

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

**DIRECT TESTIMONY AND SUPPORTING EXHIBITS OF
MATTHEW I. KAHAL**

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

NOVEMBER 3, 2021

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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

**DIRECT TESTIMONY OF
MATTHEW I. KAHAL**

I. QUALIFICATIONS

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 Division of Public Utilities and Carriers (“Division”). My business
4 address is 1108 Pheasant Xing, Charlottesville, VA 22901.

5 **Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND.**

6 A. I hold B.A. and M.A. degrees in economics from the University of Maryland and have
7 completed course work and examination requirements for the Ph.D. degree in
8 economics. My areas of academic concentration included industrial organization,
9 economic development and econometrics.

10 **Q. WHAT IS YOUR PROFESSIONAL BACKGROUND?**

11 A. I have been employed in the area of energy, utility and telecommunications consulting
12 for more than 35 years working on a wide range of topics. Most of my work has
13 focused on electric utility integrated planning, plant licensing, environmental issues,
14

1 mergers and environmental issues, mergers and financial issues. I was a co-founder of
2 Exeter Associates, and from 1981 to 2001 I was employed at Exeter Associates as a
3 Senior Economist and Principal. During that time, I took the lead role at Exeter in
4 performing cost of capital and financial studies. In recent years, the focus of much of
5 my professional work has shifted to electric utility restructuring and competition.
6 Prior to entering consulting, I served on the Economics Department faculties at the
7 University of Maryland (College Park) and Montgomery College teaching courses on
8 economic principles, development economics and business.

9 **Q. HAVE YOU PREVIOUSLY TESTIFIED AS AN EXPERT WITNESS BEFORE**
10 **UTILITY REGULATORY COMMISSIONS?**

11 A. Yes. I have testified before approximately two-dozen state and federal utility
12 commissions in more than 440 separate regulatory cases. My testimony has addressed
13 a variety of subjects including fair rate of return, resource planning, financial
14 assessments, load forecasting, competitive restructuring, rate design, purchased power
15 contracts, merger economics and other regulatory policy issues. These cases have
16 involved electric, gas, water and telephone utilities. A list of these cases, along with
17 my statement of qualifications, is provided in Exhibit A to this testimony.

18 **Q. WHAT PROFESSIONAL ACTIVITIES HAVE YOU ENGAGED IN SINCE**
19 **LEAVING EXETER AS A PRINCIPAL IN 2001?**

20 A. Since 2001, I have worked on a variety of consulting assignments pertaining to electric
21 restructuring, purchase power contracts, environmental compliance, cost of capital and
22 other regulatory issues. Current and recent clients (other than the Division) include the
23 U.S. Department of Justice, U.S. Air Force, U.S. Department of Energy, the California
24 Public Utilities Commission, Connecticut Attorney General, Pennsylvania Office of

1 Consumer Advocate, the New Hampshire Consumer Advocate, New Jersey Division
2 of Rate Counsel, Louisiana Public Service Commission, Arkansas Public Service
3 Commission, Maryland Department of Natural Resources and Energy Administration,
4 the New Mexico Attorney General and the Ohio Consumers' Counsel.

5 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE RHODE ISLAND**
6 **COMMISSION?**

7 A. Yes. I have testified on cost of capital and other matters before the Rhode Island Public
8 Utilities Commission ("Commission") in gas, electric and water cases during the past
9 35 years. I was retained as the Division's witness to address cost of capital and fair
10 rate of return in National Grid USA's ("National Grid") base rate cases before the
11 Public Utilities Commission in 2009, 2012 and 2017 (RIPUC Docket Nos. 4065, 4323
12 and 4770). In 2017, I provided testimony to the Commission regarding financial
13 impacts concerning the National Grid Revolution Wind PPA (Docket No. 4929).

14 **Q. DO YOU HAVE EXPERIENCE IN REVIEWING UTILITY DEBT ISSUANCE**
15 **APPLICATIONS?**

16 A. Yes, I have done so on numerous occasions during the last ten years on behalf of utility
17 commission staffs and consumer advocacy agencies. I assisted the Division and served
18 as its expert witness in National Grid's last four debt issuance applications in 2009
19 (Division Docket No. D-09-49), 2012 (Division Docket No. D-12-12), 2017 (Division
20 Docket No. D-17-36) and 2019 (Division Docket No. D-19-17). The 2019 filed
21 Application was resolved through an uncontested Settlement approved by the Division
22 in December 2019.

23

1 **II. OVERVIEW AND SUMMARY**

2 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

3 A. On May 4, 2021 PPL Corporation (“PPL Corp.”), PPL Rhode Island Holdings, LLC
4 (“PPL Rhode Island”), collectively, (“PPL”), National Grid, and Narragansett Electric
5 Company (“Narragansett” or “the Company”) (collectively, “the Petitioners”) filed a
6 Petition with the Division of Public Utilities and Carriers (“the Division”) for authority
7 to transfer the ownership of Narragansett to PPL Rhode Island (referred to as “the
8 Transaction”). Since PPL Rhode Island, which has been established for purposes of
9 this Transaction, is a wholly-owned subsidiary of PPL, as a practical matter under this
10 Transaction the effective ownership and control of Narragansett would transfer to the
11 ultimate parent, PPL. As a matter of convenience my testimony refers to PPL as the
12 prospective owner of Narragansett rather than to PPL Rhode Island. Narragansett is
13 presently owned, controlled and managed by National Grid (which itself is a subsidiary
14 of the British utility company National Grid plc). I have been retained by the Division’s
15 Advocacy Section to review the Petition and evaluate potential issues associated with
16 financing and cost of capital.

