UM 1804
NWIGU 100
Finklea

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

TESTIMONY

OF

EDWARD FINKLEA

ON BEHALF OF

NORTHWEST INDUSTRIAL GAS USERS

June 14, 2017

Q. Please state your name, business address and occupation?

A. My name is Edward Finklea. My business address is 545 Grandview Drive, Ashland, Oregon 97520. I am the Executive Director of the Northwest Industrial Gas Users ("NWIGU").

Q. Please summarize your educational background and experience.

A. My resume is attached as Exhibit 101 to this testimony.

Q. On whose behalf are you appearing in this proceeding?

A. I am appearing on behalf of NWIGU. NWIGU member companies purchase sales and transportation service from Oregon local distribution companies, including Northwest Natural Gas Company ("NW Natural" or the "Company").

Q. What is the purpose of your testimony?

A. I will respond to the Company's proposal to create a holding company structure.

Q. What is NW Natural's current corporate structure?

A. NW Natural is currently a publicly held operating company.[1] The utility operations of NW Natural are all conducted at the operating company level, while a number of wholly and partially owned subsidiaries operate the Company's other businesses.[2]

Q. What change is NW Natural proposing to its corporate structure?

A. NW Natural is proposing a reorganization of its corporate structure, which will come about through a series of transactions. A new company will be formed (referred to in the proposal as "HoldCo"), as a subsidiary of NW Natural, and a second company will be formed as a subsidiary of HoldCo to serve as a merger subsidiary.[3] The merger subsidiary will be used for the sole purpose of effectuating the reorganization.[4] Once HoldCo and the merger subsidiary are formed, NW Natural will contribute to HoldCo all of its stock and its interest in its current subsidiaries. At that point, the merger subsidiary will be merged into NW Natural (with NW

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[1] *In re Northwest Natural Gas Company, Application for Approval of Corporate Reorganization to Create a Holding Company*, Docket UM 1804, Application of Northwest Natural Gas Company at 3.
[2] *Id.*
[3] *Id.* at 4.
[4] *Id.*

Natural as the surviving company) and the merger subsidiary will cease to exist.[5] Then, each share of NW Natural will convert into one share of HoldCo (with identical rights as NW Natural shares). After the Reorganization, HoldCo will be owned by public shareholders, and it will hold the stock of one or more operating companies, including the utility NW Natural.[6] All NW Natural operations, and any current or future affiliates, will be at the subsidiary level. The NW Natural subsidiary will continue to operate as a regulated utility under the jurisdiction of the Public Utility Commission of Oregon ("Commission").[7]

Q. Why is NW Natural proposing this change?

A. NW Natural has stated that it believes the holding company structure will allow the Company to better respond to the changing business environment of the natural gas industry. As I understand it, what this means is that NW Natural's proposed reorganization will provide a better structure for the HoldCo parent company to pursue business opportunities separate and apart from the utility operations.[8]

Q. Has NW Natural indicated what business opportunities HoldCo will pursue?

A. While NW Natural has shared the types of business opportunities it may explore, there is no specific business opportunity for the Commission to review in this docket, and nothing would prevent HoldCo from pursuing something completely different if NW Natural's application is approved.

Q. What legal standard applies to this proposed corporate reorganization?

A. ORS 757.511 bars acquisition of "the power to exercise any substantial influence over the policies and actions of a public utility" without approval of the Commission. The statute sets forth the filing requirements, as well as the applicable legal standard. If the Commission determines that approval of the application will serve the public utility's customers in the public

[5] *Id.*
[6] *Id.* at 5.
[7] *Id.*
[8] *See In re Northwest Natural Gas Company, Application for Approval of Corporate Reorganization to Create a Holding Company*, Docket UM 1804, Opening Testimony of Shawn M. Filippi NW Natural at 8.

interest, the Commission shall issue an order granting the application. The Commission may condition an order authorizing the acquisition upon the applicant's satisfactory performance or adherence to specific requirements. The Commission otherwise shall issue an order denying the application. The applicant bears the burden of demonstrating that granting the application is in the public interest.[9]

The Commission interpreted ORS 757.511 in Docket UM 1011, which the Commission opened to review the legal standard for Commission approval of mergers under ORS 757.511. The Commission concluded in that docket that the statute directed a two-part analysis: "first, the assessment that utility customers will be served; second, the demonstration that granting the application is in the public interest. . . . Therefore, in addition to finding a net benefit to the utility's customers, we must also find that the proposed transaction will not impose a detriment on Oregon citizens as a whole."[10]

Q. Does NW Natural's proposal satisfy the net benefits test?

A. I do not think NW Natural's proposal meets the net benefits standard without rate credits or some other financial benefit being realized by ratepayers.

