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**I. INTRODUCTION AND PURPOSE**

**Q. PLEASE STATE YOUR NAME, AFFILIATION AND BUSINESS ADDRESS.**

A. My name is John Reed. I am Chairman and Chief Executive Officer (“CEO”) of Concentric Energy Advisors, Inc. (“Concentric”) and CE Capital, Inc. (“CE Capital”) located at 293 Boston Post Road West, Suite 500, Marlborough, Massachusetts 01752.

**Q. ON WHOSE BEHALF ARE YOU SUBMITTING THIS REBUTTAL TESTIMONY?**

A. I am submitting this rebuttal testimony on behalf of National Fuel Gas Distribution Corporation (“Distribution” or “the Company”) in its rate case filing (Case 16-G-0257) before the New York State Public Service Commission (the “Commission”).

**Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE IN THE ENERGY AND UTILITY INDUSTRIES.**

A. I have more than 40 years of experience in the energy industry and have worked as an executive in, and consultant and economist to, the energy industry. Over the past 28 years, I have directed the energy consulting services of Concentric, Navigant Consulting, and Reed Consulting Group. I have served as Vice

1 Chairman and Co-CEO of the nation's largest publicly-traded consulting firm and  
2 as Chief Economist for the nation's largest gas utility. I have provided regulatory  
3 policy and regulatory economics support to more than 100 energy and utility  
4 clients and have provided expert testimony on regulatory, economic, and financial  
5 matters on more than 150 occasions before the Federal Energy Regulatory  
6 Commission, Canadian regulatory agencies, state utility regulatory agencies,  
7 various state and federal courts, and before arbitration panels in the United States  
8 and Canada, including on matters related to mergers, divestitures, asset  
9 acquisitions, and reorganizations. As part of my work, I have developed cost of  
10 capital, capital structure, risk profile, ring-fencing and financing strategy  
11 recommendations for utilities across North America. I have also testified many  
12 times on regulatory policy issues. My educational background and prior  
13 experience, including expert testimony, is presented in more detail in Exhibit\_(JR-  
14 1): Résumé and Testimony Listing.

15 **Q. PLEASE DESCRIBE CONCENTRIC'S AND CE CAPITAL'S**  
16 **ACTIVITIES IN ENERGY AND UTILITY ENGAGEMENTS.**

17 A. Concentric provides financial and economic advisory services to many energy  
18 and utility clients across North America. Our regulatory, economic, and market  
19 analysis services include utility ratemaking and regulatory advisory services,  
20 energy market assessments, market entry and exit analysis, corporate and business

1 unit strategy development, demand forecasting, resource planning, and energy  
2 contract negotiations. Our financial advisory activities include both buy- and sell-  
3 side merger, acquisition and divestiture assignments, due diligence and valuation  
4 assignments, project and corporate finance services, and transaction support  
5 services. In addition, we provide litigation support services on a wide range of  
6 financial and economic issues on behalf of clients throughout North America. CE  
7 Capital is a fully registered broker-dealer securities firm specializing in merger  
8 and acquisition activities. As CEO of CE Capital, I hold several securities  
9 licenses that cover all forms of securities and investment banking activities.

10 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS**  
11 **PROCEEDING?**

12 A. The purpose of my rebuttal testimony is to review and respond to the direct  
13 testimony of the Department of Public Service Staff Finance Panel (“Staff” or the  
14 “Staff Finance Panel”) regarding their recommendations for the imposition of  
15 “ring-fencing” provisions on Distribution. My rebuttal testimony addresses ring-  
16 fencing from a regulatory policy, purpose and precedent, and investment  
17 community perspective. The rebuttal testimony of the Company Finance Panel  
18 addresses Staff’s ring-fencing proposal as it relates to the facts and circumstances  
19 specific to Distribution and its parent, National Fuel Gas Company (“NFG”).

20 **Q. AS A PRELIMINARY MATTER, PLEASE DEFINE “RING-FENCING.”**

1 A. As I discuss in more detail later in my rebuttal testimony, “ring-fencing” is a term  
2 used to refer to financial conditions (*e.g.*, securities restrictions, dividend  
3 restrictions, and capital availability covenants) and related governance conditions  
4 (*e.g.*, restrictions on the ability to pledge assets or declare bankruptcy) that are  
5 intended to financially and/or operationally isolate and protect one entity from its  
6 parent and other affiliates. In the context of utility regulation, ring-fencing is a  
7 tool used in the context of utility mergers, acquisitions or reorganizations. Ring-  
8 fencing encompasses a range of measures; the specific measures employed, if  
9 any, vary by utility transaction.

10 **Q. WHAT SPECIFIC EXPERIENCE DO YOU HAVE IN REVIEWING OR**  
11 **DEVELOPING RING-FENCING PROTECTIONS FOR PUBLIC**  
12 **UTILITIES?**

13 A. This is an issue I have dealt with in many proceedings over the past 20 years. For  
14 example, I testified before the Public Utility Commission of Texas in support of  
15 ring-fencing measures that were implemented as part of Energy Future Holdings’  
16 2007 acquisition of Oncor Electric Delivery Company. I have also had recent  
17 experience with these issues in the NextEra Energy/Hawaiian Electric, Wisconsin  
18 Energy/Integrus, Fortis/UNS, Northeast Utilities/NStar and Macquarie/Cleco  
19 transactions. As part of this work, I have reviewed ring-fencing provisions in  
20 many utility mergers over the past 20 years.

1 **Q. HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?**

2 A. Section II summarizes my understanding of the Staff Finance Panel’s ring-fencing  
3 proposals and my key conclusions in response to that testimony. In Section III, I  
4 address the Staff Finance Panel’s testimony purporting a need for and precedent  
5 supporting the imposition of new ring-fencing measures in this rate case  
6 proceeding. Section IV addresses the Staff Finance Panel’s testimony regarding  
7 the views of Moody’s Investors Service (“Moody’s”) and Standard & Poor’s  
8 (“S&P”) (collectively, with Fitch Ratings, referred to as the “Credit Rating  
9 Agencies”) regarding ring-fencing and utility risks. In Section V, I provide my  
10 assessment of the specific ring-fencing measures proposed by the Staff Finance  
11 Panel. Finally, Section VI summarizes the conclusions and recommendations of  
12 this rebuttal testimony.

