Before the
Public Service Commission
of Maryland

In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.	**)** **)** **)**	**Case No. 9449**

Direct Testimony
of
Scott Hempling

On Behalf of
Maryland Office of People's Counsel

August 14, 2017

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Exhibit SH-1: Resume of Scott Hempling

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Direct Testimony of Scott Hempling

On Behalf of
Maryland Office of People's Counsel

Introduction and Overview

A. Qualifications and experience

Q. State your name, position and business address.

A. My name is Scott Hempling. I am the President of Scott Hempling, Attorney at Law LLC. My business address is 417 St. Lawrence Drive, Silver Spring, Maryland 20901.

Q. Describe your employment background, experience and education.

A. I began my legal career in 1984 at a private law firm, where I represented municipal power systems and others on transmission access, holding company structures, nuclear power plant construction prudence and producer-pipeline gas contracts. From 1987 to 1990 I was an attorney at a public interest organization, working on electric utility issues. From 1990 to 2006 I had my own law practice, advising public and private sector clients—primarily state regulatory commissions, and also municipal systems, independent power producers, consumer advocates, public interest organizations and utilities—with an emphasis on electric utility regulation.

From October 2006 through August 2011, I was Executive Director of the National Regulatory Research Institute (NRRI). Founded by the National Association of Regulatory Utility Commissioners (NARUC), NRRI is a Section 501(c)(3) organization, funded primarily by state utility regulatory commissions to provide research to regulatory decision-makers. As Executive Director, I was responsible for working with commissioners and commission staff at all 51 state-level regulatory agencies to develop

1 and carry out research priorities in electricity, gas, telecommunications and water. In
2 addition to overseeing the planning and publication of over 80 research papers by NRRI's
3 staff experts and outside consultants, I published my own research papers, advised
4 contract clients (including state commissions, regional transmission organizations, private
5 industry and international institutions), and wrote monthly essays on effective regulation.
6 In September 2011, I returned to private practice to focus on writing books and
7 research papers, providing expert testimony, and teaching courses and seminars on the
8 law and policy of utility regulation. I am an adjunct professor at Georgetown University
9 Law Center in Washington, D.C., where I teach courses on public utility law and
10 regulatory litigation.
11 I have represented and advised clients in diverse state commission cases, and in
12 federal proceedings under the Federal Power Act of 1935 and the Public Utility Holding
13 Company Act of 1935. The latter proceedings took place before the Federal Energy
14 Regulatory Commission (FERC), the Securities and Exchange Commission (SEC) and
15 U.S. courts of appeals. I have participated in many merger proceedings—as an attorney
16 advising litigating parties, as an advisor to a regulatory commission or as an expert
17 witness.[1] I have testified many times on electric industry matters before Congressional
18 and state legislative committees.

[1] These proceedings include: Toledo Edison and Cleveland Electric Illuminating (1985); PacifiCorp and Utah Power & Light (1987-88); Northeast Utilities and Public Service of New Hampshire (1990-91); Kansas Power & Light and Kansas Gas & Electric (1990-91); Northern States Power and Wisconsin Electric Power Co. (1992); Entergy and Gulf States (1995); Potomac Electric Company and Baltimore Gas & Electric (1997-98); Carolina Power & Light and Florida Power Corp (1999); Sierra Pacific Power and Nevada Power (1998-99); American Electric Power and Central and Southwest (2001); Union Electric and Central Illinois Light Company (2001); Exelon and Constellation (2011-12); Entergy and International Transmission Company (2013); Exelon and PHI

1 My book on utility law, *Regulating Public Utility Performance: The Law of*
2 *Market Structure, Pricing and Jurisdiction,* was published by the American Bar
3 Association in 2013. This is the first volume of a two-volume treatise, the second of
4 which will address the law of corporate structure, mergers and acquisitions. My book of
5 essays, *Preside or Lead? The Attributes and Actions of Effective Regulators,* was
6 published by NRRI in 2010. I published a second, expanded edition in 2013. I have
7 written several dozen articles on utility regulation for publication in trade journals, law
8 journals and books; and taught electricity law seminars to attendees from all fifty states
9 and all industry sectors. I have spoken or taught at many industry conferences or
10 seminars in the United States, and in Australia, Canada, England, Germany, India, Italy,
11 Jamaica, Mexico, New Zealand, Nigeria, Peru and Vanuatu. As a subcontractor to the
12 U.S. Department of State, I have advised the six nations of Central America on the
13 regulatory infrastructure necessary to accommodate and encourage cross-national
14 electricity transactions.

15 I received a B.A. *cum laude* from Yale University in 1978, where I majored in
16 Economics and Political Science and in Music. I received a J.D. *magna cum laude* from
17 Georgetown University Law Center in 1984. I am a member of the Bars of the District of
18 Columbia and Maryland.

19 My resume is attached to this testimony as Exhibit SH-1. More information is
20 available at www.scotthemplinglaw.com.

Holdings (2014-15) (before the commissions in Maryland and the District of Columbia); Iberdrola and United Illuminating (2014); Macquarie and Central Louisiana Electric Company (2015); NextEra and Hawaiian Electric Industries (2015-16); and Great Plains Energy and Westar (2016-17).

1 **Q. Have you provided testimony in prior regulatory proceedings?**
2
3 **A.** Yes, before the following fora: Kansas Corporation Commission, Louisiana Public
4 Service Commission, Hawaii Public Utilities Commission, Connecticut Public Utilities
5 Regulatory Authority, District of Columbia Public Service Commission, Maryland Public
6 Service Commission, Mississippi Public Service Commission, U.S. District Court for
7 Minnesota, Illinois Commerce Commission, California Public Utilities Commission,
8 Minnesota Public Utilities Commission, U.S. District Court for Wisconsin, New Jersey
9 Board of Public Utilities, Indiana Utility Regulatory Commission, North Carolina
10 Utilities Commission, Wisconsin Public Service Commission, Texas Public Utilities
11 Commission and the Vermont Public Service Board. These proceedings are listed on my
12 resume.
13 **Q. Have you testified previously before the Commission?**
14 **A.** Yes, in Case No. 9271 (Exelon-Constellation) and Case No. 9361 (Exelon-PHI).
15 **Q. On whose behalf are you submitting this testimony?**
16
17 **A.** The Maryland Office of People's Counsel.
18 **Q. What information did you review in preparing this testimony?**
19
20 **A.** I reviewed the Merger Application filed by AltaGas Ltd ("AltaGas"), WGL Holdings,
21 Inc. ("WGLH") and Washington Gas Light Company ("Washington Gas"); the
22 Applicants' accompanying testimony; the Proxy Statement filed by WGLH with the
23 Securities and Exchange Commission; Maryland's public utility statutes; Maryland court
24 and Commission decisions; and discovery responses.
25 ***B. Transaction basics***
26 **Q. Describe the basics of this transaction.**

1 **A.** AltaGas, an $8 billion holding company, has proposed to acquire WGLH, a $6.3 billion
2 holding company, for $4.5 billion in cash while assuming $1.8 billion of WGLH's debt.
3 On receiving $88.25 per share, a premium of 39.1% above the unaffected closing price of
4 $63.45,[2] the current owners of WGLH's 51,219,000 shares will depart, with an
5 acquisition premium of $1.27 billion.[3] WGLH and Washington Gas, a regulated gas
6 distribution company operating in Maryland, will become 100%-owned subsidiaries
7 within the AltaGas system. As a result, AltaGas will exercise substantial influence over
8 the policies and actions of Washington Gas.

9 AltaGas's financing plans for the $4.5 billion cash payment are incomplete.
10 According to the Application (at 19-20):

> 11 The transaction will be financed through a combination of (i) the net
> 12 proceeds from a bought subscription receipt public offering of
> 13 approximately $1.7 billion; (ii) the net proceeds of an approximately $0.3
> 14 billion private placement of subscription receipts; (iii) a fully committed
> 15 bridge financing facility; (iv) potential divestures of assets of AltaGas; and
> 16 (v) future senior debt, hybrid security or equity or equity-linked security
> 17 financings.
> 18

19 AltaGas has not identified either (1) who will provide the "future senior debt, hybrid
20 security or equity or equity-linked security financings" or on what terms, including what
21 interest rate will apply[4]; or (2) which AltaGas assets will be divested and when.

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[2] The $63.45/share figure, which produces a premium of 39.1% is the volume-weighted average trading price of WGLH common stock for the 30 trading days ending November 28, 2016, the day before a Bloomberg newsletter published a story stating that WGLH was in talks with a third party. The Applicants assert that the premium is 28% because they use a higher unaffected market price—the one on the single day of Nov. 28, 2016. OPC Witness Ralph Smith discusses these matters.

[3] The $1.27 is the result of this arithmetic: (88.25-63.45) x 51,219,000.

[4] *See* Response to OPC 13-17 ("AltaGas expects interest rates for debt issued in relation to the acquisition of WGL Holdings to be a function of the market rates at the time of issuance.").

C. Statutory basics

Q. Summarize the relevant statutory provisions.

A. Because this transaction would give AltaGas "substantial influence" over Washington Gas, a "public service company" as that phrase is defined in the Public Utility Act, it triggers this Commission's jurisdiction under Section 6-105 of the Public Utility Act. Section 6-105(g) states: "If the Commission finds that the acquisition is consistent with the public interest, convenience, and necessity, including benefits and no harm to consumers, the Commission shall issue an order granting the application." The statute requires three separate findings: public interest, benefits and no harm.[5]

To make these findings, the Commission must consider this non-exhaustive list of factors:

> (i) the potential impact of the acquisition on rates and charges paid by customers and on the services and conditions of operation of the public service company;
>
> (ii) the potential impact of the acquisition on continuing investment needs for the maintenance of utility services, plant, and related infrastructure;
>
> (iii) the proposed capital structure that will result from the acquisition, including allocation of earnings from the public service company;
>
> (iv) the potential effects on employment by the public service company;
>
> (v) the projected allocation of any savings that are expected to the public service company between stockholders and rate payers;
>
> (vi) issues of reliability, quality of service, and quality of customer service;

[5] "[I]t is not enough for the Companies to prove that the Transaction is 'consistent with the public interest, convenience and necessity'—they also must demonstrate that the Transaction will offer 'benefits and no harm to consumers.'" *In the Matter of the Current and Future Financial Condition of Baltimore Gas and Electric Company*, Order No. 82986 (EDF-Constellation Phase 2), 2009 Md. PSC LEXIS 59; 27 P.U.R.4th 365 (2009).

(vii) the potential impact of the acquisition on community investment;

(viii) affiliate and cross-subsidization issues;

(ix) the use or pledge of utility assets for the benefit of an affiliate;

(x) jurisdictional and choice-of-law issues;

(xi) whether it is necessary to revise the Commission's ring-fencing and code of conduct regulations in light of the acquisition; and

(xii) any other issues the Commission considers relevant to the assessment of acquisition in relation to the public interest, convenience and necessity.

D. Executive summary

Q. Summarize your testimony.

A. My testimony has four major parts, summarized here. After those four summaries I emphasize two other points: First, this transaction is unlike the others approved by the Commission. Second, the Application is missing information about the ultimate purchase price and the terms of the acquisition debt. Without this information, a determination of "public interest" and "harm" is logically impossible.

1. The Applicants' purposes conflict with the public interest

In Maryland, acquisitions of utilities must be consistent with the public interest. In designing this transaction, the parties did not focus on the public interest. WGLH asked: "How do we sell the company for the highest possible price?" AltaGas asked: "How do we find a 'foothold' and 'platform' that will 'drive our future growth' and expand our 'portfolio'?" A transaction with these origins is unlikely to satisfy the public interest.

Part I explains that the "public interest" has four characteristics: alignment of shareholder and ratepayer interests, economic efficiency, regulatory outcomes that

1 replicate competitive outcomes, and respect for legitimate shareholder expectations.
2 Because WGLH's purpose was to seek the highest possible purchase price, with customer
3 benefits an afterthought, the outcome of its efforts conflicted with those four factors.
4 AltaGas's priorities—buying a "foothold" and a "platform" for earnings growth and
5 future acquisitions, with no pretense of improving service or lowering costs for
6 Washington Gas customers, were also inconsistent with those four factors. On these
7 bases alone, the transaction fails the statutory "public interest" test.

8 Because the Applicants' purposes were financial and strategic, their transaction
9 produces no true consumer benefits. They admit as much. (Mr. Harris: "[T]o be clear,
10 this transaction is not a synergies-driven one.") They talk generically of "synergies" and
11 "best practices"; but these boilerplate phrases are unaccompanied by any specifics or any
12 commitments.

13 ***2. The entire $1.27 billion acquisition premium would go to WGLH***
14 ***shareholders, even though much of the value AltaGas wants to buy is***
15 ***attributable to Washington Gas ratepayers***
16
17 This transaction is a sale of public franchise for private gain. The measure of that
18 gain is the $1.27 billion acquisition premium—the excess of purchase price over market
19 price. Under the Merger Agreement, the parties allocate this entire amount to WGLH
20 shareholders and zero to ratepayers.

21 This $1.27 billion is what AltaGas is willing to pay, above market price, to gain
22 100% control of WGLH. **Part II** analyzes the possible sources of the value that AltaGas
23 sees. This value is not likely attributable to any risk-taking by WGLH shareholders or
24 decision-making by WGLH executives; it is more likely attributable to the franchise

privilege created and granted by Maryland government, as well the historic and future presence of, and payments by, Washington Gas's captive ratepayers.

On these facts, it is illogical to allocate the entire acquisition premium to WGLH shareholders, automatically and without factual support. Rather, the Commission should allocate that amount between shareholders and ratepayers based on their contribution to the value implicit in the premium. This result is consistent with both the statutory "public interest" standard and the U.S. Constitution's guarantee of "just compensation."

3. AltaGas's complexities—current and future, known and unknown—bring risks of harm with insufficient benefit

With the 2005 repeal of the federal Public Utility Holding Company Act of 1935, there no longer is any federal law limiting the types, sizes, timing, locations or risks associated with acquisitions and mergers of gas and electric utilities. AltaGas's corporate structure, and its ambitions for "footholds" and "growth," exemplify the new complexities and risks from which Washington Gas's customers will need protection.

Part III explains that the Commission cannot readily protect customers from risks it does not know about, let alone risks it has no authority to control. That is the situation caused by this transaction. AltaGas's future actions—its acquisitions, its borrowings, its asset sales, its executive decisions, its Board membership—will occur outside this Commission's jurisdiction and even outside this Commission's knowledge, unless the Commission conditions otherwise.

Applicants say ratepayers will be protected by "ring-fencing." But their ring does not surround all risks, and their fence has holes. Most importantly, while ring-fencing might help prevent AltaGas from draining equity *from* Washington Gas, ring-fencing does nothing—literally nothing—to ensure that AltaGas puts sufficient equity *into*

1 Washington Gas. Given that Washington Gas will depend 100% on AltaGas for equity
2 (real equity, not debt-financed equity achieved through "double-leveraging"), the
3 possibility that AltaGas's future business risks could leave it unable to finance
4 Washington Gas should rise to the highest level of Commission concern.

5 The transaction itself—meaning, the meshing of two companies—has no
6 commitment-backed benefits. Washington Gas does not need AltaGas's "financial
7 strength"; the utility, backed by its commissions and its captive ratepayers, has its own
8 financial strength. The claimed "synergies" and "best practices" are generalities repeated
9 in many merger cases, here unbacked by commitments. The minor dollars from
10 eliminating duplication do not justify transferring control of Washington Gas's
11 distribution infrastructure to a company we have just met and whose ambitions are at
12 odds with Maryland's needs. The inducements, such as the rate credit and the
13 storage/renewable energy commitment, are unrelated to the transaction; they are not, as
14 required by statute, from "the acquisition."

15 ***4. Conditions are necessary, but their enforceability is uncertain***
16
17 While I recommend the Commission disapprove this transaction, **Part IV**
18 presents conditions, focusing on reducing the risk of harm and increasing the likelihood
19 of benefit. But these conditions are not sufficient to address the adverse effects I have
20 described. Of most concern is their enforceability, because AltaGas is not a "public
21 service company" over which the Commission has express statutory jurisdiction after the
22 acquisition. To aid enforceability, the Commission should make explicit its authority to
23 order Washington Gas to disaffiliate from AltaGas should adverse circumstances so
24 require.

5. This transaction is unlike all others approved by this Commission

This is not a "merger of equals." The shareholders of two similar, separate organizations are not exchanging stock to form a new organization they own jointly. This is a cash buyout, where the shareholders of the target company take their gain and leave, economically indifferent to the company customers they leave behind. Nor is this a merger of adjacent companies, combining comparable customer bases within the same economic region—a rational joining of service territories whose boundaries were drawn decades ago. Nor is this an acquisition containing any assertion, let alone evidence, that the acquirer will improve the performance of the target.

Unlike most prior transactions, AltaGas makes no pretense of acquiring WGLH to improve utility service in Maryland. AltaGas's purpose is solely strategic: to gain control of Washington Gas's government-protected franchise, its captive customer base and its government-granted opportunities to expand its rate base, all to create a "foothold" and a "platform" for future acquisitions. Those future acquisitions will leave Washington Gas with a successively smaller role in AltaGas's increasing "portfolio." And those future acquisitions, of unknown type, size, location, timing or risk, will occur outside of this Commission's jurisdiction. The Commission thus will have neither the power nor the information to ensure that AltaGas, on whom Washington Gas will be 100% dependent for equity financing, remains capable of providing that financing.

6. Essential information is missing

Unlike prior transactions, this one lacks two pieces of information essential to determining its viability. First, we do not know the final price, because that price depends on the exchange rate between Canadian and U.S. dollars at closing. That

1 exchange rate can vary greatly.[6] Second, since the acquisition debt at present is only

2 bridge financing, we do not know the final terms of the long-term debt that will replace

3 the bridge. We don't know the lenders, the interest rates, the consequences of default

4 (including what happens to the key asset, Washington Gas)—because 11 months after

5 starting its negotiations and 6 months after signing the Merger Agreement, AltaGas has

6 yet to finalize the financing.[7]

7 Because of these multiple concerns, my testimony recommends rejection.

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[6] As explained in the testimony of OPC Witness Michael Arndt. *See also* AltaGas Ltd, *Annual Information Form for Year Ended Dec. 31, 2016* at pp. 59-72 (Feb. 22, 2017):

> As AltaGas anticipates funding a portion of the purchase price of the WGL Acquisition from a combination of Canadian and U.S. dollar denominated securities and credit facilities, and the purchase price of the WGL Acquisition is denominated in U.S. dollars, a significant decline in the value of the Canadian dollar relative to the U.S. dollar at the time of closing of the WGL Acquisition could increase the cost to AltaGas of funding the purchase price of the WGL Acquisition.

[7] *See* AltaGas Ltd, *Annual Information Form for Year Ended Dec. 31, 2016* at pp. 59-72 (Feb. 22, 2017):

> If the WGL Acquisition is completed on the terms contemplated in the Merger Agreement, AltaGas anticipates incurring additional debt, including as a result of borrowings under the Bridge Facility, in order to complete the Merger Agreement on the terms contemplated therein. Such borrowings are anticipated to represent a material increase in AltaGas' consolidated indebtedness. Such additional indebtedness will increase AltaGas' interest expense and debt service obligations and may have a negative effect on AltaGas' results of operations or credit ratings. The increased indebtedness will also make AltaGas' results more sensitive to increases in interest rates.

1 **I.**
2 **In this sale of public franchise for private gain,**
3 **AltaGas's and WGLH's goals conflict with ratepayers' interests**
4
5 **Q. Explain the nature of this transaction.**
6
7 **A.** WGLH, a holding company, is the 100 percent owner of Washington Gas, a public
8 utility. For decades, Washington Gas has been the sole beneficiary of government-
9 granted franchises to provide gas distribution service within defined service territories in
10 Maryland, the District of Columbia and Virginia. Washington Gas provides this service,
11 on a *de facto* exclusive basis, at government-set rates whose reasonableness is assured by
12 statutory and constitutional law. Those rates ensure that Washington Gas has a
13 reasonable opportunity to recover its prudent costs and earn a fair return on its used and
14 useful investment. With few exceptions, customers of gas distribution service have no
15 choice but to pay what Washington Gas charges; they cannot negotiate the rates or buy
16 distribution service from others.
17 Washington Gas's franchised status is a valuable, government-granted privilege.
18 That privilege has enabled WGLH, to earn reasonable profits from Washington Gas's
19 activities, at relatively low risk. The stable, low-risk revenue stream, brand recognition
20 and ready access to capital, all flowing from Washington Gas's franchised status, has
21 helped WGLH enter various competitive product markets, especially the retail sale of
22 natural gas and electricity through its affiliate WGL Energy Services (WGLES). These
23 franchise-assisted activities have added to WGLH's value.

1 In this transaction, WGLH shareholders will sell all their stock for cash, at a

2 premium of 39.1%, or $1.27 billion, over market price.[8] Mechanically they are selling

3 their WGLH stock; but in reality they are selling, in part, the right to control Washington

4 Gas's franchise—that government-granted right to provide an essential service at rates

5 that customers have little choice but to pay.

6 Understood for what it is—a sale of public franchise for private gain—this

7 transaction is not in the public interest. It cannot be in the public interest because neither

8 AltaGas's nor WGLH's goals are in the public interest. In this Part I, I first explain that

9 to satisfy the public interest, acquisitions should align shareholder interests with ratepayer

10 interests. I then explain the two main reasons why this transaction subordinates ratepayer

11 interests to shareholder interests: In choosing AltaGas, WGLH placed shareholder gain

12 ahead of ratepayer needs; and in choosing WGLH, AltaGas's priorities were "strategic

13 positioning" and "growth," not cost reduction and customer service.

14 ***A. To satisfy the public interest, acquisitions should align shareholder interests***
15 ***with ratepayer interests***

16 ***1. The "public interest": a standard needing definition***
17

18 **Q. Explain the need for a definition of "public interest."**
19

20 **A.** Section 6-105 does not define "public interest." Section 6-105(g)(2) has a 12-factor

21 checklist. But a checklist is not a standard; it is a means of assessing compliance with a

[8] As determined by OPC Witness Ralph Smith, based on the volume-weighted average trading price of WGL Holdings common stock for the 30 trading days ending November 28, 2016. There is a difference between the acquisition premium as calculated by Mr. Smith and that calculated by the Applicants, who use the stock price on Nov. 28, 2016 instead of a 30-day average. That date is the day before a Bloomberg newsletter published a story stating that WGLH was in play.

1 standard. A standard is "a level of quality or attainment";[9] "something set up and

2 established by authority as a rule for the measure of ... value, or quality";[10] "something

3 established by authority, custom, or general consent as a model or example."[11] Your car

4 repair shop has a checklist—brakes, steering, transmission, emissions, air conditioning.

5 The shop uses that checklist to assess whether your car meets the manufacturer's (and

6 your) standards for quality: for safety, efficiency and comfort. The Section 6-105

7 checklist is not itself a standard.

8 Because the "public interest" standard is not defined by the statute, it must be

9 defined by the Commission. While Commission has not defined the term, it has provided

10 some guidance. It has said that the public interest is not satisfied by "merely [making]

11 people better off generally with this deal than without it.;[12] that the Commission's

12 "mandate to evaluate the 'public interest' is 'not to decide whether the Transaction is a

13 good or bad idea nor to weigh it against alternative deals or the status quo;'"[13] and that

14 there is a public interest in improved performance.[14] But the Commission has not said

15 what quantity of improvement, from barely visible to extraordinary, is sufficient to satisfy

---

[9] https://www.google.com/search?q=standard+definition&sourceid=ie7&rls=com.microsoft:en-US:IE-Address&ie=&oe=&rlz=&gws_rd=ssl.

[10] https://www.merriam-webster.com/dictionary/standard.

[11] *Id.*

[12] Order No 82986 text adjacent to n90.

[13] Order No 84698 (*Exelon-Constellation*) (2012) at text accompanying n.142.

[14] *See, e.g.*, Order No. 83788 (*FirstEnergy-Allegheny*) at text accompanying n.86 ("[T]here seems to be an opportunity going forward to improve on recent performance in this regard. We recognize though that the commitment the Applicants are making supports a finding that the Merger is in the public interest").

the public interest. The Commission's prior merger opinions do not have a comprehensive definition of the public interest standard.

Nor does the Application, or the testimony of any of the Applicants' 14 witnesses, have a definition of "public interest."

The public interest being the statute's central purpose, this phrase cannot be treated as surplusage. To give my testimony a logical foundation, and a standard against which this transaction can be judged, I offer a definition next—one that that carries out the purpose and provisions of Section 6-105 while reflecting the mainstream principles of utility regulation. By adopting this definition, the Commission can ensure that future proposals satisfy the *public* interest and not only the proponents' interests.

2. The public interest requires shareholder-ratepayer alignment, economic efficiency, competitive outcomes, and respect for legitimate expectations

Q. How do you recommend the Commission define the public interest standard?

A. I recommend that the Commission define the public interest standard to satisfy four criteria: alignment of shareholder and ratepayer interests, economic efficiency, replication of competitive outcomes, and respect for legitimate expectations. Regulatory decisions, whether about rates, service quality or acquisitions, will satisfy the public interest if they satisfy these four criteria.

