

Contents

I.	INTRODUCTION	1
II.	THE PURPOSE OF RING FENCING	2
IV.	DOMINION RESOURCES RING FENCING PROPOSALS	7
V.	REVIEW OF DAYMARK’S RING FENCING PROPOSALS AND THE DIVISION’S RECOMMENDATIONS	11
VI.	CONCLUSIONS AND RECOMMENDATIONS	12

1

2

Direct Testimony of Charles E. Peterson

3

4 **I. INTRODUCTION**

5

6 **Q. Please state your name, business address and title.**

7 A. My name is Charles E. Peterson. My business address is 160 East 300 South, Salt Lake City,
8 Utah 84114. I am a Technical Consultant in the Utah Division of Public Utilities (Division,
9 or DPU).

10

11 **Q. On whose behalf are you testifying?**

12 A. The Division.

13

14 **Q. Would you summarize your background for the record?**

15 A. I am currently a Technical Consultant for the Division. I have been employed by the Division
16 for 11 years, during which time I have filed testimony and memoranda with the Commission
17 involving a variety of economic, financial, and policy topics.

18

19 Most relevant to this docket is Docket No. 05-035-54, which dealt with the acquisition of
20 PacifiCorp by MidAmerican Energy Holdings Company (now Berkshire Hathaway Energy)
21 where I was the Division's lead and, among other things, provided testimony regarding the
22 ring fencing structures that were going to be put around PacifiCorp. Additionally, in Docket

23 No. 05-053-01 (Uinta Basin Telephone) I also provided testimony regarding ring fencing
24 issues.

25

26 I have an M.S. in Economics and Master of Statistics degree, both from the University of
27 Utah. My resume is attached as DPU Exhibit 2.1 DIR.

28

29 **Q. What is the purpose of your testimony?**

30 A. I first provide an analysis of the ring fencing structures that Dominion Resources (Dominion)
31 witnesses propose to be put in place for Questar Gas Company (Questar Gas) if it becomes
32 Dominion Questar Gas (DQG). Next I compare those proposals with the ring fencing
33 structures put in place for PacifiCorp when it was acquired in 2006 and ring fencing
34 suggestions for DQG made by the Division's consultant, Daymark Energy Advisors
35 (Daymark). Finally, I set forth the Division's proposal for ring fencing DQG.

36

37 **II. THE PURPOSE OF RING FENCING**

38

39 **Q. Please discuss what ring fencing is and its purposes.**

40 A. Ring fencing can be defined as structural and operational practices and concepts imposed on
41 a utility operating company that insulate the utility from the operations and financial results
42 of affiliates or a parent holding company. The utility can be said to be "fenced-off" from
43 businesses of the parent company or from the parent itself. Ring fencing procedures and
44 practices are designed to protect the utility and its customers from negative effects of

45 financial or other distress in affiliates or a parent company. Regulators are concerned about
46 protecting the utility's credit standing in the market place, the effects of going-
47 concern/bankruptcy of affiliates or even the parent, and affiliate transaction issues.

48

49 **Q. Are these ring fencing procedures among the “best practices”? What are some of the**
50 **principal ring fencing procedures and practices?**

51 A. The following is a list of “best practices” that can be gleaned from Standard & Poor's and
52 Fitch rating services. This “best practices” list is not exhaustive of the items that could be
53 included by regulators for their purposes in a ring-fence, such as extending conditions on
54 transactions with affiliates.¹

- 55 1. The regulated utility is a corporate subsidiary in a holding structure.
- 56 2. The regulated utility is placed in a Special Purpose Entity, which is legally
57 separate from the non-regulated affiliates of the parent.
- 58 3. The provision of so-called “nonpetition” (bankruptcy) language by the parent.
- 59 4. The utility is managed separately and has a separate board of directors.
- 60 5. The utility's books and records are kept separate from any affiliates.
- 61 6. The utility has its own bank accounts and credit facilities, its own separate debt
62 and has its own separate credit rating.
- 63 7. Limits imposed on capital structure, e.g. setting a minimum common equity
64 percentage in the capital structure.

¹ Peterson, Charles E., and Elizabeth M. Brereton, *Report on Ring-Fencing*, Utah Division of Public Utilities, September 2005, pp. 19-21.

- 65 8. Limits on inter-company guarantees and loans—including loans to money pools.
66 9. Limits on dividends.
67 10. A written Affiliate Code of Conduct is in place.
68 11. Finally, violations of these practices are supported by clear penalties from
69 regulatory authorities.

