
UM 1804
Application to Create a Holding Company
Data Request Response

Request No. UM 1804-OPUC-DR 37:

Please identify and describe in detail all net benefits to Oregon NW Natural (NWN) ratepayers that will result from the HoldCo structure, that are not currently available today without the HoldCo structure. Please describe:

- a. Quantitative benefits
- b. Financial benefits
- c. Legal/structural benefits
- d. Qualitative benefits
- e. Any other benefits

Response:

Please see the Direct Testimony of Brody Wilson and the Direct Testimony of Shawn M. Filippi filed on March 30, 2017 for the Company's description of the benefits to NW Natural's consumers that will result from the Company's request to reorganize its corporate structure to create a holding company.



Rates & Regulatory Affairs
UM 1804
Application to Create a Holding Company
Data Request Response

Request No. UM 1804-OPUC -DR 56:

56. How is the corporate restructuring being financed; and have any costs been, or will be, allocated to NW Natural Gas Company?

Response:

All costs associated with the creation of the holding company are being financed with retained earnings of NW Natural. There are no costs being allocated to NW Natural's local gas distribution company utility business ("Utility").



Rates & Regulatory Affairs
UM 1804
Application to Create a Holding Company
Data Request Response

Request No. UM 1804-OPUC -DR 57:

57. Please produce an accounting of the costs to form a HoldCo structure thus far. This accounting should address management time among other factors.

Response:

We have been tracking all costs associated with the application to form a Holding Company in SAP through internal order 3475906. This includes the tracking of non-payroll costs, which life to date are \$90,181 and represent legal fees incurred, as well as internal payroll costs, which are \$78,263 life to date.



Rates & Regulatory Affairs
UM 1804
Application to Create a Holding Company
Data Request Response

Request No. UM 1804-OPUC -DR 46:

Re: Affiliates and Non-Regulated Assets — Page NWN/100, Filippi/4-5

46. Under the current corporate structure, if NW Natural Gas Company were in financial difficulty, could the Company directly decide to sell Gill Ranch Storage, LLC (a subsidiary) and use the proceeds to improve the finances of NW Natural Gas Company?

If No:

- a. What legal barriers prevent that from occurring?
- b. Who are the owners (with percentages owned) of Gill Ranch Storage, LLC now?
- c. Please explain why NW Natural Gas Company could not sell Gill Ranch under the current structure and use the proceeds to improve the finances of NW Natural Gas Company.
- d. Could the Company shed (sell) other current non-regulated businesses it owns to bolster NWN finances if necessary?

Response:

a) The DR suggests that NW Natural could choose to “directly decide to” sell Gill Ranch Storage, LLC (Gill Ranch). To be clear, Gill Ranch has its own Board of Directors, and it is that Board of Directors that would make the decision as to whether to sell Gill Ranch Storage Facility (Facility). Further, Gill Ranch owns only 75 percent of the Facility, and is party to a Joint Operating Agreement with Pacific Gas and Electric (PG&E), governing ownership of the Facility. Among other things, the Joint Operating Agreement contains a right of first refusal, that effectively requires PG&E to consent to any sale of the Facility or change in ownership of Gill Ranch.

As to the question of proceeds from a sale of the Facility, assuming that PG&E would consent to a sale: Gill Ranch’s portion of the Facility was funded by using retained earnings (commonly referred to as shareholder dollars) of Northwest Natural Gas Company, an Oregon corporation (NW Natural). It is currently reflected on the NW Natural balance sheet as an equity investment in NW Natural Energy, LLC (Energy). Any sale of the Facility would result in proceeds to Gill Ranch (if an asset sale) or Gill Ranch’s parent NW Natural Gas Storage, LLC (Storage) (if a stock sale). There would be determinations at that time as to whether proceeds from Gill Ranch or Storage, as applicable, would be distributed to its immediate parent or redeployed for other

purposes at Gill Ranch, Storage or Energy. Additionally, if these funds were to be distributed "up the chain" to NW Natural, they would be considered retained earnings/shareholder dollars and would not be required to be used to subsidize the utility portion of NW Natural (Utility).

This practical effect would be the same in a holding company structure, as the proceeds of a hypothetical sale would be distributed to Gill Ranch in the event of an asset sale or Storage in the event of a stock sale, and the Boards of those entities would determine whether to make a distribution to a parent company. If distributions were made all the way up the chain to the holding company, the holding company could choose to reinvest those (or other) funds into NW Natural as an equity contribution.

b) Gill Ranch Storage, LLC (Gill Ranch) is a wholly-owned subsidiary of NW Natural Gas Storage, LLC (Storage), which is a wholly-owned subsidiary of NW Natural Energy, LLC, which is a wholly-owned subsidiary of NW Natural. Gill Ranch has a 75% undivided interest in the Gill Ranch Storage Facility. The other 25% undivided interest is held by Pacific Gas and Electric.

c) See (a) above.

d) We assume this question is asking about other unregulated subsidiaries of which NW Natural is the ultimate parent. The answer for each of these unregulated subsidiaries is the same answer as question (a). In addition, since Gill Ranch is the only substantial unregulated subsidiary with NW Natural as the ultimate parent, the sale of other unregulated subsidiaries would not result in meaningful proceeds. As described in (a), the answer would be the same in a holding company structure.



Rates & Regulatory Affairs
UM 1804
Application to Create a Holding Company
Data Request Response

Request No. UM 1804-OPUC -DR 55:

55. How does the Company propose that its ring-fencing conditions will isolate the NWN board's decisions from any economic allegiance to HoldCo — given minimal difference in makeup of the two boards?