Q. Is the determination of net benefits simply a review of whether customers receive rate credits under a proposed reorganization?

A. No. While rate credits are one way to satisfy the test, the determination of whether or not there are net benefits can vary. The Commission addressed this issue in Docket UM 1121, where it considered the potential sale of PGE, held by a bankrupt parent (Enron), to an investment company.[11] In that case, which presents a very different situation than in NW Natural's application, the Commission looked at the "net benefits" by comparing the proposed transaction to a utility acting as a standalone company.[12] Ultimately, the Commission determined that the

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[9] ORS 757.511(3).
[10] *In re Legal Standard for Approval of Mergers*, Docket UM 1011, Order No. 01-778 at 11.
[11] *In re Oregon Electric Utility Company LLC, et al., Application for Authorization to Acquire Portland General Electric Company,* Docket UM 1121, Order No. 05-114 at 18.
[12] *Id. at 33-34.*

applicants in that docket "failed to establish that Oregon Electric's acquisition of the common stock of PGE from PGE's parent company, Enron, serves the utility's customers in the public interest."[13] In another case in which the Commission reviewed the sale of a utility by one parent company to another parent company, the Commission stated that it determined net benefits by comparing the proposed acquisition of the utility to "the continued prudent and well-managed operation of" the utility under its current owner.[14] As I will explain later, I do not believe the Commission can find that NW Natural's proposal provides any non-monetary benefits and, therefore, any net benefits that may satisfy the legal standard would need to be in the form of rate credits or some other financial benefit to ratepayers.

Q. Does NW Natural propose rate credits or other financial benefits to customers as part of this transaction?

A. No.

Q. Are you aware of other merger proceedings where rate credits or other financial benefits were included as part of the transaction?

A. Yes. As part of a 2009 final order issued by the Washington Utilities and Transportation Commission ("WUTC"), the WUTC addressed the reorganization of Puget Energy, the parent company of Puget Sound Energy, a regulated utility providing natural gas and electric service in Washington.[15] The final order in that proceeding adopted a settlement stipulation that included rate credits of $100 million ($10 million per year for a 10-year period) commencing at the closing of the transaction.[16] Those rate credits were allocated between PSE's gas and electric operations on an annual basis. For natural gas customers, these credits were returned on an equal percent of margin basis to all customer classes.[17]

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[13] *Id.* at 36.
[14] *In re MidAmerican Energy Holdings Company Application for Authorization to Acquire Pacific Power & Light, dba PacifiCorp*, Docket UM 1209, Order No. 06-082 at 3.

[15] *In re Puget Sound Holdings and Puget Sound Energy, Inc., For an Order Authorizing Proposed Transaction*, Docket U-72375, Order 08.
[16] *Id.* at 38.
[17] *Id.*

Q. Are there corporate reorganizations where rate credits have been given in Oregon?

A. Yes. In Docket UM 1283, for example, the Commission adopted a stipulation relating to MDU Resources Group's acquisition of Cascade Natural Gas. There, the company agreed to make annual rate credits of $200,000 from the fall of 2008 through December 31, 2012.[18]

Q. Are you suggesting that NW Natural provide $100 million in rate credits as part of this transaction?

A. No, but I do believe that there should be some financial benefits to customers in order to satisfy the net benefits test under the circumstances presented in NW Natural's application, because no other benefits exist. While I do not have a specific proposal at this time, I believe NW Natural should propose rate credits or some other quantifiable financial benefit that ratepayers would realize over a defined period of time.

Q. What does NW Natural offer as evidence of the existence of net benefits?

A. NW Natural argues that the regulatory and ring fencing commitments included in its proposal satisfy the net benefits test.

Q. Why do you not agree with NW Natural that regulatory and ring fencing commitments are net benefits?

A. NW Natural's approach attempts to offer ratepayers protection from a proposed transaction that does not yet exist and appears to be applying a "no harm" standard.

Q. Are there risks associated with the proposal in NW Natural's application?

A. Yes. It appears that the proposed corporate reorganization is driven by NW Natural's desire to pursue business opportunities separate and apart from the utility operations. Because we do not know with any certainty what types of business opportunities HoldCo will pursue in the next one, five, or even ten years, there must be protections built into any order approving this transaction to prevent financial harm to ratepayers. In other words, ratepayers must be protected

[18] *In re MDU Resources Group Inc., Application for Authorization to Acquire Cascade Natural Gas Corporation*, Docket UM 1283, Order 07-221 at 4.

and held harmless from hypothetical and unknown risks that could flow from future acquisitions or other business transactions.

