

BEFORE THE
STATE OF RHODE ISLAND
DIVISION OF PUBLIC UTILITIES AND CARRIERS

IN RE: Petition of PPL Corporation, PPL Rhode
Island Holdings, LLC, National Grid USA, and
The Narragansett Electric Company for
Authority to Transfer Ownership of The
Narragansett Electric Company to PPL Rhode
Island Holdings, LLC and Related Approvals

Docket No. D-21-09

**SURREBUTTAL TESTIMONY OF
MATTHEW I. KAHAL**

**ON BEHALF OF
THE RHODE ISLAND DIVISION OF PUBLIC UTILITIES AND CARRIERS
ADVOCACY SECTION**

DECEMBER 9, 2021

TABLE OF CONTENTS

	<u>PAGE</u>
I. OVERVIEW AND SUMMARY.....	1
II. DISCUSSION OF ISSUES	6
A. Ring-Fencing Provisions	6
B. Goodwill and the Common Equity Ratio.....	6
C. The Need for a Minimum Common Equity Ratio.....	9
D. The Issuance of Long-Term Debt	10
E. Clarification of Short-Term Debt Issues	12
III. CONCLUSION.....	14

BEFORE THE
STATE OF RHODE ISLAND
DIVISION OF PUBLIC UTILITIES AND CARRIERS

IN RE: Petition of PPL Corporation, PPL)
Rhode Island Holdings, LLC, National Grid)
USA, and the Narragansett Electric)
Company for Authority to Transfer) Docket No. D-21-09
Ownership of the Narragansett Electric)
Company to PPL Holdings, LLC and)
Related Approvals)

**SURREBUTTAL TESTIMONY OF
MATTHEW I. KAHAL**

I. OVERVIEW AND SUMMARY

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Matthew I. Kahal. I am employed as an independent consultant retained
3 in this matter by the Advocacy Section of the Division of Public Utilities and Carriers
4 (“Division Advocacy Section”). My business address is 1108 Pheasant Xing,
5 Charlottesville, VA 22901.

6 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS DOCKET?**

7 A. Yes. I submitted direct testimony¹ filed on November 3, 2021 on behalf of the Division
8 Advocacy Section addressing financial policy/cost of capital issues associated with the
9 proposed acquisition of Narragansett Electric Company (“Narragansett” or “the
10 Company”) from National Grid USA by PPL Corporation (“PPL”), referred to in my
11 testimony as the “Transaction.”

12 **Q. WHAT WERE THE MAIN CONCLUSIONS AND RECOMMENDATIONS**
13 **SET FORTH IN YOUR DIRECT TESTIMONY?**

¹ Direct Testimony of Matthew I. Kahal (“Kahal Direct Test.”).

1 A. My direct testimony recognizes the Rhode Island’s standard for approving a change of
2 ownership and control of a utility is that the change must be shown to be “consistent
3 with the public interest,” which also means an expectation of no net harm to utility
4 customers.² My testimony notes that utility mergers, unlike mergers among
5 unregulated companies, inevitably impose merger-related risks on utility customers,
6 rather than those risks being absorbed by shareholders.³ This is because the utility
7 being acquired is regulated on a cost of service basis, which means that if the merger
8 results in higher costs, there is a substantial risk that such costs will be passed on to
9 customers through the ratemaking process rather than being absorbed by shareholders.
10 Thus, if a merger is to meet the “no net harm” public interest standard, there must be a
11 showing that the post-acquisition risks for customers, both in terms of the cost and
12 quality of service, are convincingly addressed and mitigated. Often, this requires
13 protective approval conditions and commitments to the regulator by the prospective
14 new owner.