13 **II. SUMMARY OF THE STAFF FINANCE PANEL’S TESTIMONY**

14 **Q. WHAT IS YOUR UNDERSTANDING OF THE PURPOSE OF THE STAFF**  
15 **FINANCE PANEL’S TESTIMONY?**

16 A. The Staff Finance Panel describes the purpose of their testimony as to “establish  
17 the fair rate of return (ROR) that will be used to determine the revenue  
18 requirement for National Fuel Gas Distribution Corporation...” The Staff  
19 Finance Panel goes on to note that “estimating the ROR requires an estimation of

1 the proper capital structure” and assert that their recommendation “provides the  
2 Company with continued access to reasonably-priced capital.”<sup>1</sup>

3 **Q. PLEASE BRIEFLY SUMMARIZE THE STAFF FINANCE PANEL’S**  
4 **RING-FENCING RELATED TESTIMONY.**

5 A. The Staff Finance Panel introduces ring-fencing in the context of establishing the  
6 appropriate capital structure for ratemaking purposes and opposes the 48% utility  
7 stand-alone equity ratio requested by Distribution. The Staff Finance Panel  
8 argues that NFG’s corporate common equity ratio, which it calculates as 42.3%,  
9 should be used in establishing Distribution’s rate of return unless “suitable ring-  
10 fencing” is in place.<sup>2</sup> The Staff Finance Panel testifies that NFG’s non-regulated  
11 businesses, in particular its exploration and production business (“E&P”), expose  
12 NFG’s utility operations, including Distribution, to risk. Staff also provides its  
13 interpretation of the hypothetical impacts on Distribution of the impairments of  
14 E&P’s assets, the recent one notch downgrade by Moody’s of NFG’s credit rating  
15 from Baa2 to Baa3, and the debt covenant restrictions under NFG’s 1974  
16 indenture.<sup>3</sup> The Staff Finance Panel asserts that “it is essential that additional,  
17 strong ring-fencing provisions be instituted,”<sup>4</sup> arguing that the majority of other  
18 New York operating companies have adopted ring-fencing measures, and

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<sup>1</sup> Staff Finance Panel Testimony, at 5-6.

<sup>2</sup> *Ibid.*, at 16-17.

<sup>3</sup> *Ibid.*, at 25-29.

<sup>4</sup> *Ibid.*, at 33.

1 recommends the imposition of six specific ring-fencing measures on NFG.<sup>5</sup> The  
2 Staff Finance Panel concludes its ring-fencing testimony stating that if NFG  
3 “implements our recommended ring-fencing provisions, and they are recognized  
4 by S&P and Moody’s, then we would view Distribution’s assets as properly  
5 insulated from the parent and a higher common equity ratio, perhaps one in the  
6 48.0% range, should be considered in the next rate proceeding.”<sup>6</sup>

7 **Q. PLEASE IDENTIFY THE SPECIFIC RING-FENCING MEASURES**  
8 **PROPOSED BY THE STAFF FINANCE PANEL.**

9 A. The Staff Finance Panel proposes that six specific ring-fencing measures be  
10 imposed in this proceeding:

- 11 1. Distribution be prohibited from paying dividends to NFG if its average  
12 common equity ratio for the trailing 12 months prior to the dividend payment  
13 is more than 200 basis points below the common equity ratio used in setting  
14 rates.
- 15 2. Distribution should be required to issue its own long-term debt.
- 16 3. NFG should pursue obtaining individual credit ratings from Moody’s and  
17 S&P for Distribution.
- 18 4. If Distribution is unable to obtain its own credit rating and NFG is  
19 downgraded from either the current S&P ‘BBB’ rating or the Moody’s ‘Baa3’  
20 rating, the interest rate for Distribution in subsequent rate filings should match  
21 that of Staff’s proxy group, for “BBB+” utilities.
- 22 5. Distribution should be required to create a special class of preferred stock, to  
23 be held by a trustee approved by the Commission, which shall be referred to  
24 as the “golden share.” The holder of the “golden share” would be independent  
25 of the holding company and its affiliates, and could prevent a bankruptcy of  
26 the parent, or any of its affiliates, from triggering a voluntary bankruptcy of

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<sup>5</sup> *Ibid.*, at 36-38.

<sup>6</sup> *Ibid.*, at 39.

1           Distribution. The holder of the “golden share” would exercise the voting right  
2           for the protection of the interests of New York ratepayers.  
3         6. NFG’s general counsel should issue a non-consolidation letter that will be  
4           filed with the Commission to demonstrate the implementation of the ring-  
5           fencing provisions and the legal and credit separation of Distribution from its  
6           parent and affiliates.<sup>7</sup>

7         **Q.    WHAT IS YOUR OVERALL REACTION TO THE STAFF FINANCE**  
8           **PANEL’S RING-FENCING TESTIMONY?**

9         A.    The Staff Finance Panel’s concerns regarding the financial stability of NFG are  
10           misplaced, and that the imposition of their proposed ring-fencing measures in this  
11           rate proceeding for Distribution is unnecessary. There are simply no facts  
12           supporting the Staff Finance Panel’s unprecedented and unwarranted position, no  
13           plausible need for the imposition of ring-fencing measures in this proceeding, and  
14           no reasonable public policy reason to adopt their views or their recommendations  
15           regarding ring-fencing.

16           The Staff Finance Panel attempts to paint a dark picture of NFG as a risky holding  
17           company supporting its declining non-regulated businesses on the back of its  
18           utility operations. As discussed in more detail by the Company Finance Panel,  
19           and later in this testimony, there are no facts to support Staff’s view. The Staff  
20           Finance Panel’s recommendations are significant, and in some cases extreme.  
21           The forms of ring-fencing Staff would impose through this rate case to protect

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<sup>7</sup> *Ibid.* at 37-38.

1 Distribution from these hypothetical risks and to better position it with the Credit  
2 Rating Agencies are unnecessary, unworkable and poor public policy.

3 **Q. TO PROVIDE CONTEXT FOR THE REMAINDER OF YOUR**  
4 **TESTIMONY, PLEASE SUMMARIZE THE COMPANY FINANCE**  
5 **PANEL'S RING-FENCING RELATED TESTIMONY AND**  
6 **CONCLUSIONS MOST RELEVANT TO YOUR TESTIMONY.**

7 A. In response to the Staff Finance Panel's ring-fencing related testimony, the  
8 Company Finance Panel testifies and concludes that:

- 9 • The Company has mechanisms in place via its Money Pool arrangement to  
10 insulate Distribution from its non-rate-regulated subsidiaries.
- 11 • The impairment of E&P's assets is an accounting adjustment based on a  
12 formulaic computation required by the U.S. Securities and Exchange  
13 Commission ("SEC") that establishes a valuation based on historical oil and  
14 natural gas prices and a 10% discount rate. That valuation does not impact or  
15 consider NFG's on-going cash flow.
- 16 • The one-notch downgrade of NFG's credit rating by Moody's had no impact  
17 on either NFG's (1) embedded cost of debt reflected in its rates proposed in  
18 this rate case, or (2) the predominant credit rating that would be used from the  
19 perspective of many market participants to establish the cost of new debt NFG  
20 may issue in the future.