Q. Could the HoldCo approach result in an increase in the cost of utility service or the erosion of service quality?

A. Yes. HoldCo could increase the leverage of the parent entity or another subsidiary, which could negatively impact the credit rating of NW Natural. If NW Natural's credit quality erodes, that would increase the cost of capital for the utility, thus impairing its ability to fund needed infrastructure improvements.

Q. Why do NW Natural's regulatory and ring fencing provisions not protect against these types of risk?

A. There are two problems with NW Natural's approach. First, without knowing which specific transactions HoldCo might enter, it is impossible to know if the ring fencing provisions are adequate. Second, my testimony is not that ring fencing provisions cannot be a benefit or that they do not protect against risk. Rather, in this case, they do not provide a net benefit. As currently structured, NW Natural is required to bring certain types of transactions to the Commission for review and approval. In that approval process, the Commission would determine if the risks to ratepayers outweigh the benefits to NW Natural. Whether NW Natural seeks to acquire a small chain of coffee shops, an interstate pipeline, or anything in between, the operative inquiry of the Commission would be whether NW Natural's ratepayers would realize a net benefit from the acquisition, and whether the transaction protects ratepayers and is in the public interest, consistent with ORS 757.511. The specifics of the transaction would be before the Commission for careful analysis.

NW Natural's proposal essentially asks NW Natural's ratepayers to exchange the protections afforded by existing regulatory oversight for the ring fencing being offered to protect NW Natural ratepayers in the event future unknown ventures are pursued by HoldCo. Because we do not know what specific transaction HoldCo will enter into, the Commission cannot possibly determine whether the ring fencing provisions are any more protective of ratepayer interest than the Commission's normal oversight. The "trade" NW Natural offers, therefore, is at best an equal trade, and at worse a detriment to ratepayers. Either way, there is no net benefit that NW Natural can show with certainty.

Q. Will you describe in more detail what the difference is between NW Natural's proposed reorganization and other reorganizations?

A. This proposal is unique because there is no particular acquisition or merger made part of the reorganization. Rather, the reorganization is being pursued to make it easier for the Company to grow and make acquisitions – presumably without regulatory oversight. If NW Natural was seeking to make a major acquisition as part of this proposal, ratepayers and the Commission would have all the details of that transaction before them as they evaluated the risks and benefits. For example, the Commission engaged in that level of oversight when it reviewed NW Natural's proposal to purchase Portland General Electric.[19] While that transaction was never completed, the approval process provided this Commission with a complete record to show how such an acquisition would have impacted NW Natural's ratepayers. NWIGU, Oregon Citizens' Utility Board and Commission Staff had the ability to fully discover the specifics surrounding that proposal. The costs and benefits were clearly identified. The quantifiable risks could be compared to identifiable benefits. If ring fencing was applied, the provisions would have been selected with the full knowledge of what risks were posed by the acquisition.

In contrast, with NW Natural's current proposal it is impossible to quantify the specific risks or benefits, because there is no specific proposal. Will there be economies of scale and efficiencies once HoldCo acquires a new company? Is HoldCo leveraging off NW Natural's current management's expertise and strength, or is the new company going into a line of business that has little in common with natural gas distribution? Is the premium HoldCo is paying for the

[19] *See generally In re Application of Northwest Natural HoldCo and Northwest Natural Gas Company for an Order Authorizing Northwest Natural HoldCo to Exercise Substantial Influence Over the Policies and Actions of Portland General Electric Company and Northwest Natural Gas Company*, Docket UM 1045.

company it is acquiring reasonable under the circumstances and at a level that HoldCo can absorb over a reasonable planning horizon, or is the premium steep and so large as to challenge the new company's cash flow for the foreseeable future? Will HoldCo's counterparties view the new company differently because it has NW Natural as a well-established subsidiary? We cannot answer any of these questions when we have no specific transaction before us to analyze.