Alignment of the shareholder and ratepayer interests: In regulating public utilities, the public interest is served when shareholder and ratepayer interests are aligned; that is, when pursuit of the shareholder interest simultaneously advances the consumer interest. That is how competition works: When a market has low entry barriers and no anticompetitive behavior, the most successful businesses have the most satisfied customers.

1 ***Economic efficiency:*** Economic efficiency means biggest bang for the buck. It

2 means no waste. Investors seek the highest return for a given level of risk. Consumers

3 seek the lowest price for a given quality of product. Business managers seek the highest

4 possible output for a given level of input. When benefits are allocated to those who

5 create them, and costs are allocated to those who cause them, economic efficiency is

6 honored.

7 ***Replication of competitive outcomes:*** Economic regulation seeks to replicate the

8 outcomes of effective competition.[15] This goal is necessarily aspirational. Given the

9 many market imperfections (imperfect consumer knowledge, entry barriers, externalities,

10 oligopolistic and monopolistic market structures), effective competition is difficult to

11 achieve, let alone measure so as to replicate. Despite this difficulty, regulation aims to

12 replicate competition because competition, ideally, is objective. It ranks players

13 ruthlessly, based solely on merits. Regulation must do the same.

14 ***Respect for legitimate expectations:*** In a competitive market, customers expect

15 products to have the quality and price levels reflecting the efficiencies of the best

16 competitor. Shareholders expect profit levels consistent with their company's

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[15] As the Maryland Court of Appeals has stated:

> [T]he state through its [public utility] commission takes the place of competition and furnishes the regulation which competition cannot give, and at the same time avoids the expense of duplication in the investment and operation of competing municipal public utilities.

Delmarva Power & Light Co. v. Public Service Com'n of Maryland, 370 Md. 1, 6 (2002) (quoting Oscar L. Pond, *A Treatise on the Law of Public Utilities*, 29-31 § 901 (3d ed.1925)). *See also* Alfred Kahn, *The Economics of Regulation: Principles and Institutions*, Vol. 2 at 112 (1971, 1988) (stressing the "importance of making regulation more intelligent and more effective in those circumstances in which competition is simply infeasible").

1 performance for customers. Under regulation, the expectations should be similar. In
2 both competition and regulation, customers have no legitimate expectation of superlative
3 service at bargain-basement prices; investors have no legitimate expectation of
4 superlative returns at below-average risks. Legitimate expectations have legal protection,
5 under regulatory statutes and under the Constitution (as I will explain in Part II.D below).
6 All other expectations are only aspirations; regulators are not bound by them.

7 ***3. Applying the public interest standard: Which policies serve the public***
8 ***interest?***
9
10 **Q. How would you apply the four public interest criteria to this transaction?**
11
12 **A.** This transaction presents a series of choices. Applying to each policy choice the four
13 public interest criteria—shareholder-ratepayer alignment, economic efficiency,
14 replication of competitive market outcomes and respect for legitimate expectations—
15 produces decisions that satisfy the public interest. Consider these four questions:

16 1. Where government grants a utility the franchise privilege, and the utility
17 paid nothing to receive that privilege, which policy serves the public
18 interest: (a) allowing the utility's shareholders to sell the franchise for a
19 gain equaling 5-7 times what customers receive,[16] or (b) sharing the gain
20 between shareholders and customers based on the value each has
21 contributed?
22
23 2. In evaluating the transaction as a whole, which policy serves the public
24 interest: (a) approving a transaction where the acquirer's goal was
25 strategic positioning and the target's goal was maximum gain, or (b)
26 approving transaction whose central purpose was making customers better
27 off?
28
29 3. When evaluating claims of benefits from the merger, which policy serves
30 the public interest: (a) counting only benefits backed by enforceable
31 commitments, or (b) counting also benefits which are only aspirational but
32 not committed?
33

[16] I will explain these numbers in Part III.B.1.b.

1 4. When evaluating whether merger benefits bear an appropriate relationship
2 to merger costs, which policy serves the public interest: (a) counting only
3 benefits arising from efficiencies caused by the merger, or (b) counting
4 also side payments unrelated to the merger itself but offered solely to win
5 support?
6
7 A transaction is more likely to be in the public interest if the transacting parties'
8 goals are in the public interest. As the next two subsections show, WGLH sought the
9 highest possible purchase price, while AltaGas sought a "foothold" for future "growth."
10 In the context of regulated monopolies, these goals—neither of which displays a
11 consumer-benefitting purpose—are not consistent with the public interest.

12 ***B. In choosing AltaGas, WGLH placed shareholder gain ahead of ratepayer needs***

13 **Q. Is there a public interest problem in the way WGLH chose AltaGas?**
14
15 **A.** Yes. WGLH sought the highest price possible. That goal dominated all other
16 considerations. The customer interest and the public interest were incidental—relevant
17 only to ensure that the highest-price purchaser would win regulatory approval.
18 By placing purchase price ahead of customer performance, WGLH actions
19 conflicted with the public interest. While WGLH had a fiduciary obligation to its
20 shareholders, that obligation is necessarily constrained by its public utility obligation to
21 its customers. The next five subsections explain these points.

22 ***1. WGLH sought the acquirer offering the highest price***
23
24 **Q. Explain the actions WGLH took to influence the purchase price.**
25 **A.** WGLH detailed its actions in the Proxy Statement filed with the Securities and Exchange
26 Commission on March 31, 2017. This narrative shows that WGLH's singular goal was

"long-term value to the Company's shareholders." Here are the key excerpts from the Proxy Statement:[17]

> The Board and the Company's executive management team ("Executive Management") regularly review and evaluate the Company's strategic plan as part of their ongoing efforts to provide ***long-term value to the Company's shareholders***, taking into account economic, competitive, regulatory and other conditions, as well as historical and projected industry trends and developments.
>
> On September 27, 2016 ... the Board authorized Mr. McCallister to engage in preliminary discussions with AltaGas and other companies….
>
> [Preceding this Sept. 27, 2016 WGLH Board meeting, WGLH had received expressions of interest in a potential transaction from AltaGas and representatives of two other energy companies. To each of these representatives, Mr. McCallister responded that WGLH was "not engaged in a sale process and expressed the Company's intention to execute on its strategic plan." In response to a second contact from AltaGas, on Sept. 26, 2016, "Mr. McCallister informed Mr. Harris that the Company was not engaged in a sale process, but noted that he would convey AltaGas' interest to the Board at its next meeting."]
>
> On October 2, 2016, the chief executive officer of Party A contacted Mr. McCallister….Mr. McCallister indicated that the Company was not engaged in a sale process and was instead focused on executing the Company's strategic plan, but that the Company was always willing to listen to potential opportunities ***to enhance shareholder value***.
>
> On October 11, 2016,…Mr. McCallister informed the representative of Party B that the Company was not engaged in a sale process and was instead focused on executing the Company's strategic plan, but that the Company was always willing to listen to potential opportunities ***to enhance shareholder value***.
>
> [During a dinner on October 14, 2016], Mr. McCallister indicated that the Company was not "for sale" nor was the Company running a sale process and was instead focused on executing the Company's strategic plan, but that the Company was always willing to listen to potential opportunities ***to enhance shareholder value.*** Mr. McCallister also noted that, if the Company were to consider any potential strategic transaction, ***maximizing value for shareholders and ensuring a high-level of transaction closing certainty, including certainty related to obtaining any necessary regulatory approvals,*** would be of paramount importance to the Board....

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[17] These excerpts come from pp.29-41 of the Proxy Statement. Emphases are added. In these excerpts, "Company" refers to WGLH.

On November 2, 2016, the Company received a written indication of interest from Party A, which proposed a merger-of-equals between the two companies….The proposed merger consideration described in the proposals implied ***little to no premium to the then current trading price of the Company common stock***.

On November 4, 2016, Mr. McCallister contacted the chief executive officer of Party A and communicated that the proposal sent by Party A on November 2, 2016 did not offer ***sufficient shareholder value*** to warrant discussing with the Board.

On November 9, 2016, the Company received a written indication of interest from Party B. The indication of interest proposed several potential strategic combination alternatives, including an all-cash transaction and a transaction with a mix of stock and cash consideration, and contemplated a 20% to 30% premium to the then current trading price of the Company common stock.

On November 14, 2016,…representatives of Party A conveyed a change to the proposed merger consideration that … implied an approximately ***10% premium*** to the then current trading price of the Company common stock.

[On November 15, 2016, following briefings and advice from outside financial and legal advisors.] "[T]he Board determined that ***pursuing the merger-of-equals transaction proposed by Party A was not in the best interests of the Company's shareholders.***

[O]n November 18, 2016, ..Mr. Harris delivered a written indication of interest from AltaGas, which proposed an all-cash transaction with a ***per share offer price of between $88-$92.50***, and requested a period of exclusivity.....

Following the Board meeting on November 15, 2016, per the directions of the Board at such meeting, a representative of Goldman Sachs contacted the chief executive officer or other senior officer of three of the companies that previously had been identified in consultation with Goldman Sachs, Lazard and members of Executive Management, based on their respective industry knowledge, as being those most likely to be interested in and capable (from a financial and regulatory perspective) of executing ***a potential all-cash strategic transaction*** with the Company. ….

On November 29, 2016, Bloomberg published an article entitled "WGLH Said to Weigh Sale After Interest From Spain's Iberdrola," which reported that the Company had held preliminary talks with Iberdrola S.A. about a potential strategic transaction, and was weighing options, including a sale transaction. The article also reported that the Company was working with financial advisers on such matters. Immediately subsequent to the publication of such article, the Company common stock experienced heavy trading volume and an approximately

nine percent increase in its share price, compared to the closing share price of the Company common stock on November 28, 2016.

On December 5, 2016, Party D contacted Mr. McCallister and indicated that they would not be submitting an indication of interest, citing that ***they did not believe they could offer a meaningful premium to the then current trading price of the Company common stock***, and indicating their belief that such a proposal would not be attractive to the Board. Also on December 5, 2016, Party E contacted Goldman Sachs and indicated they would not be submitting an indication of interest, citing concerns about the ***potential business compatibility between the two companies, as well as regulatory approval considerations***.

On December 6, 2016, a senior officer of Party B verbally communicated to representatives of Goldman Sachs and Lazard an indicative offer of approximately $80 per share. However, no updated written proposal was presented by Party B.

[During a December 7, 2016 Board meeting] "the Board determined that, if the Company were able to get comfortable through negotiations and reverse due diligence that AltaGas was highly likely to close a potential transaction, that the price and other terms of the AltaGas proposal appeared to be ***favorable both in absolute terms and as compared to the existing and potential proposals of other potential transaction partners***. Following further discussion of the relative advantages and disadvantages related to the various process alternatives, the Board decided to proceed further with AltaGas, but not to grant them exclusivity at such time. The Board also authorized Mr. McCallister to inform Party B that its current proposal ***did not offer compelling shareholder value In reaching its determination, the Board considered a number of factors***, ***including the significant premium that the AltaGas proposal represented over the Company's recent and historical share price, including as compared to recent industry transactions, and as compared to Party B's proposal;*** the significant ***incremental value that would be received by the Company's shareholders in a transaction with AltaGas*** based on the indicative price range relative to the preliminary financial analyses of the Company on a standalone basis using the Company's strategic plan that had been performed by Goldman Sachs and Lazard; the fact that the proposed all-cash consideration would provide certainty of value and liquidity to the Company's shareholders….

Also on December 7, 2016, following the Board meeting, Messrs. McCallister and Harris had a telephone conversation regarding AltaGas' proposal during which Mr. McCallister ***emphasized the importance of AltaGas refining their price range***.

Also on December 7, 2016, following the Board meeting, Mr. McCallister contacted a senior officer of Party B to inform him that the Board did not view Party B's current proposal as ***offering compelling shareholder value….***

On December 19, 2016, Mr. McCallister and Mr. Harris had a telephone conversation during which Mr. Harris … communicated that ***AltaGas was narrowing its indicative price range to $90-$91.50 per share***. Mr. McCallister and Mr. Harris also discussed the allocation of regulatory risk, which Mr. McCallister again conveyed was a key focus of the Board, specifically noting the Company's expectation that AltaGas would be required to pay a regulatory termination fee in the event the transaction were not consummated due to a failure to obtain a required regulatory approval.

Later that same day, AltaGas provided a letter to the Company that memorialized the ***revised price range of $90-$91.50 per share***.

On January 17, 2017, Mr. Harris communicated to Mr. McCallister that, following the AltaGas board meeting the day before, AltaGas was still prepared to move forward with a potential transaction at ***a price of $88 per share (citing certain concerns regarding credit rating agency adjustments to the Company's funds from operations forecasts identified during due diligence)***, and with no obligation for AltaGas to pay a regulatory termination fee in the event the transaction were not consummated due to a failure to obtain a required regulatory approval, provided AltaGas had complied with its contractual obligations to try to obtain such approval. Mr. Harris also proposed January 24, 2017 as the date for signing the merger agreement. Mr. McCallister communicated to Mr. Harris that such terms were ***unacceptable*** to the Company.

On January 19, 2017, …. Mr. Harris again reiterated the ***price of $88 per share, which he described as AltaGas' best and final offer***, and indicated that a summary of AltaGas' final proposal would follow.

On January 20, 2017, Mr. McCallister received an email from Mr. Harris with an updated proposal from AltaGas, which re-affirmed the $88 price per share (identifying several key drivers for the price reduction from the previously communicated price range of $90.50-$92 per share)….

On the morning of January 21, 2017, … Mr. Harris communicated that AltaGas would agree to ***increase the price to $88.25 per share, which he characterized as AltaGas' best and final offer***, and also agreed to increase the size of AltaGas' termination fee payment to the Company in certain circumstances.

[On January 25, 2017, following a detailed discussion with executive management and outside advisors], ... ***the Board unanimously ... determined that entry into the merger agreement is in the best interests of the Company and its shareholders....***

On the afternoon of January 25, 2017, following the Board meeting, the Company and AltaGas executed the merger agreement and the subscription agreement....

1
2 AltaGas's bid was the highest bid received.[18]

3 Having obtained the highest price, WGLH recommended shareholder approval,

4 giving these reasons:

5 the $88.25 per share price, which represents a ***27.9% premium*** over the closing
6 price per share of Company common stock on November 28, 2016, the last
7 trading day prior to news reports of a potential acquisition of WGLH by a third
8 party, and a ***38.8% premium*** over the volume weighted average price per share of
9 Company common stock for the thirty trading days ended November 28, 2016;
10
11 the fact that the per share merger consideration is to be ***paid entirely in cash***,
12 which provides ***certainty of value and liquidity to the Company's shareholders***,
13 including because ***such shareholders will not be exposed to any risks and***
14 ***uncertainties*** relating to the Company's and AltaGas' future value if the merger is
15 consummated;
16
17 the possible alternatives to the merger, including a strategic transaction with
18 another party or continuing as a standalone company, and the timing and
19 likelihood of effecting such alternatives, which alternatives the Board evaluated
20 and determined were ***less favorable to the Company's shareholders*** than the
21 merger at a price of $88.25 per share, given the potential benefits, risks and
22 uncertainties associated with those alternatives;
23
24 the Board's belief, based on the progress and outcome of the transaction
25 negotiations with AltaGas, that the $88.25 per share price represented the ***highest***
26 ***price per share that AltaGas was willing to pay***, as well as the ***highest value***
27 ***reasonably obtainable by the Company***, and that the merger agreement contained
28 the most favorable terms for the Company to which AltaGas was willing to agree;
29
30 AltaGas' history of positive relationships with its regulators, its shared cultural
31 commitment to customer service, reliability and safety issues, its commitment to
32 preserving a strong employee base in order to maintain such culture, and the post-
33 closing commitments made by AltaGas in the merger agreement...
34
35 the fact that the Company will ***still be able to consider and respond to unsolicited***
36 ***acquisition proposals o***r engage in discussions or negotiations regarding such
37 proposals under certain circumstances.;
38

[18] Response to OPC 1-18(b).

1 the Company's ability, under certain circumstances, to ***terminate the merger***
2 ***agreement in order to enter into an agreement providing for a "superior***
3 ***proposal"*** (as defined in the merger agreement)....[19]
4
5 Not one of these items displays any consideration of ratepayers. For WGLH, this was
6 purely a financial transaction, not a ratepayer transaction.

7 ***2. Customer benefits were an afterthought***
8
9 **Q. Is there other evidence that customer benefit was not WGLH's purpose or priority?**
10
11 **A.** Yes. WGLH admits it did not consider "the bidders' abilities to provide cost-effective
12 service in comparing bids." [20]

13 At no point in the narrative did Mr. McAllister demand, or even ask, that
14 prospective acquirers offer any customer benefits. Nor did the WGLH Board ever
15 require Mr. McAllister to do so. I reviewed the minutes of each of 21 WGLH Board
16 meetings, provided in response to OPC 1-23 (legal discussions redacted). I saw no
17 mention by any Board member or executive of customer benefits. The Board discussion
18 was always about maximizing gain to WGLH shareholders. According to the minutes,
19 AltaGas and WGLH bargained over, and the WGLH Board was briefed on, price, cash
20 ratio, breakup fees, Board membership and headquarters location, but they never
21 bargained over consumer benefits. During the Board's deliberations, no one gathered or
22 presented serious information, conducted serious analyses or made any serious plans,
23 about performance. Customer benefits were, literally, beside the point.

24 **Q. Besides running a competition based on price, how else did WGLH reveal that**
25 **purchase price took priority over customer benefit?**
26

[19] Proxy Statement at 41-42.

[20] Response to OPC 1-18(a).

1 **A.** WGLH reserved the right to walk away from AltaGas in favor of a "superior" proposal
2 from someone else. Section 4.2(c) of the Merger Agreement allows AltaGas, under
3 certain circumstances, to consider a "Competing Proposal [which] is, or could reasonably
4 be expected to lead to, a Superior Proposal," if "the failure to engage in such activities
5 would reasonably be expected to be inconsistent with its fiduciary duties under applicable
6 Law."[21] Under Section 8.1, a "Superior Proposal" is one that is "more favorable to the
7 holders of Company Common Stock from a financial point of view" compared to the
8 AltaGas proposal. These provisions underscore the conflict between WGLH's
9 shareholders and Washington Gas's customers. WGLH could reject AltaGas in favor of
10 another acquirer, even one less likely to produce customer benefits, as long as the
11 alternative offered the WGLH shareholders more money.

12 I recognize that these provisions are commonplace in merger agreements for
13 public companies. They protect a target's board from shareholder lawsuits for breach of
14 fiduciary duty to seek the highest price. But as I discuss in Part I.B.2 below, that
15 fiduciary duty under corporate law is subordinate to a company's obligations under
16 public utility law. Otherwise routine limits on the authorized return on equity or safety
17 standards with penalties would be superseded by the fiduciary duty to get the highest
18 possible price. And public utility law in Maryland law requires an acquisition to be in the
19 public interest. The public interest does not allow a government-protected utility to sell
20 out on terms that maximize its gain while making customer benefits an afterthought.

21 **Q.** **Are you saying that in WGLH's decision-making, consumer benefits were**
22 **irrelevant?**
23

[21] In the ensuing passages "Company" refers to WGLH, and "Parent" refers to AltaGas.

1 **A.** No. I will assume that WGLH learned enough about AltaGas to determine that AltaGas
2 would at least not reduce Washington Gas's performance (although there is no evidence
3 that any WGLH decision-maker considered the risks I will discuss in Part III.A.3 below).
4 But the Proxy Statement makes clear that WGLH was not looking for a performer; it was
5 looking for cash. Holding out for the highest price meant being willing to deny customers
6 benefits unless WGLH received that price. That is putting the customer last, not first.

7 **Q. What if WGLH argues that the Proxy Statement never mentioned customer benefits**
8 **because the chief purpose of a Proxy Statement is to discuss shareholder benefits?**
9
10 **A.** That argument fails. Had WGLH actually focused on customer benefits, Proxy Statement
11 would need to say so because those benefits would come at a cost that would affect the
12 shareholders' gain. The Proxy Statement never mentions customer benefits because Mr.
13 McCallister's priority, and his instructions from the Board, did not include customer
14 benefits. Customer benefits were relevant only to win regulatory approval for a
15 transaction whose purpose was price.

16 **Q. Didn't each of AltaGas and WGLH obtain a "fairness" opinion from its respective**
17 **their financial advisor?**
18
19 **A.** Yes, but the purpose of a "fairness" opinion is to verify that the price is "fair" to
20 shareholders; it tells us nothing about fairness to customers.

21 **Q. Does the Applicants' talk of "best practices" show regard for the customers?**
22
23 **A.** No. A true commitment to the best practices means selecting the best performer. WGLH
24 was not looking for the best performer. And best practices are already the obligation of
25 every utility, including Washington Gas. Best practices are not normally secret; they are
26 the standard practices of efficient companies. I see this "best practices" statement in
27 merger cases frequently. If best practices are so readily offered by acquirers, why are

1 these practices not already known by the targets? Of 14 Applicant witnesses, not one
2 describes a best practice AltaGas uses that Washington Gas does not use, or could not use
3 on its own.

4 **Q. In understanding the priority WGLH placed on customers, is it relevant that this**
5 **transaction is a cash buyout rather than a stock-for-stock exchange?**
6
7 **A.** Yes. In a stock-for-stock exchange, the shareholders of the target company become
8 shareholders in the post-acquisition company. They still have skin in the game: a stake
9 in the financial health of that company, including its ability to serve customers well. A
10 cash buyout is fundamentally different. The WGLH shareholders will take their cash and
11 leave. What they leave behind is no longer their concern. On this point, there is no
12 dispute: "AltaGas agrees that post-Merger, WGL Holdings' current shareholders will
13 have no economic interest in WGL unless they invest in AltaGas."[22] Whereas the
14 WGLH shareholders get "certainty of value,"[23] the Washington Gas ratepayers do not.
15 Whereas the WGLH shareholders are freed from "any risks and uncertainties relating to
16 [WGLH's] and AltaGas' future value,"[24] the Washington Gas ratepayers are not. That
17 difference underscores my point: In this transaction, customer benefit was not WGLH's
18 priority.

19 ***3. Seeking the highest price rather than the best performer conflicted with***
20 ***Washington Gas's obligations to its customers***
21
22 **Q. What is a public utility's obligation to its customers?**
23

[22] Response to OPC 10-22(d).

[23] Proxy Statement at 41.

[24] *Id.*

1 **A.** A utility receives privileges from government. In return, the utility must serve all its
2 customers using the most cost-effective practices, and at the lowest feasible cost.
3 Consider these precedents:

4 1. A utility must "operate with all reasonable economies."[25]
5
6 2. A utility must use "all available cost savings opportunities...as well as
7 general economies of management."[26]
8
9 3. A utility has an obligation to serve at "lowest feasible cost."[27]
10
11 These regulatory standards replicate the pressures of competition.[28] If a firm
12 subject to effective competition did not "operate with all reasonable economies," serve at
13 "lowest feasible cost" and use "all available cost savings opportunities," it would lose its
14 customers to companies that did. If Maryland utilities do not meet these standards—if
15 regulation does not replicate the discipline of effective competition—their rates will not
16 be "just and reasonable" as required by Maryland law.

17 **Q.** **Did WGLH's selection process square with its obligation to its customers?**
18
19 **A.** No. By ranking acquirers based on price only, WGLH created an unnecessary conflict
20 between shareholders and customers, then resolved that conflict against the customers.
21 WGLH caused its customers harm—what economists call "opportunity cost harm."

---

[25] *El Paso Natural Gas Co. v. Federal Power Commission*, 281 F.2d 567, 573 (5th Cir. 1960).

[26] Midwestern Gas Transmission Co. v. E. Tenn. Natural Gas Co., 36 FPC 61, (1966), *aff'd sub nom. Midwestern Gas Transmission Co. v. Federal Power Commission*, 388 F.2d 444 (7th Cir. 1968).

[27] *Potomac Elec. Power Co. v. Pub. Serv. Comm'n of the D.C.*, 661 A. 2d 131, 137 (D.C. 1995).

[28] As required by *Delmarva Power & Light Co. v. Public Service Com'n of Maryland*, 370 Md. 1, 6 (2002), discussed in n.15 above.

1 "[T]he opportunity cost of an item—what you must give up in order to get it—is its true
2 cost."[29] Opportunity cost is opportunity lost. It is waste. A utility acquisition causes
3 opportunity cost harm if it displaces some other action that would produce more benefits
4 to the public, at the same or lower cost. From a target's perspective, choosing the highest
5 price was economically rational. But from a public interest perspective, the decision was
6 economically irrational.

7 **Q. Does your standard preclude all mergers?**
8
9 **A.** No, only the ones that place customers last. Had WGLH placed customers first, its
10 application to this Commission would have guaranteed public benefits at least equal to
11 the maximum benefits that the most cost-effective coupling could produce, less whatever
12 profit from the transaction was necessary to make the acquirer and target each better off
13 than compared with their other alternatives. The public interest standard, and my
14 reasoning, allow mergers that are consistent with the public interest—mergers that
15 produce benefits for the public comparable to what a competitive market would produce.