Response:

As a technical matter, and by virtue of corporate law, a Board of Directors owes its fiduciary duty to the entity on which Board it serves. So, the Board of Directors of Northwest Natural Gas Company, an Oregon corporation (NW Natural), would, under corporate law be obligated to act in the best interests of NW Natural's business. As a practical matter, the Board of Directors of both HoldCo and NW Natural would have every incentive to act in the best interests of NW Natural to keep it financially strong and operating effectively. As a matter of practice, the current members of the Board of Directors have demonstrated years of effective oversight of NW Natural, and an ongoing commitment to keeping NW Natural strong, local and independent.



Rates & Regulatory Affairs
UM 1804
Application to Create a Holding Company
Data Request Response

Request No. UM 1804-OPUC -DR 59:

59. How does NW Natural currently maintain legal separation between its regulated operations and other affiliated operations?

Response:

Currently, Northwest Natural Gas Company, an Oregon corporation (NW Natural), and the entity within which NW Natural's utility operations are held (Utility), maintains legal separation between the its regulated operations and other affiliated operations in two ways. For those affiliated operations that are held in separate and distinct corporate entities, the legal separation between regulated operations and affiliated operations is a construct of corporate law. Each corporation or other legal entity is recognized as a separate and distinct entity under the law and is afforded those protections of separation. We support those constructs of corporate separateness by, among other practices: maintaining separate and distinct corporate records, maintaining a separate Board of Directors for each entity; maintaining arms-length transactions among entities as reflected in our Cost Allocation Manual and Shared Services Agreement and reflected in our annual Affiliated Interest Reports; observing corporate formalities in behavior and documentation; maintaining separation of employees, bank accounts, materials and other assets; maintaining adequate capitalization for operating subsidiaries; and other practices of good "corporate hygiene."

It is worth noting that these above-described facets of corporate separation will be present in a holding company structure and would be further strengthened in such a structure with the ring-fencing provisions we have proposed.

The second way in which we maintain legal separation between regulated Utility operations and other affiliated operations occurs for those unregulated affiliated operations that occur within the NW Natural corporate entity. Examples of such unregulated operations would include the appliance store, time "green-carded" by employees reflecting work that is not borne by shareholders, and certain other costs and functions that are not part of rate base (i.e. some components of marketing). Because those operations occur within the NW Natural entity, they are not afforded the same corporate separateness by function of law, and therefore the "legal separation" is weaker. These functions are separate more for regulatory and accounting purposes than for corporate law purposes. Therefore, we maintain legal separation between those functions and the Utility primarily via cost tracking and accounting.

For further information regarding NW Natural's charging and billing of affiliates, please see responses to UM 1804-OPUC-DR 18 and UM 1804-OPUC-DR 19.



Rates & Regulatory Affairs
Application to Create a Holding Company
Data Request Response

Request No. UM 1804-OPUC-DR 66:

66. Is the Company closely targeting a 50 percent Common Equity (CE), 50 percent Long-Term (LT) Debt Capital Structure looking forward for the regulated utility?

Response: While in some years Common Equity may be slightly higher or lower than the target due to timing of issuances and redemptions, NW Natural targets a 50 percent Common Equity (CE), 50 percent Long-Term (LT) Debt Capital Structure for the regulated utility.

Staff/105
Muldoon/21-25

Pages 21-25 are confidential and is subject to

Protective Order No. 17-052

Staff/105
Muldoon/26-44

**Pages 26-44 are Highly Confidential and is subject
to Protective Order No. 17-135**

CASE: UM 1804
WITNESS: MATT MULDOON

**PUBLIC UTILITY COMMISSION
OF
OREGON**

STAFF EXHIBIT 106

**Exhibits in Support
Of Reply Testimony**

June 14, 2017

PUCT Rejects NextEra's Rehearing Motion for Oncor

by Colby Bermel – SNL Financial LC – Jun. 7, 2017

Texas regulators on June 7 denied NextEra Energy Inc.'s motion for rehearing on an earlier rejection of the company's proposed \$18.7 billion acquisition of Oncor Electric Delivery Co. LLC.

The **Public Utility Commission of Texas' decision officially ended NextEra's current effort to purchase Oncor.** In rejecting the rehearing motion, commissioners used their April 13 order initially denying the deal but added further rationale in response to their solicitation of comments from NextEra, PUCT staff and outside stakeholders.

The PUCT on May 18 hinted at its rejection, with Commissioner Kenneth Anderson saying he remained "unpersuaded" to grant the rehearing motion. Commissioner Brandy Marty Marquez said she had not changed her decision upon reading the motion.

Energy Future Holdings Corp., which is going through protracted bankruptcy proceedings, owns 80.03% of Oncor, while OMERS Administration Corp. has 19.75% and Oncor Management Investment LLC has 0.22%, according to SNL Energy data.

NextEra would have acquired each of these three interests under the transaction's terms. But what gave commissioners pause, in part, was that the Florida company rolled these three transactions into one omnibus application. And problems with individual transactions resulted in a rejection of the whole package.

The 19.75% interest is indirectly held by Texas Transmission Holdings Corp., or TTH, and NextEra sought to merge its affiliate, WSS Acquisition Company, into TTH. This would have resulted in NextEra owning all of TTH and Texas Transmission Investment LLC, including the latter's 19.75% interest in Oncor.

Commissioners took issue with this part of the deal in its rehearing rejection, saying in a June 6 draft order that it would go against state law because it would constitute the transfer of a controlling interest or operational control in Oncor. The PUCT wanted independence for Oncor's board members, while NextEra pushed for greater control.

"Obviously we can't pay \$18.7 billion for a utility that we can't run and we can't control the board and we can't have access to dividends," **NextEra** Chairman, President and **CEO Jim Robo said** on an April 21 earnings call.