17 **Q. PLEASE BRIEFLY DESCRIBE THE PROPOSED TRANSACTION.**

18 A. On March 17, 2021, PPL (and its subsidiary) entered into the Share Purchase
19 Agreement with National Grid to purchase 100 percent of the common shares of
20 Narragansett.¹ Post-closing, Narragansett will continue to operate as a Rhode Island

¹ 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, Division Docket No. D-21-09 (May 4, 2021) (“Petition”). Petition ¶¶ 1, 2. Under this Agreement the buyer is another PPL subsidiary, PPL Energy Holdings, LLC with that ownership transferring to PPL Rhode Island upon closing. PPL is also a party to certain sections of the agreement to provide certain guarantees.

1 retail electric and gas utility with its existing assets and business operations but with a
2 new owner.² The Transaction is entirely a cash purchase by PPL with a purchase price
3 of about \$3.8 billion (with normal pricing adjustments at closing), and PPL also will
4 assume Narragansett’s outstanding debt and preferred stock, presently about \$1.5
5 billion.³ Thus, the entire value of the purchase is about \$5.3 billion. As part of this
6 Transaction, Narragansett and its prospective former parent National Grid will enter
7 into a Transition Services Agreement (“TSA”), anticipated to cover a time period post-
8 closing of up to two years, whereby National Grid will continue to provide various
9 utility-related business services to Narragansett until Narragansett and PPL are fully
10 capable of providing those necessary services on their own.⁴

11 It is important to note that this Transaction is linked to another asset sale taking place
12 within this same time frame involving PPL and National Grid plc. Until recently, PPL
13 owned and operated the British electric distribution utility, Western Power Distribution
14 (“WPD”). At approximately the same time as this Transaction, PPL entered into an
15 agreement to sell WPD to an affiliate of National Grid plc for a dollar equivalent price
16 of approximately \$10 billion. Hence, PPL is able to purchase Narragansett on an
17 entirely cash basis without the need for any external debt financing. In fact, these two
18 combined transactions leave PPL with additional net cash after purchasing
19 Narragansett of about \$6 billion, which can be used for some combination of debt
20 reduction at the holding company level and additional future investments.⁵ This cash

² *Id.* ¶ 12.

³ Petition, ex. 1, at 11-12, testimony of Vincent Sorgi (“Sorgi test”).

⁴ Petition ¶¶ 19-20.

⁵ *PPL Corporation, Value Line Investment Survey* (Aug. 13, 2021).

1 inflow provides PPL with an opportunity to strengthen its balance sheet and credit
2 quality.

3 **Q. PLEASE BRIEFLY DESCRIBE PPL.**

4 A. PPL is a large public utility holding company, headquartered in Allentown,
5 Pennsylvania, with a market capitalization of approximately \$22 billion. It presently
6 owns three utility companies: PPL Electric Utilities (formerly Pennsylvania Power &
7 Light Company), an electric delivery service utility in Pennsylvania; Louisville Gas &
8 Electric Company (“LG&E”), a combination electric and gas utility; and Kentucky
9 Utilities (“KU”), an electric utility. LG&E and KU operate mostly or entirely in
10 Kentucky, and their electric operations are vertically integrated, meaning they own and
11 operate generation facilities in addition to providing delivery service. In total, the three
12 utilities have approximately 2.5 million electric customers and 1.3 million gas
13 customers.⁶ PPL also has a financing subsidiary, PPL Capital Funding, Inc., which is
14 not a regulated utility, but which can provide financing (when needed) for PPL’s
15 utilities. At the present time PPL has a relatively small amount of non-utility
16 investments, mostly related to renewable energy resources, but PPL consists
17 predominantly of its fully regulated utility investments.

18 PPL and its utility subsidiaries have relatively strong, investment grade credit ratings.
19 Standard & Poor’s (“S&P”) rates PPL and all three utilities A- (issuer rating). Moody’s
20 rates PPL holding company Baa2, but rates each of the three utilities as A3.⁷ With the
21 exception of the PPL Moody’s rating of Baa2, these ratings are similar to or slightly

⁶ Sorgi test. at 5:21-6:2.

⁷ PPL’s response to Advocacy Section Data Request DIV 8-6, at 1-2.

1 better than the current ratings for Narragansett, which is rated Baa1 by Moody's and
2 BBB+ by S&P. Narragansett presently is rated by Moody's (issuer rating) as one notch
3 lower than the ratings it has assigned to each of the three PPL utility subsidiaries.⁸

4 **Q. HOW DO PETITIONERS SUPPORT DIVISION APPROVAL OF THE**
5 **PROPOSED TRANSFER OF OWNERSHIP OF NARRAGANSETT?**

6 A. The Petition cites to the Rhode Island legal standard, which requires a demonstration
7 that the transfer will not result in a degradation or diminution in utility service and the
8 ownership transfer be found to be consistent with the public interest (which includes
9 the interests of utility customers).⁹ Stated differently, Petitioners assert that the legal
10 standard is one of no net harm to utility customers from the ownership transfer rather
11 than a showing of affirmative net benefits. The Petition and supporting testimony
12 attempt to show that these standards have been met. Witness Gregory Dudkin observes
13 that upon closing Narragansett will continue to operate as it has under National Grid
14 ownership, with the same utility plant, the same operating field personnel maintaining
15 those facilities and charging rates under the existing Rhode Island Commission
16 approved tariffs.¹⁰ But, as discussed by Advocacy Section witnesses Gregory L. Booth,
17 Bruce R. Oliver, and Michael R. Ballaban, PPL has not adequately demonstrated that
18 it will be able to provide the same level of service without adverse impacts to
19 Narragansett ratepayers.