16 **Q. Isn't seeking the highest price what profit-maximizing targets are expected to do?**
17
18 **A.** Yes, in competitive markets—but subject to a constraint. In competitive markets, the
19 target's desire for a high price is disciplined by the acquirer's need to retain the target's
20 former customers. Consider the sale of an apartment building, in a city with plenty of
21 apartment vacancies—and therefore effective competition among building owners. The
22 interests of the building seller, building buyer and renters are all aligned. The building
23 seller will demand the highest possible price, but the buyer will resist paying a price
24 above what she predicts she can recover as she competes for tenants. So the building

[29] Krugman, P. R., and R. Wells, *Microeconomics* (Macmillan 2012).

1 buyer will pay a premium no greater than the new economic value she believes she can
2 create as the new owner. That new economic value is a public interest benefit.
3 Competitive pressures discipline the acquisition price. With that discipline in place, an
4 acquisition contest run by the seller, based on highest possible price, can produce a public
5 interest result.

6 Monopoly utility service is not like competitive apartment rentals. Gas
7 distribution customers cannot shop for distribution service elsewhere. So the interests of
8 company seller, company purchaser and the ultimate consumer are not aligned. That
9 non-alignment produces a conflict—here, between WGLH's shareholders and
10 Washington Gas's customers. Seeking and insisting on the highest price produces an
11 outcome different from seeking and insisting on the best performer.

12 **Q. What if Applicants argue that the purchase premium was comparable to other**
13 **acquisitions of utilities?**
14
15 **A.** I expect Applicants to argue that their advisors compared the purchase price (including its
16 relationship to WGLH's market price) to other acquisitions of utilities. But if those other
17 transactions were, like this one, undisciplined by competition for the customer's benefit,
18 the argument merely introduces circularity. WGLH's premium has no objective basis in
19 any public interest analysis. Its sole characteristic is that it is the highest price WGLH
20 could get an interested party to pay.

21 **Q. But doesn't regulation necessarily replicate the results of competition?**
22
23 **A.** No. That is the theoretical goal but it is not necessarily the practical effect. This
24 complex acquisition presents the problem of information asymmetry. If information were
25 perfect, the Commission staff could establish now, for the post-merger Washington Gas,
26 cost levels and performance standards equivalent to what a competitive market would

1 have produced. Then the Commission, in evaluating and conditioning this transaction,
2 could impose conditions that hold WGLH to those standards. But that scenario is
3 unrealistic, because we cannot readily replicate the result of competitive conditions.[30]

4 Because we cannot replicate the exact results, the next best option is to evaluate
5 the process. A process which sells a government franchise to the highest payor rather
6 than the most cost-effective performer is not, from the customer's perspective, a
7 competitive process.

8 ***4. The Applicants did not bargain at "arm's-length"***

9

10 **Q. Can the Applicants justify this transaction by asserting they bargained at "arm's-**
11 **length"?**

12

13 **A.** Only if they remove the arm's-length principle from its proper context. "Arm's-length"
14 refers to two companies that are independent of each other, each subject to independent
15 competitive pressures. When each company is subject to independent competitive
16 pressures, any negotiating inefficiency—such as paying too much or demanding too
17 much—will expose the company to penalties in the marketplace. For the acquirer-target
18 bargaining to be truly at arm's-length, the post-acquisition company must be subject to
19 competitive pressures. That factor is, of course, absent here. Washington Gas, as the
20 supplier of gas distribution service, will not be subject to effective competition.

21 Also, arm's-length bargaining is bargaining between adversaries. Once the other
22 prospective acquirers dropped out, the AltaGas-WHLH dialogue necessarily changed
23 from negotiating to strategizing—strategizing jointly about what terms would work best

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[30] *See, e.g.*, Department of Justice/Federal Trade Commission Horizontal Merger Guidelines at section 10 ("[Merger] efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms.").

to achieve each side's purpose: WGLH wanted the highest price, AltaGas wanted to maintain investment grade bond ratings, and both companies needed to win approval from the regulators.

For all these reasons, this transaction was not reached through "arm's-length bargaining," as that phrase is properly applied. It therefore does not deserve Commission deference.

5. A holding company's fiduciary responsibility to its shareholders is constrained by the utility's obligation to its customers

Q. Didn't the WGLH Board have a fiduciary duty to maximize its shareholders' wealth?

A. I assume so, based on the statutory law of its incorporation state. But a board's fiduciary duty is always subject to other legal duties. Otherwise companies could, without legal consequence, evade taxes, trade with forbidden countries, or subject workers to health hazards, all in the name of complying with a fiduciary duty to maximize profit. Applying that reasoning here: Whatever fiduciary duty the WGLH Board has to maximize its shareholders' wealth is constrained by Washington Gas' Maryland law duty to provide the most cost-effective service to its customers. That is the obligation the WGLH Board violated when it bid out its franchise based on highest possible price rather than best possible performance. By stating that the selections of acquirers based on shareholder gain rather than customer benefits fail the public interest test, the Commission will confirm that the franchise is a privilege to be earned through performance, not an asset to be sold for gain.

The common comparison of regulation to competition works here as well. In competitive markets, the fiduciary responsibility to get the highest price is constrained by

1 a competitive reality: An excessive price will render the acquirer unable to serve its
2 customers without raising prices or cutting quality. Market competition constrains the
3 fiduciary responsibility. The same constraint must be replicated by regulation.

4 **Q.** **You have reasoned that when the target seeks the highest price for its shareholders**
5 **with customers an afterthought, the resulting transaction cannot be in the public**
6 **interest. Are you asking the Commission to "change the rules mid-game"?**
7
8 **A.** Not if the rules are the basic rules of utility regulation. Nearly every feature of regulation
9 flows from two major principles: The utility must serve its customers cost-effectively,
10 and the regulator must provide shareholders a reasonable opportunity to earn a fair return
11 on investments that are prudent and used and useful. These two principles align the
12 interests of shareholders and customers. They do not leave shareholders free to sell a
13 government-granted privilege for the highest price, then keep the entire gain for
14 themselves.

15 ***C. In choosing WGLH, AltaGas's priorities were "strategic positioning" and***
16 ***"growth," not cost reduction and customer service***
17
18 **Q.** **You have discussed the problems in how WGLH chose AltaGas. Are there public**
19 **interest problems in the way AltaGas chose WGLH?**
20
21 **A.** Yes. AltaGas's testimony and internal documents are candid. AltaGas's central purpose
22 is not performance for the customer. AltaGas is buying WGLH for its territory and its
23 customers—especially Washington Gas's territory and customers—so AltaGas can then
24 buy more territory and more customers. I discuss these points next.

1 *1. AltaGas views Washington Gas's territory as a "strategic foothold"— a*
2 *"platform" for AltaGas's future "growth"*
3
4 **Q. What has AltaGas said about its reasons for acquiring WGLH?**
5
6 **A.** AltaGas's drive for territory is made clear by its testimony:

7 [T]he business of WGL in combination with our existing U.S. business
8 establishes a significant foothold in areas with growth potential."[31] By
9 "foothold," Mr. Harris means "a position usable as a base for further
10 advance."[32]
11
12 ... [W]e believe that WGLH and the Greater Washington, D.C.
13 metropolitan area will be the U.S. platform from which the combined
14 company will drive our future growth.[33]
15
16 The Merger provides a broader platform ... to continue to expand the
17 combined company's gas distribution portfolio....[34]
18
19 [T]he business of WGLH in combination with our existing U.S. business
20 establishes a significant foothold in areas with growth potential.[35]
21
22 AltaGas is buying what was "built" by WGLH—thanks to Washington Gas's ratepayers,

23 whose government-set rates give AltaGas "confidence":

24 The combined company will harness the strength of the platform that
25 WGLH has built in Maryland, Virginia and Washington, D.C. to continue
26 to grow our presence in each of these jurisdictions, and to further invest in
27 the region. We view this Merger as a "vote of confidence" in Maryland,
28 Virginia, and the District as good places to do business, and are excited to
29 pursue growth opportunities in the region.[36]

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[31] Harris Direct at 19.

[32] Response to OPC 10-21(a).

[33] Harris Direct at 6.

[34] Harris Direct at 10.

[35] Harris Direct at 19.

[36] Harris Direct at 7.

The goal is expansion rather than efficiency:

> In particular, recent cross-border transactions wherein Canadian companies have acquired U.S. utilities are generally pursued for growth or geographic footprint expansion rather than synergies attainment.[37]

There is no pretense to pursuing customer benefits:

> [M]anagement is focused on growing the combined company, as opposed to focusing on capturing cost synergies.[38]

2. AltaGas views Washington Gas Light's customers as a money source with which to leverage more acquisitions

Q. What has AltaGas said about the value of Washington Gas's customers?

A. AltaGas sees Washington Gas's customer base as a stable source of revenue. That revenue can assist more acquisitions. In its internal strategy documents, there is no sign that AltaGas views the customers as citizens it is privileged to provide with the most cost-effective service. The main acquisition goal is residential consumers, who pay on time, preferably packed densely—and the revenue that comes from favorable rates that regulators command those customers to pay. AltaGas values Washington Gas for its role in a portfolio:

> The strong financial position post-Merger supports AltaGas's strategy of focusing on high quality, low risk and long-life assets to achieve a diversified, long-term business mix.[39]

And, it is not just loyal, captive customers; it is also the unique "experience and knowledge" which has been paid for by those customers:

> The combined portfolio of power assets and the experience and knowledge of the employees within both companies in the power business will provide the combined company with a great platform and incremental

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[37] Jirovec Direct at 16-17.

[38] Jirovec Direct at 13.

1 market understanding to expand the power business in this region, which
2 will allow us to further develop renewable power backed by long-term
3 contracts with creditworthy counterparties providing stable cash flows for
4 the combined company.[40]
5
6 The message in these documents is clear: This transaction carries out a strategy

7 whose core is bigger numbers, not better service.

[39] Toivanen Direct at 4 (echoing Mr. Harris—The "vision" is to "grow[] by adding stable, regulated, long-life assets." (Harris Direct at 10)).

[40] O'Brien Direct at 9.

II.
Though WGLH's value to AltaGas is due in part to Washington Gas's captive ratepayers, the $1.27 billion acquisition premium would go entirely to WGLH's shareholders

Q. Explain the organization of this Part II.

A. AltaGas has agreed to pay WGLH shareholders a $1.27 billion premium over WGLH's unaffected market price. WGLH's shareholders propose to keep the entire amount for themselves.

This feature of the transaction, in and of itself, violates the public interest standard and causes harm. After explaining the term "acquisition premium," I explain why the entire amount should not automatically go to the WGLH shareholders. AltaGas is paying this amount in part to get control of Washington Gas's franchise—that government-assisted privilege of providing essential gas distribution service for a profit. The value of that franchise was not created by WGLH shareholders; it is attributable, at least in part, to regulatory actions and ratepayer financial support. Since that financial support, through Commission-set rates, has already provided the WGLH shareholders fair compensation, the gain from the acquisition premium is overcompensation. To allow them to keep all that overcompensation is to treat the franchise as a shareholder-owned asset rather than what it is—a government-created privilege. The proper treatment of the acquisition premium is not to allocate it automatically to the shareholders, but to share it between ratepayers and shareholders based on each group's contribution to the value of the franchise.

A. Definition: "acquisition premium"

Q. Explain the concept of "acquisition premium"

1 **A.** I will use the term "acquisition premium" to refer to the excess of purchase price over
2 unaffected market value. (Sometimes the term "acquisition premium" is also used to
3 refer to the excess of purchase price over book value. I will not be using the term in that
4 way.) By "unaffected market value" I mean the market price for the target's stock before
5 that price was affected by the possibility of its acquisition. In this case, OPC will use for
6 unaffected market value the price provided by the Applicants in their response to OPC
7 14-1: $63.45/share. That figure, as explained by OPC Witness Ralph Smith, is based on
8 the volume-weighted average price for the 30 trading days prior to the day when news of
9 the takeover bid became public. Given the purchase price of $88.25/share, and assuming
10 total WGLH shares of 51,219,000, the acquisition premium is $1.27 billion.

11 **Q. What about the excess of unaffected market price over book value—is that relevant**
12 **to your discussion in this Part II?**
13
14 **A.** No, but it will be useful to explain that concept briefly. It is not uncommon for a utility's
15 stock to trade at a market value that exceeds its book value, if, for example, investors
16 expect future earnings to exceed the commission-authorized return on equity. And since
17 WGLH has competitive affiliates, investors could expect those businesses to have future
18 earnings that cause their market value to exceed their book value. Regardless of the
19 explanation, that difference between market price and book value is not relevant to my
20 discussion of the acquisition premium. The circumstances causing the stock price to
21 exceed book value pre-date the announcement of this transaction. They therefore have no
22 bearing on the extra amount offered by AltaGas in this transaction. My focus is solely on
23 the difference between the purchase price and the unaffected market price.

24 **Q. Why might an acquirer pay a purchase price exceeding market price?**
25

1 **A.** When buying a company, an acquirer pays a purchase price exceeding market price to
2 gain control, because the acquirer views control as a way to increase earnings beyond the
3 expectation of ordinary investors. To understand this point, consider the difference
4 between an ordinary purchaser of stock in a company, vs. an acquirer of the entire
5 company. An ordinary purchaser of stock tells her broker, "Buy me some shares at the
6 market price." An ordinary purchaser of stock would not pay more than the market price.
7 An acquirer of all the stock, in contrast, would be willing to pay more than the market
8 price, because it is buying more than merely stock; it is buying control. With that
9 control, the acquire can determine the future direction of the company—by installing its
10 own board of directors and its own executives, and by using its control to advance the
11 acquirer's overall business objectives. Acquirers pay an acquisition premium to acquire
12 control.

13 Why might an acquirer see the potential for higher earnings than would ordinary
14 shareholders? The acquirer might believe it can use its control to increase the quality of
15 the products or lower the cost, so as to generate more sales or more profit-per-sale. As
16 discussed below, AltaGas has made clear that increasing quality or lowering costs at
17 Washington Gas is not why AltaGas is paying an acquisition premium. There must then
18 be another reason for the premium. That reason, I will explain, is the franchise: AltaGas
19 is paying this premium in part due to the role it expects Washington Gas's government-
20 created franchise to play in increasing AltaGas's future earnings.

21 ***B. The value AltaGas sees in controlling WGLH was not created by WGLH***
22 ***shareholders alone***

23 **Q. Provide the context for your conclusion that the value AltaGas sees in controlling**
24 **WGLH was not created by WGLH alone.**
25

1 **A.** Assuming AltaGas is rational, it is paying the premium because it expects that WGLH,
2 under AltaGas's control, will produce earnings that justify that extra payment. The
3 question is whether this extra payment should go to the WGLH shareholders alone, or
4 whether instead it should be shared with the ratepayers according to some objective
5 principle.

6 The appropriate objective is the principle of economic efficiency. When
7 competition is effective, the result is economic efficiency. Economic value is created,
8 with gain going to those who create that value.[41] Shareholders deserve gain when they
9 take risks, and when their executives take actions, that together produce new value. In
10 the context of a corporate acquisition (and again assuming competitive markets), that new
11 value will be created not because the post-acquisition company is charging prices above
12 competitive levels, but because joining the acquirer and the target results in improved
13 service, lower costs or other actions that all together increase customer satisfaction.

14 Acquisitions of franchised monopoly utilities do not occur in competitive
15 markets. The acquirer may see extra value in the target for reasons unrelated to
16 improving service or lowering costs for the benefit of customers. Such unrelated reasons
17 must exist here, because AltaGas has said this acquisition is unrelated to synergies.
18 In this subsection I will discuss three such unrelated reasons—reasons that have nothing
19 to do with improving service or lower costs for customers:

20 1. AltaGas might expect to earn equity-level returns on an acquisition
21 financed with lower-cost debt.
22

[41] *See* F.M. Scherer and D. Ross, *Industrial Market Structure and Economic Performance* at 19-20 (1990) (describing competitive market theory, which concludes that under competition, "resources are employed at maximum production efficiency).

2. AltaGas might expect Washington Gas's actual return to exceed AltaGas's "required" return.

3. AltaGas might expect Washington Gas's actual return to exceed the utility's authorized return.

I will explain why none of these four factors is attributable to WGLH shareholder risk-taking or WGLHJ executive decision-making. That fact leads to the conclusion that there is no logical or policy basis for allowing WGLH shareholders to keep the entire acquisition premium. After discussing those four factors, I provide reasons why ratepayers are a logical source of the acquisition premium value.

1. AltaGas might expect to earn equity-level returns on an acquisition financed with lower-cost debt

Q. How might AltaGas's debt financing affect its willingness to pay an acquisition premium?

A. AltaGas could earn equity-level returns on an investment made with lower-cost debt. The prospect of earning this extra profit would be a reason to pay a premium. Here is how it works:

To buy a company is to buy its equity. In buying WGLH, AltaGas is buying WGLH's equity (and also, of course, taking on WGLH's debt). The purchase price—the price AltaGas would pay for WGLH's equity—is $4.52 billion. To finance this purchase of equity, AltaGas has identified some sources, but will also issue new debt.[42]

Debt costs less than equity because the investor's risk is lower: A borrower is contractually obligated to pay back the lender's principal with interest, while an issuer of common equity stock is not obligated to pay the stock buyer anything. Stock buyers face

[42] How much, we don't know, as explained in the testimony of OPC Witnesses Ralph Smith and Michael Arndt.

1 a higher risk of losing their investment, so they demand a higher return. To use a
2 plausible example: Suppose the interest rate on AltaGas's acquisition debt is 5.00%,
3 while Washington Gas's most recent authorized return on equity granted by this
4 Commission is 9.5%.[43] If AltaGas can finance the Washington Gas equity it is buying at
5 5.00% but have an authorized return on that equity of 9.50%, AltaGas will earn
6 substantial additional income, annually. Financial analysts describe this action as
7 "double-leveraging," because there is debt at both the holding company level and the
8 utility level. They also call it "financial engineering" because the profit comes not from
9 physical improvements but from financial arrangements.[44]

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[43] Based on an imputed capital structure of 53.02% equity. Case 9322, Order No. 86013 (November 22 2013). Of course, Washington Gas's actual return on equity will vary from its authorized return.

[44] In rejecting the proposed Great Plains Energy acquisition of Westar, the Kansas Corporation Commission criticized double leveraging, because it allows the utility to charge rates exceeding cost:

> 44. ... [I]t appears that while the Joint Applicants do not propose to include the acquisition costs in rate base, they still plan to recover the acquisition premium indirectly from ratepayers. As CURB, BPU, KEPCo, and Staff claim, *if the Joint Applicants are allowed to use a capital structure for ratemaking purposes that is not representative of the financing for the transaction, the ratepayers are actually subsidizing the acquisition premium.* There is a separate weighted cost of capital at the operating utility level versus the parent level. Traditionally, there is little difference between the weighted cost of capital at both levels. But as proposed by the Joint Applicants, the parent (GPE) is taking on additional leverage at historically low rates. As a result, the weighted cost of capital for GPE will be significantly less than that of the operating utility subsidiaries. Such a financial *structure allows the Joint Applicants to recover the acquisition premium by taking advantage of the difference between the higher returns paid to the operating utilities and the low cost of debt*. - GPE "acknowledges that there is a financial benefit derived from the way the transaction is being financed." Rather than refund the difference to the ratepayers, GPE is retaining those funds to pay the acquisition premium. *Essentially, GPE is using the ratepayers as its bank.*

1 The anticipation of that extra profit is one possible explanation for why AltaGas
2 would pay a price for WGLH exceeding WGLH's stock market price. This extra profit is
3 solely the result of four factors: (a) the differentiation that financial markets make
4 between interest cost and equity cost, (b) the fact that Washington Gas's customers have
5 no choice but to pay the rates set by the Commission, (c) AltaGas's expectation that the
6 Commission will set rates that authorize an equity-level return on equity purchased with
7 debt, and (d) AltaGas's ability to use its control of WGLH to effect the double-
8 leveraging—not something an individual stockholder could do. None of these factors
9 owes its origins to risk-taking by WGLH shareholders or managerial decision-making by
10 Washington Gas executives. Nor does this extra profit reflect improvement in business
11 operations that could benefit customers. There is, therefore, no necessary reason why
12 WGLH shareholders should receive the portion of the premium associated with this
13 value.
14 My point is neither to criticize double leveraging as an acquisition strategy, nor to
15 advise on the Commission on whether to authorize equity-level returns on equity

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Order in Docket No. 16-KCPE-593-ACQ at paras. 44 and 45 (Apr. 19, 2017) (footnotes omitted) (emphasis added). The Kansas Commission rejected this transaction in an order dated April 19, 2017, in Docket No. 16-KCPE-593-ACQ. An order on reconsideration issued on May 23, 2017. That reconsideration order left open the possibility of a revised application at a lower price with less debt. *See* Order on Reconsideration at para. 9 ("The Commission encourages the parties to continue working together to 'revise the Transaction to address the Commission's concerns related to purchase price, capital structure and other issues" and welcomes the filing of a new application that can satisfy the merger standards and advance the public interest.'") (citation omitted). A few months after the reconsideration order issued, the two companies reached a new agreement under which they would merge via a stock-for-stock exchange, replacing the rejected transaction in which most of the payment to the Westar shareholders was in cash. The new agreement will trigger a new application before the Kansas Corporation Commission.

1 financed with debt. My point is more specific: to demonstrate that, in this acquisition
2 context, the portion of the premium attributable to double-leveraging does not reflect
3 value created by WGLH shareholders.

4 Adding to the value of double leveraging is the current low level of interest rates.
5 What goes for home buyers goes for utility acquirers. When interest rates are low, a
6 home buyer will be willing to pay more for a house (or buy a larger house) than she
7 would when interest rates are high. Similarly, a corporate acquirer will be willing to pay
8 more for a utility during a low-interest period than during a high-interest period. That
9 factor also contributes to the premium—and has no source in WGLH risk-taking or
10 decision-making. Indeed, AltaGas has noted that low interest rates were increasing the
11 demand for, and therefore increasing the premia paid for, franchised utilities. This
12 reasoning was shared by the target's CEO in the proposed acquisition of Westar (the
13 holding company owner of Kansas Gas & Electric and Kansas Power & Light and some
14 unregulated subsidiaries) by Great Plains Energy (the holding company owner of Kansas
15 City Power & Light and some unregulated subsidiaries). In the Kansas Corporation
16 Commission proceeding, Westar CEO Mark Ruelle testified:

> 17 [U]tilities are trading at pretty high values. The reason for that is low
> 18 interest rates. That meant that the value for our shareholders is good, and
> 19 that with a combination could be even better, yet there were assurances
> 20 that a buyer could finance the transaction on acceptable terms. Maybe
> 21 those conditions will persist, maybe they won't, but we felt it important to
> 22 capture those advantages.[45]

23
24 Like double-leveraging itself, the presence of low interest rates owes nothing to WGLH
25 shareholders' risk-taking or its executives' decision-making.

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[45] Direct Testimony of Mark Ruelle at 6, Docket No. 16-KCPE-593-ACQ.

1 ***2. AltaGas might expect Washington Gas's actual return to exceed***
2 ***AltaGas's "required" return***
3
4 **Q. Explain the difference between actual return and "required" return, and why that**
5 **difference might explain a portion of the acquisition premium.**
6
7 **A.** For any prospective acquisition, the acquirer has a "required" return, sometimes called its
8 hurdle rate. This percentage is the return on a prospective investment below which the
9 acquirer would not make that investment, because the acquirer has more attractive uses
10 for its funds. It is the level of return sufficient to attract the to-be-invested funds. Here's
11 a simple example: Assume the target company was a single-state, utility-only entity
12 (often called "pure play"). Assume also that based on the returns on equity authorized by
13 the target's state commission in recent rate cases, the prospective acquirer expects to earn
14 an equity return of 9.50%. If the acquirer would be satisfied with 7.00% (its "required"
15 return, because its next best alternative would earn that amount), the acquirer will be
16 willing to pay a premium for the target—an amount above market value—to get the
17 opportunity to earn two percentage points more than what it otherwise would find
18 satisfactory. (Of course, given the premium, the actual return will be less than 9.50%, but
19 as long as the actual return exceeds 7.00% the premium was worth paying.) Indeed, data
20 from WGLH's proxy statement indicate that a premium paid to bring the purchase price
21 to $88.25/share would be justified by a required return of between 6 and 7 percent.
22 Where the target includes a regulated utility, the acquirer's expectation that actual
23 return will exceed required return is influenced in part by a third number: the
24 Commission-authorized return. (I discuss the authorized return in the next subsection.)
25 That is, the authorized return itself could exceed the acquirer's required return.