15 In my direct testimony, I find that the proposed Transaction fails to meet Rhode Island’s
16 “no net harm” to customers and “consistent with the public interest” standards.⁴ This
17 is due to the absence of protective conditions and commitments, both in the filed
18 Petition and data responses, and as set forth in the testimony of other Division
19 Advocacy Section witnesses. Those witnesses explain the concerns and customer risks
20 resulting from the loss of scale economies and synergies that Narragansett enjoys today
21 through its affiliation with National Grid USA. The testimony of the Division

² Kahal Direct Test. at 6:7-9.

³ This observation sets aside the critical public interest and antitrust issue for unregulated mergers of potential impairment to competition and market function. That issue does not arise in the context of this proposed Transaction.

⁴ Kahal Direct Test. at 11:19-12:3.

1 Advocacy Section witnesses also raises concerns regarding potential adverse impacts
2 on Narragansett customers resulting from transition costs. I therefore recommend in
3 my direct testimony that the Division deny approval of the proposed Transaction.

4 In the event, however, that the Division is inclined to approve the Transaction, my
5 direct testimony recommends that an approval be accompanied by several conditions
6 addressing issues of financial policy.⁵ These include enforceable conditions to: (1)
7 implement a set of “ring fencing” measures to protect Narragansett’s financial integrity
8 and prevent affiliate abuse; (2) address on a prompt basis liquidity and short-term debt
9 needs; (3) exclude goodwill from Narragansett’s ratemaking capital structure; (4)
10 maintain a minimum common equity ratio of 48 percent (calculated on a regulatory
11 basis) for at least five years post-closing; and (5) issue future Narragansett long-term
12 debt in the form of secured debt if determined to be feasible, practicable and cost
13 effective. Unfortunately, most of these very straight-forward commitments were either
14 absent from the Petition or explicitly rejected by PPL.

15 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

16 A. On November 23, 2021, the Petitioners submitted the Pre-Filed Rebuttal Testimony of
17 Tadd Henninger, Vice President – Finance and Treasurer of PPL Corporation. His
18 testimony discusses Narragansett’s planned financial policies under PPL ownership
19 and responds to my proposed approval conditions. Mr. Henninger appears to commit
20 PPL to a set of ring-fencing measures similar (though not identical) to much of what I
21 recommend.⁶ In addition, he states that Narragansett will participate in a new PPL
22 Credit Facility that can serve as a source for short-term debt. He further states that

⁵ *Id.* at 12:3-13:8.

⁶ Rebuttal Testimony of Tadd Henninger at 6:15-7:9 (“Henninger Rebuttal Test.”).

1 post-closing, Narragansett will submit this Credit Facility to the Division for its review
2 and approval, although no information on timing is provided.⁷ The Division review
3 process for this application can serve as an appropriate vehicle for addressing the
4 liquidity and short-term debt sourcing issues I have raised, and I interpret Mr.
5 Henninger's testimony stating the plans to submit this application as being a firm
6 commitment.

7 Unfortunately, Mr. Henninger rejects my other three recommended commitments, even
8 though he does not appear to have any substantive disagreement with them.
9 Specifically, he states Narragansett's post-closing intention to maintain a common
10 equity ratio of approximately 51 percent, but he refuses to commit to that planned figure
11 or for that matter to any minimum common equity ratio for any period of time.⁸ He
12 acknowledges that it is normal practice for all three PPL utilities to issue secured long-
13 term debt (under first mortgage bond indentures), and he states that post-closing
14 Narragansett will investigate doing the same. But again he refuses to make any
15 commitment.⁹ Finally, he admits that it is standard practice for utilities to exclude
16 goodwill from the ratemaking capital structure, and he states that post-closing he
17 expects Narragansett to continue this long-standing practice. However, he is unwilling
18 to commit to doing so, stating that PPL reserves the right to have Narragansett reflect
19 goodwill in its ratemaking capital structure in the future if doing so at that time is
20 deemed to be appropriate.¹⁰

21 **Q. PLEASE SUMMARIZE YOUR RESPONSE TO MR. HENNINGER.**

⁷ *Id.* at 8:9-12.

⁸ *Id.* at 10:14-11:4.