20 **Q. DO PETITIONERS OFFER ANY CUSTOMER BENEFIT OR PROTECTION**
21 **COMMITMENTS IN THE PETITION?**

⁸ National Grid's response to Advocacy Section Data Request DIV 8-5.

⁹ Petition ¶ 4.

¹⁰ Petition, ex. 2, at 5:5-19, testimony of Gregory Dudkin.

1 A. Petitioners do not claim or demonstrate net benefits relative to continued ownership by
2 National Grid, and they provide only limited customer protection commitments. Based
3 on my review, I note that the commitments identified in the Petition are limited to the
4 following: (a) no rate recovery of the acquisition premium;¹¹ (b) no rate recovery of
5 transaction costs;¹² (c) commitments for a period of time post-closing regarding
6 Narragansett employee compensation;¹³ and (d) the commitment of Petitioners to enter
7 into the TSA to ensure the continuation of certain required business services during the
8 transition period.¹⁴ As I discuss below in testimony, Petitioners appear to be open to
9 at least the possibility of taking other measures that will help to protect customer
10 interests post-closing, but these are often expressed as “plans” or expectations and not
11 as firm commitments. Unenforceable statements of intention cannot be the basis of a
12 finding that the proposed transaction meets the public interest legal standard for
13 Division approval.

14 **Q. DO YOU HAVE ANY COMMENTS ON PETITIONERS’ CLAIM THAT THE**
15 **TRANSACTION TRANSFERRING OWNERSHIP OF NARRAGANSETT TO**
16 **PPL MEETS THE LEGAL STANDARD FOR APPROVAL?**

17 A. Yes. As noted above, the Petitioners cite to Rhode Island’s legal standard requiring
18 that the Transaction result in no diminishment of utility service and consistent with the
19 public interest. Petitioners’ interpretation of the legal standard implies that Petitioners

¹¹ Petition ¶ 38.

¹² *Id.* This is a narrow category of expenses including those associated with entering into and completing the Transaction such as legal and outside consultant fees, due diligence expenditures and expenses associated with securing the required regulatory approvals. PPL will not incur any expenses associated with obtaining outside financing since it is using cash from the sale of WPD for the asset purchase.

¹³ *Id.* ¶ 17.

¹⁴ *Id.* ¶ 19-20. As discussed in some detail in Advocacy Section witness David J. Efron’s testimony, it appears that PPL is willing to hold utility customers harmless from the loss of deferred tax benefits by some means.

1 need not show that customers necessarily would be better off under the change of
2 ownership. As a result, the Petition does not make that assertion.

3 In considering this standard for approval, it is important to understand the distinction
4 between public utility mergers (or change of ownership) and mergers in the unregulated
5 economy. For the unregulated economy, there is no need for the standard of review
6 normally applied to utility mergers. Rather, the standard (as overseen by the U.S.
7 Department of Justice and/or Federal Trade Commission) focuses primarily on the
8 avoidance of undue impairment to competition, excessive market concentration and the
9 proper functioning of competitive markets.¹⁵ Setting aside these vitally important
10 antitrust issues, the merger risks for unregulated companies are often considerable and
11 are borne by the merging parties' shareholders. Capital and product markets in which
12 the unregulated merging parties operate therefore provide the competitive discipline
13 for their merger decision making. Investors in the acquiring company must bear the
14 risk of any resulting costs, inefficiencies and losses that might result from the merger.
15 The circumstances for public utility mergers are quite different since utilities operate
16 as cost-of-service regulated monopolies. To at least a very large extent, utility
17 customers must inevitably bear the costs and risks of change of ownership transactions
18 that fail to achieve claimed objectives, efficiencies and performance.¹⁶ As a result, it
19 is crucially important that there is a high degree of confidence that the favorable
20 performance claims asserted by Petitioners are realistically achievable. Utility

¹⁵ The Narragansett change of ownership does not appear to raise these market concentration concerns since Narragansett is entirely regulated utility and does not operate in competitive, unregulated markets.

¹⁶ Properly structured hold-harmless and other protective conditions of approval to some limited degree can mitigate such customer risks. However, such protective conditions can be implemented only for issues that can be identified upfront and generally only in the short-run. They cannot ensure protection from adverse outcomes for customers on a long-run basis.

1 customers inevitably will bear the cost if performance claims are not achieved, and for
2 that reason it is vitally important that Transaction approval be coupled with legally
3 enforceable protections and commitments. As discussed in my testimony and that of
4 other Advocacy Section witnesses, this is to a large degree missing from the Petition.
5 For the Transaction to be approved as being consistent with the public interest,
6 Petitioners must demonstrate an expectation of no harm but also provide such
7 protections, commitments, and, where feasible, even benefits that compensate utility
8 customers for involuntarily assuming the considerable merger performance and
9 execution risks. As demonstrated in this testimony and by other Advocacy Section
10 witnesses, Petitioners' filing does not provide sufficient protections and commitments
11 needed to make the requisite demonstration of no harm.

12 **Q. PLEASE SUMMARIZE YOUR MAIN FINDINGS FROM YOUR REVIEW OF**
13 **THE PETITION.**

14 A. My review of the Petition and discovery responses focuses mainly on the financial
15 policy and cost of capital issues. My main findings are:

- 16 1. PPL is a large utility holding company that operates three major electric/gas
17 utilities providing retail utility service in Pennsylvania, Kentucky and Virginia.
18 In attempting to demonstrate that the proposed Transaction meets Rhode
19 Island's legal standard for approval, the Petition documents PPL's experience
20 and accomplishments in operating its three utilities.
- 21 2. PPL has the financial capability and qualifications to acquire Narragansett,
22 including access to capital. This Transaction is entirely a cash purchase and
23 does not require PPL to issue any new debt or equity to finance the asset
24 purchase.