1 Both these possibilities (expected return exceeding required return, and required
2 exceeding authorized return) are possible reasons why AltaGas would choose to pay a
3 premium above market price. And as with double-leveraging (discussed in the
4 immediately preceding subsection), these two factors owe nothing to decisions made or
5 actions taken by WGLH's shareholders or executives. In both situations, what makes the
6 investment attractive to AltaGas is the relative certainty, thanks to Washington Gas's
7 franchise, that the ratepayers will loyally pay the rates that support the acquirer's
8 projections and calculations. To the extent the premium is based on these factors,
9 WGLH's shareholders are not the reason.
10 Finally, if AltaGas does have an expectation that its actual return will exceed its
11 required return, that expectation is not limited to a return on the rate base Washington
12 Gas has currently. AltaGas expects to profit from adding to that rate base. Relevant to
13 AltaGas's determination of its price offer was its "expectation that Washington Gas will
14 have opportunities to rate-base new investments in its infrastructure."[46]
15 This expectation of profit from future investment, like the other factors just
16 discussed, is not a logical basis for granting WGLH shareholders the entire acquisition
17 premium. First, AltaGas's opportunity to increase WGLH's rate base exists because
18 decades ago, Maryland government bodies granted Washington Gas (or its predecessor
19 corporations) its franchise. Unlike a McDonald's franchisee or a New York City cab

[46] Response to OPC 10-39(j) (quote is from OPC's question). *See also* Response to OPC 10-42 ("To the extent [OPC's question] is asking whether AltaGas took into consideration Washington Gas's projected returns on investments in its distribution infrastructure, then yes, AltaGas considered that factor.").

1 driver, the utility paid nothing to receive its franchise.[47] While the Washington Gas
2 franchise documents I have reviewed state that they are not legally exclusive, the legal
3 reality is that no one is likely to enter the market to provide gas distribution service. So
4 when Washington Gas needs new infrastructure, Washington Gas has, at least under
5 current practice, the automatic and exclusive opportunity to make the rate-basing and
6 therefore earnings-increasing investments that AltaGas values. (As well, some of these
7 investments are made under the STRIDE program, which reduces the risk that
8 Washington Gas will not recover its investments and earn a return on them.) It is this
9 franchise-produced insulation from competition, not WGLH's merits, that creates the
10 value AltaGas expects and therefore the premium it is willing to pay. The WGLH
11 shareholders have no logical entitlement to it.

12 ***3. AltaGas might expect Washington Gas's actual return to exceed the***
13 ***utility's authorized return***
14

15 **Q. Explain the difference between actual return and authorized return, and why that**
16 **difference might explain a portion of the acquisition premium.**
17

18 **A.** In a given year, a utility's actual return can exceed its commission-authorized return, for
19 several reasons. The main (and obvious) reasons are if either (a) the utility's actual costs
20 for the year are less than the projected costs underlying its approved revenue
21 requirement; or (b) its actual sales exceed the projected sales underlying its approved
22 rates. (The reverse can be true also.) Actuals always deviate from projections; also, the
23 projections themselves might have been erroneously conceived yet inadvertently

[47] WGLH says: "Except for potential application fees or the posting of bonds and deposits with various county and municipal franchisors, *Washington Gas did not provide payment to any government entity to acquire its right to provide gas distribution service in Maryland*." Response to OPC 10-17 (emphasis added).

1 accepted by the regulator. The resulting excess of actual return over authorized return
2 will last until the Commission sets new rates. (The intervening period is often referred to
3 as "regulatory lag"). Because the new rates go into effect prospectively (due to the legal
4 prohibition against retroactive ratemaking), the utility's shareholders keep the excess
5 earnings (except where specific costs are subject to true-up procedures).

6 An expectation that actual returns will exceed authorized returns (due to lower-
7 than-projected costs or higher-than-projected sales) might already be "baked into"
8 WGLH's market price. That is, where the market price for a utility's stock exceeds the
9 book value used for ratemaking purposes (as is the case with WGLH), that difference can
10 reflect the stock market's expectation that actual returns will exceed authorized returns,
11 over some period of time. In that case, the expectation would not affect the premium.
12 But if AltaGas expects to grow that difference—to increase the gap between actual
13 returns to exceed Washington Gas Light's authorized returns beyond the market's
14 expectations, such as by increasing the periods of regulatory lag or developing rate case
15 strategies that cause the Commission to approve cost levels higher than appropriate—
16 AltaGas will be willing to pay a premium to receive those extra returns.

17 To the extent AltaGas's premium reflects this expectation of actual returns
18 exceeding authorized returns, the reason, once again, not any action taken by WGLH, its
19 shareholders or its executives. The expectation instead flows from regulation's inherent
20 imperfections. Rates are supposed to reflect prudent cost. In a competitive market, when
21 a seller's prices exceed prudent cost, price correction occurs as competitors enter (or
22 threaten to enter). In utility regulation, price correction occurs only if the regulator (or
23 consumer intervenor) discovers the excess, initiates a rate case and changes the rates—

1 and then the correction is prospective only. In the meantime, regulatory lag allows the
2 utility to profit from the imperfection (unless the rate can be corrected retroactively back
3 to the date of the discovery or initiation of the rate case). This imperfection is not a result
4 of WGLH shareholder risk-taking or WGLH management decision-making.
5 It is true that lowering costs or raising sales between rate cases can result from
6 management skill; when it does, there is a legitimate argument that WGLH shareholders
7 deserve a portion of the premium—again, unless the earnings expectation associated with
8 such actions is already reflected in the market price. Regulatory lag is a legitimate
9 inducement to efficiency. Just as a cost-cutting competitor keeps its extra profit until
10 other competitors cut their costs and drive the prices down, so does a utility keep its extra
11 profit until regulatory correction occurs. To the extent AltaGas's expectation is based on
12 this possibility, its payment of a premium to the WGLH shareholders has some
13 justification—but only to the extent a comparable market competitor would benefit. In
14 other words, regulatory imperfection is not a valid basis for paying or keeping the
15 premium. In any event, this new ability to exploit regulatory lag would occur after the
16 acquisition, not before; so the departing shareholders would have no logical right to it.
17 The actual source of the extra return is the customer base provided by the franchise.
18 WGLH might respond that retaining the premium is appropriate compensation
19 because it has endured periods when its actual earnings were below its authorized
20 earnings. This argument violates the prohibition against retroactive ratemaking. If
21 WGLH thought prior rates were too low, it needed to appeal the Commission's rate
22 decision, or seek prospective rate increases. Because regulation cannot correct rates

1 retroactively (the exceptions to the prohibition not being relevant here), the treatment of
2 the premium is unrelated to prior rate levels.

3 **Q. Didn't the WGLH shareholders provide the investment and hire the executive team**
4 **that created the utility's value?**
5
6 **A.** To answer this question, one must take care with the term "value." Looking only at the
7 market value before the acquisition, including the excess of market price over book
8 value, one could argue that that value is attributable to shareholders' actions. That value
9 has two components. The excess of market price over book value reflects the market's
10 expectation that future earnings will exceed authorized earning (as I have already
11 discussed). That value ordinarily belongs to shareholders, because they risked their
12 dollars hoping for get earnings exceeding those associated with book value; and, we do
13 not hold ratepayers responsible when market price falls below book value.

14 But the acquisition premium at issue here—the excess of the acquirer's purchase
15 price over market price—is a different story, for the reasons I have already discussed in
16 this subsection and those I will discuss in the next subsection. The acquisition premium
17 is not necessarily attributable to shareholder risk-taking or target management skill.
18 Ratepayers already compensate shareholders for their risk, through the return on equity
19 element in the capital cost portion of the revenue requirement equation. And ratepayers
20 already compensate the shareholders for management effectiveness when they pay rates
21 that reflect management costs. Good utility performance is the *quid pro quo* for the
22 regulatory commitment to base rates on reasonable cost and a fair rate of return. There is
23 no logical basis for extra compensation in the form of an acquisition premium.

1 2 ***C. WGLH's value to AltaGas is attributable at least in part to Washington Gas's government-granted franchise***

3 4 5 **Q. Is at least some of WGLH's value to AltaGas based on Maryland government decisions rather than WGLH's merits?**

6 **A.** Yes. The preceding subsections explained that (a) AltaGas is willing to pay a premium to
7 control WGLH, but (b) the value underlying that premium is not attributable to WGLH
8 shareholders' risk-taking or WGLH management's decision-making. That value must
9 have some other source. The three factors discussed in the immediately preceding
10 subsection—all related to AltaGas's earnings expectations—comprise one set of sources.
11 We also know that AltaGas's reasons for the premium do not include improving service
12 or lowering costs at Washington Gas.

13 The other possible reason for the premium, then, is Washington Gas's franchise—
14 its government-granted, *de facto* exclusive right to provide an essential service, and to
15 receive government-sanctioned rate payments in return. Those customer payments, like
16 the franchise itself, are established by regulators based on stable legal principles that give
17 the utility a reasonable opportunity to earn a fair return on its prudent, used and useful
18 investment. Control of that franchise—that privilege to provide an essential service at
19 regulated rates—is something AltaGas is buying with the premium.

20 Here is another way to understand the point. By buying control of WGLH's
21 shares, AltaGas is actually buying two things: control of the utility's assets, and control
22 of the utility's franchise (along with WGLH's non-utility businesses, which I will set
23 aside for purposes of this discussion)[48]. Today, the utility assets sit on Washington Gas's

[48] In Part II.E.3 I will discuss methods for allocating the premium between WGLH's regulated and unregulated businesses.

1 books at book value. After the acquisition, those same assets will sit on the same books
2 at the same book value (a necessary result of not putting the acquisition premium into
3 rate base). Because Maryland's gas distribution rates are based on book value, we can
4 assume that the value to AltaGas of these assets (*i.e.*, the assets separated from the
5 franchise) is book value—the net present value of the future stream of earnings made by
6 possible by charging rates based on book value.[49] If AltaGas is offering a purchase price
7 above book value, it is paying for more than just the assets. It is paying for control of the
8 franchise.

9 As I have explained, an ordinary stock-purchaser pays the market price because
10 what she is purchasing is stock and only stock: a small piece of the company. What she
11 controls is nothing more than her stock, which entitles her to her small share of the
12 company's future earnings and growth in value—however those earnings and value are
13 determined by the Commission when it sets rates. She is a passive owner. The
14 difference between that purchaser of some stock, and the purchaser of all the stock, is not
15 just a difference in degree. Whereas the small stock purchaser has purchased only the
16 right to a small portion future earnings and growth in value, the purchaser of control has
17 purchased that and more: specifically, control of all the decisions the target company can
18 make to increase those earnings:

19 1. control over the Board and top management;
20
21 2. control over the timing of rate cases;
22
23 3. control over the types and timing of synergies;

[49] As explained in Part II.A, a utility's stock can trade at prices above (or below) book value if, for example, the market expects that through regulatory lag or other means the utility's actual return on equity will exceed (or fall below) the authorized return. That variation does not affect this analysis.

4. control over whether and when to withhold the savings from such actions from ratepayers);

5. control over whether, when and how to influence government policy on the allocation of risk between shareholders and ratepayers;

6. control over the nature and timing of infrastructure spending;

7. control over decisions about the mix of debt and equity (including the ability to increase earnings by using holding company debt to buy equity, and then earn higher equity returns on equity bought with lower-cost debt);

8. control over the company's relations with regulators and the political sector (including decisions about whether to allow or suppress opportunities for other businesses to perform functions normally performed by the utility); and

9. control over decision about how to use the existing utility franchise to create more business opportunities (such as home energy auditing, heating, ventilation and air conditioning, and including acquiring other utilities whose business opportunities are assisted due to government protection from competition).

In short, the purchase of control of a utility is the purchase of control over the franchise—specifically, the exclusive market position granted by the franchise, and all the value that franchise can produce.

Q. Are not acquisition premia paid in acquisitions outside the utility sector?

A. Yes, but that fact supports my reasoning. When the acquirer of a non-utility business pays an acquisition premium, it does so at least in part to get control of the target's *market position*. With control of the target's market position, the acquirer can achieve objectives broader and larger than a single stockholder can achieve by buying merely a small slice of the company. That ability to achieve objectives broader and larger is what the acquirer of a utility is buying when it buys the full company. And in the unregulated context, the target company has earned its market position with its own investment risk

1 and managerial skill. But in the regulated monopoly context, *the utility's market position*
2 *has been granted by the government*; it has not been earned through investment risk or
3 managerial skill. That is what the acquisition premium is buying: the ability to control a
4 market position granted by the government. And that is why the acquisition premium is
5 attributable, at least part, to actions by the government.

6 One more way to understand the point: Suppose prior to the price negotiations,
7 Maryland passed a law allowing and encouraging multiple companies to provide the
8 service Washington Gas provides, such that the utility's *de facto* monopoly would
9 disappear. One would expect the value to AltaGas of buying WGLH, and therefore the
10 price it offered, to drop—because the value of controlling the franchise had dropped.

11 **Q. Is there evidence that AltaGas sees value in Washington Gas's franchise?**
12
13 **A.** Yes. Multiple statements by Applicant witnesses confirm that at least part of the
14 WGLH's value to AltaGas lies in the revenue stability promised by government
15 regulation. Here is one example:

16 The combined company will harness the strength of the platform that
17 WGLH has built in Maryland, Virginia and Washington, D.C. to continue
18 to grow our presence in each of these jurisdictions, and to further invest in
19 the region. We view this Merger as a "vote of confidence" in Maryland,
20 Virginia, and the District as good places to do business, and are excited to
21 pursue growth opportunities in the region.[50]
22
23 Maryland, Virginia and the District are "good places to do business" because the utility's
24 franchises ensure stable, profitable revenue streams from the ratepayers. Those stable,
25 profitable revenue streams also assisted WGLH's entry into non-utility businesses,
26 especially the competitive retail gas affiliate, the similarly named WGL Energy Services.

[50] Harris Direct at 7.

1 No one can dispute that WGLES gained an advantage over independent providers of
2 competitive gas service due to affiliation with a longstanding, reliable utility that enjoyed
3 the government's imprimatur. That affiliation brought with it the advantages of name
4 recognition and access to lower cost capital (because of its financially stable utility
5 sibling)—advantages that independent start-ups could replicate only with years of
6 experience and dollars of costly advertising. Executives of the affiliates likely had long
7 careers with the utility, giving them intensive knowledge of the potential customer
8 base—knowledge funded by ratepayers and replicable by competitors only with time and
9 money. All these advantages are part of the value AltaGas sees, part of the value
10 supporting the premium.

11 Here is another example:

12 WGLH's management and employees will play important roles within the
13 combined company. Not only will they continue to be the leaders of
14 WGLH's existing businesses, but they will also assist with the
15 management of our other U.S. utility businesses by providing strategic
16 oversight and guidance.[51]
17
18 The value to AltaGas of WGLH's "management and employees" is also due in part to the
19 ratepayers' historic financial support that enabled these individuals' professional growth.

20 And a third example:

21 In pursuing growth, both Mr. McCallister and I agree it is important to
22 maintain a balance between regulated and non-regulated businesses
23 because we believe a combined portfolio provides us with insight into
24 developments in the broader energy sector, which benefits all of our
25 subsidiary companies and their customers going forward.[52]
26

[51] Harris Direct at 8.

[52] Harris Direct at 19.

By "regulated businesses," Mr. Harris necessarily means franchised utilities whose ratepayers have no choice but to buy service from companies AltaGas owns. This relative certainty of profitable ratepayer payments is worth a premium.

Finally, the presence of regulated utilities in AltaGas's portfolio lowers AltaGas's finance costs, compared to a situation in which AltaGas owned only unregulated businesses. These lower finance costs enable future acquisitions of utilities, leading to additional certainty of profitable ratepayer payments.

To summarize this discussion of the sources of value AltaGas sees:

1. AltaGas is paying the acquisition premium to get control of Washington Gas's franchise.

2. The value of a utility's franchise is due to its stable source of revenue.

3. That source of revenue is stable because of Maryland government decisions to (a) grant franchises to Washington Gas and (b) require that customers wanting gas distribution service pay rates set by the government based on principles that provide WGLH a reasonable opportunity to earn a fair return.

WGLH's value to AltaGas owes much to Maryland government decisions and *de facto* ratepayer choicelessness. It cannot be true, therefore, that the sole source of value is actions by WGLH shareholders and the executives they hired.

D. Washington Gas's franchise is not the shareholders' asset to sell for gain

1. The franchise is not the shareholders' private asset; it is a privilege granted to Washington Gas for public benefit

Q. Explain the concept of a utility franchise.

A. A utility's franchise consists of rights and responsibilities: rights granted by government to the utility, a set of responsibilities undertaken by the utility. The rights include the right to provide legally-defined services to a largely captive customer base, and to receive in return compensation that satisfies statutory and constitutional standards. The responsibilities include the obligation to provide service that complies with standards set by the statute and the commission, to refrain from undue discrimination and to charge only those rates approved by and filed with the commission.

The franchise is thus a conditional privilege. The privilege of receiving a reasonable profit for providing an essential service is conditioned on complying with the standards attached to that service. This privilege is not an asset that can be sold and resold, like a McDonald's franchise or a New York City taxi medallion. It is not like corporate stock, or buildings, or trucks or power plants. The franchise privilege is not a commodity, to be sold to the highest bidder. The franchise is not bought and sold by anyone. The franchise remains with the government, to be granted to whichever company the government chooses.

Because the franchise is a privilege created by government, it cannot have been created by the shareholders; nor was it purchased by shareholders.[53] The franchise does

[53] As noted earlier, WGLH says: "Except for potential application fees or the posting of bonds and deposits with various county and municipal franchisors, *Washington Gas did not provide payment to any government entity to acquire its right to provide gas distribution service in Maryland*." Response to OPC 10-17.

have value, because the right to provide compensable service has value. But that specific value, as I explained in Part II.C, does not derive from actions of shareholders or executives; it derives from actions by government—specifically, actions limiting competition for the defined product and compelling ratepayers to pay government-set rates for that product. The franchise is not a private asset because it never loses its public character.

Because it is a privilege rather than an asset, the franchise does not include the right to sell it for gain. That AltaGas views Washington Gas's franchise privilege as something worth paying for does not make the privilege WGLH's to sell for gain.

2. Commission-set rates grant shareholders appropriate compensation; gain from selling the franchise is overcompensation

Q. Explain the connection between the compensation WGLH shareholders receive through utility rates, and the gain they would receive from the acquisition premium. Begin by explaining how rate-setting provides utility shareholders their legally required compensation.

A. A utility's shareholders have a legal right to fair compensation. That legal right comes from two sources: the statutory requirement that rates be "just and reasonable"; and the Constitutional standard, inscribed in the Fifth Amendment's Takings Clause (as applied to the states through the Fourteenth Amendment's Due Process Clause), stating: "nor shall private property be taken without just compensation."

In conventional cost-based ratemaking, the utility's annual revenue requirement reflects reasonable expenses, depreciation, debt and capital expenditures, as well as a fair return on equity. From that revenue requirement, regulators derive rate levels that will produce that fair return on equity if actual sales equal reasonably projected sales and if actual costs reflect the reasonably projected costs. The return on equity is applied to a

rate base that reflects assets necessary to provide utility service. As Justice Brandeis famously explained:

> The thing devoted by the investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. Upon the capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return.[54]

Justice Brandeis's analysis is the basis for our modern understanding of how the Constitution applies to ratemaking.

The phrase "capital embarked in the enterprise," Justice Brandeis explained, is the money invested in assets that serve the public, *i.e.*, book value, otherwise known as rate base:

> The adoption of the amount prudently invested as the rate base and the amount of the capital charge as the measure of the rate of return would give definiteness to these two factors involved in rate controversies which are now shifting and treacherous, and which render the proceedings peculiarly burdensome and largely futile. Such measures offer a basis for decision which is certain and stable. The rate base would be ascertained as a fact, not determined as matter of opinion. It would not fluctuate with the market price of labor, or materials, or money.[55]

When this Commission lawfully sets cost-based rates, utility shareholders receive the compensation required by statute and Constitution.

Q. You have explained how Commission-set rates provide shareholders appropriate compensation. What is the relationship between that rate-related compensation and the acquisition premium?

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[54] *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276, 290 (1923) (Brandeis, J., concurring (and dissenting)).

[55] *Id.*, 262 U.S. at 307-08.

1 **A.** If lawfully set rates give shareholders sufficient compensation, then the acquisition
2 premium is necessarily overcompensation.[56] The acquisition premium has no connection
3 to the utility's obligation to provide service. The acquisition premium is instead
4 attributable to AltaGas's desire to own and control Washington Gas's franchise.
5 Applying Justice Brandeis's wording, the acquisition premium does not represent "capital
6 embarked in the [public utility] enterprise."
7 If the acquisition premium does not represent utility assets, then what is it? It
8 represents the possible increase in value prospective acquirers see when they circle
9 around a target. In this case, it represents what AltaGas is willing to pay WGLH
10 shareholders to obtain, among other things, control of Washington Gas Light's franchise.
11 Because the acquisition premium does not represent investment in utility service
12 assets, WGLH shareholders have no legally protected expectation of receiving it. Any
13 expectation of receiving a premium arises from shareholders betting in the stock market,
14 not from utilities investing in public service assets. Justice Brandeis's formulation says
15 nothing about the Constitution protecting bets on stock prices. Rate base is where
16 government honors its constitutional obligations; stock value is where shareholders bet
17 their money. The dollars shareholders spend to buy stock are therefore constitutionally
18 distinct from the dollars a utility spends to acquire utility assets. Only the latter dollars—
19 dollars associated with utility service rather than acquirers' speculation—receive
20 constitutional protection.

---

[56] I am referring, of course, only to that portion of the acquisition premium that is properly allocable to Washington Gas's Maryland activity. I discuss that allocation issue at Part II.E.3 below.

1 Here is another way to understand the point. When Maryland granted
2 Washington Gas the franchise privilege (for which Washington Gas paid nothing), the
3 utility undertook an obligation to serve. To fulfill that obligation, the utility invested in
4 utility assets. In imposing this obligation to invest, Maryland has, in the language of the
5 Constitution's Fifth Amendment, "taken" private property for which the Constitution
6 requires "just compensation." That just compensation takes the form of rates which
7 provide Justice Brandeis's "opportunity to earn a fair return." From this logic, we see
8 that the constitutionally required just compensation relates solely to the utility's
9 investment in utility assets. A shareholder's decision to buy stock, in contrast, is not an
10 obligation imposed by government to serve the public; it is a voluntary act made by stock
11 buyers to increase their wealth. In the utility regulatory context, stockholders do not
12 receive any government protection of that wealth—let alone a promise to keep gain
13 arising solely from an acquirer's desire to control the franchise.

14 **Q. Companies in non-regulated markets routinely sell their businesses at a premium,**
15 **with their shareholders keeping the gain. What's the difference?**
16
17 **A.** In a non-regulated market, the acquirer's willingness to pay the premium, and the target's
18 expectation of a premium, are both disciplined by competition in the market for the
19 target's product. In that product market, the target company receives neither government
20 protection from competition nor government assurance of reasonable prices. So if the
21 acquirer pays an acquisition premium for the target, we can logically attribute the
22 premium to real economic value created by the acquisition—value that, due to
23 competition in the product market, will have to be shared with the consumer. (This
24 reasoning assumes that the acquisition and the accompanying premium are not motivated
25 by an intent to lock out competitors in the product market by behaving anti-

1 competitively.) The discipline imposed by competition in the product market will
2 discipline the size of the premium, leaving no logical reason to question its
3 appropriateness or the target shareholders' expectation of keeping the gain. In a
4 regulated utility market, that key fact—competition in the ultimate product market to
5 discipline the premium—is absent.

6 **Q. Has the issue you discuss here been addressed by a commission decision?**
7
8 **A.** I have presented the above-summarized reasoning in several prior acquisition
9 proceedings. No commission decision has addressed this reasoning, or the specific
10 question of whether and how the acquisition premium should be allocated between
11 shareholders and ratepayers. I presented this reasoning in this Commission's and the
12 District of Columbia Commission's proceedings on the Exelon-PHI transaction, as a
13 witness for the Office of People's Counsel and for GRID2.0, respectively. In each of
14 those two proceedings, the majority opinions did not address this issue, although the
15 dissenting opinions in both proceedings cited aspects of my reasoning. Both majority
16 opinions did, of course, approve the transaction and thus allow the PHI shareholders to
17 capture the entire acquisition premium. This Commission's decision, on that specific
18 subject and others, will be reviewed by the Maryland Court of Appeals due to the
19 Maryland Office of People's Counsel's appeal of the lower court opinions upholding the
20 Commission.[57]

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[57] *Maryland Office of People's Counsel v. Maryland Public Service Commission*, *cert. granted* June 21, 2017, Case No. COA -REG -0015-2017 (September Term 2017).