⁹ *Id.* at 12:4-13.

¹⁰ *Id.* at 9:14-10:3.

1 A. Mr. Henninger’s rebuttal testimony is helpful in resolving the ring fencing and short-
2 term debt issues that are posed by the Transaction, although some clarification is still
3 needed. On the three remaining issues—minimum common equity ratio, the potential
4 issuance of secured debt (if appropriate) and the ratemaking capital structure—there is
5 little substantive disagreement between our respective testimonies. His descriptions of
6 the planned financial policies for Narragansett track my recommendations closely. The
7 problem is that on these three issues PPL is unwilling to provide any commitments –
8 and offers only unenforceable statements of plans and intentions.
9 I therefore find that his Rebuttal Testimony does not support Division approval of this
10 Transaction as being consistent with the public interest. I continue to recommend that
11 the Division deny approval of the Transaction. These issues are discussed further in
12 Section II of my Rebuttal Testimony.

13 **II. DISCUSSION OF ISSUES**

14 **A. Ring Fencing**

15 **Q. HOW DOES MR. HENNINGER’S COMMITMENT REGARDING RING-**
16 **FENCING MEASURES COMPARE WITH YOUR RECOMMENDATION?**

17 A. They are generally similar. On pages 16-17 of my direct testimony, I list eight
18 recommended ring-fencing measures. Measures (7) and (8) pertain to short-term debt
19 financing and the minimum common equity ratio which are issues discussed separately
20 by Mr. Henninger and later in this surrebuttal testimony. At pages 6-7 of his Rebuttal
21 Testimony, Mr. Henninger commits to implementing five ring-fencing measures which
22 are similar to the first six of my ring-fencing measures.

23 While Mr. Henninger’s five ring-fencing measures are acceptable, as far as they go, I
24 include two measures that Mr. Henninger did not explicitly address (or dispute).

1 Specifically, I propose (in measure (4)) that Narragansett be precluded from lending
2 funds to corporate affiliates on a long-term basis, and propose (in measure (5)) that
3 Narragansett be restricted to using the proceeds from its long-term debt issues solely
4 for the purposes of financing its utility investments and operations. Since Mr.
5 Henninger did not contest these two measures, I assume PPL would not object to their
6 inclusion in a set of ring-fencing protections.

7 **B. Goodwill and the Common Equity Ratio**

8 **Q. WHAT IS MR. HENNINGER'S POSITION REGARDING GOODWILL IN**
9 **THE RATEMAKING CAPITAL STRUCTURE?**

10 A. Mr. Henninger explains that post-Transaction there will be a total of about \$1.7 billion
11 in goodwill. About \$1 billion of that will be from the acquisition premium resulting
12 from this Transaction which will be reflected on the balance sheet of PPL Rhode Island
13 rather than Narragansett. There will be another \$0.7 billion which is presently on the
14 Narragansett balance sheet, and under National Grid USA ownership this amount has
15 been consistently removed from the ratemaking capital structure.¹¹

16 Mr. Henninger seems to accept that the exclusion of goodwill from the ratemaking
17 capital structure is a proper practice, but he is unwilling to commit that Narragansett
18 under PPL ownership will follow that practice in the future. He states: "PPL will
19 continue to exclude goodwill from this [capital structure] calculation so long as this
20 treatment of goodwill remains consistent with the prevailing regulatory best practices
21 with respect to ratemaking capital structure."¹² He further explains that Narragansett
22 under PPL ownership would not change this practice "unless the regulatory paradigm

¹¹ Henninger Rebuttal Test. at 8:16-19.

¹² *Id.* at 9:6-9.

1 changes.”¹³ He does not explain what he means by a change in the “regulatory
2 paradigm” or why this could possibly justify providing rate recovery (even in part) of
3 goodwill, which is merely a non-cash accounting write-up which does not support
4 either utility investment or utility operations.