Q. What types of rate payer protections should be included in any order approving the corporate reorganization?

A. I recommend that the Commission include ring fencing provisions to protect ratepayers from any business transactions at the HoldCo or non-NW Natural subsidiary level. Typical ring fencing provisions include an obligation to: (i) hold NW Natural's ratepayers harmless from any business and financial risk exposures associated with HoldCo or any of its affiliates; (ii) maintain separate books and records; and (iii) agree to prohibitions against loans or pledges of utility assets to the HoldCo or any affiliate without Commission approval. Further, NW Natural should maintain separate debt and preferred stock, if any, and maintain its own corporate and debt credit rating, as well as ratings for long-term debt and preferred stock. I also recommend that at least one director of NW Natural be an Independent Director who is not a member, stockholder, director, officer, or employee of the HoldCo or its affiliates.

Q. Has NW Natural offered to provide a non-consolidation opinion?

A. Yes, NW Natural has offered and should be required to file a non-consolidation opinion with the Commission which concludes, subject to reasonable assumptions and exceptions, that the ring fencing provisions are sufficient that a bankruptcy court would not order the substantive consolidation of the assets and liabilities of NW Natural with those of the HoldCo or its affiliates or subsidiaries. If the ring fencing provisions are insufficient to obtain a non-consolidation opinion, NW Natural should immediately: (i) notify the Commission of this inability to obtain a non-consolidation opinion and (ii) propose and implement, upon Commission approval, such additional ring fencing provisions around NW Natural as are sufficient to obtain a non-consolidation opinion subject to reasonable assumptions and exceptions.

Q. Do you have concerns about how costs will be allocated between NW Natural and HoldCo and future affiliates?

A. Yes. Anytime you have a corporate structure or business that includes regulated and non-regulated operations, the allocation of costs between the operations can become difficult to track. NW Natural should be required to provide annual cost allocation reports that contain the methodologies and details used to allocate HoldCo or any affiliate-related costs to NW Natural. And, as a condition of approval, there should be no cross-subsidization by NW Natural customers of unregulated activities.

Q. Has the Commission required cost allocation reports before as a condition of approval?

A. Yes. As part of the Commission's order approving MDU Resources Group's acquisition of Cascade Natural Gas Corporation, the Commission imposed several conditions of approval regarding cost allocation. Those conditions included requirements to report changes to corporate cost allocation for rate setting, accounting standards to be used for that purpose, and a requirement to implement a reporting system. I recognize that the Company has proposed similar commitments in its application and I urge the Commission to implement those kinds of commitments as conditions of approval if it determines it will approve NW Natural's application.

Q. Should the reorganization affect NW Natural's rate of return?

A. No. NW Natural's ratepayers should be held harmless from the liabilities of any non-regulated activity of HoldCo or any of its affiliates. In any proceeding before the Commission involving rates of NW Natural, the fair rate of return for NW Natural should be determined without regard to any adverse consequences that are demonstrated to be attributable to HoldCo or any of the non-regulated activities of any subsidiaries or affiliates. The Commission should specifically condition any approval to prohibit NW Natural from advocating in future proceedings for any higher cost of debt or equity capital that is higher than those costs would be in the absence of HoldCo's ownership of NW Natural.

Q. Should NW Natural be required to advise the Commission of any acquisition of an affiliate of HoldCo or NW Natural?

A. Yes. HoldCo and NW Natural should be required to notify the Commission subsequent to HoldCo's board approval and as soon as practicable following any public announcement of: (1) any acquisition of a regulated or unregulated business representing five percent or more of the capitalization of HoldCo; or (2) the change in effective control or acquisition of any material part of NW Natural by any other firm, whether by merger, combination, transfer of stock or assets.

Q. Should NW Natural's ratepayers bear any of the legal or financial advisory cost of this transaction?

A. No. If the Commission were to approve this corporate reorganization, as a condition of approval, NW Natural's ratepayers should not shoulder any of the legal or financial advisory costs of the transaction.

Q. What should this Commission do if the WUTC imposes additional conditions on NW Natural's application?

A. In the event the Commission approves this transaction, and the WUTC later approves the transaction but requires additional conditions, the Commission should have the ability to modify the Oregon Order if the additional conditions are determined to be in the public interest.

Q. Does this conclude your testimony?

A. Yes, it does.

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EXHIBIT 101

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June 14, 2017

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Edward A. Finklea

Primary Professional Experience

Lead counsel for the Northwest Industrial Gas Users ("NWIGU") from 1986 until 2008 in all regulatory interventions concerning Williams Gas Pipeline West and TransCanada Gas Transmission Northwest, and before state regulatory commissions concerning regulation of the five regional natural gas local distribution companies ("LDCs").