70

71 A paper prepared by the National Association of Regulatory Utility Commissioners'
72 (NARUC) Subcommittee on Accounting and Finance outlined five areas of possible ring
73 fencing measures:²

- 74 1. Commission authority to restrict and mandate use and terms of sale of utility
75 assets. This includes restriction against using utility assets as collateral or
76 guarantee for any non-utility business.
77 2. Commission authority to restrict dividend payments to a parent company in order
78 to maintain financial viability of the utility. This may include, but is not limited
79 to, maintenance of a minimum equity balance.
80 3. Commission authority to authorize loans, loan guarantees, engagement in money
81 pools and large supply contracts between the utility and affiliate companies.
82 4. Commission authority over establishment of a holding company structure
83 involving a regulated utility.
84 5. Expand commission authority over security applications to include the ability to
85 restrict type and use of financing.

² Ibid.

86 These lists were derived from a 2005 study performed by the Division. This study is included
87 in Appendix 1.

88

89 **Q. Did the Commission include these conditions proposed by credit rating agencies and**
90 **NARUC in its order approving MidAmerican Energy Holdings Company's (MEHC)³**
91 **acquisition of PacifiCorp?**

92 A. Yes. These conditions were summarized in DPU Exhibit 1.1 attached to my direct testimony
93 in Docket No. 05-035-54. This exhibit is produced as Appendix 2. Of note is the creation of a
94 special purpose entity, PPW Holdings, LLC (PPW). The sole member of PPW is MEHC.
95 PPW's sole purpose is to hold the common stock of PacifiCorp and it has "an independent
96 director from whom assent is required to place [PPW] or PacifiCorp into bankruptcy."⁴
97 Additionally, MEHC committed to providing a non-consolidation opinion attesting that the
98 ring fencing around PPW was sufficient to prevent it from being pulled into bankruptcy.⁵

99

100 **Q. Are there possible detriments to a successful ring fencing of regulated utilities?**

101 A. Yes. A tight ring-fence could eliminate subsidies or prevent other benefits from flowing to
102 DQG from other affiliates of Dominion. DQG may find that it is not able to participate in
103 economies of scale that the total parent holding company, and non-ring-fenced affiliates,
104 might enjoy resulting from larger purchases; or in having company-wide services such as
105 human resources, legal, and accounting.

³ MidAmerican Energy Holdings Company changed its name to Berkshire Hathaway Energy in 2014.

⁴ Goodman, Patrick J., *Direct Testimony of Patrick J. Goodman*. Testimony filed with the Public Service Commission of Utah, July 2005, Docket No. 05-035-54, pp. 16-17.

⁵ Commitment U29, Docket No. 05-035-54.

106

107 **Q. Could a middle ground be obtained where the benefits of ring fencing could be enjoyed,**
108 **but loss of some of the economies you mention could be mitigated?**

109 A. Yes. For example, the parent holding company or a subsidiary might provide “staff”
110 functions such as human resources, legal, and accounting and possibly financing and
111 purchasing, but detailed accounting processes will need to be in place and regulators will
112 need to closely follow the transactions.

113

114 **III. CURRENT COMMISSION CONDITIONS FOR QUESTAR GAS**

115

116 **Q. Is Questar Gas Company already ring fenced?**

117 A. Yes, to some degree. DPU Exhibit 2.2 sets forth the 14 conditions that the Commission
118 imposed on Questar Gas Company as part of its approval of the reorganization of Mountain
119 Fuel Supply Company into the Questar holding company structure we have today. These
120 conditions were established in the Commission’s Case No. 84-057-10. Most of these
121 conditions would be considered part of ring fencing.

122

123 **Q. Is the current Questar Gas Company ring fencing complete?**

124 A. While it does have some good features, it is incomplete. For example, there is no mention of
125 co-mingling of accounting records, asset transfers, or specific bankruptcy protections.

126

127 **Q. Would these current structures transfer over to DQG?**

128 A. It is unclear that these would automatically transfer over to the new entity absent a specific
129 Commission order.