5 **Q. SINCE THE RATEMAKING CAPITAL STRUCTURE IS SUBJECT TO**
6 **COMMISSION APPROVAL, WHY IS YOUR RECOMMENDED**
7 **COMMITMENT NEEDED?**

8 A. Mr. Henninger is stating that he expects to follow Narragansett’s past long-standing
9 practice on capital structure, but, if circumstances change (e.g., a new paradigm), then
10 PPL reserves the right to include goodwill as part of the ratemaking capital structure.
11 The goodwill amounts either on PPL Rhode Island balance sheet or Narragansett’s own
12 balance sheet post Transaction would be massive, and its inclusion would sharply
13 increase the authorized rate of return on rate base by inflating the equity ratio. This
14 could adversely and significantly increase customer rates as compared to
15 Narragansett’s long-standing practice under National Grid USA ownership.
16 Mr. Henninger accurately observes that the ratemaking capital structure in base rate
17 cases is subject to Commission approval. However, there are two potential problems
18 with leaving the discretion over capital structure calculation to PPL. First, Narragansett
19 in a future base rate case could include some amount of goodwill in the capital structure
20 without informing the Commission that it has done so and has made this change to
21 methodology. Second, if in a base rate case PPL were to propose the change in
22 methodology (i.e., include goodwill) and Commission decided to reject that proposed
23 change as inappropriate, Narragansett could appeal the Commission’s decision on the

¹³ *Id.* at 9:18-19.

1 grounds that the goodwill it has included is part of its actual book equity. These
2 possibilities expose utility customers to risks that are not present in the current
3 structure.

4 **Q. WHAT DO YOU RECOMMEND?**

5 A. I recommend that as a condition of approval PPL must commit that Narragansett will
6 follow its long-standing practice under National Grid USA ownership of excluding
7 goodwill from the ratemaking capital structure. As with all of my recommendations,
8 Narragansett retains the right to request a Division or Commission waiver or
9 modification to this commitment upon an appropriate public interest showing. This
10 should address Mr. Henninger’s concern regarding the unspecified changing
11 “regulatory paradigm.”

12 **C. The Need for a Minimum Common Equity Ratio**

13 **Q. MR. HENNINGER IS UNWILLING TO COMMIT TO A MINIMUM**
14 **COMMON EQUITY RATIO DURING A FIVE-YEAR TRANSITION PERIOD.**
15 **WHAT EXPLANATION DOES HE PROVIDE FOR THIS POSITION?**

16 A. At page 10 of his Rebuttal Testimony, Mr. Henninger responds to my recommendation
17 by stating that it is PPL’s intention that, post-Transition, Narragansett will maintain a
18 common equity ratio of about 51 percent, consistent with the determination in its most
19 recent base rate case.¹⁴ However, beyond this statement of “intention” he is unwilling
20 to provide any enforceable commitment to the 51 percent level or to any other level of
21 common equity. He seems to suggest that PPL’s expression of its intention and plans
22 is sufficient assurance and that no enforceable commitment is needed. He provides no

¹⁴ *Id.* at 10:7-10.

1 convincing explanation regarding why a minimum common equity ratio commitment
2 is inappropriate or not needed.

3 **Q. DO YOU CONTINUE TO SUPPORT THE IMPOSITION OF A MINIMUM**
4 **COMMON EQUITY RATIO REQUIREMENT FOR A PERIOD OF FIVE**
5 **YEARS POST CLOSING?**

6 A. Yes. While I appreciate PPL's statement of intention, as circumstances change,
7 Narragansett's balance sheet during the first several years following closing could
8 unduly weaken absent a commitment by PPL to maintain a reasonable minimum
9 common equity ratio. As the ultimate parent, PPL has the ability to weaken
10 Narragansett financially either by draining cash through excessive dividend payments
11 or by failing to provide equity capital when needed for utility investment. This could
12 harm Narragansett's credit quality and impair its ability to undertake needed capital
13 spending. A minimum common equity ratio requirement and commitment is a basic
14 financial protection which should accompany any Division approval of this
15 Transaction.