Represented NWIGU before the Federal Energy Regulatory Commission in interstate pipeline rate and certificate proceedings, before the Oregon Public Utility Commission in natural gas rate and other regulatory proceedings, before the Washington Utilities and Transportation Commission in natural gas rate, safety and other regulatory proceedings and in proceedings before the Idaho Public Utility Commission..

Employment History

Executive Director for the Northwest Industrial Gas Users, August 2012 to present

Adjunct Professor at Northwestern School of Law, Lewis and Clark College "Law and Economics" Current

Senior Counsel, NiSource Corporate Services Inc. Regulatory counsel to interstate pipeline, representing company before Federal Energy Regulatory Commission and advising company on federal regulatory compliance and business transactions. November, 2009 to November, 2011

Executive Director, Energy Action Northwest. Organization advocated for siting and permitting of interstate pipelines, liquefied natural gas terminals, and high voltage transmission projects in Oregon and Washington.

Represented organization before state legislature and in media relations. July, 2008 to October, 2009

Partner, Cable Huston Benedict Haagensen & Lloyd. Private law practice specializing in energy law. 2004 until July 2008.

Managing Partner, Energy Advocates LLP. Founded firm with offices in Portland, Oregon and Washington D.C. 1997-2003

Partner, Ball Janik LLP. 1994-1997

Partner, Heller Ehrman White & McAuliffe. 1990-1994

Partner, Tonkin Torp Galen Marmaduke & Booth. 1986-1990

Associate, Garvey Schubert. 1986-1988

Assistant General Counsel to Northwest Natural Gas handling state regulatory matters and providing counsel to the company on energy projects, including a landfill gas project. 1984-1986

Counsel to the Bonneville Power Administration litigating electric rate issues in administrative hearings and defending BPA before the Ninth Circuit Court of Appeals. 1982-84

Trial Attorney for the Federal Energy Regulatory Commission in hydroelectric licensing and co-generation regulation. 1981-82

Law Clerk for the Council on Wage and Price Stability, Executive Office of the President of the United States. 1980-81

Summary of Professional Engagements

Represented Columbia Gulf Transmission in general rate proceeding before the Federal Energy Regulatory Commission.

Represented applicants in proceeding before Federal Energy Regulatory Commission seeking authorization to provide incentive fuel mechanism and natural gas hub services.

Represented industrial gas consumers in contract negotiations for the purchase of natural gas commodity and interstate pipeline services.

Counsel to a medical center interconnecting a cogeneration plant with an investor-owned utility and advising client on long-term gas purchasing arrangement for electric generation.

Represented numerous clients to secure direct connections to interstate pipelines, addressing all regulatory issues involving certification of connecting facilities and operations of private pipelines.

Represented liquefied natural gas developer in governmental relations associated with securing federal and local permits for development of an energy project.

Represented customers in negotiating special contracts for purchasing natural gas distribution services from local utilities.

Represented public port authority in a pipeline siting issue.

Represented Eugene Water and Electric Board in select issues concerning Bonneville Power Administration.

Represented irrigation farmers in electric rate dispute involving FERC-licensed hydroelectric project before the Oregon Public Utility Commission.

Represented clients in trial court and appellate litigation on energy–related issues.

Represented industrial customer in anti-trust litigation and FERC refund proceedings stemming for 2000-2001 Western Energy Crisis.

Represented industrial electric customers in the restructuring of electric utilities in Oregon.

Represented an oil company shipper on an intrastate oil pipeline in rate proceeding before the Washington Utilities and Transportation Commission.

Individual clients while in private practice in addition to NWIGU included Alcoa, Armstrong World Industries, Blue Heron Paper, Boeing, ESCO, James River Paper (now Georgia Pacific) JR Simplot, Legacy Health Systems, MicroChip Technology, NorthernStar Natural Gas, Texaco Gas Marketing, Valley Medical Center, WaferTech, Wah Chang, West Linn Paper, and Weyerhaeuser.

Education

BA in Political Science from the University of Minnesota 1974

J.D. Northwestern School of Law, Lewis and Clark College 1980

Professional Memberships

Admitted to practice law in the States of Oregon and Texas and before several Federal district and appellate courts.

Adjunct Professor at Northwestern School of Law, Lewis and Clark College “Northwest Energy Law”. 1984 to 2005

Past Chairman of “Energy, Telecom and Utilities” section of the Oregon State Bar.

Member of the Federal Energy Bar Association.

Lecturer: Buying and Selling Electric Power in the West, Law Seminars International Conference. Presentations on natural gas industry. 2004 to 2009.