- 1 3. While citing to its qualifications and experience in operating its three U.S.
2 utilities, the Petition does not affirmatively commit that Narragansett's
3 customers will enjoy net benefits from PPL ownership as compared to
4 continued National Grid ownership, merely that there will be no net harm.
5 However, the assertion of no net harm does not go far enough, and leaves utility
6 customers exposed to risk.
- 7 4. One potential concern is whether the Transaction will likely result in an increase
8 in Narragansett's cost of capital. Provided that PPL and Narragansett accept
9 reasonable "ring-fencing" and other financial protections (protections that
10 Petitioners have not yet agreed to accept), the Transaction should not cause an
11 increase in Narragansett's cost of capital as compared to continued National
12 Grid ownership. In fact, there is the potential for at least a modest cost of capital
13 savings at some time in the future.
- 14 5. There are several areas of financial policy and practices that require greater
15 clarity and certainty from PPL. This includes ring-fencing measures, sources
16 of liquidity and short-term debt, capital structure policy and long-term debt
17 issuance practices.

18 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS AT THIS TIME.**

19 A. Based on the information and very limited affirmative commitments provided by
20 Petitioners to date, I do not support approval of the as-filed Petition. As noted,
21 Petitioners assert that the Transaction meets Rhode Island's public interest standard for
22 approval because it will result in no net harm to utility customers. As discussed in my
23 testimony and that of other Advocacy Section witnesses, the Transaction exposes utility
24 customers to considerable risk and even likelihood of harm, without adequate

1 protections against those substantial risks. The absence of such commitments and
2 protections means that the Transaction cannot meet the no net harm standard of
3 approval. That said, I have several recommendations for conditions pertaining to
4 financial policy and cost of capital that, if accepted by Petitioners, could provide some
5 needed protections against risk. These are as follows:

- 6 1. PPL and Narragansett should commit to implementing a comprehensive set of
7 ring-fencing measures as described in Section III.A. of my testimony. Such
8 measures, which PPL seems inclined to accept but to which it is unwilling to
9 commit, are needed to protect the Narragansett credit ratings and financial
10 integrity from adverse impacts associated with the Transaction and to avoid
11 potential affiliate abuse.
- 12 2. PPL and Narragansett should investigate and provide greater clarity regarding
13 the most appropriate and cost-effective means of providing Narragansett with
14 needed liquidity and short-term debt financing. This should be accomplished
15 within six months of closing on the Transaction and submitted to the Division
16 for its review.
- 17 3. PPL and Narragansett must commit to excluding from the ratemaking capital
18 structure and equity balance any goodwill on its balance sheet (inclusive of any
19 pre-closing goodwill). Specifically, Narragansett should continue its past
20 practice of subtracting all such goodwill from its per books common equity
21 balance when stating ratemaking capital structure ratios.
- 22 4. PPL and Narragansett must commit to using best efforts to target a common
23 equity ratio of at least 48 percent, as calculated on a regulatory basis (e.g.,
24 excluding goodwill from equity and including short-term debt), for a period of

1 at least five years post-closing on the Transaction. In the event the equity ratio
2 falls below 48 percent, PPL and Narragansett should make best efforts to rectify
3 that shortfall as soon as possible, including by Narragansett refraining from
4 making dividend payments to its parent or by parent cash equity infusions until
5 the minimum common equity ratio is restored.

- 6 5. To the extent determined to be feasible, practicable and cost-effective,
7 Narragansett should establish and maintain the capability of issuing secured
8 long-term debt in order to minimize over time its future cost of long-term debt.

9
10 **III. DISCUSSION OF ISSUES AND RECOMMENDATIONS**

11 **A. Ring-Fencing Provisions**

12 **Q. WHY IS IT IMPORTANT TO ESTABLISH AND IMPLEMENT RING-**
13 **FENCING PROVISIONS UPON PPL ASSUMING OWNERSHIP OF**
14 **NARRAGANSETT?**

15 A. Ring-fencing refers to a set of structural measures, required practices and regulatory
16 (or legal) restrictions intended to provide a business, financial and legal separation of
17 the operating utility company from its corporate affiliates. Such arrangements are very
18 widely implemented in the utility industry (including by PPL and National Grid) due
19 to the predominate use in the industry of the holding company, utility subsidiary
20 structure with multiple subsidiaries. Ring-fencing is intended to place restrictions on a
21 utility's financial practices and policies, as well as providing transparency, in order to
22 protect the utility's financial integrity and credit quality and to ensure proper regulatory
23 oversight. Such measures can also provide protection to the utility (as well as to its
24 customers and regulators) in the event of an affiliate bankruptcy. A further key purpose

1 of ring-fencing is to prevent “affiliate abuse”, i.e., the utility improperly subsidizing a
2 corporate affiliate. Such improper subsidies can come at the expense of the utility
3 customers since the utility is cost-of-service regulated.¹⁷

4 Credit rating agencies often review and consider the adequacy and strength of the
5 utility’s ring-fencing protective measures as part of the ratings process. For example,
6 Moody’s credit rating report for Narragansett dated September 12, 2019 lists as a credit
7 challenge or constraint the “absence of significant ring-fencing provisions at
8 [Narragansett] to restrict higher leverage” as well as the high level of debt on the
9 balance sheet of parent National Grid.¹⁸ To be clear, a utility’s affiliation with a
10 financially strong parent and/or consolidated corporation can be advantageous,
11 particularly when combined with prudent financial policies and appropriate ring-
12 fencing measures. This is because the parent is the ultimate source of equity to the
13 utility subsidiary, and adequate equity financing makes it possible for the utility to
14 conduct cost-effective debt financing.