16 **D. The Issuance of Long-Term Debt**

17 **Q. WHAT IS YOUR CONCERN REGARDING THE ISSUANCE OF LONG-**
18 **TERM DEBT?**

19 A. In my direct testimony at page 24 I noted the potential for substantial savings for
20 Narragansett and its customers if it were to issue long-term debt as secured instead of
21 unsecured.¹⁵ Secured debt for a given utility and debt tenor is normally rated higher by
22 credit rating agencies and therefore carries a lower cost rate as compared to unsecured
23 debt for the same utility. I therefore recommend that PPL investigate this issue for

¹⁵ Kahal Direct Test. at 23:20-24:9.

1 Narragansett and in future years issue secured long-term debt if it is determined to be
2 cost effective, practicable and feasible.

3 Mr. Henninger notes that PPL's three utility subsidiaries do indeed issue secured long-
4 term debt and that PPL intends to investigate having Narragansett do so. He confirms
5 that post closing "PPL will evaluate the costs, benefits, and constraints associated with"
6 establishing a secured indenture for Narragansett which would enable it to issue
7 secured first mortgage bonds in the future.¹⁶ After stating PPL's intention to proceed
8 with a secured indenture for Narragansett (if deemed feasible and cost effective), he
9 appears to object to PPL reporting back to the Division or committing to anything
10 pertaining to secured debt. He further argues that such a condition pertaining to the
11 issuance of secured debt would be improper, claiming that there is no such
12 corresponding obligation for Narragansett under National Grid USA ownership.¹⁷

13 **Q. WHAT IS YOUR RESPONSE TO MR. HENNINGER'S POSITION ON THIS**
14 **ISSUE?**

15 A. Mr. Henninger and I seem to be in agreement on the substantive question regarding
16 whether the use of secured debt by Narragansett is potentially beneficial and should be
17 investigated and pursued if deemed feasible and cost effective. The issue in this
18 proceeding, however, is whether PPL should commit to doing so in connection with
19 the Division approval of this Transaction. My recommended commitment appears to
20 be entirely consistent with what PPL intends to do in any case. Such a commitment is
21 important and entirely appropriate because it will help ensure that, under PPL
22 ownership, Narragansett will finance its future capital investments at the lowest

¹⁶ Henninger Rebuttal Test. at 12:10-11.

¹⁷ *Id.* at 13:7-9.

1 reasonable cost. As I demonstrated in my direct testimony (see page 24), secured debt
2 can provide considerable savings for customers.¹⁸ It is particularly pertinent to identify
3 potential cost savings from this Transaction given the very substantial risks that utility
4 customers must bear if this Transaction is approved, as documented extensively by
5 Division Advocacy Section witnesses.

6 I also disagree with Mr. Henninger's argument that requiring such an approval
7 condition is improper because there is no such corresponding secured debt requirement
8 for Narragansett under continued National Grid USA ownership. While the
9 circumstances and context of the proposed Transaction versus continued National Grid
10 USA ownership differ somewhat, substantially the same issue was addressed in
11 Narragansett's most recent debt financing docket before the Division (Division Docket
12 No. D-19-17). In that docket, Narragansett and the Division Advocacy Section reached
13 a settlement agreement approved by the Division in December 2019.¹⁹ While the
14 settlement provides flexibility, authorizing the issuance of either secured or unsecured
15 long-term debt, paragraph 4 of that settlement states that in the event Narragansett does
16 issue unsecured instead of secured long-term debt, Narragansett will be obligated to
17 submit testimony in its next rate case that explains and justifies that decision.
18 Moreover, the Division Advocacy Section would retain the right to challenge the rate
19 recovery of any such unsecured debt cost premium.²⁰ Hence, the Division-approved
20 settlement in that docket does indeed establish both obligations for Narragansett and
21 cost recovery exposure with respect to decisions about long-term debt. While not

¹⁸ Kahal Direct Test. at 23:19-24:9.