- 1           • Further, NFG has no plans to issue new long-term debt until April 2018. As a  
2           result, the debt covenant restrictions on the issuance of incremental long-term  
3           that are discussed in the Staff Finance Panel’s testimony are expected to have  
4           no impact on NFG or Distribution, and certainly have no impact on this rate  
5           case. In addition, the debt covenant in question does not prohibit the re-  
6           financing of maturing debt, which is the stated purpose of NFG’s next two  
7           debt issuances.
- 8           • NFG is not, as one might infer from the Staff Finance Panel’s ring-fencing-  
9           related testimony and proposals, a company facing a threat of bankruptcy.  
10          NFG, Distribution and its other subsidiaries are, and have been, financially  
11          sound.
- 12          • To provide additional assurance of Distribution’s ability to access debt in the  
13          near-term, NFG is in the process of amending the Money Pool to reserve a  
14          portion of its committed credit facility solely for the benefit of Distribution,  
15          essentially providing Distribution with a dedicated line of credit without  
16          having to incur additional costs to obtain its own credit rating.
- 17          • The ring-fencing measures proposed by the Staff Finance Panel are not only  
18          unnecessary but would also be harmful. First, the implementation of the  
19          Staff’s proposed “golden share” class of stock would: (1) run counter to the  
20          Company’s existing credit agreement, jeopardizing a critical component of the  
21          Company’s liquidity profile; and (2) potentially violate certain covenants in

1           the Company's 1974 bond indenture. Second, the implementation of the  
2           proposed ring-fencing provisions would have significant costs that would  
3           need to be recovered from ratepayers.

4   **Q. PLEASE BRIEFLY SUMMARIZE YOUR RESPONSE TO, AND KEY**  
5   **CONCLUSIONS REGARDING, THE STAFF FINANCE PANEL'S RING-**  
6   **FENCING RELATED TESTIMONY.**

7   A. As I discuss in more detail later in my rebuttal testimony:

- 8           • The purpose of this proceeding is for the Commission to set just and  
9           reasonable rates for Distribution. The Commission has the necessary  
10          authority and tools available to it within the rate case to set just and  
11          reasonable rates without imposing ring-fencing.
- 12          • In my more than 40 years in this industry, I have never seen the ring-  
13          fencing measures proposed by the Staff Finance Panel in this proceeding  
14          imposed in a rate case. Ring-fencing is a tool used in some, but not all,  
15          utility mergers, acquisitions or reorganizations. In New York, ring-  
16          fencing for electric and natural gas utilities has been implemented largely  
17          in the context of restructuring, reorganizations, and acquisitions of local  
18          utilities by international holding companies. In those cases, ring-fencing  
19          has been adopted based on the desire to provide protections appropriate to  
20          the facts and circumstances specific to those transactions, which involved

1 an underlying change in ownership structure and/or governance. That is  
2 not the case here.

- 3 • There has been no incremental cost to customers or other harm that needs  
4 to be addressed by the Commission in this rate case that would be solved  
5 by ring-fencing. If the cost of future debt issuances is increased due to  
6 non-utility factors, the ready remedy available to the Commission in a  
7 future rate case is simply to adjust the cost of debt for the affected  
8 issuance at that point in time.
- 9 • It would be entirely inappropriate to conclude that an accounting  
10 adjustment for E&P caused largely by the fluctuation of oil and natural gas  
11 prices should affect the ratemaking capital structure of Distribution.
- 12 • The corporate structure and financing of NFG and its subsidiaries was  
13 explicitly approved by the Commission in its Order Approving Corporate  
14 Reorganization with Conditions issued on June 21, 1974 in Case 26434.<sup>8</sup>  
15 It is inappropriate to seek to impose a significant change to the corporate  
16 structure and financing of NFG, a long-standing, well-functioning holding  
17 company in order to purportedly protect the customers of one of the state's

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<sup>8</sup> Order Approving Corporate Reorganization with Conditions, Joint Petition of Iroquois Gas Corporation and Pennsylvania Gas Company for Approval to Transfer Franchises and Facilities to NFG Gas Corporation and for Approval to Transfer by Merger all remaining Assets of Iroquois Gas Corporation and Pennsylvania Gas Company to United Natural Gas Company, Case 26434, June 21, 1974.

- 1 most efficient distribution utilities from hypothetical and highly  
2 speculative future risks.
- 3 • The Staff Finance Panel misunderstands the interests of the Credit Rating  
4 Agencies. Ring-fencing is not always viewed as a positive attribute by the  
5 Credit Rating Agencies for utility holding companies. Adopting the Staff  
6 Finance Panel’s ring-fencing beliefs and proposals would not result in  
7 lower rates, or be favorable for customers. In fact, it could disadvantage  
8 both NFG and Distribution.
  - 9 • Adopting Staff’s position has the potential to harm Distribution by  
10 increasing the regulatory risk perceived by the investment community due  
11 to the introduction of unexpected and extreme actions.
  - 12 • NFG’s existing practices, and the Commission’s existing policies,  
13 reasonably and appropriately isolate and protect Distribution from NFG  
14 and its non-regulated subsidiaries. NFG’s existing Money Pool  
15 agreement, along with a proposed modification, would provide  
16 Distribution with priority and exclusive access to near-term debt. These  
17 measures, coupled with the Commission’s existing ratemaking tools more  
18 than adequately protect Distribution customers.
  - 19 • I am also concerned about the appropriateness of effectively holding  
20 Distribution’s allowed return on rate base as a “hostage” in Staff’s attempt  
21 to use this proceeding to impose ring-fencing measures that have no place

1 in a rate case. These measures may be appropriate to consider in a  
2 proposed transaction, such as a merger or acquisition (including the  
3 acquisition of New York utilities by foreign entities), where the public  
4 interest is broadly considered, but are not necessary to, or appropriate for,  
5 setting just and reasonable rates in a rate proceeding.

- 6 • The Staff Finance Panel's ring-fencing proposal is neither necessary nor  
7 appropriate in this rate case and should be rejected.

8 **III. THE STAFF FINANCE PANEL'S POSITION ON RING-FENCING**

9 **Q. WHAT TOPICS WILL YOU ADDRESS IN THIS SECTION OF YOUR**  
10 **REBUTTAL TESTIMONY?**

11 A. In this section of my rebuttal testimony, I will address the positions put forth by  
12 the Staff Finance Panel on ring-fencing overall. In particular, I address the  
13 following:

- 14 • The definition of ring-fencing;
- 15 • The role of ring-fencing in this rate case;
- 16 • When ring-fencing is appropriate;
- 17 • The use of ring-fencing in New York; and
- 18 • NFG's existing practices to isolate Distribution from its other subsidiaries.

19 In later sections of my rebuttal testimony I will address the Staff Finance Panel's  
20 testimony regarding the Credit Rating Agencies' view of ring-fencing and the six  
21 specific ring-fencing measures Staff recommends in this proceeding.