In a Feb. 23 PUCT meeting on the deal, Robo told commissioners that retaining the **independent directors** was "**burdensome and a deal killer.**" He **also made this characterization** regarding PUCT staff proposals **on** Oncor's budgets and **dividend policies.**

"This conversation between Mr. Robo and the Commission underscored the Commission's understanding that NextEra Energy would not close the proposed transactions if the Commission imposed certain conditions on the proposed transactions," commissioners wrote.

NextEra did not request that the 19.75% transaction be approved on a standalone basis, commissioners wrote, only presenting it as part of the overall \$18.7 billion proposal. The **company "offered no evidence"** for them to evaluate it, they added.

"A **public interest evaluation** of the purchase of Texas Transmission Holdings would necessarily be different than the proposed transactions addressed in this application," the order read. "On the current state of the record and the application, it would be inappropriate for the Commission to rule on any single piece of the original application."

Commissioners reinforced their reasoning that the deal increased risk to Oncor ratepayers and lacked tangible benefits.

NextEra was also stymied in its attempt to acquire a utility in 2016, when the Hawaii Public Utilities Commission denied its proposed \$4.3 billion deal for Hawaiian Electric Industries Inc. But analysts recently suggested they are confident that NextEra can still achieve 6% to 8% compound annual EPS growth without Oncor.

"We're very comfortable with our organic growth prospects. We do not have to do anything. I love our stand-alone prospects. I love our two businesses," Robo said on an April 21 earnings call in reference to subsidiaries Florida Power & Light Co. and NextEra Energy Resources LLC.

Oncor remains a sought-after asset, and an investor group led by Hunt Consolidated Inc. could be another possible buyer. In March 2016, their plan to convert the utility to a real estate investment trust, or REIT, was approved by the PUCT. But a group of Energy Future Holdings creditors backed out after commissioners imposed several conditions regarding the REIT's internal lease structure and tax savings.

Going back to Energy Future Holdings' bankruptcy declaration in April 2014, potential bidders for Oncor cited in media reports have included American Electric Power Co. Inc., Berkshire Hathaway Energy, CenterPoint Energy Inc., Edison International and Exelon Corp.

NextEra Tenders Bid for Rehearing of Texas PUC Order Rejecting Oncor Acquisition

by Lilian Federico – Regulatory Research Associates (RRA) – May 9, 2017
An Affiliate of SNL Financial LLC and S&P Global Market Intelligence.

On May 8, just under the statutory deadline, NextEra Energy Inc. filed for reconsideration of the April 13 Public Utility Commission of Texas order rejecting its proposed acquisition of Energy Future Holdings Corp., or EFH, parent of Oncor Electric Delivery Co. LLC.

NextEra said the order "contains a number of serious errors that require correction" and "represents an expansion of power that exceeds the limits set by the Legislature and the bounds of the Commission's own precedent."

NextEra alleges that the provisions of state law upon which the commission based its denial of the application do "not authorized that remedy." In addition, NextEra claims the order does not take into account all of the factors the commission is required to consider in performing its public interest analysis, and "sets forth a new, more stringent public interest standard ... that requires a showing of tangible benefits to ratepayers that are 'unique' and 'exclusive' to the transaction."

According to NextEra, the order's "ad hoc imposition of new requirements and the resulting findings and summary denial of the two separately negotiated transactions at issue stand in contrast to those in the order issued only last year, in [its review of the proposed acquisition of Oncor by a group of investors led by Hunt Consolidated Inc. parent of Sharyland Utilities LP], where the Commission found a proposed transaction to acquire Oncor ... to be in the public interest subject to certain conditions. The contrast is especially striking because the [Hunt] order found the transaction proposed there to be in the public interest despite evidence establishing that billions of dollars in debt entirely dependent on Oncor cash flows for servicing would continue to reside directly above Oncor and that Oncor would, at least initially, be owned by a non-investment grade entity. The transactions in this case would eliminate all of that debt through refinancing by a traditional utility holding company parent that is A- rated, widely diversified, and highly liquid with more than \$7 billion of annual operating cash flows. Despite this evidence, the Order summarily denies NextEra Energy's proposed acquisition of Oncor outright."

NextEra said the commission "failed to give any consideration to the benefits and protections offered by NextEra Energy's 73 regulatory commitments — commitments that include and exceed many of those adopted by the Commission in [the Hunt proceeding] Notably, the Order denies these and other benefits of the proposed transactions because the Commission is unwilling to allow NextEra Energy to exercise governance control over Oncor, an entity in which NextEra Energy will invest \$12.2 billion to acquire."

NextEra requests that the commission issue an order on rehearing "finding the proposed transaction to be in the public interest, and, in order to ensure sufficient time to consider the merits of this motion and encourage possible settlement discussions, NextEra Energy respectfully requests that the Commission extend the period for acting on this motion for rehearing to the maximum extent allowed by law."

However, the **filing does not include any indication that NextEra would offer any additional commitments** in order to secure approval of the transaction. Even if NextEra were to offer "enhanced" commitments, depending on the scope and impact of the revised concessions, approval by the EFH stakeholders and the U.S. Bankruptcy Court could be required.

At this juncture, **given** that the commission's denial reflected the commissioners' understanding that **NextEra was unwilling to compromise with respect to the main areas of concern** — namely, the **independence of Oncor's board of directors** and **maintenance of the pre-existing ring fence** — **Regulatory Research Associates views it as unlikely that the commission would grant the motion for rehearing, or that if granted, the rehearing process would result in a substantially different outcome.**

Further muddying the waters is the fact that Chairman Donna Nelson is slated to leave the commission May 15, in advance of its next open meeting, which is scheduled for May 18. It is unclear whether her departure could be delayed to address this "open issue" or what impact the lack of a full complement of commissioners would have on the process.