¹⁹ *In re. The Narragansett Elec. Co. d/b/a National Grid, Application for Auth. to Issue Long-Term Debt*, Report and Order, Division Docket No. D-19-17 (Dec. 20, 2019).

²⁰ *Id.*, Settlement Agreement ¶ 4.

1 precisely the same as my recommendation in this case on that issue (as the
2 circumstances and context are quite different), I believe the present requirement for
3 Narragansett is analogous to my proposed condition, in that both are attempts to
4 achieve the same end result.

5 **E. Clarification of Short-Term Debt Issues**

6 **Q. HOW HAS MR. HENNINGER ADDRESSED YOUR CONCERNS**
7 **REGARDING NARRAGANSETT'S LIQUIDITY AND ACCESS TO SHORT-**
8 **TERM DEBT POST TRANSACTION?**

9 A. Mr. Henninger states that PPL is in the process of establishing a new Credit Facility in
10 which Narragansett will be able to participate as a borrower and thereby access needed
11 liquidity and short-term debt.²¹ This planned Credit Facility can serve as either a direct
12 source of funds or as a backstop for a commercial paper program. He states that at this
13 time PPL has no plans to create a new utility money pool arrangement in which
14 Narragansett can participate, but "PPL will continue to evaluate and consider whether
15 a money pool would be beneficial prospectively."²² Any such new money pool
16 agreement involving Narragansett would be submitted to the Division for its review
17 and approval.²³

18 Post-closing, Narragansett will file an application with the Division for the review and
19 approval of the planned new Credit Facility agreement.

20 **Q. WHAT IS YOUR RESPONSE TO PPL'S PLANS CONCERNING THE**
21 **PROVISION OF SHORT-TERM DEBT?**

²¹ Henninger Rebuttal Test. at 14:4-13, 15:3-16:3.

²² *Id.* at 16:12-13.

²³ *Id.* at 17:7-9.

1 A. I interpret Mr. Henninger's statement regarding Narragansett's intention to file and
2 application for Division review and approval of a new Credit Facility agreement as a
3 commitment that largely meets my concerns. While he does not specify the timing of
4 this anticipated filing, I believe that it would be appropriate to specify a time period for
5 that filing of up to six months after the Transaction closes (which date could be subject
6 to modification by the Division for good cause). This resulting Division docket could
7 be used as a forum for examining the various issues associated with Narragansett's
8 short-term debt practices under PPL ownership.

9 **IV. CONCLUSION**

10 **Q. BASED ON YOUR REVIEW OF MR. HENNINGER'S REBUTTAL**
11 **TESTIMONY, PLEASE SUMMARIZE YOUR MAIN CONCLUSIONS.**

12 A. There are some areas of agreement between Mr. Henninger and myself on the
13 substantive issues of financial policy. In particular, we are to a large extent in
14 agreement on the need (and commitment) for certain ring-fencing measures for
15 Narragansett. In addition, I believe that his testimony has adequately addressed the
16 various potential issues associated with short-term debt. I interpret his proposal to file
17 an application for Division review and approval of a Credit Facility agreement as a
18 commitment to do so. Unfortunately, his rebuttal testimony fails to set forth the needed
19 commitments regarding the exclusion of goodwill from the ratemaking capital
20 structure, the use of secured long-term debt (if determined to be feasible and cost
21 effective), and the commitment to maintain for a period of several years a reasonable
22 minimum common equity ratio to protect Narragansett's credit quality and financial
23 strength. Such commitments would be needed in the event that the Division is inclined
24 to approve the Transaction. I continue to recommend that the proposed Transaction

1 not be approved by the Division as it fails to meet Rhode Island’s “consistent with the
2 public interest” and “no net harm” standard, as discussed in my testimony and that of
3 other Division Advocacy Section witnesses.

4 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

5 A. Yes, it does.