1           **A. DEFINITION OF RING-FENCING**

2   **Q.   EARLIER IN YOUR TESTIMONY YOU DEFINED “RING-FENCING.”**  
3           **DOES YOUR DEFINITION OF RING-FENCING DIFFER FROM THAT**  
4           **PUT FORTH BY THE STAFF FINANCE PANEL?**

5   A.   Yes.  An important distinction that is missing from the Staff Finance Panel’s  
6           testimony is that ring-fencing is a tool that has been used in varying degrees, if at  
7           all, in utility mergers and acquisitions to address the specific risks triggered by  
8           individual utility transactions.  That was the case in the mergers and acquisitions  
9           of the New York utilities discussed by the Staff Finance Panel.  In a merger  
10          proceeding the Commission is asked to render findings on a proposed transaction  
11          that would create new ownership, changed operational control and/or a modified  
12          organizational structure of the utility being acquired or reorganized.  In applying  
13          for approval from state regulators of a utility transaction, merging companies may  
14          proactively propose ring-fencing provisions in order to demonstrate that, post  
15          transaction, the utility and its customers will be insulated from potential financial  
16          risks associated with a new ownership structure.  In some circumstances, state  
17          regulators may require the implementation of additional financial and associated  
18          governance restrictions to further insulate and protect the utility and its customers.  
19          Those merger and acquisition approval proceedings, however, are very different  
20          than a rate case such as the instant proceeding, in which the Commission is

1 required to establish just and reasonable rates for the utility based upon the  
2 utility's known and reasonably verifiable forecasted test period costs.

3 **B. THE ROLE OF RING-FENCING IN THIS RATE CASE**

4 **Q. WHAT IS THE PURPOSE OF THIS RATE CASE PROCEEDING?**

5 A. The purpose of this rate case proceeding is for the Commission to establish just  
6 and reasonable rates for Distribution.

7 **Q. IS THE STAFF FINANCE PANEL'S RING-FENCING PROPOSAL**  
8 **RELEVANT TO THE COMMISSION'S ESTABLISHMENT OF JUST**  
9 **AND REASONABLE RATES FOR DISTRIBUTION IN THIS**  
10 **PROCEEDING?**

11 A. No. The Staff Finance Panel's ring-fencing proposal has nothing to do with  
12 establishing just and reasonable rates for Distribution in this proceeding. As  
13 discussed by the Company Finance Panel, Distribution's embedded cost of debt  
14 reflected in its proposed rates were not impacted by the E&P impairment or the  
15 Moody's downgrade. The Staff Finance Panel is asking the Commission to  
16 impose ring-fencing in this rate case to purportedly address hypothetical potential  
17 future risks. The Staff Finance Panel is also asking the Commission to set rates  
18 using the parent holding company's equity ratio that reflects the very thing that  
19 Staff asserts they wish to protect customers from, *i.e.* the influence of NFG's non-  
20 regulated businesses. This is in sharp contrast to the 48 percent equity ratio that

1 Staff recommended in the Company's last rate case (Case 13-G-0136). This has  
2 the appearance of a being a results oriented, "heads-I-win-tails-you-lose"  
3 approach to ratemaking. In my more than 40 years in the industry, I have never  
4 seen ring-fencing like this imposed in a rate case.

5 **Q. DOES THE COMMISSION HAVE THE NECESSARY TOOLS**  
6 **AVAILABLE TO IT WITHIN ITS RATE CASE AUTHORITY TO SET**  
7 **JUST AND REASONABLE RATES WITHOUT IMPOSING RING-**  
8 **FENCING?**

9 A. Yes. New York's approach to utility ratemaking and the Commission's ability to  
10 adjust Distribution's allowed costs when warranted by the facts and  
11 circumstances provide the Commission with all the tools it needs. If the  
12 Commission were to conclude that Distribution's cost of debt was unreasonable,  
13 which has certainly not been shown in this case, the ready remedy available to the  
14 Commission is to simply adjust Distribution's weighted average cost of debt. By  
15 doing so, customers would be held harmless for the costs that were deemed to be  
16 unreasonable.

17 In addition, by using a utility capital structure for establishing the rate of return,  
18 the Commission insulates Distribution and its customers from the capital structure  
19 of its holding company parent that has had an equity ratio as high as 63.5% and  
20 has averaged 56.7% over the past five years. It would be entirely inappropriate to

1 allow an accounting adjustment (*i.e.*, an impairment charge) caused largely by the  
2 recent fluctuation in oil and natural gas prices affecting E&P to influence the  
3 allowed capital structure of Distribution. In fact, avoiding that is part of the  
4 objective of the stand-alone approach to utility ratemaking. At a minimum, it is  
5 inconsistent for the Staff Finance Panel to argue on the one hand that Distribution  
6 should be specifically isolated from NFG and its other subsidiaries, but on the  
7 other hand if it is not, then adopt NFG's corporate capital structure; a capital  
8 structure that coincidentally contains a lower equity ratio than any natural gas  
9 utility equity ratio authorized by the Commission over the last 10 years, and all  
10 but one natural gas utility over the last 20 years.<sup>9</sup> As discussed in the direct and  
11 rebuttal testimonies of Ann Bulkley, the 48% equity ratio requested by the  
12 Company conforms to the Commission's capital structure decisions over the last  
13 five years and should be used to establish the allowed rate or return in this  
14 proceeding.

15 **C. WHEN RING-FENCING IS APPROPRIATE**

16 **Q. PUTTING ASIDE WHETHER IT IS RELEVANT TO ESTABLISHING**  
17 **JUST AND REASONABLE RATES IN THIS RATE CASE, IS THERE A**  
18 **GENERAL THEME TO WHEN RING-FENCING PROTECTIONS**  
19 **SHOULD BE EMPLOYED FOR PUBLIC UTILITIES IN THE ENERGY**

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<sup>9</sup> Source: Regulatory Research Associates Past Rate Case History, accessed September 9, 2016.

1           **INDUSTRY AND DO THOSE CIRCUMSTANCES EXIST HERE FOR**  
2           **DISTRIBUTION?**

3       A.     Yes, there is a general theme, however those circumstances do not exist here.  
4           Isolation of an electric or gas utility subsidiary through ring-fencing began with  
5           foreign utilities acquiring U.S. utilities, which was the circumstance in New York,  
6           and the emergence of private equity companies acquiring public utilities in  
7           transactions that involved unprecedented levels of debt at the holding company  
8           level. Neither of those situations exists with regard to Distribution. Under the  
9           circumstances in which it was perceived that the utility was being acquired by a  
10          riskier parent, regulators sought to protect customers from unfamiliar business  
11          models or highly-leveraged capital structures. Regulators also sought to ensure  
12          that a utility's operations under such circumstances would be managed on a  
13          "stand-alone" basis. This was understandable in situations where the new owners  
14          did not bring operational expertise to the management of the acquired company,  
15          or when extraordinarily high levels of holding company debt were used to finance  
16          a utility acquisition. These ring-fencing provisions were often derived from credit  
17          enhancement techniques that had previously been used to issue securitized debt  
18          for recovery of stranded costs arising in industry restructuring. That is certainly  
19          not the case here with NFG and Distribution.