Gov. Greg Abbott, a Republican, could appoint a successor to fill the vacancy, but if that individual is appointed while the legislature is still in session, that individual could not serve until confirmed by the Senate. Historically, the governor has waited for the session to end before filling an open seat on the commission so the appointee may begin serving pending confirmation in the next session. The legislature is expected to adjourn May 29 and is not in session in 2018.

By law, in a contested rate case, a motion for rehearing may be filed within 25 days after the commission's final decision, unless extended. Replies to the motion for rehearing must be tendered within 40 days after the issuance of the final order in the case the motion refers to. The commission must respond to a motion for rehearing within 55 days after the issuance of the final order.

Based on these guidelines, other parties may file comments by May 23, and the deadline for commission action is June 7; the commission has a meeting scheduled for that date as well. **If the commission does not take action on or before June 7, the request for rehearing expires. NextEra could pursue review of the order in the courts, but RRA views this as unlikely.**

The Public Utilities Commission order

The commission's April 13 order adopted, with one minor wording change, a draft order formally rejecting a proposed acquisition of Oncor by NextEra due to certain irreconcilable differences.

The order comes as **no surprise, as the commission had signaled that it would reject the proposal at its March 30 open meeting**, citing certain "deal breakers," issues on which the commission and NextEra management were unable to agree.

The commission conducted the merger review proceeding (Docket No. 46238) directly, rather than assigning it to the State Office of Administrative Hearings. While this

accorded the commissioners an unusual opportunity to interact directly with NextEra management, it did not allow them to come to a meeting of the minds.

In fact, the opposite is true. At the March 30 hearing, the commissioners noted that during the hearings, NextEra management indicated that there were certain conditions to which it would not agree. While expressing appreciation for NextEra's candor, the **commissioners opined that the company's stance on the issues left the commission no choice but to reject the transaction as formulated.**

The order concluded that although NextEra is "well-regarded," the "expansive and diversified structure of NextEra Energy and its affiliates would subject Oncor to new and potentially substantial risks. NextEra Energy's method of financing the proposed transaction does not entirely eliminate the debt above Oncor, but merely refinances that debt with new debtThe revenues of Oncor would continue to support the repayment of that debt, albeit to a lesser extent."

According to the commission, the "sole tangible and quantifiable benefit" offered by NextEra is a commitment to share 90% of the interest rate savings on Oncor's cost of debt with ratepayers until new rates reflecting the lower debt costs are implemented. The **commission opined that other benefits cited by NextEra had either not been quantified or are not exclusive to this transaction.**

With respect to the Oncor ring-fence, which has been a major issue of contention in this proceeding, NextEra sought to remove provisions of the existing ring-fence that would restrict NextEra's ability to appoint, remove or replace members of the Oncor board of directors and that allow certain shareholders to veto dividends declared by the Oncor board, as well as capital and operating budgets. NextEra claimed that retention of either of these provisions would prevent the desired linkage of the Oncor and NextEra credit profiles. This issue was one of the so-called deal breakers.

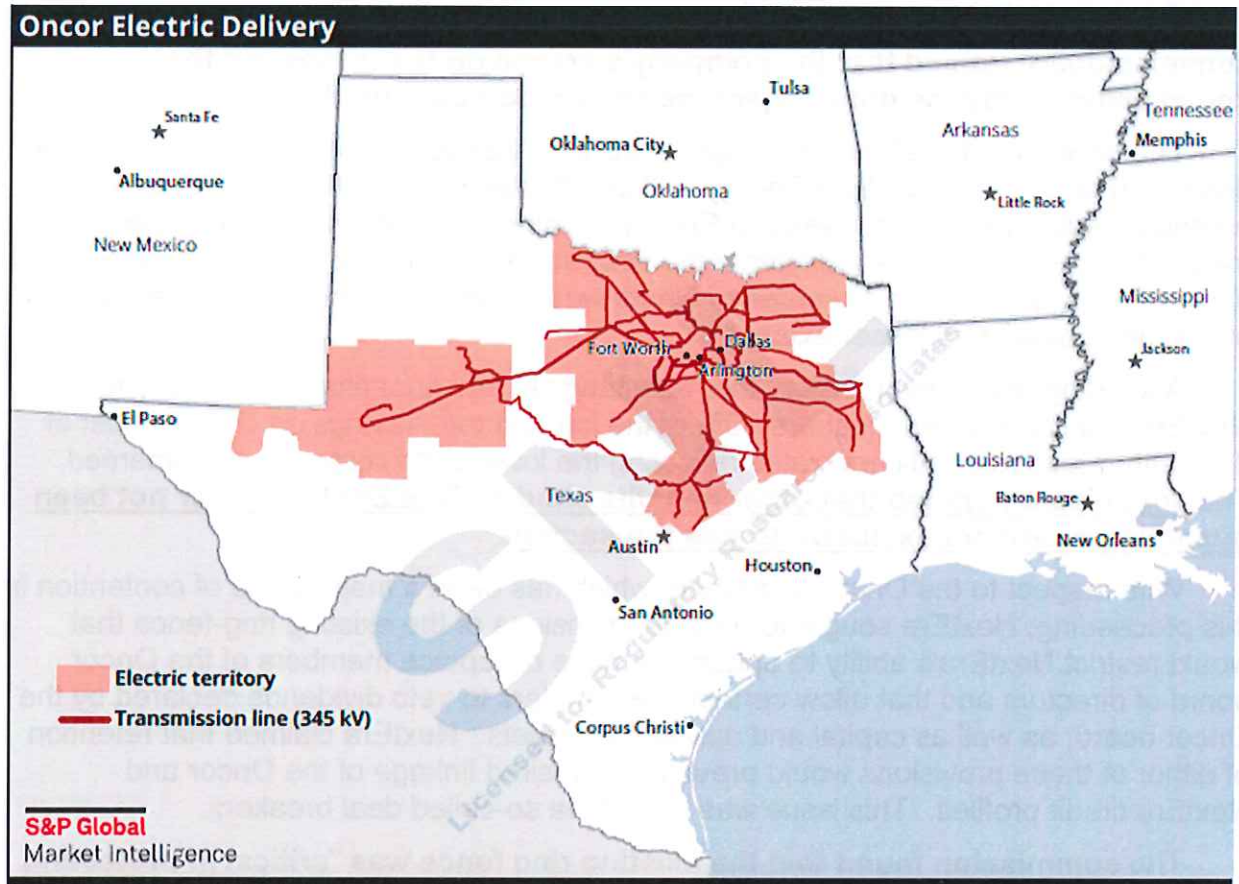
The **commission found that the existing ring fence was "critical in protecting Oncor from the bankruptcy of its indirect parent company.** Under the proposed transactions, a robust ring-fence is **still necessary** to protect Oncor if NextEra Energy or one of its subsidiaries were to file for bankruptcy."