130

131 **IV. DOMINION RESOURCES RING FENCING PROPOSALS**

132

133 **Q. What are the ring fencing provisions that appear to be proposed by Dominion**
134 **Resources?**

135 A. At this time Dominion has proposed relatively few provisions. The following are the
136 proposals and commitments made by Dominion that I identify as related to ring fencing:

- 137 1. Dominion Questar Gas will be a wholly owned subsidiary of Dominion
138 Questar, which in turn is part of the larger Dominion Resources parent.
- 139 2. Dominion Questar Gas will be managed as a separate regional business
140 under Dominion, with responsibility for making decisions that achieve the
141 objectives of customer satisfaction, reliable service, customer, public and
142 employee safety, environmental stewardship, and collaborative and
143 productive relationships with customers, regulators, other governmental
144 entities and interested stakeholders.
- 145 3. Dominion Questar Gas will maintain a complete set of books and records,
146 including accounting records, for Dominion Questar Gas at its corporate
147 office in Salt Lake City, Utah.
- 148 4. Dominion, through Dominion Questar, will provide equity, as needed, to
149 Dominion Questar Gas with the intent to maintain Questar Gas' current capital
150 structure.
- 151 5. Dominion Questar Gas will not transfer its debt to Dominion without prior
152 Commission approval.

- 153 6. Dominion plans to operate Dominion Questar Gas in the same manner as
154 it is operated today, including keeping Dominion Questar Gas'
155 headquarters in Salt Lake City, Utah.
- 156 7. Dominion intends to maintain credit metrics that are supportive of strong
157 investment grade credit ratings for Dominion Questar Gas.
- 158 8. Dominion Questar Gas will not transfer material assets to, or assume liabilities of,
159 Dominion or any other subsidiary of Dominion without prior Commission
160 approval.
- 161 9. Neither Dominion nor its other subsidiaries will, without prior
162 Commission approval, make loans to Dominion Questar Gas that bear
163 interest at rates that are greater than (i) rates being paid at the time of such
164 loan by Dominion or such other subsidiary on its own debt or (ii) rates
165 available, at the time of such loan, on similar loans to Dominion Questar
166 Gas from the market.
- 167 10. Dominion Questar Gas will only lend funds to Dominion in accordance
168 with the current practice of Questar Gas whereby it occasionally provides
169 short-term funds to Questar Corporation as seasonal working capital needs
170 fluctuate.
- 171 11. As part of this and future regulatory proceedings, Dominion Questar Gas
172 will provide information about Dominion or its other subsidiaries relevant
173 to matters within the Commission's jurisdiction to the Commission upon
174 request of the Commission.
- 175 12. Goods and services provided to Dominion Questar Gas by Dominion or its
176 other subsidiaries will be provided at prices either (i) subject to regulation
177 by regulators with jurisdiction over those subsidiaries or (ii) at the lower
178 of cost or market. This commitment does not apply to good or services
179 provided to Dominion Questar Gas by Wexpro, which shall be provided
180 pursuant to the terms of the Wexpro Stipulation and Agreement, the
181 Wexpro II Agreement or the conditions approved in connection with

182 inclusion of properties in the Wexpro II Agreement (“Wexpro
183 Agreements”).⁶

184
185 These items are also included in the list prepared by Daymark witness Kathleen Kelly and
186 included in her Exhibit 2.

187

188 **Q. What are your preliminary comments regarding this list?**

189 A. Compared to PacifiCorp’s list, the Joint Applicant’s list is fairly short. Item 10 seems to
190 simply mean that Dominion and DQG will follow the law; item 12 supports item 3 regarding
191 the location of books and records. Other items have a certain amount of ambiguity. For
192 example, item 9 states that Dominion intends to maintain metrics “supportive of strong
193 investment grade credit ratings.” This commitment is not clear since an investment grade
194 rating can be as low as a Standard & Poor’s rating of BBB-. By comparison, Questar Gas
195 Company’s current rating is A.⁷ The Division believes that Dominion should make a more
196 specific commitment that it will maintain metrics supportive of an A rating or higher for

⁶ See the testimony of the following Joint Applicant’s witnesses: Direct Testimony of Diane Leopold, pages 11 and 13; Direct Testimony of Fred G. Wood, III, pages 14-16.

⁷ By comparison in the PacifiCorp Acquisition, Docket No. 05-035-54, MEHC made the following General Commitment 37:

Reduced Cost of Debt: MEHC believes that PacifiCorp’s incremental cost of long-term debt will be reduced as a result of the proposed transaction, due to the association with Berkshire Hathaway. Historically, MEHC’s utility subsidiaries have been able to issue long-term debt at levels below their peers with similar credit ratings. MEHC commits that over the next five years it will demonstrate that PacifiCorp’s incremental long-term debt issuances will be at least a spread of ten basis points below its similarly rated peers. MEHC’s demonstration will include information from a third party industry expert supporting its calculation and conclusion. If MEHC is unable to demonstrate to the Commission’s satisfaction that PacifiCorp has achieved at least a ten-basis point reduction, PacifiCorp will accept up to a ten (10) basis point reduction to the yield it actually incurred on any incremental long-term debt issuances for any revenue requirement calculation effective for the five-year period subsequent to the approval of the proposed acquisition. It is projected that this benefit will yield a value roughly equal to \$6.3 million over the post-acquisition five-year period.