1 **Q. IS RING-FENCING NECESSARY FOR ALL UTILITIES THAT HAVE A**  
2 **HOLDING COMPANY PARENT AND NON-REGULATED AFFILIATES?**

3 A. No. Ring-fencing is not a universal benefit or risk reduction mechanism for all  
4 utilities that are part of a holding company structure. The Staff Finance Panel's  
5 ring-fencing testimony and proposal appear to have been triggered by the  
6 impairment of E&P. The impairment is not the result of imprudent or  
7 irresponsible investments or financial management of NFG, it is simply an  
8 accounting entry resulting from rules put forth by the SEC and a cyclical change  
9 in oil and natural gas prices that has no impact on NFG's on-going cash flow.  
10 The Staff Finance Panel's assertion that this accounting entry requires the  
11 imposition of massive ring-fencing and bankruptcy protections is a  
12 misunderstanding and overreaction to the facts. The Staff Finance Panel's  
13 proposed ring-fencing measures are truly a solution in search of a problem. Staff  
14 has not identified any problem where the ratepayer has been harmed due to  
15 NFG's financial policies, nor is there a hypothetical future problem that may not  
16 be addressed with the ratemaking tools already available to the Commission. As  
17 further support, I also note the Commission has consistently approved the debt  
18 financing approach employed by NFG for Distribution for many years without  
19 requiring ring-fencing provisions.<sup>10</sup>

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<sup>10</sup> See, e.g., Order Authorizing Issuance of Securities, Case 14-G-0228, November 14, 2014.

1 **D. RING-FENCING IN NEW YORK**

2 **Q. PLEASE DESCRIBE THE CIRCUMSTANCES THAT LED TO THE**  
 3 **ADOPTION OF VARIOUS RING-FENCING MEASURES AT OTHER**  
 4 **NEW YORK UTILITIES.**

5 A. The main driver behind the initial adoption of ring-fencing for other New York  
 6 operating companies has been primarily the merger of utilities or acquisition of  
 7 New York utilities by foreign buyers, as shown in the table below.

<b>Utility(ies)</b>	<b>Ring-Fencing Driver</b>	<b>Case No.</b>
Consolidated Edison Company of New York, Inc., and Orange and Rockland Utilities Inc.	Merger or acquisition	98-M-0961
CH Energy Group Inc.	Merger or acquisition	12-M-0192
New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation	Merger or acquisition	07-M-0906
Niagara Mohawk Power Corporation	Merger or acquisition; petition to issue \$2 billion of long-term indebtedness and enter into derivative hedging instruments	01-M-0075 06-M-0878 08-E-0827 08-M-1352 10-E-0050
KeySpan Energy Delivery Long Island and KeySpan Energy Delivery New York	Merger or acquisition	06-M-0878

8 **Q. SHOULD THE COMMISSION BE SWAYED BY THE STAFF FINANCE**  
 9 **PANEL’S TESTIMONY THAT THE MAJORITY OF NEW YORK**  
 10 **OPERATING COMPANIES HAVE ADOPTED RING-FENCING**  
 11 **PROTECTIONS SIMILAR TO THOSE PROPOSED BY STAFF HERE?**

1 A. No. The Staff Finance Panel simply makes a sweeping conclusion that because  
2 some major New York operating companies have ring-fencing, NFG should as  
3 well. The Staff Finance Panel completely ignores the events, facts and  
4 circumstances that led to the initial adoption of ring-fencing by the other New  
5 York operating companies to which it refers. In Exhibit FP-11 the Staff Finance  
6 Panel identifies other New York operating companies and summarizes its  
7 understanding of the ring-fencing measures put in place for those companies.  
8 What Staff neglects to say is that the events that triggered the origination of the  
9 ring-fencing provisions for those companies (provisions that Staff is seeking to  
10 impose here) were issues stemming from mergers and changes in ownership and  
11 operational control of the New York utility. The Staff also neglects to  
12 acknowledge that the specific ring-fencing measures in place for each company  
13 are not the same, and furthermore that they differ based upon the facts and  
14 circumstances at the time the Commission rendered its orders putting these  
15 measures in place. For example, only some of the transactions included  
16 provisions related to the “golden share” and non-consolidation opinions.

17 **Q. IN WHAT CIRCUMSTANCES HAS THE COMMISSION MANDATED A**  
18 **“GOLDEN SHARE” PROVISION FOR NEW YORK UTILITIES?**

19 A. The “golden share” provisions that Staff cites in Exhibit FP-11 for the utilities  
20 were approved by the Commission in the context of the acquisition of a New

1 York utility by an international holding company, driven by concerns over  
2 holding companies using a highly-leveraged financial structure with large  
3 amounts of goodwill as well as additional concerns regarding financial  
4 transparency, complex corporate structures, and uncertain business models. The  
5 first New York utilities cited in Staff’s Exhibit FP-11 for which the Commission  
6 implemented a “golden share” provision were KeySpan Energy Delivery Long  
7 Island (“KEDLI”) and KeySpan Energy Delivery New York (“KEDNY”) in its  
8 Order approving the acquisition of KeySpan Corporation by the multinational  
9 utility holding company National Grid plc (“National Grid”).<sup>11</sup>

10 In that same Decision, the Commission ruled that similar financial protections,  
11 including the “golden share” provision, would also subsequently be applied to  
12 Niagara Mohawk Power Corporation (“NMPC”) out of a concern that the same  
13 financial risks being posed to KEDLI and KEDLI by the National Grid  
14 acquisition also applied to NMPC given that many of these protections and the  
15 “golden share” provisions were not mandated following National Grid’s earlier  
16 acquisition of NMPC.

17 The Commission applied similar “golden share” provisions to New York State  
18 Electric & Gas Corporation and Rochester Gas and Electric Corporation

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<sup>11</sup> See, Abbreviated Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Requirement Determinations for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island, Case 06-M-0878, August 23, 2007, at 12 and Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Requirement Determinations for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island, Case 06-M-0878, September 17, 2007.

1 following their acquisition by Iberdrola, S.A.,<sup>12</sup> and also in its approval of the  
2 acquisition of CH Energy Group, Inc. by Fortis, Inc.<sup>13</sup> Similarly, in those cases  
3 the “golden share” requirement was driven by concerns of international holding  
4 companies with complex corporate structures and large amounts of goodwill.

5 **Q. WHY IS THAT INFORMATION SIGNIFICANT FOR THIS CASE?**

6 A. The Commission has never required a “golden share” for a utility that was owned  
7 by a domestic holding company. Thus, Staff’s proposal here is inconsistent with  
8 past Commission policy and practice.

9 **Q. HAS STAFF RECOMMENDED A “GOLDEN SHARE” FOR OTHER**  
10 **NEW YORK UTILITIES THAT ARE OWNED BY A DOMESTIC**  
11 **HOLDING COMPANY?**

12 A. Yes. Staff is currently recommending in the Consolidated Edison of New York  
13 (“Con Edison”) rate case that Con Edison issue a “golden share” and provide a  
14 non-consolidation opinion.<sup>14</sup> While the case is yet to be decided, Con Edison  
15 vigorously opposed Staff’s ring-fencing recommendations in rebuttal testimony.

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<sup>12</sup> See, Order Authorizing Acquisition Subject to Conditions, Case 07-M-0906, September 9, 2008, at 43-49.

<sup>13</sup> See, Order Authorizing Acquisition, Case 12-M-0192, June 26, 2013, at 42.

<sup>14</sup> Staff Finance Panel Testimony, Cases 16-E-0060 and 16-G-0061, at 28-29.