In the end, the **commission concluded** that "**NextEra Energy ownership of Oncor would subject Oncor and its ratepayers to, significant new risks. The tangible benefits to Texas ratepayers that are specific to the proposed transactions are minimal, and would do little to compensate ratepayers for any of the additional risks imposed. When the Commission weighs the additional risks and the lack of tangible benefits, combined with NextEra Energy's insistence on eliminating two critical ring-fencing protections, the Commission finds that the proposed transactions are not in the public interest, and the application is denied.**"

Background of Oncor/EFH

Texas implemented retail competition for generation service in 2002, for the utilities whose service territories were part of the Electric Reliability Council of Texas, or ERCOT (see the Texas PUC Commission Profile for details).

As part of that plan, the existing companies were unbundled based on function, forming separate subsidiaries for transmission and distribution utility operations, power generation ownership and the provision of retail electric service, known as retail electric providers.



In 2008, the commission approved a settlement related to the leveraged buyout, or LBO, of TXU Corp., then the parent of what is now Oncor, by a consortium of private investors led by Kohlberg Kravis Roberts & Co. LP and TPG Inc. Commission approval of the LBO was not required prior to the 2007 completion of the transaction. The new company became known as EFH.

However, the 2008 settlement included a **stringent ring-fence around Oncor**, in addition to substantial rate credits and write-offs. In addition, through Dec. 31, 2012, dividends paid by Oncor to the parent company were limited to "an amount not to exceed Oncor's net income." Oncor also agreed to certain capital spending requirements over the five years following the merger, as well as certain reliability and customer service standards.

The **commission prohibited Oncor from guaranteeing any new debt issued in conjunction with the transaction or thereafter**, and **directed that Oncor's debt ratio be maintained "at or below the debt-to-equity ratio established from time to time by the Commission for ratemaking purposes," most recently 60% debt and 40% equity, with dividend payments to the parent to be limited if such payments would cause the debt ratio to rise above 60%.**

Largely due to reversals at its competitive businesses, **EFH** filed for **bankruptcy** protection under Title 11 of the U.S. Bankruptcy Code **in 2014**. Subsequent attempts to acquire Oncor have been tied to bankruptcy reorganization proposals.

In a failed attempt to acquire Oncor, in 2015, a consortium of investors led by Hunt Consolidated Inc. had proposed a transaction that would have restructured Oncor into a real estate investment trust, or REIT.

The utility commission conditionally approved the acquisition in March 2016 but set forth conditions designed to flow the tax benefits of the REIT structure to ratepayers, require commission approval of the lease transactions between the operating company and the asset company, and require the operating company and asset company to file joint rate cases. The ensuing litigation led certain participants in the bankruptcy reorganization plan to withdraw from the deal.

Hunt later came forward with an amended deal under which transmission and distribution operations would have been separated, with only the transmission business converted to a REIT.

The revised Hunt deal included a commitment to share with ratepayers 20% of the tax savings associated with the formation of the new REIT. Hunt also committed to keeping total debt at the holding companies above Oncor at or below \$3.5 billion and debt levels at the transmission company holding company at or below \$1.6 billion. Hunt also agreed to confer authority to the utility commission to regulate the internal leases, another key sticking point in prior negotiations.

However, before this deal could gain traction, the NextEra proposal was announced.

NextEra Proposal

Under the transaction, announced July 29, 2016, NextEra proposed to acquire EFH, Energy Future Intermediate Holding Co. LLC and its ownership interest in Oncor. NextEra also planned to spin off the merchant generation and retail electricity service businesses and retain Oncor as a principal business alongside its vertically integrated utility, Florida Power & Light Co.

NextEra already has a presence in Texas in the form of gas and wind generation, a retail electric provider and an electric transmission-only utility, Lone Star Transmission LLC.

NextEra also planned to acquire Texas Transmission Investment LLC and its approximately 20% indirect interest in Oncor. NextEra also agreed to acquire the remaining 0.22% indirect interest in Oncor that is owned by Oncor Management Investment LLC.

NextEra had proposed to remove the debt directly above Oncor and finance the \$12.2 billion funding requirement with roughly 60% debt and 40% equity, and contended that the proposed transactions would not impact its financial strength and capabilities.