197 DQG. There is ambiguity in what the capital structure it is managing to in item 5;
198 “operate...in the same manner” is not defined in item 6; and short-term loans discussed in
199 item 10 are done pursuant to Commission order. In general though, this list is a good start.
200 But the Division does not believe it goes far enough. By comparison in the PacifiCorp
201 acquisition, MEHC offered additional and specific commitments that are ring fencing-
202 related.

203

204 **Q. Have you compared Dominion’s commitments with the best practices list?**

205 A. Yes. DPU Exhibit 2.3 compares the Dominion commitments with the credit agencies and
206 NARUC “best practices” list and the additional commitments. DPU Exhibit 2.3 also sets
207 forth Daymark’s recommendations and the Division’s proposals. I have attempted to initially
208 match the ring fencing proposals with the ‘best practices’ discussed above followed by
209 additional ring fencing-related proposals and recommendations. This analysis highlights the
210 shortfalls in the Dominion proposals; it has made no commitment for five items on the credit
211 agencies list.

212

213 The Division’s ring fencing recommendations are also found on DPU Exhibit 2.3. Although
214 some of Dominion’s list overlaps with comparable items in the Division’s list, the Division
215 proposes a number of additional items, and where there is overlap, the Division seeks greater
216 specificity.

217

218

219 **V. REVIEW OF DAYMARK'S RING FENCING PROPOSALS AND**
220 **THE DIVISION'S RECOMMENDATIONS**
221

222 **Q. What are Daymark's recommendations?**

223 A. Daymark has made a fairly comprehensive list of recommendations that are related to ring
224 fencing, many of these based upon prior Utah transactions. Its complete list is found on
225 Daymark's Exhibit 3.3 D included with the direct testimony of Ms. Kelly. The Division
226 agrees with the items in Daymark's list and there is consequently considerable overlap
227 between the Daymark's and the list Division would independently propose. In the list setting
228 forth the Division's final ring fencing recommendations on DPU Exhibit 2.3, I have adapted
229 and included Daymark's recommendations with the Division's to create the Division's
230 recommended list of ring fencing provisions.

231

232 **Q. Can you summarize the main points Division is trying to achieve with its ring fencing**
233 **proposal?**

234 A. Yes. At a minimum the following points need to be achieved in order for this proposed
235 acquisition of Questar Gas Company to be in the public interest. The following bullet points
236 describe the principal purposes of the Division's proposed ring fencing provisions.

- 237
- 238 • DQG must be a legally separate corporation with its own accounting
239 system, debt, preferred stock (if any should be issued), credit rating, with
240 its own management and board of directors. DQG should be
241 headquartered in Salt Lake City, Utah. The books and records of DQG
242 should be located in Salt Lake City.
 - 243 • There should be an independent director in a special service entity that has
the power to veto putting DQG into bankruptcy. There should be sufficient

244 protections of DQG that would prevent the distress in affiliates or
245 Dominion Resources as a whole from forcing DQG into bankruptcy.
246 • Transactions between DQG and affiliates should be arm's length. It should
247 be recognized that the Commission and the Division of Public Utilities
248 have authority to audit these transactions and receive any requested
249 information concerning inter-affiliate transactions and relationships with
250 DQG.
251 • In order to protect the financial integrity of DQG, there are potential
252 restrictions on dividends, capital structure, and the selling of assets or
253 reorganizing or selling DQG without Commission approval.
254

255 **VI. CONCLUSIONS AND RECOMMENDATIONS**

256

257 **Q. What are your conclusions and recommendations?**

258 A. The Division concludes that the Dominion ring fencing proposals, while a good start, are
259 insufficient to protect ratepayers and the financial integrity of DQG as they currently stand.
260 The Division recommends that the Commission order the adoption of the Division's
261 conditions set forth on DPU Exhibit 2.3.
262

263 **Q. Does that complete your testimony?**

264 A. Yes.

APPENDIX 1

Report on Ring Fencing

September 2005

DPU Exhibit 2.0 DIR
Charles E. Peterson
Docket No. 16-057-01
July 7, 2016

APPENDIX 2

**Ring Fencing Around PacifiCorp
DPU Exhibit 1.1
Docket No. 05-035-54**