1 **Q. IS THIS RATE CASE SIMILAR TO THOSE INSTANCES IN WHICH**  
2 **RING-FENCING WAS IMPLEMENTED FOR OTHER NEW YORK**  
3 **UTILITIES?**

4 A. No, not at all. First, this proceeding is a rate case in which Distribution is entitled  
5 to have rates set that are just and reasonable, including a reasonable opportunity  
6 to earn a fair return. Staff's proposal does not meet that standard. The key  
7 distinctions between this proceeding and the cases in which ring-fencing was  
8 implemented for other New York utilities is that, in those merger and  
9 reorganization cases the applicants needed to show that proposed transactions  
10 were in the public interest, and the Commission was faced with something new  
11 and different from a financial and governance perspective: a new utility owner, a  
12 new corporate structure, and/or a new and uncertain business model. Importantly,  
13 none of those circumstances exists in this proceeding. Rather, as described  
14 herein, the triggering events for Staff's proposal were a series of accounting  
15 entries that had no impact on the cash flow or substantive credit profile of  
16 Distribution, and a one-notch downgrade of NFG by Moody's that had no impact  
17 on the debt costs embedded in Distribution's revenue requirement. As such, the  
18 fact that ring-fencing provisions may have been implemented at other New York  
19 utilities seeking approvals of transactions is irrelevant to this proceeding in that  
20 those provisions were put in place in the context of facts, circumstances, and  
21 issues that don't exist for Distribution.

1           **E. NFG’S EXISTING PRACTICES**

2   **Q.    ARE THE PRACTICES NFG HAS IN PLACE TODAY TO INSULATE**  
3           **DISTRIBUTION FROM THE ACTIVITIES OF NFG AND ITS OTHER**  
4           **SUBSIDIARIES REASONABLE AND APPROPRIATE?**

5    A.    Yes. As discussed in more detail by the Company Finance Panel, the company  
6           currently has mechanisms in place via its Money Pool that insulate Distribution  
7           while still affording it the benefits of being part of the NFG family. In addition,  
8           NFG is in the process of amending the Money Pool to reserve a portion of its  
9           committed credit facility solely for the benefit of Distribution, essentially  
10          providing Distribution with a dedicated line of credit without having to incur  
11          additional costs to obtain its own credit rating or credit facility. The Company  
12          also employs other practices that insulate Distribution, including: (1) imposition  
13          of limits on subsidiary borrowing from parties other than NFG provide a “check-  
14          and-balance” that no subsidiary may engage in borrowing that deviates from  
15          NFG’s approach to prudent fiscal management; and (2) Distribution maintains  
16          separate bank accounts and does not comingle its funds with its affiliates,  
17          providing clear separation of funds.<sup>15</sup> Lastly, Distribution’s cost allocation  
18          practices and affiliate transaction rules provide further protective measures.

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<sup>15</sup> NFG Response to Department of Public Service Request for Information DPS-181, Case 16-G-0257.

1 **Q. IS THE STAFF FINANCE PANEL’S PROPOSED RING-FENCING**  
2 **NECESSARY AND WOULD IT ENHANCE THE COMPANY’S**  
3 **EXISTING PRACTICES?**

4 A. No. It is entirely inappropriate to impose a significant change to the corporate  
5 structure and financing of NFG, a long-standing, well-functioning holding  
6 company, in order to protect the customers of one of the state’s most efficient  
7 distribution utilities from hypothetical and highly speculative future risks. Staff’s  
8 proposal is not a necessary or appropriate approach to establish just and  
9 reasonable rates; the Commission already has the necessary tools at its disposal  
10 without imposing the costs, disruption and poor regulatory policy of ring-fencing  
11 through a rate case. In addition, there is no universal benefit to be derived from  
12 ring-fencing. Ring-fencing as practiced in New York has been the product of the  
13 events (*i.e.*, mergers and acquisitions), and facts and circumstances surrounding  
14 those events – it is not a “one-size-fits-all” solution. The Staff Finance Panel’s  
15 ring-fencing testimony and proposal are truly a solution in search of a problem,  
16 and here, that problem does not exist.

17 **IV. CREDIT RATING AGENCIES AND RING-FENCING**

18 **Q. DOES STAFF DISCUSS THE CREDIT RATING AGENCIES’ VIEWS ON**  
19 **RING-FENCING?**

20 A. Yes. The Staff Finance Panel points to comments by Moody’s regarding how  
21 ring-fencing can create separateness between a utility and its parent. However,

1 missing from the Staff Finance Panel's assessment is any analysis of how the  
2 Credit Rating Agencies might view the imposition of ring-fencing in *this* case.  
3 Because ring-fencing provisions are typically proposed by merging utilities in  
4 order to provide assurance to regulators regarding the lack of harm to ratepayers  
5 caused by the merger, such ring-fencing provisions tend to be viewed favorably  
6 by the Credit Rating Agencies if they are seen as providing protection from the  
7 financial risks of a significantly lower-rated parent and/or financial investor.  
8 However, if in this case the restrictive ring-fencing provisions proposed by the  
9 Staff Finance Panel were to be imposed in the context of a rate case, the increase  
10 in the regulatory risk perceived by the investment community would offset (if not  
11 outweigh) any arguable benefits of the ring-fencing. Simply put, creating a  
12 substantial disruption in corporate financing plans, higher costs to retire and  
13 refinance existing debt, and confiscatory return levels to insert protections against  
14 potential future financing risks would be seen by any rational investor as being  
15 detrimental to a utility's financial integrity.

16 **Q. WHAT FACTORS DID YOU CONSIDER IN COMING TO THE OPINION**  
17 **THAT THE IMPOSITION OF STRICT RING-FENCING PROVISIONS IN**  
18 **A RATE CASE WOULD *INCREASE* THE REGULATORY RISK**  
19 **PERCEIVED BY THE INVESTMENT COMMUNITY?**

1 A. The main factor I considered was that the imposition of strict ring-fencing  
2 provisions in a rate case would be a clear departure from Commission standard  
3 practice that, if coupled with a capital structure that contains less equity than any  
4 utility capital structure authorized by the Commission for a natural gas utility in  
5 the last 10 years, and the second lowest in 20 years, as discussed above, would  
6 significantly increase the perceived risk related to the regulatory framework in  
7 New York within which Distribution operates.