Oncor/NextEra filed for approval of the proposed transaction Oct. 31, 2016, and on Nov. 10, 2016, the utility commission indicated that it would hear the case directly.

The commission outlined the issues it was most concerned about early in the proceeding, among them federal income tax issues that were not as contentious in this proceeding as they had been in the Hunt proceeding, due to the traditional structure of the transaction. NextEra had already offered certain commitments with respect to debt reduction and maintenance of credit ratings, as well as capital investment and service quality commitments.

Intervening parties filed testimony in January 2017 supporting enhanced ring-fencing measures. Hearings were held in February, and briefs were filed in March.

The primary areas of contention were related to the composition of the post-merger Oncor board, the level of "independence" of that board, limitations on the ability of Oncor to make dividend payments to NextEra, the level of linkage between Oncor debt and parent company debt, and the timing of Oncor's next base rate case. The latter is largely moot as Oncor filed a base rate case March 17.

Public utility commission merger approval authority

Legislation enacted in 2007, requires utility commission preapproval before the completion of any merger involving an electric transmission and distribution utility, or any transaction under which more than 50% of the stock of a utility holding company would change hands.

Prior to that, commission approval was not required, but merger hopefuls generally tendered filings offering certain concessions. Interestingly, commission preapproval was not required of the LBO of TXU that created Oncor's existing structure.

In order to approve a transaction, the commission must determine that the transaction is in the public interest and will not adversely affect the health and safety of customers or employees, result in the transfer of jobs outside the state, or result in a decline in service.

The commission must also consider whether the utility will receive consideration equal to the reasonable value of the assets when it sells, leases or transfers assets, the impact of the transaction on competitive markets and the extent to which the transaction mitigates market power in either the retail or wholesale electricity market.

The commission must rule on a proposed transaction within 180 days. If it has not made a determination before the 181st day, the transaction is considered approved.

Ring-Fencing Issues Continue to Dominate NextEra / Oncor Merger Review

by Lilian Federico — Regulatory Research Associates (RRA)

An affiliate of SNL Financial LC — Mar. 20, 2017

Note: RRA is an offering of S&P Global Market Intelligence.

Based on briefs filed on March 10, as part of the Public Utility Commission of Texas' ongoing review (Docket No. 46238) of NextEra Energy Inc.'s proposed acquisition of Oncor Electric Delivery Co. LLC, it appears that **ring-fencing issues will be the largest obstacles to completing this proposed transaction**. Reply briefs were filed on March 17, and the parties largely reiterated their prior positions.

The primary areas of contention appear to be the **composition of the Oncor board post-merger**, the level of "**independence**" of that board, **limitations on the ability of Oncor to make dividend payments to NextEra** and the **timing of Oncor's next base rate case**.

Texas PUC		
Commissioners	Party	Term ends
Donna Nelson (Chairman)*	Republican	8/2021
Kenneth Anderson	Republican	8/2017
Brandy Marquez	Republican	8/2019
Other details		
Gov. Greg Abbott (Term ends)		1/2019
Size of staff (members)		217
Rate case time frame		185 days**
Legislative session ends		05/29/17
Merger approval standard		Public Interest
Merger review time frame		180 days
RRA Ranking		Below average/1
* Serving pending Senate confirmation.		
** From proposed effective date.		
Source: Regulatory Research Associates, an offering of S&P Global Market Intelligence		

From a procedural standpoint, hearings have been concluded, and these briefs represent the parties' final opportunity to make their cases to the commissioners prior to public deliberations. The **PUC has elected to hear the case directly**; consequently, **there will be no administrative law judge's recommendation issued**.

The deadline for a PUC decision is April 29, and in the unlikely event a decision is not rendered by that time, by law, the transaction would be

deemed approved. Between now and the April 29 deadline, the PUC has three open meetings scheduled at which the issues in this case may be addressed March 30, April 13 and April 28.

The **transaction is part of the bankruptcy reorganization of Oncor parent Energy Future Holdings Corp., or EFH**.

In order to approve a transaction, the commission must determine that the transaction is in the **public interest** and will **not adversely affect the health and safety of customers or employees, result in the transfer of jobs outside the state or result in a decline in service**. The PUC must also consider whether the utility will receive **consideration equal to the reasonable value** of the assets when it sells, leases or transfers assets, the **impact** of the transaction **on competitive markets**, and the extent to which the transaction mitigates **market power** in either the retail or wholesale electricity market (see the Texas PUC Commission Profile).

NextEra / Oncor Brief

NextEra / Oncor characterize the proposed transaction as an opportunity to **bring the EFH era of Oncor's history to a close** in a manner that is beneficial to Oncor's customers and clearly in the public interest."

NextEra / Oncor mention the following as benefits of the transaction:

* The **elimination of** approximately \$11 billion in EFH **legacy debt** that now resides directly above Oncor.

* **Improved financial strength and credit ratings for Oncor** that will **result in interest and tax savings**, estimated at **\$360-600 million through 2045**, for electric distribution customers, with additional savings possible from the potential future consolidation of NextEra transmission subsidiary Lone Star Transmission LLC with Oncor.

* **Full and unconditional funding of Oncor's five-year long-range capital investment plan** as well as **commitments regarding capital structure management**.

* **Assurances that NextEra and its subsidiaries will not incur any new debt disproportionately reliant on Oncor's revenues or stock unless approved by the commission.**

* A "**robust suite of regulatory commitments** that will continue and, in many respects, **improve upon the current protections provided to Oncor, its employees, and its customers.**"

NextEra proposes to remove the debt directly above Oncor and finance the \$12.2 billion funding requirement with roughly 60% debt and 40% equity, and contends that the proposed transactions will not impact NextEra's financial strength and capabilities.