1 *3. Legal ownership of WGLH stock does not mean legal entitlement to the*
2 *acquisition premium*
3
4 **Q. What about the argument that WGLH stockholders are entitled to the premium**
5 **because they are the legal owners of WGLH's stock?**
6
7 **A.** This argument again assumes the answer to the question being asked. The
8 question is: "Are the owners of stock entitled to the premium?" The answer cannot be:
9 "Yes, because they are owners of the stock." In the utility regulatory context, the value
10 of utility stock is always affected by regulatory decisions, which can raise or lower that
11 value depending on how those decisions affect earnings. When utility shareholders
12 volunteer to enter a government-regulated market, they impliedly accept that regulation
13 can reduce the value of their holdings. That has been the law since medieval times,
14 memorialized in the landmark case of *Munn v. Illinois*, 94 U.S. 113, 126 (1877). There
15 the Supreme Court stated that when someone

16 devotes his property to a use in which the public has an interest, he, in
17 effect, grants to the public an interest in that use, and must submit to be
18 controlled by the public for the common good, to the extent of the interest
19 he has thus created. He may withdraw his grant by discontinuing the use;
20 but, so long as he maintains the use, he must submit to the control.
21
22 Recall also that AltaGas's purchase price is buying two things: ownership of
23 stock (which is what ordinary stock purchasers buy) and control of the franchise (which
24 is what AltaGas wants, along with ownership of stock). The portion of the purchase price
25 equal to market price of the stock pays for that stock. So that amount of course goes to
26 shareholders: payment for stock goes to the owner of the stock. The acquisition
27 premium, in contrast, is paying for control of the franchise. Because that franchise is a
28 conditional privilege granted to the utility, not an asset owned by it, the utility's

1 shareholders have no necessary right to the portion of the purchase price associated with
2 the franchise.

3 WGLH's shareholders may have hopes of selling the franchise for a gain; they
4 may feel disappointment when they don't get that gain. But hopes and disappointment
5 associated with purchases of regulated utility stock are not the Constitution's concern;
6 prudent investment in utility assets is.

7 **Q. Where does your analysis leave the Commission?**
8
9 **A.** Because the WGLH shareholders have no legally protected expectation of receiving an
10 acquisition premium,[58] the Commission is free to require that a reasonable portion of that
11 premium be shared with the ratepayers. I discuss principles for effecting that sharing
12 next.

13 ***E. The acquisition premium should be shared between ratepayers and***
14 ***shareholders based on each group's contribution to the value of the franchise***

15 ***1. The public interest criterion: benefit goes to the benefit-creator***
16
17 **Q. In determining how to share the acquisition premium, what standard should apply?**

18 **A.** Because WGLH's shareholders have no constitutional entitlement to the acquisition
19 premium, the Commission is free to allocate it according to some standard. The
20 necessary standard is the statutory "public interest" standard.

21 In Part I.A.2, I explained that the public interest has four major components:
22 shareholder-ratepayer alignment, economic efficiency, outcomes consistent with
23 competition, and respect for legitimate expectations. The sharing principle that satisfies
24 all four of these criteria is a principle consistently used in utility regulation: benefit goes

[58] As I will explain in Part II.E.3, the amount under discussion is not the entire acquisition premium of $1.27 billion, but only the portion properly attributable to Washington Gas's Maryland business.

1 to the benefit-creator. In regulation, we commonly allocate costs to cost-causers, rewards

2 to risk-takers and benefits to benefit-creators. Ratepayers pay for the costs they cause,

3 utilities are compensated for the risks they take, benefits are allocated to those who create

4 them. Applied here, this principle requires allocating the acquisition premium between

5 WGLH shareholders and WGLH ratepayers according to each group's relative

6 contribution to the premium's value.

7 **Q. Is your recommendation for allocating the acquisition premium consistent with**
8 **"gain on sale" precedent?**
9
10 **A.** Yes. Commissions follow the benefit-follows-burden principle when they allocate the

11 gain from a utility's sale of an asset previously used for utility service. If that asset had

12 been in the utility's rate base (and therefore its costs borne by ratepayers), and if the

13 utility then sells that asset for a price above the asset's net book value (original cost less

14 accumulated depreciation), the gain typically goes to ratepayers, in the form of a credit

15 against the utility's revenue requirement. Because the ratepayers bore the cost, they get

16 the gain. If the asset had not been in rate base, the gain normally goes to shareholders

17 because they bore the economic burden. Benefit goes to the benefit-creator.[59]

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[59] In *Democratic Central Comm. of the District of Columbia v. Washington Metropolitan Area Transit Comm'n,* the court stated:

> Ratepayers bear the expense of depreciation, including obsolescence and depletion, on operating utility assets through expense allowances to the utilities they patronize. It is well settled that utility investors are entitled to recoup from consumers the full amount of their investment in depreciable assets devoted to public service. This entitlement extends, not only to reductions in investment attributable to physical wear and tear (ordinary depreciation) but also to those occasioned by functional deterioration (obsolescence) and by exhaustion (depletion). . . .[Since customers] have shouldered these burdens, . . . it is eminently just that consumers, whose payments for service reimburse investors for the ravages of wear and

1 Although the gain-on-sale cases typically allocate the entire gain to ratepayers

2 (where the entire asset, including associated return, has been paid for by ratepayers), I am

3 not saying that the entire acquisition premium necessarily goes to ratepayers. The

4 benefit-follows-benefit-creator principle allocates the gain according to the contribution

5 each group makes to the relevant value. I apply the principle to this acquisition next.

6 ***2. Application of the public interest standard to the acquisition premium***

7

8 **Q. Based on your principle for allocating the acquisition premium, are you**
9 **recommending a specific allocation at this time?**

10

11 **A.** No. The Commission will need to determine the relative contribution made by

12 shareholders and ratepayers, based on evidence presented to the Commission.

13 **Q. What are the arguments for ratepayers?**

14

15 **A.** As detailed in Part II.B above, the logic for allocating the acquisition premium to

16 ratepayers starts by explaining that there is no clear logic for allocating it to shareholders,

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> waste occurring in service, should benefit in instances where gain eventuates—to the full extent of the gain.

485 F.2d 786, 808–11, 822 (D.C. Cir. 1973) (footnotes omitted); *id.* at 808 ("[I]f the land no longer useful in utility operations is sold at a profit, those who shouldered the risk of loss are entitled to benefit from the gain."). *See also Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities*, 2 FCC Rcd. 6283, 6295 ¶¶ 113–14 (Sept. 17, 1987) (order on reconsideration) (observing that "[t]he equitable principles identified in [*Democratic Central Committee*] have direct application to a transfer of assets out of regulation that produces gains to be distributed," and requiring "that ratepayers receive the gains on assets when the market value of the assets exceeds net book cost."); *N.Y. Water Serv. Corp. v. Pub. Serv. Comm'n of N.Y.*, 12 A.D.2d 122, 129 (N.Y. App.Div. 1960) (allocating gain on sale to ratepayers when ratepayers bore the risk of a loss in value of the assets); *N.Y. State Elec. & Gas*, Case No. 96-M-0375, 1996 N.Y. PUC LEXIS 671, at *8 (N.Y. Pub. Serv. Comm'n Nov. 19, 1996) (memorandum opinion) (reserving the net gains on the sale of land for ratepayers is "equitable and reasonable"); N.*Y. Tel. Co. v. N.Y. Pub. Serv. Comm'n*, 530 N.E.2d 843 (N.Y. 1988) (ratepayers entitled to benefits on sale of yellow pages advertisements).

1 and that the real value flows from the payments made by ratepayers, who are captive

2 customers due to government policy:

3 1. AltaGas is paying the acquisition premium to get control of Washington
4 Gas's franchise.
5
6 2. The value of the franchise is due to its stable source of revenue.
7
8 3. That source of revenue is stable because of government actions in
9 awarding the franchise and guaranteeing reasonable rates, which
10 Washington Gas's customers have no choice but to pay.
11
12 4. This value owes nothing to WGLH's shareholder risk-taking or its
13 executives' decision-making.
14
15 The Applicants might argue that the ratepayers' history payments do not entitle

16 them to the acquisition premium because they got what they paid for: gas distribution

17 service. That is a fair argument. It tells us ratepayers do not *automatically* get the entire

18 acquisition premium. It does not tell us, however, that their presence and payments entitle

19 them to zero.

20 **Q. What are the arguments for shareholders?**
21
22 **A.** The shareholders certainly have a right to that portion of the acquisition premium

23 attributable to WGLH's non-regulated businesses because their value is created by

24 shareholders. (Note, however, that to the extent the success of the non-regulated

25 businesses is attributable in part to the presence of the regulated business—a point that

26 AltaGas explicitly has endorsed—then not all of the premium that otherwise would be

27 attributable to the non-regulated business should go to the shareholders). As for the

28 portion attributable to Washington Gas, WGLH might argue that but for its shareholders'

29 investment, there would be no service for ratepayers to pay for; therefore, the source of

30 the value underlying the acquisition premium is the shareholders. This argument fails

1 because, as I explained in Part II.D.2, the shareholders already received compensation for
2 their investment through the authorized return on equity included in Commission-set
3 rates, as required by statute and Constitution; and, given the ratepayer payments for
4 service, one cannot say that the ratepayers' contribution to utility service was any less
5 than the shareholders' contribution.

6 Also unavailable to the shareholders is their version of the gain-on-sale reasoning.
7 As I explained, if a utility-funded asset was not placed in rate base, its cost was borne by
8 the shareholders, so the shareholders keep the gain on sale. Benefit follows benefit-
9 creation. But as WGLH has acknowledged, *WGLH never paid for the franchise*. There
10 being no financial burden borne by WGLH to buy the franchise, there is no burden
11 justifying a benefit.

12 **Q. What if the ratepayer and shareholder entitlement are of equal weight; or, equally**
13 **unclear?**
14
15 **A.** Looking at the various arguments, the Commission might decide they are of equal weight
16 (or weightlessness). Or, that the acquisition premium is, technically, a windfall--a lucky
17 value to which no one actually contributed. In that situation, I recommend the
18 Commission use a default of 50-50. If two friends simultaneously discovered a cashier's
19 check of $1.27 billion, they would split it in half. Absent evidence demonstrating a
20 relative contribution other than 50-50, equal sharing is the logical result.

21 I am not suggesting that the correct evidentiary result is likely to be 50-50. I am
22 saying that if the evidence is inconclusive or equal in weight, there is no logic to granting
23 100% to the shareholders, any more than there is logic to grant 0% to the shareholders.
24 In that context, a 50-50 sharing recognizes that both shareholders and ratepayers have
25 played a role, or that neither played a role; so that where a weighting of the relative

1 values of that role is not possible, a default to equality is consistent with the public
2 interest. This approach contrasts with the Applicants' proposal, which is a conclusive
3 presumption, an erroneous rule of law, without any evidence or any logical or legal
4 reasoning to support it, that the WGLH shareholders should receive 100 percent.

5 6 7 ***3. The portion to be shared: The Maryland portion of Washington Gas's share of WGLH's total control premium***

8 9 10 **Q. Is determining how to share the acquisition premium, what portion is relevant to your analysis?**

11 **A.** The relevant portion is the Maryland share of Washington Gas's share of the total $1.27
12 billion acquisition premium paid to WGLH. To determine that portion, three allocation
13 steps are necessary. First, we must allocate the acquisition premium between the
14 WGLH's regulated and unregulated businesses. Second, because WGLH has two
15 regulated businesses (Washington Gas and Hampshire Gas), we must allocate between
16 those two businesses. Third, we must determine the Maryland share of the Washington
17 Gas business. Taking those three steps will give us what we need: the Maryland share of
18 Washington Gas's share of the $1.27 billion acquisition premium.

19 OPC Witness Ralph Smith displays these calculations in his Exhibit RCS-17, and
20 presents the results as a table in his Direct Testimony. He shows that the Washington
21 Gas share of the WGLH regulated businesses is 99.4%, while the Maryland share of
22 Washington Gas is 39.2%. Those figures are unlikely to be in dispute. The variables
23 about which there is likely to be dispute are the size of the acquisition premium,[60] and the

[60] As I explained in note 2 above, the Applicants view the unaffected market price as the price on November 28, 2016, while OPC Witness Ralph Smith uses the unaffected market price as the volume-weighted average for the 30 trading days prior to that date. The two different dates produce very different acquisition premia. The

1 allocation between WGLH's regulated and unregulated businesses. It is the latter item
2 that I turn to here.[61]

3 OPC Witness Ralph Smith's describes three different ways to allocate the
4 premium between WGLH's regulated and unregulated businesses. My purpose here is
5 not to argue for any of them. Instead I explain each one, offer some thoughts on the
6 strengths and limitations of each one, and then recommend a procedure by which the
7 Commission in this proceeding can decide which of them (or others that might appear) is
8 appropriate.

9 **Q. Explain each of the allocation methods.**

10 **A.** Mr. Smith's "Alternative 1" allocates the acquisition premium to WGLH's Regulated
11 Utility business segment based on that segment's share of WGLH''s 2017 earnings
12 before interest and taxes (EBIT). This allocation produces a Washington Gas-Maryland
13 amount of $332 million. His "Alternative 2" applies the same technique to the period
14 2017-2021, producing a Washington Gas-Maryland amount of $283 million. His
15 "Alternative 3" allocates the premium based on the ratio that the WGLH Regulated
16 Utility business segment's implied equity value bears to the total WGLH implied equity
17 value. He uses the high end of Goldman Sachs analysis, as summarized in the Proxy
18 Statement, of the implied equity value for each WGLH business segment. Alternative 3
19 produces a Washington Gas-Maryland amount of $257 million.

Commission will need to determine which one should apply, but that is not the subject of this subpart of my testimony.

[61] This step of allocating the acquisition premium between the regulated and unregulated portions of WGLH was not necessary in the Exelon-PHI transaction because PHI's business was virtually all regulated.

1 **Q. Provide your comments about each of the methods.**

2 **A.** While allocations in regulation are common, this one presents an analytical challenge.
3 The acquisition premium AltaGas is willing to pay is based on AltaGas's projection of
4 how the acquisition will increase its future earnings. AltaGas already owns, and would
5 be buying, both regulated and unregulated operations. AltaGas also expects the to-be-
6 acquired regulated operations to contribute to the profitability of the unregulated
7 operations, both current and future. If this transaction were simpler—if it involved only
8 two regulated utilities and no unregulated holdings—the allocation task would be
9 relatively straightforward because a utility's earnings flow from regulatory decisions on
10 expenses and capital costs—items that can be predicted with relative certainty. The
11 substantial presence of unregulated companies makes projections are more difficult,
12 because the earnings from unregulated businesses are less certain, and because the direct
13 and indirect contributions that the regulated businesses make to the unregulated
14 businesses (such as reducing overall cost of capital, balancing the portfolio, contribution
15 to common costs, lending name recognition and branding value) are real but are difficult
16 to quantify. No allocation method will be perfect; all will require informed judgment.

17 For example, a merit of Alternative 1 (estimated 2017 earnings based on EBIT,
18 which is a measure of cash flow) is that it does not depend excessively on guesswork
19 about the future. But because the acquisition premium reflects the acquirer's bet about
20 the future rather than about 2017, there is a mismatch in time period. Alternative 2
21 (estimated 2017-2021 earnings) does look more to the future, although it is based on
22 projections rather than real numbers; and its five-year time period is likely shorter than
23 what AltaGas considered when determining the premium it was willing to pay.

1 Alternative 3 (the Goldman Sachs business segment implied equity value) has the
2 advantage of attempting to show the relative value of each WGLH business segment, and
3 applies acquisition transaction multiples to earnings and cash flow expectations.
4 However, like Alternatives 1 and 2, it is based on projections. It is difficult to project
5 credibly the earnings from a transportation business dependent on pipelines yet unbuilt.
6 About WGLH's transportation business, AltaGas has cited the following risks:
7 "legislative and regulatory obstacles," "equipment failures" affecting both construction
8 and operations, "supply chain disruptions," and "personnel issues and related risks."
9 AltaGas has described events that could "further delay the in-service date of WGL
10 Midstream's projects or disrupt operations of these projects, which could have an adverse
11 effect of its financial results."[62] OPC Witness Michael Arndt discusses these risks and
12 uncertainties in more detail.

13 **Q. What procedure do you recommend the Commission follow to select a method for**
14 **allocating the acquisition premium between WGLH's regulated and non-regulated**
15 **businesses?**
16
17 **A.** Because the question of how to allocate the acquisition premium has not been considered
18 before, by the Commission or by the parties, and because the potential dispute could
19 involve as much as $75 million (the difference between Alternative 1 ($332 million) and
20 Alternative 3 ($257 million)), I recommend the Commission direct all parties to provide
21 limited, supplemental testimony on this question. The testimony would address the
22 allocation methods described in OPC Witness Smith's testimony and any other methods
23 the parties wish to recommend.

[62] *See* AltaGas's 2016 Annual Information Form at 23-24.

1 The purpose of this allocation step is *not* to decide whether shareholders or
2 ratepayers ultimately receive some or all of the acquisition premium. The purpose is
3 solely to determine the amount of money that is at stake on this issue.
4

III.
AltaGas's complexities—current and future, known and unknown—bring risks of harm with insufficient benefit

A. The acquisition causes harm that conditions cannot eliminate

Q. Explain how you will organize your discussion of harm.

A. First I will define and explain two types of harm: status quo harm and opportunity cost harm. Then I will describe how Maryland faces a policy gap in protecting customers of utility subsidiaries controlled by complex holding companies like AltaGas. Then I will discuss the following harms that arise from this transaction:

> AltaGas's acquisitions and activities—current and future, known and unknown—will bring financial risks the Commission cannot control
>
> AltaGas's acquisition debt, incurred to pay the high premium, risks limiting the Commission's future options on rate levels

1. The two meanings of "harm"

Q. How do you recommend the Commission define "harm"?

A. Section 6-105 requires the Commission to find that an acquisition causes "no harm." The Commission has interpreted the prohibition against harm to require that "ratepayers are protected against any increased risks of harm...."[63]

Where a utility is not subject to competition, customers are harmed when their utility performs less effectively, and/or at higher cost, than if it were subject to competition. The utility must make all feasible, cost-effective efforts to reduce costs and increase quality. Failure to do so denies ratepayers what they deserve. That denial is harm.

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[63] Order 86990 (at text accompanying n.155, quoting Exelon/CEG, 103 MD PSC at 45).

1 An acquisition can cause two distinct types of harm: status quo harm and
2 opportunity cost harm. I discuss each type next.

3 ***a. Status quo harm***
4
5 **Q. Explain the concept of status quo harm, and how it applies to this transaction.**

6 **A.** Status quo harm occurs if the transaction adversely affects the cost or quality of
7 Washington Gas's service. AltaGas's ownership of Washington Gas creates three types
8 of status quo harm.

9 First, as AltaGas makes more acquisitions, and as acquired businesses grow, the
10 attention AltaGas can pay to Washington Gas, managerially (in terms of the executive
11 team and board) and financially (in terms of providing capital), necessarily shrinks. For
12 the recent and upcoming months, AltaGas's priority will be Washington Gas. After the
13 acquisition is accomplished, AltaGas will have other priorities. Mr. Harris is buying a
14 "foothold" for "growth."

15 Second, as the corporate family invests in ventures less financially secure than
16 state-regulated, monopoly distribution service, the investor portrait can change.
17 Conservative investors—those who buy-and-hold patiently, content with stable dividends
18 and stable share value or modest growth—no longer can treat the corporate family as a
19 predictable place to put their money. A different type of investor is more likely to enter:
20 one seeking higher-risk, higher-return opportunities. These new investors can bring
21 pressures on AltaGas's leadership for more growth—especially if that leadership
22 continually talks growth, as Mr. Harris does. That additional growth requires additional
23 risks, affecting the leadership's priorities and drawing its attention further away from the
24 core utility business. Also, bond rating agencies can no longer give consistently stable

1 ratings based on the Washington Gas's operational performance and regulatory treatment
2 (both of which factors are under this Commission's control or influence), because
3 AltaGas's financial health (which this Commission cannot control) will not be based
4 solely on those relatively predictable variables.

5 Third, to the extent the holding company is acquiring non-utility businesses,
6 Washington Gas's managers may believe that the best path to advancement is not through
7 the traditional utility activities, but instead through non-utility activities and "corporate
8 strategy." We do not want to lose good managers—people whose development was
9 funded by customers' rate payments—to AltaGas's non-utility ventures. And essential
10 craftspeople—men and women who make things work—can face more job risk, because
11 failures in the unrelated businesses can create financial strains that cause the utility to
12 reduce or defer maintenance and modernization. That greater job risk can make
13 recruitment more difficult.

14 ***b. Opportunity cost harm***
15
16 **Q. Explain the concept of opportunity cost harm, and how it applies to this transaction.**
17
18 **A.** In the context of utility acquisitions, opportunity cost harm occurs if the proposed
19 transaction displaces some other opportunity that would produce more benefits to the
20 public. A utility is obligated to provide service at a quality and cost comparable to what
21 competition would produce. If a transaction diverts or displaces resources from more
22 productive uses, thereby incurring what economists call "opportunity cost," it fails this
23 test.

24 In competitive markets, transactions that involve opportunity cost have less
25 success than transactions that do not, all else equal. In the utility acquisition context,

disregarding this type of harm violates the principle that regulation should induce performance comparable to what competition would produce.

A utility acquisition proposal arises, directly or indirectly, explicitly or implicitly, from a competition for control: acquirers competing for control of a target. The target has a fiduciary obligation to pick the acquirer that offers the most to the target's shareholders. But if the target pursues that fiduciary obligation to its shareholders while ignoring its service obligation to its customers, it will choose the acquirer offering the highest price rather than the acquirer promising the best service. Selecting the wrong acquirer necessarily precludes selecting the right acquirer (from the customers' perspective). The resulting loss of benefits is opportunity cost—causing customers to forego a service that is lower cost and higher quality. That loss of opportunity is harm. Were this a competitive market, customers could avoid that harm by seeking another supplier. But for gas distribution service, as a practical matter there is no other supplier. When customers are captive, and their supplier fails to choose the best acquirer, customers are harmed.

2. In protecting utility customers from holding company risk-taking, Maryland faces a regulatory gap

Q. Explain how the federal regulatory role, prior to 2006, supported state commissions in protecting consumers of utilities owned by complex holding companies

A. Until its repeal in 2005, the federal Public Utility Holding Company Act of 1935 (PUHCA) required, subject to certain exceptions, that each utility holding company constitute a "single integrated public-utility system." The purpose was to align each utility's corporate form with its public service obligations. The Act's key provision restricted acquisitions of utilities to those that would serve the public interest by "tending

1 towards the economic and efficient development of an integrated public-utility system." Section 10(c)(2) of PUHCA (repealed). Acquiring utilities merely for purposes of "footholds," "platforms" and "growth" was contrary to the public interest, as PUHCA defined the public interest. Another provision, Section 7(d), prohibited utility holding companies from issuing securities that, among other things, involved an "improper risk" or were "detrimental to the public interest or the interest of investors or consumers."

For 70 years, these provisions and others caused electric and gas utilities to "stick to their knitting." Undistracted by the prospect of "footholds" and "platforms," they devoted their management attention and financial resources to providing essential utility service, locally. They avoided the corporate structures and managerial behaviors that had caused harm to "investors, consumers and the public interest": disconnected dispersion of utility properties, arbitrary mixes of utility and non-utility businesses, excess leveraging of debt to buy equity (thereby reducing a holding company's real economic stake in the utilities it controlled), and interaffiliate transactions that "milked" utility funds to support non-utility affiliates and pay cash dividends to the leveraged holding company owners.

1 **Q. Why was this federal role important to state commissions?**
2
3 **A.** The Act reduced the possibility that the cost or quality of utility service would be
4 compromised by conflicting business objectives. As a result, state commissions could
5 focus their limited resources on reducing cost and improving quality, rather than have
6 their attention and resources diverted to harm prevention—as this Commission's attention
7 was diverted in the lengthy Exelon cases involving Constellation and PHI, and is being
8 diverted in the current case.
9 The Energy Policy Act of 2005 repealed the entire 1935 Act—all its limits and
10 reviews of utility holding company acquisitions. As a result, today there is no federal
11 limit on holding company arrangements involving geographically dispersed,
12 operationally unrelated utilities; mixtures of utility and non-utility businesses; excess
13 debt; or complex corporate family structures.[64] Without federal protection, consumers
14 now depend on state protection.

15 ***3. AltaGas's acquisitions and activities—current and future, known and***
16 ***unknown—will bring financial risks the Commission cannot control***
17
18 ***a. AltaGas's business activities—all beyond the Commission's***
19 ***control—will affect Washington Gas's access to equity***
20
21 **Q. Explain Washington Gas's dependence on equity from AltaGas.**
22
23 **A.** Equity is a business's financial lifeblood. To fund its future infrastructure, Washington
24 Gas will need hundreds of millions of dollars in financing, in the form of equity and debt.

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[64] There remains some review by the Federal Energy Regulatory Commission under Section 203 of the Federal Power Act, 16 U.S.C. sec. 824b, and under a vestige of PUHCA 1935 now called PUHCA 2005. But in all its merger cases since the late 1980s, FERC has not used these provisions to protect customers from the risks discussed in my testimony; FERC has focused on the risks of vertical and horizontal market power. I make this statement objectively, based on my study every FERC decision issued since the late 1980s and my participation in several of them.