8 As noted in the Staff Financial Panel's testimony (at page 24), 50% of Moody's  
9 ratings evaluations of utilities is based on the supportiveness of the regulatory  
10 environment in which a utility operates. Specifically, Moody's credit evaluation  
11 is based 25% on the regulatory framework, and 25% on a utility's ability to  
12 recover costs and earn its return, which is derived in large part from its rate  
13 structure. Subsumed in Moody's credit evaluation of the regulatory framework is  
14 the rating sub-factor of "consistency and predictability of regulation." In  
15 describing why the regulatory framework matters to its credit evaluations,  
16 Moody's states:

17 For rate-regulated utilities, which typically operate as a monopoly,  
18 the regulatory environment and how the utility adapts to that  
19 environment are the most important credit considerations. The  
20 regulatory environment is comprised of two rating factors - the  
21 Regulatory Framework and its corollary factor, the Ability to  
22 Recover Costs and Earn Returns. Broadly speaking, the Regulatory  
23 Framework is the foundation for how all the decisions that affect  
24 utilities are made (including the setting of rates), as well as the

1 predictability and consistency of decision-making provided by that  
2 foundation.<sup>16</sup>

3 Similarly, S&P states:

4 The regulatory framework/regime's influence is of critical  
5 importance when assessing regulated utilities' credit risk because it  
6 defines the environment in which a utility operates and has a  
7 significant bearing on a utility's financial performance.<sup>17</sup>

8 S&P goes on to state that a lack of predictability and consistency is reflective of a  
9 weak qualifier in terms of S&P's "preliminary regulatory advantage  
10 assessment."<sup>18</sup>

11 In my opinion, the abrupt and unwarranted imposition of the Staff Finance  
12 Panel's proposed ring-fencing measures in the context of a rate case would be a  
13 clear display of regulatory unpredictability and inconsistency.

14 **Q. NFG IS CURRENTLY RATED BBB BY S&P AND BAA3 BY MOODY'S.**  
15 **ARE THOSE INVESTMENT GRADE RATINGS?**

16 A. Yes, they are. Notwithstanding the downgrade of NFG's credit rating by  
17 Moody's, NFG remains an investment grade company. From a ratings quality  
18 perspective, the key demarcation is that between investments grade issuers (*i.e.*,  
19 BBB-/Baa3 and above) and sub-investment grade issuers (*i.e.*, BB+/Ba1 and  
20 below). Many institutional investors have requirements to invest only in bonds

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<sup>16</sup> Moody's Investor Service, "Regulated Electric and Gas Utilities," December 23, 2013, at 9.

<sup>17</sup> Standard & Poor's Ratings Services, "Key Credit Factors for the Regulated Utilities Industry," November 19, 2013, at 6.

<sup>18</sup> *Ibid.*, at 8.

1 that are investment grade or above. While NFG is “split rated” (*i.e.*, has different  
2 ratings from S&P and Moody’s), as the Company Finance Panel states, it still  
3 maintains a predominant rating of BBB as viewed by many investors.

4 Thus, in the context of this rate proceeding, in which the revenue requirement and  
5 test year assume investment-grade bond ratings in the embedded cost of debt,  
6 there is no reasonable basis on which to impose governance or financing  
7 restrictions that are designed to isolate the utility from a parent or affiliate that is  
8 not creditworthy.

9 **Q. BEYOND CREDIT RATINGS, ARE THERE OTHER FACTORS THAT**  
10 **WOULD INDICATE RING-FENCING MIGHT BE APPROPRIATE IN**  
11 **THIS CASE?**

12 A. None that I am aware of. For instance, there is no evidence of harvesting capital  
13 on the part of NFG or its non-utility affiliates, under-investing in the utility, or  
14 service quality deterioration, nor is the Staff Finance Panel suggesting that such  
15 circumstances exist.

16 **V. SPECIFIC RING-FENCING MEASURES PROPOSED BY THE STAFF**  
17 **FINANCE PANEL**

18 **Q. WHAT TOPICS WILL YOU ADDRESS IN THIS SECTION OF YOUR**  
19 **REBUTTAL TESTIMONY?**

20 A. Putting aside the policy implications of the Staff Finance Panel’s ring-fencing  
21 positions and proposals, as well as the question of whether ring-fencing as

1 described by Staff can be imposed in the context of a rate case, there are  
2 significant practical issues that would be created by the Staff Finance Panel's  
3 proposed ring-fencing measures. I address these practical considerations in this  
4 section of my rebuttal testimony.

5 **Q. EARLIER IN YOUR TESTIMONY YOU IDENTIFIED THE SPECIFIC**  
6 **RING-FENCING MEASURES PROPOSED BY THE STAFF FINANCE**  
7 **PANEL. FOR CONVENIENCE, PLEASE LIST THEM AGAIN.**

8 A. The Staff Finance Panel proposes that the following six specific ring-fencing  
9 measures be imposed in this proceeding.

- 10 1. Distribution be prohibited from paying dividends to NFG if its average  
11 common equity ratio for the trailing 12 months prior to the dividend payment  
12 is more than 200 basis points below the common equity ratio used in setting  
13 rates.
- 14 2. Distribution should be required to issue its own long-term debt.
- 15 3. NFG should pursue obtaining individual credit ratings from Moody's and  
16 S&P for Distribution.
- 17 4. If Distribution is unable to obtain its own credit rating and NFG is  
18 downgraded from either the current S&P 'BBB' rating or the Moody's 'Baa3'  
19 rating, the interest rate for Distribution in subsequent rate filings should match  
20 that of Staff's proxy group, for "BBB+" utilities.
- 21 5. Distribution should be required to create a special class of preferred stock, to  
22 be held by a trustee approved by the Commission, which shall be referred to  
23 as the "golden share." The holder of the "golden share" would be independent  
24 of the holding company and its affiliates, and could prevent a bankruptcy of  
25 the parent, or any of its affiliates, from triggering a voluntary bankruptcy of  
26 Distribution. The holder of the "golden share" would exercise the voting right  
27 for the protection of the interests of New York ratepayers.
- 28 6. NFG's general counsel should issue a non-consolidation letter that will be  
29 filed with the Commission to demonstrate the implementation of the ring-

1 fencing provisions and the legal and credit separation of Distribution from its  
2 parent and affiliates.<sup>19</sup>

3 **Q. PLEASE DESCRIBE THE PRACTICAL ISSUES THAT WOULD BE**  
4 **CREATED BY THE STAFF FINANCE PANEL'S PROPOSED RING-**  
5 **FENCING MEASURES.**

6 A. The Staff Finance Panel's proposed ring-fencing measures would create a  
7 veritable Rubik's Cube of cascading issues. As the Company Finance Panel  
8 testifies, the proposed measures would potentially require modifications to, or  
9 possibly the elimination, of NFG's existing 1974 indenture. In addition to the  
10 costs associated with modifying NFG's indenture, there are the significant costs  
11 that would be incurred to register Distribution with the SEC and obtain ratings  
12 from the Credit Rating Agencies. The initial upfront and ongoing costs for  
13 compliance and required SEC filings would likely be substantial. All of those  
14 costs would be the responsibility of Distribution ratepayers. Further, as discussed  
15 by the Company Finance Panel, there are no plans to issue new debt during the  
16 rate year and Distribution's need for new debt after the rate year is limited.  
17 Assuming *arguendo* that Distribution could borrow at a lower rate than NFG,  
18 there is no near-term opportunity to realize interest rate savings yet there are  
19 significant costs. In addition, any short-term borrowing needs Distribution may  
20 have are more than satisfied by the Money Pool.

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<sup>19</sup> Staff Finance Panel Testimony, at 37-38.