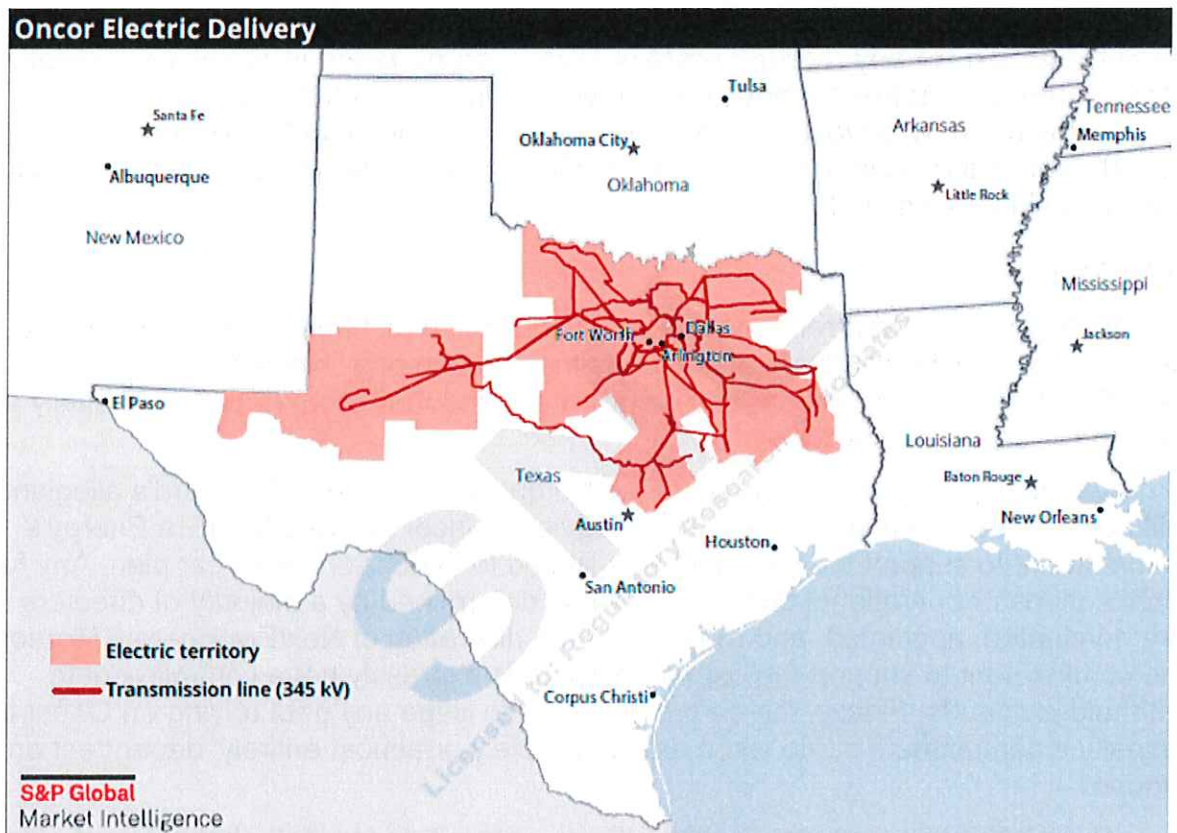
According to NextEra / Oncor, "arguments that a 'chamber of horrors' or 'unforeseen events' might lead to default, or induce **NextEra Energy to extract excessive dividends** in disregard of Oncor's obligation to invest in and operate its system safely and reliably, are **unsupported** and squarely refuted by NextEra Energy's commitment to unconditionally fund Oncor's five-year capital plan."

The companies contend that "preservation of the status quo is not an attractive option and that it is not realistic to believe that either stand-alone equitization or alternative buyers will provide the benefits of the NextEra Energy proposal."

No synergy savings are estimated because NextEra "does not seek to 'transform' Oncor's business or operations. There is unanimous consensus among parties that Oncor is an extremely well-run utility. NextEra Energy is committed to retaining the experienced Texas management and employees that have guided and served as stewards of Oncor's commitment to providing safe, reliable electric service at a reasonable cost."

NextEra and Oncor note that they have **agreed to updated** system average interruption duration index, or SAIDI, and system average interruption frequency index, or SAIFI, **performance metrics** that will **further improve service**.

With respect to ring-fencing issues, **NextEra asserts that it "has candidly stated that a partnership with Oncor must be structured in a manner that enables NextEra Energy to maintain the strong credit ratings necessary to allow Oncor and its customers to realize the benefits of the Proposed Transactions. To achieve this outcome, Oncor's and NextEra Energy's credit profiles must be linked.** Credit linkage between a parent and its subsidiary is common in transactions such as those proposed in this case. What is unique in this instance is the presence of **Oncor's current ring-fence [established in 2009],** which was **put in place to protect Oncor from its financially weak and highly leveraged parent company, EFH. To establish credit linkage between Oncor and NextEra Energy,** two provisions in the current ring-fence structure must be omitted: (1) restrictions on NextEra Energy's ability to appoint, remove, and replace a majority of members of the Oncor **Board** of Directors, (the 'Board Appointment Restriction'); **and** (2) the **ability to veto Oncor Board-approved dividends and capital and operating budgets** beyond the restrictions in the proposed regulatory commitments (the '**Veto Restriction**')."



NextEra contends that the so-called Board Appointment Restriction and Veto Restriction are no longer necessary.

According to Oncor CEO Bob Shapard, there are three key commitments in this proposed transaction that will continue to ensure Oncor's credit quality: "[T]hey've committed the capital, they've committed the [capital] structure, and, finally, better than we did seven years ago, they're not going to issue any debt relying on Oncor, not secured by the assets or the stock of Oncor. When you can't do that, you commit to the

[capital] structure and the capital plan, you've pretty well protected the credit quality of this company."