1 For the mix of equity and debt to be cost-effective, the share of equity in the utility's
2 capital structure must be a cost-effective amount—typically between 45 and 50 percent.
3 After the acquisition, Washington Gas's sole source of equity will be AltaGas.
4 AltaGas's ability and willingness to inject equity into Washington Gas will depend on
5 AltaGas's financial health, and the priority it places on Washington Gas relative to its
6 many other ventures. AltaGas's financial health, in turn, will depend on those other
7 business ventures—the size of its other investments and the risks those investments bring.
8 In short, Washington Gas's access to equity—the equity it needs to finance the gas
9 distribution system that its customers need for life—will depend on the business risks
10 AltaGas's executives choose to take, and how financial markets respond to those risks.
11 **Q. Describe the risks associated with AltaGas's current business activities.**
12
13 **A.** AltaGas is involved in competitive electric generation, a sector that has seen multiple
14 business failures. Its gas processing and transportation business includes investments in
15 both North America and Asia. As acknowledged by AltaGas and detailed by OPC
16 Witnesses Ralph Smith and Michael Arndt, the risks include throughput risk, commodity
17 risk, foreign exchange risk, cyberattack risk, interest rate risk, natural gas supply risk,
18 electric power supply risk, hydroelectric production risk, wind supply and operation risk,
19 third-party credit risk, joint venture risk, environmental risk and aboriginal risk.
20 Prior to PUHCA repeal, a holding company's non-utility investments would have
21 been limited to those that could cause no risk of harm to Washington Gas. With the Act's
22 repeal, there is no federal limit on the amount or type of AltaGas investments. Nor is
23 there any express limit in Maryland law (unlike Wisconsin, which by statute limits the

1 amount and type of utility holding company acquisitions).[65] As a result, our regulatory
2 experience with these types of businesses and their risks—monitoring them and assessing
3 their performance and risks—is limited. Our experience with AltaGas's businesses is
4 zero. We have no readily available way to assess its susceptibility to failure.

5 AltaGas plays down this point. Its application describes only its present holdings
6 and its present risks. AltaGas self-assesses those holdings as successful and low-risk.
7 But this description is stuck in the present. AltaGas claims to have "no other planned
8 acquisitions,"[66] but its internal and external documents make clear its ambitions for more
9 "growth"—including through acquisitions:

> 10 AltaGas expects to continue investing in attractive high growth
> 11 jurisdictions and is focused on achieving a balanced mix of energy
> 12 infrastructure assets over the medium to long term.[67]

13 Because AltaGas insists on making additional, unknown acquisitions without the
14 Commission's review, its description of the present tells us nothing about the future.

15 I expect AltaGas to insist to this Commission that its acquisition efforts will cause
16 no risk. But when addressing this issue with its shareholders, under securities laws that
17 require candor, AltaGas shows more candor:

> 18 To the extent that external sources of capital become limited or
> 19 unavailable or available on onerous terms, AltaGas' ability to make
> 20 capital investments and maintain existing assets may be impaired,
> 21
> 22 If cash flow from operations is lower than expected or capital costs for
> 23 these projects exceed current estimates, or if AltaGas incurs major
> 24 unanticipated expenses related to construction, development or
> 25 maintenance of its existing assets, it may be required to seek additional

[65] *See* Wisc. Stat. sec. 196.795.

[66] Response to OPC 10-15.

[67] Application, App. B (AltaGas 2016 Annual Report) at 11.

1 capital to maintain its capital expenditures at planned levels. Failure to
2 obtain financing necessary for AltaGas' capital expenditure plans may
3 result in a delay in AltaGas' capital program or a decrease in dividends.[68]
4
5 This transaction thus is not merely about a takeover of Washington Gas by current
6 AltaGas. Explicitly, AltaGas's Application seeks approval of only this transaction. But
7 implicitly, and in reality, AltaGas seeks permission not only to acquire Washington Gas
8 but to acquire any other company AltaGas wants in the future, regardless of the risks
9 those acquisitions cause. The Commission would be approving Washington Gas's
10 association with not only AltaGas's present holdings and present risks, but also all of
11 AltaGas's future holdings and risks. That result cannot be consistent with the public
12 interest and with a statutory prohibition against harm.

13 **Q. Will this acquisition diminish Washington Gas's role in its holding company family**
14 **and thus its access to equity if equity is scarce?**
15
16 **A.** Yes. In calendar year 2016, Washington Gas represented 47.31% of WGLH's total
17 operating revenues.[69] After the acquisition, Washington Gas will represent no more than
18 28% of AltaGas's operating revenues (based on 2016 data).[70] That percentage will
19 continue to decline as Washington Gas AltaGas adds to its many subsidiaries involved in
20 gas pipeline ownership (no benefit to Washington Gas), electric power generators (no
21 benefit to Washington Gas) and other distribution gas companies (which companies
22 would receive help *from* Washington Gas.[71]

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[68] AltaGas, Ltd, *Annual Information Form for Year Ended Dec. 31, 2016* at pp. 59-72 (Feb. 22, 2017).

[69] Response to OPC 10-24(d).

[70] Response to OPC 10-24(e).

[71] *See* Harris Direct at 8 ("Not only will [Washington Gas's management and employees] continue to be the leaders of WGL's existing businesses, but they will also

1 AltaGas will not commit to a minimum waiting time before making its next
2 acquisition.[72] Moreover, Mr. Harris would not express any view on the "size at which
3 AltaGas will have experienced too much growth," or whether there is any "theoretical
4 limit on the growth that AltaGas can experience."[73] He wants AltaGas "to be a leading
5 North American diversified energy infrastructure company"[74]—regardless of how small
6 that makes Washington Gas in AltaGas's total system.

7 **Q. In terms of the utility's access to equity, how does the AltaGas acquisition differ**
8 **from the status quo?**
9
10 **A.** The Applicants might argue that these risks do not differ from the status quo, because
11 Washington Gas depends on WGLH for equity, and WGLH too can takes risks without
12 limit and without Commission review. But there is no evidence that WGLH is planning
13 the type of continuous acquisitions, spread across the continent, that AltaGas plans. And
14 the AltaGas risks are additive to WGLH's risks. Their effect on WGLH is not neutral.

15 **Q. What about AltaGas's argument that its proposed protective conditions are better**
16 **than what Washington Gas and WGLH have currently?**
17
18 **A.** The proposed commitments should be better than those in place, because AltaGas has
19 more complexity than does WGLH. In any event, these commitments are not
20 copyrighted by AltaGas; they are available to the Commission today and could be applied

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assist with the management of our other U.S. utility businesses by providing strategic oversight and guidance.").

[72] Response to OPC 10-33(a).

[73] Response to OP 10-33(h). (The quoted language is from OPC's question).

[74] Response to OP 10-33(h).

1 to WGLH today. The Commission does not need AltaGas's acquisition to protect
2 Washington Gas's customers from WGLH's risks.

3 In any event, if WGLH thought conditions like AltaGas's were necessary, Mr.
4 McCallister would have adopted them because he claims to care about consumers. And
5 Ms. Lapson says she has not "reach[ed] an opinion as to whether the lack of such features
6 has caused" any risk to Washington Gas' customers—although now that AltaGas has
7 proposed them she contradictorily asserts they would have value to customers.[75]

8 **Q. Are AltaGas's commitments to eliminate risk sufficiently clear, such that disputes**
9 **over their meaning and applicability will not occur?**
10
11 **A.** No. Here are two examples.

12 ***The five-year promise***: AltaGas acknowledges the possibility of "adverse rate
13 impacts due to an increase in Washington Gas's cost of debt that is caused by the Merger
14 with AltaGas, or the ongoing affiliation with AltaGas and its affiliates...." But its
15 commitment is to hold customers "harmless" for a period of only five years.[76] One
16 immediately wonders—What happens after five years? Is AltaGas then free to impose
17 adverse rate impacts on its customers? The answer, of course, is no. The obligation to
18 "hold customers harmless" is inherent in just and reasonable ratemaking. This five-year
19 commitment is, literally, without meaning.

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[75] Response to OPC 10-51(b).

[76] Reed Direct at 32.

1 ***The adverse effects from affiliation***: When asked to "identify all possible "adverse rate impacts" that could result from the affiliation," Mr. Reed avoided the question. Here is his full answer: "All known adverse rate impacts have been addressed by the Merger Commitments."[77] The question's purpose was to see if AltaGas, OPC and the Commission have a shared view of the problem, so they can design a shared solution. Saying "we've addressed the problem" means only that AltaGas and its advisors have addressed the problem as they have defined it, and only to the extent they are comfortable with the solution.

Q. What if the Applicants assert that eliminating all risk is not practical?

A. They would be right. Eliminating all risk is not practical—not where AltaGas insists on the right to engage in behaviors that cause risk without Commission approval. And that is the point. To make a defense out of "we cannot eliminate all risk" implies a right to a risk-causing acquisition. AltaGas does not have that right—not under a "public interest" and "no harm" statute.

b. Experience, logic and economic theory confirm that AltaGas's risks to Washington Gas are not "speculative"

Q. In prior acquisition cases, applicants have labeled concerns about business risk "speculative." Are they?

A. No. Adjectives do not change facts. Here are four facts:

1. Due to the repeal of PUHCA 1935, the geographic reach and type-of-business scope of AltaGas's future acquisitions have no legal limit—unless the Commission sets one. So while AltaGas has, and will have, detailed acquisition strategies that it keeps

[77] Response to OPC 10-5(c).

1 confidential, the Commission will have no idea what they are or will be. That is not
2 speculation; it is a fact.
3 2. The Commission does not know, and will have no power to control, how small
4 Washington Gas will become relative to AltaGas. Nor does the Commission know how
5 small is too small, or how many unrelated affiliates are too many unrelated affiliates,
6 before Washington Gas's welfare becomes too small to engage the attention of AltaGas's
7 leadership. Those are not speculations; those are facts.
8 3. AltaGas's acquisition aspirations are in tension with the Washington Gas's
9 public service obligations, because if equity becomes scarce for AltaGas, we have no
10 enforceable guarantee that AltaGas will put Washington Gas before any other of its
11 ventures—including its other utility subsidiaries. AltaGas cannot tell each utility
12 subsidiary's commission that it will be AltaGas's top priority, any more than all
13 Minnesota children can be above average. That is not speculation; it is a fact.
14 4. AltaGas's future acquisitions activities will occur outside the Commission's
15 jurisdiction and control. That is not speculation; it is a fact.
16 Those who call these concerns "speculative" are the ones who speculate. They
17 speculate that (a) shrinking a utility's contribution to its holding company's wealth will
18 never reduce the holding company's commitment to the utility's well-being; (b)
19 AltaGas's non-utility investment goals will never conflict with Washington Gas's service
20 obligations; (c) business failures within the AltaGas corporate family will not occur—and
21 if they do, they will have no adverse effect on Washington Gas; and (d) magnifying the
22 complexity of the regulatory task will not strain the Commission's limited regulatory
23 resources. AltaGas cannot prove these negatives. To assume them away is speculation.

1 It is not even clear that AltaGas understands its business risks. Consider Merger
2 Agreement Section 4.1(b)(xvii), providing among other things that prior to
3 consummation, WGLH,"shall not permit any of its subsidiaries to enter into any new line
4 of business." Asked "What purpose does this provision serve?", AltaGas, through Mr.
5 O'Brien, avoided the question, saying only that it is a standard provision, and that its
6 purpose was—and here AltaGas just repeated the provision's wording. Asked "Do you
7 agree that this provision was required by AltaGas because it views 'any new line of
8 business' as involving a risk that it has not accounted for in determining the desirability
9 of acquiring WGL at the negotiated price?", AltaGas again avoided the question, echoing
10 its prior answer that provision is "a standard provision."[78]

11 It should be obvious that a prospective acquirer will base its offer price on
12 perceived value; and that any change in the target's business activities could create risks
13 that reduce that value. If AltaGas, through Mr. O'Brien, is so uncomfortable
14 acknowledging something so simple and so obvious—and so relevant to regulatory
15 protection—there is cause for concern about its commitment to regulatory protection.

16 If Applicants argue these concerns are "speculative" and therefore not worth the
17 Commission's consideration, they contradict themselves. The rules of corporate
18 disclosure in Canada require AltaGas to reveal all material risks: not speculative risks,
19 just material risks. As disclosed in Canada, AltaGas' list of risks looks much like mine:

20 … changes in market; competition; governmental or regulatory
21 developments; general economic conditions;… impact of significant
22 demands placed on AltaGas and WGL as a result of the Transaction;
23 failure by the AltaGas to repay the bridge financing facility; potential
24 unavailability of the bridge financing facility and/or alternate sources of
25 funding that would be used to replace the bridge financing facility,

[78] Response to OPC 10-8.

> including asset sales on desirable terms; impact of acquisition-related expenses; accuracy and completeness of WGL's publicly disclosed information; ***increased indebtedness of AltaGas after the closing of the Transaction, including the possibility of downgrade of AltaGas' credit ratings***; … customer loss or business disruption; changes in customer energy usage; and other factors set out in AltaGas' public disclosure documents.[79]

If these are the risks AltaGas wants investors to consider, the company can hardly tell the Commission to ignore them.

Q. Do you have a solution to these problems?

A. The solution is to subject AltaGas's future acquisitions to advance Commission review calibrated to the seriousness of the risk. Here is proposed condition language:

> No member of the AltaGas corporate family shall acquire any interest in any business, where such interest exceeds a dollar level established by the Commission to eliminate the possibility of harm to Washington Gas, unless the Commission has determined that the acquisition and continued ownership of such interest will cause no harm to Washington Gas or increase the cost of the Commission oversight. The Commission will make such determinations using a procedure to be developed in a separate Commission rulemaking, before the completion of which AltaGas shall make no additional acquisitions. Such procedure may include a combination of safe harbors (no Commission review necessary), advance notice (after which the transaction may proceed unless the Commission determines that review is necessary), and express decisions granting or denying approval, all as necessary to distinguish, expeditiously, acquisitions that pose risks to consumers from those that do not.

The Commission would act only when it deems necessary. It would limit only those AltaGas activities that cause risk to ratepayers. I would expect the Commission to define tiers of accountability. Examples are:

1. a category of safe harbor transactions, so minor or routine that no Commission review is necessary;

[79] AltaGas 2016 Annual Information Form (emphasis added).

1 2. a category of transactions that might be risky—so AltaGas must inform
2 the Commission in advance; and if the Commission does nothing after
3 some period of time, say 60 days, the transaction can go forward;
4
5 3. a category of transactions that are definitely risky, but not necessarily
6 prohibited, and therefore cannot go forward without affirmative
7 Commission approval; and
8
9 4. a category of transactions so inherently dangerous, due to geography, type
10 of business, size of financing or other factors, that they are prohibited
11 without review.
12
13 The Applicants will likely say this condition limits their "freedom" to invest.
14 That is the point. AltaGas's freedom to invest is not the Commission's statutory concern.
15 The Commission's duty is not to accommodate AltaGas's strategies, but to protect
16 ratepayers from those strategies. This condition does so. If the Applicants do not trust
17 the Commission's judgment, and its ability to decide these questions reasonably, they
18 should come out and say so.
19 I readily acknowledge that this condition has not been a common feature in other
20 state merger cases. Until recently, it didn't have to be. For the many mergers prior to
21 2005, it was not necessary because Section 10(c)(2) of PUHCA 1935 restricted mergers
22 and acquisitions to those that "tend[ed] towards the economical and efficient
23 development of an integrated-public utility system." Further, some states, like
24 Wisconsin, might have statutes that directly limit the amount and type of businesses that
25 may exist in a utility holding company system. For the remaining states, their omission
26 of a condition like this has left them less able to prevent situations where their local
27 utility becomes a smaller part of a more complex holding company system.

4. AltaGas's acquisition debt will limit the Commission's future options on rate levels

Q. Is there a connection between AltaGas's acquisition debt and the Commission's flexibility in making future rate decisions?

A. Yes. The Applicants say the transaction does not affect the Commission's legal authority. But it will affect the Commission's practical authority; specifically, its ability to set Washington Gas's rates properly.

AltaGas will incur debt to buy WGLH. AltaGas has claimed that because this acquisition debt (the details of which AltaGas has not disclosed or, apparently, determined—it has procured bridge financing but we know nothing about the long-term financing) will be held at the holding company level, it will not affect Washington Gas. AltaGas's claim omits key facts. Part II.B explained that one reason AltaGas is paying a premium (and is borrowing money to pay it) could be its expectation that Washington Gas's actual returns will exceed both AltaGas's required returns and the Commission's authorized returns. If that premise turns out to be true, the Commission will need to consider lowering Washington Gas's gas distribution rates, so that its actual returns come closer to those required returns and the appropriate authorized returns. (I am not saying that the Commission should lower Washington Gas's rates; only that the facts would warrant the Commission investigating the need to do so.)

But if AltaGas has incurred acquisition debt on the expectation of actual returns exceeding required and authorized levels, a lowering of Washington Gas's rates will make it harder for AltaGas to repay its acquisition debt. In fact, the mere opening of a Commission investigation into the question could cause rating agencies to lower AltaGas's ratings. So there will be pressure on the Commission—from rating agencies,

1 lenders, stockholders, AltaGas executives and the rate case witnesses AltaGas and
2 Washington Gas pay—to set authorized returns based not on proper capital market theory
3 but on AltaGas's own needs for cash—needs that arise from AltaGas's acquisition debt
4 incurred to gain a "foothold." The Commission then may hesitate to lower Washington
5 Gas's rates for fear that AltaGas will be less able to provide Washington Gas the equity
6 capital it will depend on.

7 The way to avoid this pressure is to prevent an acquisition whose price and debt
8 will lead to that pressure. The problem, again, is that AltaGas's failure to provide
9 information on its acquisition debt leaves this Commission uninformed even about the
10 scope of this problem.[80]

11 AltaGas's witnesses might assert that this concern is "speculative." If so, the
12 Commission can test that assertion readily, by asking each of Mr. Harris, Mr. McAllister,
13 Mr. O'Brien, Mr. Chapman and Ms. Lapson—if AltaGas would be indifferent to future
14 Commission efforts to align actual returns with required returns and authorized returns.

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[80] The absence of a credible finance plan, including the level of acquisition debt and the plans to reduce it, was one reason why the Kansas Corporation Commission recently rejected the proposed merger between Great Plains Energy (the holding company for Kansas City Power & Light) and Westar (the holding company for Kansas Power & Light and Kansas Gas & Electric. *See* KCC Order in Docket No. 16-KCPE-593-ACQ (Apr. 19 2017) at para. 30 (emphasis added):

> [GPE CFO Bryant] admits that GPE still has no written plan to pay down the debt. Bryant's claim that "I think about that unwritten plan every day" is not sufficient. The Commission does not doubt that Bryant thinks about deleveraging each day, but without a written plan, the Commission has nothing to evaluate... *Since GPE has failed to formulate any written plan to pay down the debt, the Commission has nothing to review and cannot assume GPE will be able to rapidly deleverage*. Therefore, the Commission must review the Joint Application under the assumption that a post-transaction GPE will have substantial debt that will likely result in downgrades to its credit rating.

1 I doubt the answer will be "yes." The Commission also can require AltaGas to obtain
2 from credit rating agencies a specific response to the question whether such Commission
3 efforts will, in light of the acquisition debt, cause them to question ratings for either
4 AltaGas, WGLH or Washington Gas. Only by requiring that information will we know if
5 this transaction satisfies Section 6-105.

6 **Q. Is there a distinct concern about cost recovery mechanisms?**
7
8 **A.** Yes. The concern I have raised in this subsection, about acquisition debt constraining
9 Commission rate decisions, applies not only to rate levels but also to cost recovery
10 mechanisms, such as surcharges, riders and adjustment clauses.

11 Each of these devices is a departure from traditional cost-based ratemaking. In
12 traditional cost-based ratemaking, the annual revenue requirement and the resulting rates
13 are based on predictions about costs and sales. Shareholders and customers then bear the
14 risk that actual returns will vary from authorized returns because actual costs and sales
15 vary from the projections. The goal in designing cost recovery mechanisms should be to
16 allocate that risk to produce a cost-effective balance between two objectives: minimizing
17 the cost of capital (which rises with risk), while maximizing the utility's incentive to act
18 prudently (which increases its risks but creates benefits for consumers).

19 There are numerous ways to "skin this cat." My purpose is not to advise the
20 Commission on their merits. My purpose is to emphasize that once the Commission
21 approves an acquisition for which the acquirer incurs large debt, it will face pressure to
22 reallocate risks from shareholders to customers, regardless of the effects on economic
23 efficiency.

1 ***B. The proposed "benefits"—at most one-one-fifth the shareholder gain— fail the***
2 ***statutory test***
3
4 ***1. The meaning of "benefit"***
5
6 **Q. In determining whether an acquisition satisfies the public interest, how should the**
7 **Commission evaluate an applicant's assertions of benefits?**
8
9 **A.** The Commission should assess the asserted benefit's relevance and its sufficiency. After
10 explaining of these concepts, I apply them to the benefits asserted by the Applicants.

11 ***a. The relevance of the benefit: Two categories***
12
13 **Q. Explain what makes a benefit a relevant benefit, *i.e.*, one that the Commission**
14 **should count.**
15
16 **A.** Because we are analyzing an acquisition, the logically relevant benefits are the ones
17 produced by the meshing of two companies. Other benefits injected by the acquirers to
18 win support do not come from the meshing of two companies. Legal analysis produces
19 the same result. Section 6-105 requires that the benefits come from "the acquisition," not
20 from some other source, like the wallets of acquirers or the minds of regulatory
21 strategists. I apply this screen to the two general categories of benefits.

22 **Q. Discuss the first category of benefits—"synergies."**
23
24 **A.** Synergies, as that term is commonly used in acquisitions of utilities, are benefits arising
25 because two companies operate more efficiently together than apart. When a winter-
26 peaking utility merges with a summer-peaking utility, or a renewables-heavy utility
27 merges with a gas-heavy utility, these couplings can reduce the cost of energy and
28 capacity because of how the resources mesh. When a merger results in economies of
29 scale, scope or integration, or allows resource-sharing that reduces overhead expense, that
30 is a merger benefit also—a benefit caused by the merger and unavailable without the

1 merger. This type of benefit should be counted because it comes from "the acquisition."
2 It is caused by the coupling and could not be achieved without it.

3 **Q. Discuss the second category of benefits—performance improvements.**
4
5 **A.** When an acquirer improves the target's performance, this benefit arises not because two
6 operations mesh, but because the acquirer substitutes higher quality practices for the
7 target's lower quality practices. It is a benefit, but it is not a benefit attributable to the
8 acquisition because it should have been attained without the acquisition.

9 Consider this exaggerated hypothetical: The target company was using quill pens
10 and Roman numerals; the acquirer introduces computers. This benefit arises not from the
11 meshing of operations; it occurs because an under-performing target learned new lessons
12 that any prudent utility should have known. The target could have hired new managers or
13 consultants, learned from peers, attended professional conferences, or raised internal
14 standards by sharpening its recruitment and compensation policies. Or the regulator
15 could have raised standards and imposed consequences for failing to meet those
16 standards; or even held a competition to find the best performer for a particular function
17 (as did Hawaii, Maine, Oregon and Vermont, in choosing energy efficiency companies to
18 replace their utilities' energy efficiency efforts[81]).

19 To attribute to an acquisition benefits that can occur without the acquisition
20 therefore conflicts with economic efficiency. We count merger benefits to justify merger
21 costs. Counting performance improvements as merger benefits means that customers

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[81] *See How Efficiency Vermont Works*, EfficiencyVermont.com, http://efficiencyvermont.com/about_us/information_reports/how_we_work.aspx; *About Us*, Hawai'i Energy.com, http://www.Hawai'ienergy.com/4/our-team; *About Us*, EnergyTrust of Oregon, http://energytrust.org/about); *About Efficiency Maine*, EfficiencyMaine.com, http://www.efficiencymaine.com/about.

bear extra costs merely to cause their company to perform prudently. To credit an acquisition as a solution to imprudence, rather than addressing imprudence directly, is illogical.

This category of benefit has another problem: It is often unquantifiable, and therefore incapable of tracking, proof and accountability. As this Commission has stated:

> [P]rojections of benefits through synergies, 'shared services' or 'best practices' are inherently speculative and, to the extent they materialize, will likely benefit ratepayers only as 'forgone requests for rate relief,' which we have previously held to be too intangible to qualify as a benefit under PUA sec. 6-105 [*i.e.*, Maryland's merger statute, which require benefits from the acquisition].[82]

Making customers pay extra for something they are already supposed to receive is a form of customer abuse that would not occur in an effectively competitive market.

b. The sufficiency of the benefit: The proper relationship of benefit to cost

Q. For the benefits that deserve to be counted, how should regulators determine if their quantity is sufficient?

A. When a rational person makes an investment, she seeks the highest possible return relative to other investments of comparable risk. This principle applied to AltaGas (which sought the most profitable "platform" in light of the acquisition's costs and risk) and to WGLH (which sought the highest possible price from competing acquirers).

For the public interest to be protected, the same principle must be applied to customers." Their ratio of benefit to cost should be at least equal to that associated with

[82] *In the Matter of the Merger of Exelon Corporation and Constellation Energy Group*, Order No. 84698 (Feb. 17, 2012), 2012 Md. PSC LEXIS 12 at text accompanying note 356.