15 **Q. DOES PPL OPPOSE THE USE OF RING-FENCING FOR NARRAGANSETT?**

16 A. Not necessarily. However, my concern is that PPL has thus been unwilling to commit
17 to it. Ring-fencing commitments are not mentioned in the Petition or the supporting
18 testimony other than in a very limited reference to Narragansett’s planned corporate
19 structure. PPL has only addressed the need for or merits of ring-fencing measures in
20 response to Advocacy Section Data Request DIV 6-3 and DIV 8-7. The response to

¹⁷ All of these purposes of ring-fencing are particularly important in the event that the utility has substantial unregulated corporate affiliates or even if the utility company itself has unregulated operations. While it is presently the case that PPL currently has only modest unregulated operations, that could change in the future.

¹⁸ National Grid’s response to Advocacy Section Data Request DIV 8-5. A copy of all data responses cited in this testimony are contained in Exhibit B to this testimony.

1 Advocacy Section Data Request DIV 6-3 seems to indicate that PPL believes that the
2 need for ring-fencing is not strong given PPL's size and financial strength, its credit
3 ratings and its relative lack of unregulated operations.¹⁹ Nonetheless, PPL "plans" to
4 have Narragansett avoid certain behaviors that would be regarded as potentially
5 improper.²⁰ PPL's response to Advocacy Section Data Request DIV 8-7 clarifies that
6 PPL "expects" Narragansett to follow certain ring-fencing practices, but the ring-
7 fencing practices that PPL seems to support are only "plans and expectations," and "are
8 not currently specific commitments being made to obtain approval of this
9 Transaction."²¹

10 I believe that the Division should find PPL's response and outright denial of any
11 commitment to be unacceptable because it leaves ratepayers exposed to Transaction
12 risk.

13 **Q. GIVEN NARRAGANSETT'S FINANCIAL CIRCUMSTANCES AND IN THE**
14 **CONTEXT OF PPL'S ACQUISITION, WHAT ARE THE MINIMUM RING-**
15 **FENCING MEASURES THAT YOU WOULD RECOMMEND REQUIRING AS**
16 **PART OF ANY APPROVAL OF THE TRANSACTION?**

¹⁹ As noted earlier, Moody's rates PPL parent as Baa2 which is a lower rating than currently for Narragansett.

²⁰ The response to Advocacy Section Data Request DIV 6-3 indicates PPL would refrain from having Narragansett provide credit guarantees for affiliates or pledging its assets without obtaining regulatory approval. PPL's response to Advocacy Section Data Request DIV 6-3. However, the response also states these are "plans" and not commitments. *Id.*

²¹ PPL's response to Advocacy Section Data Request DIV 8-7.

1 A. I list below several key ring-fencing measures that PPL/Narragansett must commit to
2 implementing in the context of this Transaction in order to satisfy the standard for
3 approval:²²

4 1. Narragansett shall operate as a (direct or indirect) corporate subsidiary of PPL
5 (similar to the arrangement for PPL's other three utilities) with its own
6 corporate officers and Board of Directors.

7 2. Narragansett must maintain books and records and financial statements
8 pertaining to its own operations, accessible to the Division and the Rhode Island
9 Commission.

10 3. Narragansett must maintain the capability of issuing its own long-term debt,
11 including obtaining credit ratings from at least two rating agencies (e.g.,
12 Moody's and S&P).²³

13 4. Narragansett shall not be permitted to make loans to corporate affiliates on a
14 long-term basis (i.e., for a period longer than one year).

15 5. Narragansett shall issue long-term debt only for the purposes of its utility
16 investments and operations.

17 6. Narragansett shall not pledge or mortgage its assets or provide loan or credit
18 guarantees for corporate affiliates (including PPL parent holding company).²⁴

²² Please note that Advocacy Section witness Michael R. Ballaban recommends that PPL/Narragansett submit a Cost Allocation Manual to the Commission well in advance of Narragansett's next base rate case. I regard the establishment of an approved Cost Allocation Manual governing affiliate transactions as an additional important ring-fencing protection measure.

²³ PPL's response to Advocacy Section Data Request DIV 6-3 states in part: "PPL plans to have Narragansett continue to issue its own long-term debt to finance its operations."

²⁴ PPL's response to Advocacy Section Data Request DIV 6-3 states in part: "Narragansett has no plans to guarantee the credit of any PPL affiliates and will not do so at any point in the future without first obtaining regulatory approval."

1 7. Any utility money pool arrangement in which Narragansett participates or any
2 stand-alone Narragansett credit facility shall be submitted to the Division for its
3 review and approval.

4 8. Narragansett shall maintain a specified minimum common equity ratio of 48
5 percent (calculated on a regulatory basis) for at least the first five years
6 following closing on the Transaction.

7 These measures could be terminated, waived or modified by written order of the
8 Division, as deemed appropriate, based upon a public interest showing.

9 **Q. WHY ARE YOUR RECOMMENDED RING-FENCING MEASURES NEEDED**
10 **TO MITIGATE RISK AND/OR AVOID POTENTIAL HARM TO**
11 **CUSTOMERS FROM THIS TRANSACTION?**

12 A. The purpose of ring-fencing measures is to protect the financial integrity of the utility,
13 and therefore its credit ratings and to avoid the potential harmful effects of affiliate
14 abuse. These measures are a form of ratepayer financial insurance, and for that reason
15 are appropriate—if not essential—even where the current financial health of the utility
16 and its corporate parent is strong. In fact, the ring fencing measures I recommend for
17 Narragansett under PPL ownership – with one possible exception that I discuss below
18 – are the same as or are substantially similar to Narragansett’ current and past practices
19 and policies under National Grid ownership. PPL’s acquisition of Narragansett would
20 weaken the current financial protections, and PPL has not offered any reason why that
21 would be consistent with the public interest. Thus, these ring-fencing measures must
22 be a requirement in the event that the Division approves this Transaction.