NextEra has **proposed** that **Oncor** have a **board** composed of **11 members**, **four** of whom will be "**independent**" as defined by New York Stock Exchange regulations, and **three** others who will be "**disinterested** directors" with no material relationships with NextEra Energy or its subsidiaries or affiliates. Similar to the EFH restrictions, Oncor's capital and operating and maintenance budgets, as well as any changes to Oncor's dividend policy would be subject to approval by the Oncor board. In addition, an affirmative vote by a **majority of the disinterested directors would be required to approve a voluntary bankruptcy filing by Oncor for the benefit of NextEra.**

However, **NextEra agrees to commit that Oncor would be prohibited from making dividend payments to NextEra without prior PUC approval if Oncor's stand-alone credit rating by two or more of the major credit rating agencies was to fall below investment grade.**

With respect to tax issues, NextEra commits that **Oncor** and its **customers** will **not** be **responsible for any federal, state or local income taxes in excess of Oncor's standalone tax liability** for any period in which Oncor is included in a consolidated income tax return with NextEra. However, NextEra opines that "tax expense is a fact-based ratemaking issue better reserved to Oncor's upcoming base rate case." That case has since been filed.

PUC Staff

In its brief, the **staff** reiterates certain **concerns** that it has raised throughout the proceeding. Specifically, the staff supports the creation of a "**majority independent board** that is **self-nominating, self-appointing, and self-removing**, substantially as the **Oncor board exists today.**"

According to the staff: "The unanswered question is where the board's allegiance will be when the interests of NextEra Energy and Oncor diverge. NextEra Energy's commitment to support the capital plan is limited to the current five-year plan. Any future capital plans or operational budgets would be determined by a majority of directors who are nominated, appointed, and removed at the discretion of NextEra Energy. Moreover, the commitment to support the capital structure is expressly not a commitment to withhold dividends. Finally, the commitment not to issue any debt relying on Oncor is actually a commitment not to issue any debt 'solely or almost entirely' dependent on Oncor."

The **staff** further **asserts** that **NextEra's commitments "fall short of sufficiently protecting Oncor and Oncor's customers.** Because the tangible benefits arising from the proposed transactions are at best minor, the ultimate question is determining the acceptable level of risk the Commission would permit NextEra Energy to impose upon Oncor and Oncor's Texas customers."

The **staff contends that the \$5.4 billion first lien debtor-in-possession debt that currently resides above Oncor, will not be extinguished, "but only reapportioned.** ... Replacing existing debt with new debt that is guaranteed by the new parent is **not** the same as **truly eliminating the debt above Oncor.** Such debt

replacement and subsequent rebalancing of NextEra Energy's capital structure will, **according to Moody's, exhaust NextEra Energy's, debt capacity, put downward pressure on NextEra Energy's credit ratings and put pressure on Oncor to send dividends upstream to its new parent.** This **potential for equity stripping** by NextEra Energy is what **makes the ring-fencing provisions**, particularly preservation of Oncor's independent control of its board, so **essential.**"

Other Parties

Raising concerns similar to those put forth by the staff, the **Office of Public Utility Counsel, or OPUC**, continues to **assert** that the **proposed transactions are not in the public interest.** NextEra has selected a **financing plan** that **maximizes the value of the transaction to NextEra's benefit and to the benefit of its shareholders while putting Oncor and its customers at additional risk through the elimination of key ring fencing provisions.**"

The OPUC notes that the company has **declined to identify synergy savings** associated with the transaction, and has **proposed to flow only 90% of interest rate and tax savings.** OPUC suggests that, if the commission were to approve the transaction, 100% of such savings should be flowed through to ratepayers through an immediate bill credit that would be in place until the company's next base rate case, which has since been filed, is completed.

The **Texas Industrial Energy Consumers, or TIEC**, also recommend that the transaction, as presently structured be rejected. TIEC also contends that "the **transaction poses considerable-new risks for Oncor and its customers** to maximize earnings for NEE's shareholders," and that "**without additional commitments**, the **risks** of the proposed transaction **outweigh the purported benefits.**"

TIEC proposes that the commission "the Commission require a **ring-fence** that will protect Oncor against the financial risks of NEE ownership and ensure that Oncor is not dragged into a future NEE bankruptcy. NEE asserts that the ring-fence requirements necessary to achieve these objectives will preclude credit linkage, and are ultimately 'deal-killers.' But the Commission's duty is to protect Oncor and its customers, and to ensure the transaction is in the public interest—not to abide by the parameters NEE needs to achieve maximum accretion and support its \$18.7 billion bid."

Included in the remedies proposed by TIEC is a requirement that, in addition to the flow-through of tax and interest rate savings, 50% of synergy savings flow to ratepayers via an immediate rate credit. While the company has declined to quantify any synergy savings, according to TIEC, "independent third-party investment advisors" have estimated synergy savings at \$78.5 million per year.

In addition, the TIEC recommended that the PUC postpone Oncor's next rate filing, which was tendered March 17, until 2020. Oncor's last base rate case was decided in 2011; however, the company has been permitted to recognized new investment in rates through the PUC's interim transmission cost of service updates and other adjustment clauses (see the Texas PUC Commission Profile for details).

CERTIFICATE OF SERVICE

UM 1804

I certify that I have, this day, served the foregoing document upon all parties of record in this proceeding by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-001-0180, to the following parties or attorneys of parties.

Dated this 14th day of June, 2017 at Salem, Oregon



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UM 1804

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