1 all feasible alternatives (including no acquisition). For the shareholders to receive the
2 highest feasible benefit-cost ratio, while customers receive only minor benefits that
3 slightly exceed cost, is to advantage shareholders to the detriment of consumers.
4 Consider competitive markets. If Washington Gas's distribution customers had
5 competitive options, they would shop to receive the greatest value for the dollars they
6 spend. No one buys a $20,000 car that produces only $21,000 in perceived value, if one
7 can buy a different $20,000 car that produces $25,000 in perceived value. Regulation,
8 like competition, should produce for consumers the highest feasible benefit-cost ratio.
9 When evaluating a proposed acquisition, therefore, regulators should ask the same
10 question investors (and shopping consumers) ask: Will this transaction produce for
11 customers the best possible benefit-cost relationship, compared to alternative actions the
12 utility could take? The foundation of this question comes from the central purpose of
13 regulation: to replicate the results of competition. Having received protection from
14 competition, a utility must perform as if subject to competition. It must provide its
15 customers the best possible benefit-cost ratio.
16 This standard also protects against unfairness to applicants. Suppose the
17 Commission, as a condition of approval, required all Washington Gas's customer care
18 representatives to be trilingual. This "merger benefit" obviously exceeds what the
19 Commission could impose under the public interest standard, because it exceeds what
20 would the company could accomplish if subject to the pressures of effective competition.
21 If the public interest standard protects the utility from extraction of excess benefits
22 (benefits exceeding what would occur in a competitive market), it must conversely

1 protect the consumer from insufficient benefits (benefits below what would occur in a
2 competitive market).

3 If alternative acquirers had to compete with each other, with the selection
4 criterion being not the price offered to the target's shareholders but the benefits offered to
5 the target's customers, the contestants would bid up the benefits offered, up to the point
6 that their benefit-cost ratio dropped below the ratio available from other investments.
7 That, of course, is not the route this transaction took. On this record, therefore, the
8 Commission cannot conclude that benefits offered by the Applicants are sufficient to be
9 in the "public interest."

10 **Q. In terms of sufficiency of benefits, does this transaction satisfy the public interest**
11 **standard?**
12
13 **A.** No. The clearest evidence is the contrast between what the Applicants get and what they
14 offer their customers. AltaGas is obtaining control of WGLH's profitable franchises.
15 WGLH's shareholders are getting an acquisition premium (as allocated to Washington
16 Gas's Maryland business) of somewhere between $257 million and $332 million (as
17 calculated by OPC Witness Ralph Smith). The two "gets" are guarantees to those two
18 entities. But Washington Gas's customers are guaranteed, at most, only $47 million—
19 less than one-fifth the lower measure of WGLH shareholder gain.[83] From the customer's

[83] That $47 million is the maximum number to use. The Commission would use that number if it accepted as accurate all of numbers stated in Mr. Reed's response to OPC 10-75. Other witnesses are questioning the accuracy of the numbers that make up Mr. Reed's total.

1 perspective, this transaction's the benefit-cost relationship does not serve the public
2 interest.

3 4 5 ***2. Washington Gas's capital expenditure plans do not require help from AltaGas***

6 7 8 **Q. Applicants assert that AltaGas can give financial support to Washington Gas. Is this a "benefit" the Commission should count?**

9 **A.** No. There is no evidence that Washington Gas needs financial support. The Proxy
10 Statement's narrative described the why and how of WGLH's search for an acquirer. It
11 nowhere mentions need for financing. None of the 14 Applicant witnesses say
12 Washington Gas needs financial help. Like any utility, Washington Gas has a capital
13 expenditure plan. And like any utility, its state commissions are legally obligated to set
14 rates sufficient to finance that plan. There is no evidence of Washington Gas's
15 dissatisfaction with its commissions. Asked if Washington Gas had "any reason to
16 expect that, assuming reasonable rate regulation by its state jurisdictions, it will be unable
17 to attract, at reasonable cost, the capital it needs to fulfill" its "increasing commitment to
18 investing in the growth and capabilities of its distribution operations across all three of
19 the jurisdictions it serves," Washington Gas's CEO, Adrian. Chapman, said no.[84]
20 Even if Washington Gas were unable to raise the funds on its own, nothing
21 prevents WGLH from selling some of its businesses to assist Washington Gas. This
22 acquisition, with its 39.1%, $1.27 billion acquisition premium, its subordination of
23 Washington Gas's management to Mr. O'Brien's "oversight," and its exposure of our
24 customers to all the risks described in Parts III.A.3 and III.A.4, is an awkward way to
25 solve a problem whose existence no one has identified.

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[84] Response to OPC 10-18.

1 Recall as well that AltaGas has made no legal commitment to inject equity into
2 Washington Gas.[85] And it is unclear whether Maryland statutes empower the
3 Commission to order AltaGas to do so, since AltaGas is not a "public service company."
4 AltaGas cannot have it both ways: arguing that its capital availability will be a major
5 benefit to Washington Gas, while insisting on the unrestricted ability to make that very
6 capital available for non-Maryland destinations. Unless there is an explicit guarantee that
7 AltaGas will inject equity into Washington Gas when the Commission requires, not when
8 AltaGas desires, the Applicants' assertion of financial benefit lacks both value and
9 enforceability.

10 Ms. Gutermuth testifies (Direct at 9) that without AltaGas, Washington Gas
11 "would not be in a position to commit to the level of investment described above for job
12 training and workforce development initiatives." The statement is not reconcilable with
13 the facts, or with how regulation works. The small amount of dollars involved, $1.4
14 million, is well within WGLH's multi-billion dollar capital structure. More to the point:
15 If these workforce activities are good ideas, Washington Gas should propose them, so the
16 commissions can set rates to support them.

17 ***3. The asserted "synergies" should not count because they are estimates,***
18 ***not commitments***
19
20 **Q. Should the Commission count AltaGas's aspirations of synergies as merger**
21 **benefits?**
22
23 **A.** Only if backed by a financial commitment. Savings that are "expected to occur" or that
24 "should occur" are only aspirations. A ratepayer cannot take them to the bank—unlike

[85] Ms. Lapson agrees that AltaGas has made no "binding commitment" to "raise money in the capital market to make investments in shares of Washington Gas." Response to OPC 10-55(a).

1 the WGLH shareholders, who can deposit their purchase price the day it arrives. Perhaps
2 non-committed benefits could count, if backed by specific metrics, a plan for achieving
3 those metrics, a list of individuals responsible for achieving them, and clarity about
4 consequences for the utility and those individuals if achievement does not occur. But
5 each of those factors is missing here.

6 Estimates of benefits, especially when not backed by commitments, are prone to
7 excess optimism. When one company is about to get control of a multi-billion dollar
8 monopoly franchise, a "foothold" in a region with a relatively solid economy and the
9 other company's shareholders are about to receive a 39.1% acquisition premium, who
10 wouldn't make claims optimistically--especially if was committing to the claims? As the
11 Kansas Corporation Commission has stated:

12 Although the Applicants may be in the best position of projecting what
13 synergies might be achieved through merger of their operations, they
14 obviously have every reason to present overly optimistic estimates of the
15 benefits of the merger.[86]
16
17 **Q. Besides the lack of commitments, are there are other problems with synergy claims?**
18
19 **A.** Yes. Synergies are often unquantifiable, and therefore incapable of tracking, proof and
20 accountability. As this Commission has stated:

21 [P]rojections of benefits through synergies, 'shared services' or 'best
22 practices' are inherently speculative and, to the extent they materialize,
23 will likely benefit ratepayers only as 'forgone requests for rate relief,'
24 which we have previously held to be too intangible to qualify as a benefit
25 under PUA sec. 6-105.[87]
26

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[86] *In the Matter of the Application of Kansas City Power & Light Company*, Docket Nos. 172,745-U et al., at p.59 (Nov. 15, 1991).

[87] *In the Matter of the Merger of Exelon Corporation and Constellation Energy Group*, Order No. 84698 (Feb. 17, 2012), 2012 Md. PSC LEXIS 12 at text accompanying note 356.

4. "Best practices" are not benefits from the merger if they are attainable without the merger

Q. AltaGas asserts it will introduce "best practices." Should the Commission treat this assertion as a merger benefit?

A. Not if the best practice could be achieved without a merger. As explained in Part III.B.4 above, when an acquirer improves the target's performance, this benefit arises not because two operations mesh, but because the acquirer substitutes higher quality practices for the target's lower quality practices. The benefit is attributable not to the merger but to an improvement within the target's capacity to do on its own.

"Best practices" are, by definition, practical, not imaginary. They are not some secret formula; they are available to the intelligent, engaged and entrepreneurial. And so they are available without the acquisition; they are not properly attributable to the acquisition. In a competitive market, a company has no choice but to use best practices. The same should go for a utility receiving protection from competition.

In any event, the Applicants have not specified a single practice within this catchall category. "Best practices" is a mantra; it is not evidence.

5. Size does not guarantee quality

Q. Address Applicants' argument that an advantage to Maryland is AltaGas's large size.

A. Like "best practices," this argument lacks evidentiary value. AltaGas offers no evidence on whether, or how, its size (or any utility's size) is causally related to performance.

It is likely that for a particular set of services, there is some size range within which cost-effective performance is more likely to occur, compared to sizes above and below that range. But AltaGas gives us no evidence about what that size range is, or how it relates to Washington Gas's specific circumstances. The Applicants could have offered

1 statistical studies to prove this point, but they did not. Lacking statistical studies,

2 AltaGas at least could have offered anecdotal evidence comparing small utilities like

3 Madison [Wisconsin] Gas & Electric with large utilities like Pacific Gas & Electric.

4 AltaGas could have compared the Washington Gas with larger utilities. AltaGas did

5 none of this. This reference to size is mere advertising—possibly true, possibly false, but

6 it is not evidence.

7

IV.
Conditions are necessary, but their enforceability is uncertain

Q. Explain the purpose of this Part IV.

A. I propose three conditions aimed at reducing the risk of harm, and one condition aimed at increasing the probability of compliance. I do not suggest that these conditions are sufficient to eliminate the risk of harm or to ensure compliance.

A. Reducing the risk of harm

1. Protect Washington Gas Light from AltaGas's business risks

> No member of the AltaGas corporate family shall acquire any interest in any business, where such interest exceeds a dollar level established by the Commission to eliminate the possibility of harm to Washington Gas, unless the Commission has determined that the acquisition and continued ownership of such interest will cause no harm to Washington Gas or increase the cost of the Commission oversight. The Commission will make such determinations using a procedure to be developed in a separate Commission rulemaking, before the completion of which AltaGas shall make no additional acquisitions. Such procedure may include a combination of safe harbors (no Commission review necessary), advance notice (after which the transaction may proceed unless the Commission determines that review is necessary), and express decisions granting or denying approval, all as necessary to distinguish, expeditiously, acquisitions that pose risks to consumers from those that do not.
>
> The Commission shall have access, in Maryland, to the books and records of any AltaGas affiliate whose business activities the Commission reasonably believes could affect WGLH's utilities adversely.

2. Prevent inappropriate movement of capital away from Washington Gas Light

> AltaGas shall maintain the elements of the Maryland utilities' capital structure within the ranges established by the Commission from time to time. Accordingly:
>
> a. AltaGas shall inject equity into the Washington Gas Light utilities consistent with Commission policies.
>
> b. Washington Gas Light utilities shall not pay dividends except to the extent consistent with the Commission policies.

c. Washington Gas Light utilities shall not incur debt except to the extent consistent with Commission policies.

d. Washington Gas Light utilities shall not provide financial support of any type to any AltaGas business venture, other than through the purchase of goods or services consistent with the Commission's rules in interaffiliate transactions.

3. Eliminate unearned advantages in potentially competitive markets

No AltaGas affiliate providing in Maryland a competitive or potentially competitive service (as defined by the Commission) may receive from any other AltaGas affiliate any form of support unless such support is consistent with Commission rules designed to ensure that no AltaGas affiliate has any unearned advantage in any market subject to the Commission's jurisdiction.

No AltaGas affiliate shall deny to any provider of gas service any service, or access to any facility, if the Commission determines that such service or access is necessary for such provider to compete effectively. The Commission shall ensure reasonable compensation to AltaGas or its affiliate for any such service or access.

B. Ensuring compliance

Prior to consummation of the acquisition, AltaGas shall demonstrate to the Commission's satisfaction that (a) AltaGas has instituted internal procedures, with consequences for violations, sufficient to prevent or detect all violations of these conditions; and (b) AltaGas employees face no incentives to violate these conditions.

Conclusion

Q. Provide your final comments.

A. My testimony is complex because this transaction is complex. The choice for the Commission is not. AltaGas wants to control Washington Gas to gain a "foothold" and a "platform"; WGLH wants to sell Washington Gas's public franchise for private gain. Nothing about this transaction benefits consumers; much about this transaction could

1 harm them. The Commission never asked for this transaction. There are no reasons to
2 approve it, and many reasons to reject it.

3 **Q. Does this conclude your Direct Testimony?**
4
5 **A.** Yes.

Exhibit SH-1: Resume of Scott Hempling

Scott Hempling, Attorney at Law

Scott Hempling is an attorney, expert witness and teacher. As an attorney, he has assisted clients from all industry sectors—regulators, utilities, consumer organizations, independent competitors and environmental organizations. As an expert witness, he has testified numerous times before state commissions and before committees of the United States Congress and the legislatures of Arkansas, California, Maryland, Minnesota, Nevada, North Carolina, South Carolina, Vermont, and Virginia. As a teacher and seminar presenter, he has taught public utility law and policy to a generation of regulators and practitioners, appearing throughout the United States and in Canada, Central America, Germany, India, Italy, Jamaica, Mexico, New Zealand, Nigeria and Peru.

The first volume of his legal treatise, *Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction*, was published by the American Bar Association in 2013. It has been described as a "comprehensive regulatory treatise [that] warrants comparison with Kahn and Phillips." The second volume will address the law of corporate structure, mergers and acquisitions. His book of essays, *Preside or Lead? The Attributes and Actions of Effective Regulators*, has been described as "matchless" and "timeless"; a Spanish translation will be widely circulated throughout Latin America, through the auspices of the Asociación Iberoamericana de Entidades Reguladoras de la Energía and REGULATEL (an association of telecommunications regulators from Europe and Latin America). The essays continue monthly at www.scotthemplinglaw.com.

His articles have appeared in the *Energy Bar Journal*, the *Electricity Journal*, *Energy Regulation Quarterly, Public Utilities Fortnightly*, *ElectricityPolicy.com*, publications of the American Bar Association, and other professional publications. These articles cover such topics as mergers and acquisitions, the introduction of competition into formerly monopolistic markets, corporate restructuring, ratemaking, utility investments in nonutility businesses, transmission planning, renewable energy and state–federal jurisdictional issues. From 2006 to 2011, he was the Executive Director of the National Regulatory Research Institute.

Hempling is an adjunct professor at the Georgetown University Law Center, where he teaches courses on public utility law and regulatory litigation. He received a B.A. *cum laude* in (1) Economics and Political Science and (2) Music from Yale University, where he was awarded a Continental Grain Fellowship and a Patterson research grant. He received a J.D. *magna cum laude* from Georgetown University Law Center, where he was the recipient of an *American Jurisprudence* award for Constitutional Law. Hempling is a member of the U.S. Department of Energy's Future Electric Utility Regulation Advisory Group. More detail is available at www.scotthemplinglaw.com.

Education

B.A. *cum laude*, Yale University (majors: Economics and Political Science, Music), 1978. Recipient of a Continental Grain Fellowship and a Patterson Research grant.

J.D. *magna cum laude*, Georgetown University Law Center, 1984. Recipient of *American Jurisprudence* award for Constitutional Law; editor of *Law and Policy in International Business*; instructor, legal research and writing.

Professional Experience

President, Scott Hempling, Attorney at Law LLC (2011–present)

Adjunct Professor, Georgetown University Law Center (2011–present)

Executive Director, National Regulatory Research Institute (2006–2011)

Founder and President, Law Offices of Scott Hempling, P.C. (1990–2006)

Attorney, Environmental Action Foundation (1987–1990)

Attorney, Spiegel and McDiarmid (1984–1987)

Past Clients

Independent Power Producers and Marketers

California Wind Energy Association, Cannon Power Company, Electric Power Supply Association, EnerTran Technology Company, National Independent Power Producers, SmartEnergy.com, U.S. Wind Force.

Investor-Owned Utilities

Madison Gas & Electric, Oklahoma Gas & Electric.

Legislative Bodies

Vermont Legislature, South Carolina Senate.

Municipalities and Counties

American Public Power Association; Connecticut Municipal Electric Energy Cooperative; Iowa Association of Municipal Utilities; City of Jacksonville, Florida; Montgomery County, Maryland; Texas Cities; City of Winter Park, Florida.

Public Interest Organizations

Alliance for Affordable Energy, American Association of Retired Persons, Consumer Federation of America, Energy Foundation, Environmental Action Foundation, GRID2.0 (Washington, D.C.), Illinois Citizens Utility Board, Union of Concerned Scientists.

Regulatory Commissions and Consumer Agencies

Arkansas Public Service Commission, Arizona Corporation Commission, British Columbia's Office of the Auditor General, Connecticut Department of Public Utility Control, Connecticut Office of Consumer Counsel, Delaware Public Service Commission, Hawaii Public Utilities Commission, State of Hawaii Office of Planning, Indiana Utility Regulatory Commission, Kansas Corporation Commission, State of Maryland, Maryland Energy Administration, Maryland Attorney General, Maryland Office of People's Counsel, Massachusetts Attorney General, Massachusetts Department of Public Utilities, Mexico's Comisión Reguladora de Energía, Minnesota Public Utilities Commission, Mississippi Public Service Commission, Mississippi Public Utilities Staff, Missouri Public Service Commission, Montana Public Service Commission, National Association of Regulatory Utility Commissioners, Nevada Consumer Advocate, Nevada Public Service Commission, New Hampshire Public Utilities Commission, New Jersey Division of Ratepayer Advocate, North Carolina Utilities Commission, Ohio Public Utilities Commission, Oklahoma Corporation Commission, Pennsylvania Office of Consumer Advocate, Puerto Rico Energy Commission, South Carolina Public Service Commission, Texas Office of Public Utility Counsel, Vermont Department of Public Service, Virginia State Corporation Commission, Wisconsin Attorney General.

Testimony Before Legislative Bodies

United States Senate

Committee on Energy and Natural Resources, May 2008 (addressing the adequacy of state and federal regulation of electric utility holding company structures).

Committee on Energy and Natural Resources, Feb. 2002 (analyzing bill to amend the Public Utility Holding Company Act) (PUHCA).

Committee on Energy and Natural Resources, May 1993 (analyzing bill to transfer PUHCA functions from SEC to FERC).

Committee on Banking and Urban Affairs, Sept. 1991 (analyzing proposed amendment to PUHCA).

Committee on Energy and Natural Resources, March 1991 (analyzing proposed amendment to PUHCA).

Committee on Energy and Natural Resources, Nov. 1989 (analyzing proposed amendment to PUHCA).

United States House of Representatives

Subcommittees on Energy and Power and Telecommunications and Finance, Commerce Committee, Oct. 1995 (regulation of public utility holding companies).

Subcommittee on Energy and Power, Energy and Commerce Committee, July 1994 (analyzing future of the electric industry).

Subcommittee on Energy and Power, Energy and Commerce Committee, May 1991 (analyzing proposed amendment to PUHCA).

Subcommittee on Environment, Energy and Natural Resources, Government Operations Committee, Oct. 1990 (assessing electric utility policies of FERC).

Appropriations Subcommittee on Commerce, Justice, State and the Judiciary, Apr. 1989 (discussing proposals to increase staff administering PUHCA).

Subcommittee on Energy and Power, Sept. 1988 (discussing "independent power producers" and PUHCA).

State Legislatures

Judiciary Committee, South Carolina Senate (2000) (discussing options for introducing retail electricity competition).

Commerce Committee, Arkansas General Assembly (1999) (discussing legislation to introduce retail electricity competition).

Health Access Oversight Committee, Vermont General Assembly (1999) (discussing options for state regulation of prescription drug pricing).

Electricity Restructuring Task Force, Virginia General Assembly (1999) (discussing options for introducing retail electricity competition).

Study Committee, North Carolina Legislature (1999) (discussing legislation to introduce retail electricity competition).

Committees on General Affairs, Finance, Vermont Senate (February-March 1997) (discussing options for structuring the electric industry).

Task Force to Study Retail Electric Competition, Maryland General Assembly (1997) (discussing options for introducing retail electricity competition).

Interim Committee on Electric Restructuring, Nevada Legislature (1995-97) (discussing options for structuring the electric industry).

Committee on Energy and Public Utilities, California Senate (December 1989) (discussing relationships between electric utilities and their non-regulated affiliates).

Testimony before Commissions, Courts and Arbitration Panels

Kansas Corporation Commission: Utility holding company acquisition of utility holding company (2016-2017).

U.S. District Court for Middle District of Florida: Effect of disaffiliation, mandated by the Public Utility Holding Company Act of 1935, on corporation's liability under the Comprehensive Environmental Response, Compensation, and Liability Act (2016).

New Jersey Board of Public Utilities: Transfer of utility transmission assets to holding company affiliate (2015-2016).

Hawaii Public Utilities Commission: Holding company acquisition of utility holding company (2015-2016).

Louisiana Public Service Commission: Holding company acquisition of utility holding company (2015).

Connecticut Public Utilities Regulatory Authority: Holding company acquisition of utility holding company (2015).

District of Columbia Public Service Commission: Holding company acquisition of utility holding company (2014-15).

Maryland Public Service Commission: Holding company acquisition of utility holding company (2014-15).

Mississippi Public Service Commission: Utility holding company's divestiture of its utility subsidiaries' transmission assets to an independent transmission company (2013).

U.S. District Court for Minnesota: Effects of Minnesota statute limiting reliance on fossil fuels (2013).

Tobacco Arbitration Panel: Principles for regulating cigarette manufacturers (on behalf of State of Maryland) (2012).

Illinois Commerce Commission: Performance-based ratemaking (2012).

Maryland Public Service Commission: Holding company acquisition of utility holding company (2011).

California Public Utilities Commission: Performance-based ratemaking (2011).

Superior Court of Justice, Ontario, Canada: Renewable energy contractual relations under the Public Utility Regulatory Policies Act (2007).

Florida arbitration panel: Financial responsibility for stranded investment arising from municipalization (2003).

Minnesota Public Utilities Commission: Transmission expansion for renewable power producers (2002).

U.S. District Court for Wisconsin: State corporate structure regulation in relation to the Commerce Clause of the U.S. Constitution (2002).

New Jersey Board of Public Utilities: Conditions for provider of last resort service (2001).

Indiana Utility Regulatory Commission: Risks of overcharging ratepayers using "fair value" rate base (2001).

North Carolina Utilities Commission: Effect of merger on state regulatory powers (2000).

Wisconsin Public Service Commission: Effect of merger on state regulatory powers (2000).

New Jersey Board of Public Utilities: Affiliate relations in telecommunications sector (1999).

Illinois Commerce Commission: Affiliate relations and mixing of utility and non-utility businesses (1998).

Texas Public Utilities Commission: "Incentive" ratemaking, introduction of competition (1996).

Vermont Public Service Board: Cost allocation and interaffiliate pricing between service company and utility affiliates (1990).

Publications

Books

Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction (American Bar Association 2013).

Preside or Lead? The Attributes and Actions of Effective Regulators (2d edition 2013).

Articles, Papers and Book Chapters

"Maryland's Supreme Court Loss: A Win for Consumers, Competition and States," *ElectricityPolicy.com* (June 2016).

"Certifying Regulatory Professionals: Why Not?", *ElectricityPolicy.com* (June 2015).

"Litigation Adversaries and Public Interest Partners: Practice Principles for New Regulatory Lawyers," *Energy Law Journal* (Spring 2015), available at http://www.felj.org/sites/default/files/docs/elj361/14-1-Hempling-Final-4.27.pdf.

"Pricing in Organized Wholesale Electricity Markets: Can We Make the Bright Line any Brighter?", *Infrastructure* (American Bar Association, Spring 2015).

"From Streetcars to Solar Panels: Stranded Investment Law and Policy in the United States," *Energy Regulation Quarterly* (Vol. 3, Issue 3 2015).

"Regulatory Capture: Sources and Solutions," *Emory Corporate Governance and Accountability Review* Vol. 1, Issue 1 (August 2014), available at http://law.emory.edu/ecgar/content/volume-1/issue-1/essays/regulatory-capture.html.

"When Technology Gives Customers Choices, What Happens to Traditional Monopolies?" *Trends* (American Bar Association, Section of Environment, Energy and Resources July/August 2014).

"Democratizing Demand and Diversifying Supply: Legal and Economic Principles for the Microgrid Era," *ElectricityPolicy.com* (March 2014).

"Non-Transmission Alternatives: FERC's 'Comparable Consideration' Needs Correction," *ElectricityPolicy.com* (June 2013).

"Broadband's Role in Smart Grid's Success," in Noam, Pupillo, and Kranz, *Broadband Networks, Smart Grids and Climate Change* (Springer 2013).

"How Order 1000's Regional Transmission Planning Can Accommodate State Policies and Planning," *ElectricityPolicy.com* (September 2012).