23 PPL in the discovery responses that I have cited seems to indicate that it expects to
24 voluntarily follow financial policies that align with my recommended ring-fencing

1 measures. However, those same data responses make clear that PPL is unwilling to
2 commit to implement these long-standing practices. For that reason, and to avoid
3 potential harm, the ring-fencing measures must be specified as conditions of
4 Transaction approval.

5 The one important exception is my recommendation that Narragansett maintain a
6 minimum common equity ratio of at least 48 percent. There is no such specific
7 requirement today for Narragansett, although over the years Narragansett has typically
8 maintained as a matter of practice a relatively strong capital structure. The minimum
9 common equity ratio requirement is an appropriate and very much needed protection
10 for Narragansett in the context of this Transaction. The Advocacy Section witnesses
11 (particularly witnesses Oliver and Booth) have demonstrated that the Transaction is
12 likely to lead to higher costs during the transition and even in the years following. The
13 higher costs would result both from lost efficiencies and substantial transition costs.
14 These substantial cost increases may end up being partly or fully absorbed by
15 Narragansett, resulting in an erosion of equity and a weakening of the balance sheet
16 unless appropriate remedial actions are taken. This financial weakening could
17 adversely impact customers either by increasing the cost of capital or impairing
18 Narragansett's infrastructure capital spending program. Requiring a PPL commitment
19 to maintain a reasonable common equity ratio for the first five years after the
20 Transaction closes is an appropriate ring-fencing protection measure.

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

22 **Q. IS GOODWILL A CONCERN WITH THIS TRANSACTION?**

1 A. Goodwill is a non-cash accounting entry on a company's balance sheet which serves to
2 increase its book common equity. It sometimes reflects the dollar amount of the
3 acquisition premium incurred by an acquiring company. In this case, Petitioners have
4 committed not to charge utility customers for any of that acquisition premium incurred
5 in connection with the Transaction.²⁵ Since an acquisition premium is not a necessary
6 cost associated with the provision of utility service, this commitment to exclude that
7 cost from rates certainly is appropriate.

8 Yet, there is a remaining concern with goodwill. Narragansett presently (i.e., pre-
9 Transaction) has a substantial amount of goodwill (\$725 million) on its balance sheet.²⁶
10 In past base rate cases, Narragansett has subtracted that goodwill from book common
11 equity in its calculation of the capital structure ratios to be used for rate of return
12 purposes. This is a proper adjustment since goodwill, as a non-cash accounting write-
13 up, could not have been used for investment in utility assets and therefore cannot
14 support rate base. If this adjustment had not been made, the equity ratio and therefore
15 the rate of return would have been artificially inflated, thereby harming customers.

16 The Petition makes no commitments regarding pre-Transaction goodwill. Advocacy
17 Section Data Request DIV 8-11 asks PPL whether it would commit that post-
18 Transaction Narragansett will continue its long-standing practice of removing (the pre-
19 Transaction) goodwill from common equity. PPL's response is not entirely clear and

²⁵ Sorgi test. at 9:12-13. PPL's response to Advocacy Section Data Request DIV 2-36 states that the acquisition premium for this Transaction will be about \$1 billion and will not go on Narragansett's balance sheet, but rather on the balance sheet of the direct parent, PPL Rhode Island. Further, the response states that none of the goodwill or acquisition premium from this Transaction will be included in the Narragansett ratemaking capital structure.

²⁶ See the Narragansett balance sheet of June 30, 2021 provided in National Grid's response to Advocacy Data Request DIV 8-15.

1 seems to fall well short of a commitment. PPL states that it plans to continue this past
2 practice, but it will only do so if it determines that removal of goodwill in this manner
3 is consistent with the “prevailing regulatory best practices.” PPL’s response to
4 Advocacy Section Data Request DIV 8-11. I interpret this to mean that in a future rate
5 case PPL could simply decide that the removal of goodwill from equity is no longer an
6 appropriate regulatory adjustment. This statement leaves PPL with considerable
7 latitude on the regulatory treatment of goodwill, and it falls well short of the needed
8 commitment.

9 As noted above, it is improper to include goodwill in the ratemaking capital structure
10 balances and ratios. As the current amount is \$725 million, if this were to be included
11 in common equity for ratemaking, it would artificially increase the equity ratio and
12 significantly inflate the calculated rate of return harming ratepayers. The goodwill,
13 however, is merely a non-cash accounting write-up, and by definition it could not be
14 used to pay for utility plant and equipment. Goodwill therefore does not support rate
15 base. Since goodwill does not contribute in any way to the provision of utility service,
16 it must not be permitted in the ratemaking capital structure.

17 PPL’s position should not be accepted, and any approval of the Transaction must be
18 accompanied by a PPL commitment to exclude all goodwill from ratemaking including
19 from the ratemaking capital structure.

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

21 **Q. IN THE EVENT THE TRANSACTION IS COMPLETED, WHY DO YOU**
22 **BELIEVE THAT PPL SHOULD COMMIT TO A MINIMUM EQUITY RATIO**
23 **FOR NARRAGANSETT?**

1 A. My recommendation is that during a transition period of at least five years it is
2 important that Narragansett maintain its financial integrity by maintaining a strong
3 balance sheet. Thus, I recommend that PPL commit that Narragansett will maintain an
4 actual capital structure with a common equity ratio of at least 48 percent. The equity
5 ratio should be calculated on a “regulatory basis”—i.e., excluding goodwill from book
6 equity and including short-term debt. Since capital structure ratios can fluctuate on a
7 spot basis, Narragansett can comply with this requirement by maintaining the 48
8 percent minimum standard on a four-quarter moving average basis. In the event that
9 the common equity ratio falls below 48 percent, PPL and Narragansett must promptly
10 rectify that shortfall by either infusing equity and/or suspending Narragansett’s
11 dividend payments to its parent.