1 **Q. HYPOTHETICALLY, IF DISTRIBUTION WERE ABLE TO ISSUE ITS**  
2 **OWN DEBT UNDER A HIGHER CREDIT RATING THAN ITS PARENT**  
3 **WOULD THAT TRANSLATE INTO BETTER TERMS AND SAVINGS**  
4 **TO CUSTOMERS?**

5 A. Not necessarily. In addition to credit ratings, access to financial markets on  
6 favorable terms is also driven by the size, amount, frequency and timing of  
7 issuances, and the relationships the borrower has with financial institutions. All  
8 of those considerations favor issuance of securities at the consolidated level.  
9 Under the Staff Finance Panel's ring-fencing proposal, any such benefits provided  
10 to Distribution by NFG's structure and consolidated approach to financing would  
11 be lost.

12 **Q. ARE PRACTICAL CONSIDERATIONS RAISED BY THE STAFF**  
13 **FINANCE PANEL'S ALTERNATIVE RECOMMENDATION THAT IF**  
14 **DISTRIBUTION IS UNABLE TO GET ITS OWN CREDIT RATING, AND**  
15 **NFG IS DOWNGRADED, THEN DISTRIBUTION'S INTEREST COST IN**  
16 **SUBSEQUENT RATE CASES SHOULD "MATCH" STAFF'S**  
17 **RECOMMENDED PROXY GROUP?**

18 A. Yes. If the cost of a future debt issuance is increased due to non-utility factors,  
19 and the Commission concludes that Distribution's cost of debt is unreasonable,  
20 the Commission may simply adjust the cost of that debt issuance in the

1 Company's next rate case and reflect that adjusted cost in Distribution's weighted  
2 average cost of debt. A proxy credit rating and cost of debt regardless of the  
3 utility's circumstances for all debt, embedded and incremental, is unreasonable  
4 and could be confiscatory.

5 **Q. WHAT COMMENT DO YOU HAVE REGARDING THE STAFF**  
6 **FINANCIAL PANEL'S PROPOSED REQUIREMENT FOR A NON-**  
7 **CONSOLIDATION LETTER?**

8 A. First, a non-consolidation opinion is only relevant to avoiding an inclusion of the  
9 utility subsidiary in a parent's bankruptcy filing. Such an opinion would require  
10 complete separation of capital sources, which cannot be accomplished without  
11 incurring substantial incremental costs. Second, non-consolidation opinions are  
12 typically very extensive opinions building upon a multi-layered assessment of the  
13 various financial and legal separations of a subsidiary and its parent. Finally, as  
14 described by the Company Finance Panel, NFG is an investment grade issuer with  
15 sufficient credit that is not in threat of bankruptcy.

16 **Q. WHAT IS YOUR REACTION TO THE STAFF FINANCIAL PANEL'S**  
17 **PROPOSED CREATION OF A "GOLDEN SHARE"?**

18 A. This is among the most extreme forms of ring-fencing proposed by Staff and has  
19 nothing to do with capital structure or establishing just and reasonable rates.  
20 Putting aside the fact that Staff's proposal would potentially require a

1 modification to, or possible elimination of, NFG's 1974 indenture and restrictions  
2 in its corporate governance, the costs of which would be borne by ratepayers, the  
3 facts and circumstances of this rate case and NFG are dissimilar to those of the  
4 merger cases I discussed above in which the Commission adopted the  
5 implementation of a "golden share."

6 **Q. WHAT COMMENT DO YOU HAVE REGARDING THE STAFF**  
7 **FINANCIAL PANEL'S PROPOSED DIVIDEND RESTRICTIONS?**

8 A. This is another example of a restriction that is ill-defined, not based on the facts of  
9 this case and unnecessary. The legitimate purpose of a dividend restriction is to  
10 ensure that the utility has sufficient cash to invest in its operations. There is  
11 absolutely no evidence of any underinvestment by Distribution in its system. As  
12 discussed in the direct testimony of Mr. House, Distribution continues to provide  
13 its customers with safe and reliable service through a continued, and well-funded  
14 system modernization program. In addition, the direct testimony submitted by  
15 Mr. Meisl in this case discussed the fact that Distribution is among the most  
16 efficient utilities in the State. Given these circumstances, it is counterproductive  
17 and extremely poor regulatory policy to respond to that fact by imposing an  
18 unnecessary dividend restriction.

1                   **VI.    CONCLUSIONS AND RECOMMENDATIONS**

2   **Q.    IS ADDITIONAL RING-FENCING AS ASSERTED BY THE STAFF**  
3       **FINANCE PANEL NECESSARY AND APPROPRIATE FOR NFG AND**  
4       **DISTRIBUTION?**

5   A.    No. As described herein and in the Company Finance Panel testimony, NFG is an  
6       investment grade entity with sufficient credit facilities in place. Staff’s concerns,  
7       and its proposed remedies, are misplaced and are a “solution in search of a  
8       problem.” In addition, NFG’s existing practices, and the Commission’s existing  
9       policies, reasonably and appropriately isolate and protect Distribution from NFG  
10       and its non-regulated subsidiaries.

11 **Q.    IS IT COMMON FOR REGULATORS TO IMPOSE RESTRICTIVE**  
12 **RING-FENCING PROVISIONS IN A RATE CASE?**

13 A.    No. In my 40 years in the industry I have never seen an extreme proposal such as  
14       Staff’s adopted or otherwise imposed by a regulatory commission in a rate case.

15 **Q.    WILL IMPOSING STAFF’S RING-FENCING REQUIREMENTS**  
16 **THROUGH THIS RATE CASE BE FAVORABLY RECEIVED BY THE**  
17 **RATING AGENCIES AS SUGGESTED BY THE STAFF FINANCE**  
18 **PANEL?**

19 A.    No, I don’t believe so. As described in my rebuttal testimony, the consistency  
20       and predictability of the regulatory environment is a key factor used in risk

1 assessments by the Credit Rating Agencies. In my opinion, imposition of the  
2 Staff Finance Panel's ring-fencing proposal would be inconsistent with the  
3 Commission's established practices and introduce a significant element of  
4 regulatory risk from the investor's perspective.

5 **Q. SHOULD THE STAFF FINANCE PANEL'S SPECIFIC PROPOSED**  
6 **RING-FENCING MEASURES BE ADOPTED IN THIS PROCEEDING?**

7 A. No. As I have discussed herein, the Staff Finance Panel's ring-fencing proposal  
8 is neither necessary nor appropriate in this rate case and should be rejected.

9 **Q. IN LIEU OF THE IMPOSITION OF THESE RING-FENCING**  
10 **MEASURES, SHOULD NFG'S CORPORATE EQUITY RATIO, E.G.,**  
11 **42.3%, BE USED IN ESTABLISHING THE RETURN ON RATE BASE?**

12 A. No. As previously described, I am concerned about the appropriateness of using  
13 Distribution's allowed return as effectively a "hostage" in Staff's attempt to use a  
14 rate case to impose ring-fencing measures. It is also in sharp contrast to the 48  
15 percent equity ratio that Staff recommended in the Company's last rate case based  
16 primarily on Staff's position that it was an appropriate equity ratio for a gas or  
17 electric utility in New York.

18 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

19 A. Yes.