12 I make this recommendation for a couple of reasons. As noted earlier, Narragansett
13 needs strong ring-fencing protections, and the required minimum equity will enhance
14 its credit quality and attractiveness to debt investors. Narragansett only obtains this
15 credit quality/cost of debt benefit if the minimum equity ratio is a legally enforceable
16 requirement and not a voluntary or discretionary policy determined by PPL. The 48
17 percent figure is conservative given that, as PPL observes, Narragansett’s last approved
18 rate case common equity ratio was 51 percent. Additionally, there is great uncertainty
19 and risk regarding Narragansett’s financial performance during the first several years
20 post-Transaction. Advocacy Section witnesses Oliver and Booth have demonstrated
21 that the Transaction is likely to lead to higher operating costs during the two-year
22 transition and even in the years following. These increased costs would likely result
23 from both losses of operating efficiency and substantial transition costs. Moreover,
24 these higher costs may end up being partly or fully absorbed by Narragansett, resulting

1 in an erosion of earnings and a weakening of the balance sheet (if Narragansett during
2 those years pays out dividends to the parent exceeding its earnings). Even PPL has
3 conceded that some of its transition costs may not be recoverable from utility
4 customers. Since the potential for unrecoverable and substantial transition costs may
5 extend for several years, a minimum five-year common equity ratio is needed to protect
6 Narragansett's credit ratings and ensure it can undertake needed utility capital
7 spending. This is an important protection for utility customers.

8 Advocacy Section Data Request DIV 8-14 asks whether PPL would commit to
9 maintaining a minimum common equity ratio for Narragansett. PPL responded that it
10 would not do so. It stated in the alternative that it anticipates maintaining
11 Narragansett's common equity ratio at a level that is consistent with that approved by
12 the Rhode Island Commission. However, that stated intention is not enforceable and
13 therefore provides no assurance for either regulators or financial markets of
14 Narragansett's financial integrity. I consider PPL's position unacceptable. Any
15 approval of the Transaction should be accompanied by an enforceable minimum equity
16 ratio, with Narragansett's dividend payments to its parent suspended if the equity ratio
17 falls below the prescribed minimum.

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

19 **Q. PLEASE EXPLAIN YOUR RECOMMENDATION CONCERNING THE**
20 **ISSUANCE OF LONG-TERM DEBT.**

21 A. I recommend that post-Transaction Narragansett continue its past practice of issuing its
22 own long-term debt. National Grid's response to Advocacy Section Data Request DIV
23 8-2 shows that since 2010 it has issued \$1.5 billion of short-term debt in the form of

1 unsecured senior notes of terms of either ten or thirty years.²⁷ In April of this year,
2 Narragansett issued \$600 million of long-term (i.e., ten-year) debt in the form of
3 unsecured notes. PPL is generally in agreement that Narragansett should continue to
4 issue its own long-term debt, but it also raises the possibility that in the future some of
5 Narragansett's long-term debt could be sourced, as a backstop, from its financing
6 subsidiary, PPL Capital Funding, Inc. if advantageous to do so (e.g., if Narragansett for
7 some reason is not able to issue its own debt).²⁸

8 My concern is that Narragansett's past practice of issuing debt as unsecured may not
9 be the most cost-effective form of financing. There is the potential opportunity for
10 significant interest expense savings over time that I believe PPL and Narragansett
11 should pursue. Specifically, all else equal, secured debt (for a given debt tenor and
12 utility) can be expected to require a lower interest rate than unsecured debt. PPL
13 acknowledges that its existing three utilities all utilize secured long-term debt (in the
14 form of first mortgage bonds).²⁹ Moreover, the response to Advocacy Section Data
15 Request DIV 8-6 shows that both Moody's and S&P assign higher credit ratings to the
16 secured debt of all three utilities as compared to the unsecured debt. For Moody's, the
17 improvement for secured debt over unsecured debt is two notches (i.e., A1 versus A3
18 for unsecured), and for S&P the improvement is one notch (i.e., A versus A-).

19 One would expect under normal market conditions that interest rate savings would
20 follow the credit rating advantage for the secured debt. For example, if the savings for
21 issuing secured debt is as much as 25 basis points or 0.0025 percent (consistent with a

²⁷ Narragansett also has on its books a small amount of legacy Providence Gas first mortgage bonds, most of which will mature next year in 2022. National Grid's response to Advocacy Section Data Request DIV 8-2.

²⁸ PPL's response to Advocacy Section Data Request DIV 8-10.

²⁹ PPL's response to Advocacy Section Data Request DIV 8-8.

1 two-notch credit rating improvement), the annual interest expense savings for
2 Narragansett's \$1.5 billion of outstanding long-term debt would be about \$3.8 million
3 per year, or \$38 million over ten years. This potential for meaningful cost of debt
4 savings is the very reason why all three PPL utilities issue such debt.

5 My recommendation is that following Transaction closure, and where feasible,
6 practical, and cost-effective, Narragansett under PPL ownership should issue secured
7 long-term debt, as doing so will minimize long-term debt costs. PPL should be required
8 to report back to the Division on the feasibility of doing so within six months of the
9 close of the Transaction.

10 **Q. WHAT IS PPL'S POSITION ON THIS ISSUE?**

11 A. Advocacy Section Data Request DIV 8-8 asked PPL about its willingness to pursue the
12 issuance of long-term debt in the future for Narragansett. PPL made no specific
13 commitment concerning the type of long-term debt it will have Narragansett issue, but
14 it did state that it is willing to evaluate the issue after Transaction closing to determine
15 the most cost-effective and appropriate form of future debt issuances.³⁰ Specifically, it
16 agreed to investigate the cost, benefits and constraints associated with entering into
17 arrangements permitting Narragansett to issue secured debt. As a condition of this
18 Transaction, PPL should be required to undertake such an evaluation and report its
19 findings to the Division within six months of closing.

20 **Q. IS YOUR RECOMMENDATION NECESSARY FOR THE PUBLIC**
21 **INTEREST?**

³⁰ It must be noted that Narragansett appears to have no near-term plans to issue additional long-term debt given that it has recently issued \$600 million of long-term debt earlier this year.

1 A. Absent such a required condition, Narragansett, of course, still retains an affirmative
2 obligation to issue its long-term debt at lowest reasonable cost. The acknowledged
3 existence of this obligation is not an effective substitute for the recommended
4 condition. This is because in the absence of this condition, and where Narragansett
5 fails to issue the most cost-effective form of long-term debt, the only available
6 protection for customers is to challenge the prudence of the debt issuance in a base rate
7 case. Litigating a prudence challenge to the cost of debt would likely be very
8 contentious and difficult. It would require identifying what the cost rate for the debt
9 issue would have been had the utility issued a different type of debt. The best remedy
10 is not a prudence case, but to determine in advance what form of debt issuance is in the
11 best interest of utility customers.

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

13 **Q. HAS PPL EXPLAINED HOW NARRAGANSETT WILL ACQUIRE NEEDED**
14 **SHORT-TERM DEBT AND LIQUIDITY POST TRANSACTION?**

15 A. Utilities like Narragansett require continuing access to short-term financing on
16 essentially a daily basis to meet financing needs and manage cash flows. This appears
17 not to be an immediate or near-term issue for Narragansett since it recently issued \$600
18 million of long-term debt.³¹ In the past, Narragansett has turned to its parent, National
19 Grid as the source of short-term debt and liquidity through various mechanisms (credit
20 facility, commercial paper program and utility money pool).
21 The Advocacy Section in discovery sought clarification from PPL regarding how
22 Narragansett will meet its short-term debt and liquidity needs following the close of

³¹ PPL's response to Advocacy Section Data Request DIV 8-3.

1 the Transaction. While not definitive, PPL's response indicates that post-transaction it
2 would establish a third-party credit facility for that purpose. It is not clear from the
3 response whether this will be a Narragansett stand-alone facility, or a PPL credit facility
4 available to provide Narragansett funding and potentially backstopping a commercial
5 paper program.³²

6 An additional option is the use of a PPL utility money pool as a funding and liquidity
7 source and a cash management tool. PPL's response to Advocacy Section Data
8 Request DIV 8-12 states that PPL has no present plans to establish such an arrangement
9 for Narragansett but acknowledges it is a possible future option and has agreed to
10 investigate the issue.

11 **Q. WHAT IS YOUR RESPONSE TO PPL'S EXPLANATION?**

12 A. PPL correctly acknowledges that there are a number of feasible options for cost
13 effectively meeting Narragansett's future liquidity and short-term debt funding needs.
14 If the Transaction is approved, then PPL should investigate and evaluate these various
15 options and report back to the Division within six months of closing. If Narragansett
16 enters into a third-party credit facility and/or money pool agreement, these agreements
17 should be submitted to the Division for its review and potentially approval.

18 **IV. CONCLUSION**

19 **Q. PLEASE SUMMARIZE YOUR MAIN CONCLUSION.**

20 A. I have reviewed the Petition, supporting testimony and the data responses relevant to
21 my assigned issues of cost of capital, ring-fencing and financial policies. I do not at

³² *Id.*

1 this time support approval of the Transaction as I believe it creates considerable
2 uncertainty and risk for customers with very few tangible and enforceable
3 commitments by Petitioners for customer mitigation, future benefits or protections that
4 would offset or otherwise appropriately address that risk. The most serious risks for
5 customers are those discussed at length in the testimony of Division Advocacy Section
6 witnesses Booth, Ballaban and Oliver, and which highlight that the Transaction is likely
7 to result in the substantial losses of economies of scale and synergies that Narragansett
8 enjoys today from its affiliation with and ownership by National Grid. Additionally, it
9 is unclear whether customers will be required to bear significant transition costs—costs
10 that would not exist absent the Transaction. Consequently, I cannot conclude that the
11 Transaction meets the applicable legal standard for approval.

12 With specific respect to the financial policy issues that I address, the filed Petition lacks
13 even the basic protections needed to protect ratepayers. At minimum, those protections
14 would include (1) a robust set of ring-fencing measures to protect Narragansett's
15 financial integrity and avoid affiliate abuse; (2) a commitment that in future rate
16 proceedings any goodwill on the Narragansett balance sheet (regardless of source) be
17 deducted from the common equity balance when calculating capital structure ratios; (3)
18 a commitment to maintain a minimum common equity ratio of 48 percent for a
19 transition period of no less than five years post-closing; (4) a commitment to investigate
20 the use of secured as opposed to unsecured long-term debt for future debt issues to
21 achieve the lowest feasible cost of long-term debt; and (5) a commitment to investigate
22 the appropriate sources of short-term debt and liquidity and report the results of that
23 inquiry to the Division.

24 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

1 A. Yes, it does.