"Renewable Energy: Can States Influence Federal Power Act Prices Without Being Preempted?" *Energy and Natural Resources Market Regulation Committee Newsletter* (American Bar Association, June 2012).

"Can We Make Order 1000's Transmission Providers' Obligations Effective and Enforceable?" *ElectricityPolicy.com* (May 2012).

"Riders, Trackers, Surcharges, Pre-Approvals, and Decoupling: How Do They Affect the Cost of Equity?" *ElectricityPolicy.com* (March 2012).

"Regulatory Support for Renewable Energy and Carbon Reduction: Can We Resolve the Tensions Among Our Overlapping Policies and Roles?" (National Regulatory Research Institute 2011).

"Infrastructure, Market Structure, and Utility Performance: Is the Law of Regulation Ready?" (National Regulatory Research Institute 2011).

"Cost-Effective Demand Response Requires Coordinated State-Federal Actions" (National Regulatory Research Institute 2011).

"Effective Regulation: Do Today's Regulators Have What It Takes?" in Kaiser and Heggie, *Energy Law and Policy* (Carswell 2011).

Renewable Energy Prices in State-Level Feed-in Tariffs: Federal Law Constraints and Possible Solutions (lead author, with C. Elefant, K. Cory, and K. Porter), Technical Report NREL//TP-6A2-47408 (January 2010).

Pre-Approval Commitments: When And Under What Conditions Should Regulators Commit Ratepayer Dollars to Utility-Proposed Capital Projects? (National Regulatory Research Institute 2008) (with Scott Strauss).

"Joint Demonstration Projects: Options for Regulatory Treatment," *The Electricity Journal* (June 2008).

"Corporate Structure Events Involving Regulated Utilities: The Need for a Multidisciplinary, Multijurisdictional Approach," *The Electricity Journal* (Aug./Sept. 2006).

"Reassessing Retail Competition: A Chance to Modify the Mix" *The Electricity Journal* (Jan./Feb. 2002).

The Renewables Portfolio Standard: A Practical Guide (National Association of Regulatory Utility Commissioners, Feb. 2001 (with N. Rader).

Promoting Competitive Electricity Markets Through Community Purchasing: The Role of Municipal Aggregation (American Public Power Association, Jan. 2000 (with N. Rader).

"*Electric Utility Holding Companies: The New Regulatory Challenges*," Land Economics, Vol. 71, No. 3 (Aug. 1995).

Is Competition Here? An Evaluation of Defects in the Market for Generation (National Independent Energy Producers 1995) (co-author).

The Regulatory Treatment of Embedded Costs Exceeding Market Prices: Transition to a Competitive Electric Generation Market (1994) (with Ken Rose and Robert Burns).

"Depolarizing the Debate: Can Retail Wheeling Coexist with Integrated Resource Planning?" *The Electricity Journal* (Apr. 1994).

Reducing Ratepayer Risk: State Regulation of Electric Utility Expansion. (American Association of Retired Persons 1993).

"'Incentives' for Purchased Power: Compensation for Risk or Reward for Inefficiency?" *The Electricity Journal* (Sept. 1993).

"Making Competition Work," *The Electricity Journal* (June 1993).

"Confusing 'Competitors' With 'Competition.'" *Public Utilities Fortnightly* (March 15, 1991).

"The Retail Ratepayer's Stake in Wholesale Transmission Access," *Public Utilities Fortnightly* (July 19, 1990).

"Preserving Fair Competition: The Case for the Public Utility Holding Company Act," *The Electricity Journal* (Jan./Feb. 1990).

"Opportunity Cost Pricing." *Wheeling and Transmission Monthly* (Oct. 1989).

"Corporate Restructuring and Consumer Risk: Is the SEC Enforcing the Public Utility Holding Company Act?" *The Electricity Journal* (July 1988).

"The Legal Standard of 'Prudent Utility Practices' in the Context of Joint Construction Projects," *NRECA/APPA Newsletter Legal Reporting Service* (Dec. 1984/Jan. 1985) (co-author).

Speaker and Lecturer

United States: American Antitrust Institute; American Association of Retired Persons; American Bar Association; American Power Conference; American Public Power Association; American Wind Energy Association; Chicago Bar Association (Energy Section); Columbia University Institute for Tele-Information; Electric Cooperatives of South Carolina; Electric Power Research Institute; *Electric Utility Week;* Electricity Consumers Resource Council; Energy Bureau; *Energy Daily;* Executive Enterprises; Exnet; Federal Energy Bar Association; Harvard Electricity Policy Group; Infocast; King Abdullah Petroleum Studies and Research Center; Louisiana Energy Bar; Management Exchange; Maryland Resiliency Through Microgrids Task Force; MIT Energy Initiative; Mid-America Association of Regulatory Commissioners; MidAtlantic Demand Resources Initiative; Mid-Atlantic Conference of Regulatory Utility Commissioners; National Association of Regulatory Utility Commissioners; National Association of State Utility Consumer Advocates; National Conference of Regulatory Attorneys; National Governors Association; National Independent Energy Producers; New England Conference of Public Utility Commissioners; New England Public Power Association; New York Bar Association (Energy Section); North Carolina Electric Membership Corporation;

Pennsylvania Bar Institute; Puerto Rico Energy Center; Puerto Rico Institute of Public Policy; Regulatory Studies programs at Michigan State University, New Mexico State University and University of Idaho; Society of American Military Engineers; Society of Utility and Regulatory Financial Analysts; Southeastern Association of Regulatory Utility Commissioners; Universidad del Turabo (Puerto Rico); United Nations Association at Georgetown Law; U.S. Department of Energy Forum on Electricity Issues; U.S. Department of Energy Solar Energies Technology Office; U.S. Environmental Protection Agency; Wisconsin Public Utilities Institute; Wisconsin Bar-Public Utilities Section; Yale Alumni in Energy.

International: Australian Competition and Consumer Commission; Australian Energy Regulator; Canadian Association of Members of Utility Tribunals; Canadian Energy Law Forum; Central Electric Regulatory Commission (India); Comisión Reguladora de Energía (Mexico); Independent Power Producers Association of India; India Institute of Technology at Kanpur; Ludwig-Maximilians-Universitat (Munich, Germany); Management Development Institute (Gurgaon, India); National Association of Water Utility Regulators (Rome, Italy); New Zealand Electricity Authority; New Zealand Commerce Commission; Nigeria Electric Regulatory Commission; Office of Utility Regulation of Jamaica; OSIPTEL (the Peruvian Telecom Regulator) Training Program on Regulation for University Students; Petroleum and Natural Gas Regulatory Board (India); Regulatel (an international forum of telecommunications regulators); Regulatory Policy Institute (Cambridge, England); The Energy and Resources Institute (India); Utilities Regulatory Authority of Vanuatu; World Regulatory Forum.

Community Activities

Member, PEPCO Work Group, appointed by County Executive of Montgomery County, Maryland (2010–2011).

Sunday School teacher, Temple Emanuel, Kensington, Maryland (2002–2006, 2008).

Board of Trustees, Temple Emanuel (2005–2006).

Musical performer (cello), Riderwood Village Retirement Community (2003–present).

Exhibit SH-2: Data Responses

OPC 1-18(a), (b)

OPC 1-23

OPC 1-26

OPC 1-28(a)

OPC 1-30

OPC 1-31

OPC 10-5(c)

OPC 10-6(b)

OPC 10-8

OPC 10-15

OPC 10-17

OPC 10-18

OPC 10-20(f)

OPC 10-21(a)

OPC 10-22(d)

OPC 10-24(d), (e)

OPC 10-33(a), (h)

OPC 10-39(j)

OPC 10-42

OPC 10-51(b)

OPC 10-55(a)

OPC 10-75

OPC 13-17

Response of the Applicants
Maryland Public Service Commission – Case No. 9449
In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.

Discovery request submitted by: Office of People's Counsel

Discovery request set number: First Set

Response prepared by or under the direction of: Terry McCallister

Response date: June 23, 2017

OPC 1-18: Competing Bids. Confirm or deny, that prior to agreeing to a merger with AltaGas, WGL received competing bids from entities other than AltaGas that were seeking to acquire WGL. If confirmed, please explain:

a. the extent to which WGL considered the bidders' abilities to provide cost-effective service in comparing bids. Provide copies of all documents created by, or on behalf of, WGL relating in any way to your answer.

b. State Whether AltaGas's bid-per-share was the highest bid received.

c. If WGL did not receive competing offers from anyone other than AltaGas, explain why not.

Response: Please refer to the March 31, 2017 Proxy Statement relating to the Special Meeting of Shareholders of WGL Holdings, Inc. held on May 10, 2017, which can be accessed at the following link: http://www.wglholdings.com/secfiling.cfm?filingID=1193125-17-105134 . The background of the merger is described in detail at pages 29-41 of the Proxy, including other expressions of interest received by WGL Holdings, Inc.

a. WGL Holdings did not undertake such a consideration, for reasons explained in the March 31, 2017 Proxy Statement.

b. Yes.

c. See the introductory paragraph above.

Response of the Applicants
Maryland Public Service Commission – Case No. 9449
In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.

Discovery request submitted by: Office of People's Counsel

Discovery request set number: First Set

Response prepared by or under the direction of: David Harris and Terry McCallister

Response date: June 23, 2017

OPC 1-23: Board of Director Meeting Minutes. Provide copies of all Joint Applicants and affiliates Board of Director Meeting minutes in 2016 and 2017 that discuss the proposed merger.

Response:
AltaGas:
Attached are copies of the minutes of the meeting of the Board of Directors of AltaGas, Ltd. in 2016 and 2017 during which the proposed merger was addressed. See OPC 1-23_Attachment 01 (Confidential – Attorneys Eyes Only) through Attachment 12 (Confidential – Attorneys Eyes Only).

WGL:
See OPC 1-23_ Attachments 13 (Confidential – Attorneys Eyes Only) through OPC 1-23_Attachment 21 (Confidential – Attorneys Eyes Only) for meeting minutes WGL Holdings, Inc., Board of Directors meetings in 2016 and 2017 that discuss the proposed merger. Privileged information related to attorney-client communications and litigation strategy has been redacted.

Response of the Applicants
Maryland Public Service Commission – Case No. 9449
In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.

Discovery request submitted by: Office of People's Counsel

Discovery request set number: First Set

Response prepared by or under the direction of: David Harris

Response date: June 23, 2017

OPC 1-26: Board of Directors. Please identify the entity, person and mechanisms that will select the WGL and Washington Gas Boards of Directors in the event the proposed merger is consummated and provide all documents that discuss, analyze or address the selection process.

Response:

The AltaGas Board of Directors has considered certain privileged high-level governance documents, but there have otherwise been no documents prepared discussing or analyzing the post-merger WGL Holdings and Washington Gas Boards of Directors. The Boards will be selected by the respective company's shareholders.

Response of the Applicants
Maryland Public Service Commission – Case No. 9449
In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.

Discovery request submitted by: Office of People's Counsel

Discovery request set number: First Set

Response prepared by or under the direction of: David Harris

Response date: June 23, 2017

OPC 1-28: Board of Directors.

a. State whether WGL will maintain its current Board of Directors subsequent to the merger being consummated.

b. State the total number of directors on the WGL board (1) currently and (2) after the acquisition by AltaGas.

c. State the total number of independent directors (as defined by the NYSE) on the WGL board (1) currently and (2) after the acquisition by AltaGas.

d. Using the following definition of "disinterested director" (from the Code of Virginia) please state total number of disinterested directors (as defined by the NYSE) on the WGL board (1) currently and (2) after the acquisition by AltaGas. "Disinterested director" means a director who, at the time action is to be taken under § 13.1-871, 13.1-878, or 13.1-880, does not have (i) a financial interest in a matter that is the subject of such action or (ii) a familial, financial, professional, employment, or other relationship with a person who has a financial interest in the matter, either of which would reasonably be expected to affect adversely the objectivity of the director when participating in the action, and if the action is to be taken under § 13.1-878 or 13.1-880, is also not a party to the proceeding. The presence of one or more of the following circumstances shall not by itself prevent a person from being a disinterested director: (a) nomination or election of the director to the current board by any person, acting alone or participating with others, who is so interested in the matter or (b) service as a director of another corporation of which an interested person is also a director.

Response:

a. Following the Merger, WGL Holdings will no longer be a publicly-traded company and, as a consequence, its Board of Directors will be simplified from eight independent directors within the meaning of the listing standards of the New York Stock Exchange

(“NYSE”), to three members. Further particulars regarding Board composition have yet to be determined. For post-Merger composition of the Washington Gas Board of Directors, see Commitments 16 and 17 on page 5 of Appendix A to the Merger Application.

b. See subpart (a).

c. See subpart (a).

d. See subpart (a).

Response of the Applicants
Maryland Public Service Commission – Case No. 9449
In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.

Discovery request submitted by: Office of People's Counsel

Discovery request set number: First Set

Response prepared by or under the direction of: David Harris

Response date: June 23, 2017

OPC 1-30: Board of Directors. Refer to Appendix A, page 5 of 10. Admit that having the CEO of AltaGas and "four other members" serving on a nine-member WGL board will provide AltaGas with a majority of seats and effective control over major decisions affecting Washington Gas:

> 16. Washington Gas will have a board of directors consisting of nine members, including: (a) the CEO of Washington Gas; (b) the CEO of AltaGas; (c) three independent members, including if mutually agreeable up to three of the independent board members of WGL; and (d) four other members. Any successors to the legacy-WGL board members will either (1) be Independent Directors, or (2) be former directors or officers of Washington Gas or WGL. The Washington Gas and AltaGas CEOs may nominate successors to their respective positions on the Washington Gas board, each of whom shall be a member of the executive team of Washington Gas or AltaGas, respectively.
>
> (Emphasis supplied.)

If your response is anything other than an unqualified admission, explain fully and provide a copy of the analysis and documents relied upon.

Response:

AltaGas agrees that the CEO of AltaGas, together with the four other members will comprise a majority of Washington Gas' Board of Directors, post-Merger. AltaGas agrees that the proposed post-Merger composition of the Washington Gas Board of Directors will effectuate AltaGas's control over Washington Gas.

Response of the Applicants
Maryland Public Service Commission – Case No. 9449
In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.

Discovery request submitted by: Office of People's Counsel

Discovery request set number: First Set

Response prepared by or under the direction of: David Harris

Response date: June 23, 2017

OPC 1-31: Board of Directors. Refer to Appendix A, page 5 of 10. Admit that the following provision does not guarantee that any member of WGL's board (other than the AltaGas CEO per commitment 16) will actually serve on the AltaGas board of directors:

> 17. At least one current member of the WGL board of directors will be recommended by AltaGas for nomination to the AltaGas board of directors. Following that individual's term(s) on the AltaGas board of directors, AltaGas will use all reasonable efforts to nominate at least one member of the Washington Gas board of directors to the AltaGas board of directors. At least two current members of the WGL board of directors will be recommended for nomination to the AUHUS board of directors.

If your response is anything other than an unqualified admission, explain fully and provide a copy of the analysis and documents relied upon.

Response:

Commitment 17 does not guarantee that any particular member of WGL's pre-Merger Board of Directors will serve on AltaGas' post-Merger Board of Directors, however, it does guarantee that at least one current member of WGL's Board will be recommended for nomination to the AltaGas Board.

Response of the Applicants
Maryland Public Service Commission – Case No. 9449
In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.

Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: John Reed

Response date: July 21, 2017

OPC 10-5: App. 16: "... AltaGas commits that customers of Washington Gas will be held harmless for a period of five years from adverse rate impacts due to an increase in Washington Gas's cost of debt that is caused by the Merger with AltaGas, or the ongoing affiliation with AltaGas and its affiliates after the Merger, except to the extent that such adverse rate impact has been mitigated by positive changes in any other cost of capital elements."

a. Do your agree that the referenced "adverse rate impacts" are "harm," independently of positive changes in other cost of capital elements?

b. (a) Does this statement mean that AltaGas is reserving the right, from Year 6 into eternity, of asking this Commission to approve net harm to ratepayers arising from its affiliation with Washington Gas? (b) If the answer is "no," explain in detail. (c) If the answer is "yes," please explain how this response is consistent with the statute's prohibition against "harm," and identify all witnesses who agree that it is consistent with the statutory standard for the Commission to approve an acquirer who proposes harm starting in Year 6.

c. Please identify all possible "adverse rate impacts" that could result from the affiliation.

d. Please identify all possible "positive changes in any other cost of capital element" that could result from the affiliation.

e. Under this proposal, which party would have the burden of proof, and the burden of going forward, on the question of adverse rate impacts?

   Under this proposal, which party would have the burden of proof, and the burden of going forward, on the question of positive changes in any other cost of capital elements?

f. Do you agree that under this proposal, the appropriate policy is for the adverse impacts to be rebuttably presumed, with the burden of proving no adverse impacts resting on AltaGas and/or WGL and/or Washington Gas; as opposed to the burden

of proving adverse impacts being on the Commission, its staff , OPC and/or intervenors? Please explain your response

g. Do you agree that under this proposal, it is appropriate for AltaGas to compensate the Commission and intervenors for all reasonable costs associated with ensuring compliance with this commitment? Please explain your response

Response:

a. No. Adverse rate impacts would be harmful if they were not mitigated, or if customers were not otherwise held harmless from rate impacts. In this case, the hold harmless merger commitments are designed specifically to insulate customers from any such harm.

b. No. As stated in the Merger Commitments, AltaGas recognizes that the Commission's authority will remain in effect, and that it has jurisdiction to ensure that rates are just and reasonable. After the five-year term contemplated in the Merger Commitments ends, the Commission will still be able to request any documentation from the Company pertaining to revenue requirements or the cost of capital such that it can determine the appropriate rates to apply. We assume the Commission will only include costs that are reasonable in reaching just and reasonable rates. Moreover, Commission rate-making requirements will continue to apply.

c. All known adverse rate impacts have been addressed by the Merger Commitments.

d. Examples of potential positive cost of capital elements that the Joint Petitioners envision may offset increased debt costs include:
1. Reduced common equity ratio for ratemaking purposes;
2. Lower authorized return on equity;
3. Issuing a different class of debt (e.g., secured vs. unsecured, shorter maturity, etc.); and
4. Issuing preferred stock in place of common stock

e. The merger should have no effect on the Commission's policy with regard to burden of proof and burden of going forward in regulatory proceedings. We expect the Commission to apply the same standards of evidence and burden of proof that it would in any other similar proceeding involving other regulated entities.

f. No. During the five-year period during which the hold harmless commitments apply, the Companies accept that there is an affirmative obligation to provide documentation regarding any adverse impacts and mitigating factors. The

Commission will determine whether the Joint Applicants have complied with that affirmative obligation.

g. This is a public policy issue that differs in implementation from one state to the next. This merger should not have an impact on how funding for the Commission and for intervenors is handled in Maryland.

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Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: John O'Brien

Response date: July 21, 2017

OPC 10-6: App. at 6: "Washington Gas's Chief Executive Officer will continue to have the same authority as under the current Washington Gas authorized approval levels."

a. What period of time is covered by the phrase "will continue"?

b. Does this sentence embody a commitment that AltaGas (either through its executives or its Board) will make no change in Washington Gas's CEO's authority without permission from the Maryland Public Service Commission?

c. If the answer to the immediately preceding question is anything other than an unqualified "yes," revise the sentence to make it accurate and explain why the Application contained a inaccurate statement.

Response:

a. The language in Commitment 18 is not intended to have a time period restriction.
b. Yes.
c. See the response to subpart (b).

Response of the Applicants
Maryland Public Service Commission – Case No. 9449
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Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: John O'Brien

Response date: July 21, 2017

OPC 10-8: Regarding Merger Agreement Section 4.1(b)(xvii) ("Line of Business. The Company shall not, and shall not permit any of its subsidiaries to, enter into any new line of business."):

a. What purpose does this provision serve?

b. Do you agree that this provision was required by AltaGas because it views "any new line of business" as involving a risk that it has not accounted for in determining the desirability of acquiring WGL at the negotiated price? Please explain your response

Response:

a. The referenced provision is a standard provision in merger agreements. The purpose is as stated: the company shall not permit any of its subsidiaries to enter into any new line of business while the merger is pending.
b. The referenced provision is a standard provision in merger agreements.

Response of the Applicants
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Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: David Harris

Response date: July 21, 2017

OPC 10-15: Does AltaGas anticipate making any more acquisitions after this one?

Response: AltaGas has no other planned acquisitions.

Response of the Applicants
Maryland Public Service Commission – Case No. 9449
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Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: David Harris and John O'Brien

Response date: July 21, 2017

OPC 10-21: Harris 19: "[T]he business of WGL in combination with our existing U.S. business establishes a significant foothold in areas with growth potential."

a. Define "foothold."

b. Define "significant."

c. Define "areas."

d. Define "growth potential," and indentify the subject of any growth.

e. Do you agree thatthis "foothold" gained by owning another state-regulated utility, all else equal, will give AltaGas an advantage over competitors that do not own a state-regulated utility? Please explain your response

f. Do you agree that this "foothold" would be less "significant" if WGL's main asset was not a government-regulated utility? Please explain your response

Response:

a. "Foothold" is defined by Merriam-Webster as: "a position usable as a base for further advance."
b. "Significant" is defined by Merriam-Webster as: "having meaning."
c. "Areas" is defined by Merriam-Webster as: "the scope of a concept, operation, or activity."
d. "Growth potential" means the potential for growth. See the Direct Testimony of John O'Brien at pages 9-11 ("Opportunities for Post-Merger Growth of U.S. Businesses").
e. No, AltaGas's growth potential does not impede the growth potential of any other company, nor does AltaGas's ownership of another state-regulated utility provide a competitive advantage relative to competitors that do not own a state-regulated utility. Rather, there are practical advantages to having more extensive U.S. business operations where, as discussed in the Direct Testimony of David Harris at pages 6-7, the merger partners have similar business lines, skill sets, and social values. That similarity is a substantial factor in the Applicants' conclusion that the Merger will "strategically position

Response of the Applicants
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Discovery request submitted by: Office of Peoples Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: Adrian Chapman

Response date: July 21, 2017

OPC 10-17: Regarding Washington Gas's right to serve as a provider of gas distribution service in Maryland:

a. Explain whether this right is an exclusive right, and provide the basis for your answer.

b. When did Washington Gas (or its corporate predecessor) receive this right?

c. What body of government granted this right?

d. What payment was Washington Gas (or its corporate predecessor) required to provide to any government entity to acquire this right, to what body was the payment made and when was the payment made?

e. Under what circumstances can this right be revoked, by whom and subject to what compensation?

Response:

a. Please see the response to OPC 10-7 and attachments thereto.

b. Please see the response to OPC 10-7 and attachments thereto.

c. Please see the response to OPC 10-7 and attachments thereto.

d. Except for potential application fees or the posting of bonds and deposits with various county and municipal franchisors, Washington Gas did not provide payment to any government entity to acquire its right to provide gas distribution service in Maryland. Washington Gas does not have a record of potential application fees paid to county or municipal franchisors. Bond and deposit instruments are described in the attachments to OPC 10-7.

e. Please see the response to OPC 10-7 and attachments thereto.

Response of the Applicants
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Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: Adrian Chapman

Response date: July 21, 2017

OPC 10-18: Chapman 9: "[T]he Company has an increasing commitment to investing in the growth and capabilities of its distribution operations across all three of the jurisdictions it serves."

a. Does WGL have any reason to expect that, assuming reasonable rate regulation by its state jurisdictions, it will be unable to attract, at reasonable cost, the capital it needs to fulfill this "increasing commitment"?

b. Provide all facts and supporting documents indicating that WGL had, prior to be contacted by AltaGas any concerns about its ability to attract, at reasonable cost, the capital it needs to fulfill this "increasing commitment."

Response:

a. No.
b. Mr. Chapman does not testify that "WGL had prior to be (SIC) contacted by AltaGas any concerns about its ability to attract, at reasonable cost, the capital it needs to fulfill this "increasing commitment.""

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Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: David Harris and Colleen Starring

Response date: July 21, 2017

OPC 10-20: Harris 19: "I am confident that the Merger will strengthen Washington Gas and its continued ability to provide safe and reliable service to its customers."

a. (a) Why do you call this transaction a "merger" when it is an acquisition? Is the reason that someone inside one or both transacting parties recommended that using "merger" would downplay the legal and practical reality that AltaGas is the dominant entity acquiring a subordinate entity? (b) Whose decision was it to use the term "merger" throughout the Application and witness testimony?

b. In what precise ways does Washington Gas need to be "strengthened"?

c. Regarding the term "confident": Provide all the reasons why you used the term "confident" rather than "hopeful."

d. Please explain whether your current compensation formula is based on any factors connected to "strengthening" Washington Gas.

e. Provide all evidence that AltaGas's ownership of other gas utilities has "strengthened" them in ways they could not have accomplished on their own.

f. Given that you are "confident," state whether you agree or disagree with a condition on transaction approval that requires a change to your compensation formula such that your compensation depends entirely on whether such strengthening occurs. Explain in detail. If you disagree, offer an alternative change to your compensation formula that includes some weighting for the strengthening of which you are confident.

Response:

a. The Applicants describe this transaction as a "merger" because it fits within the common use of the word. For example, Merriam-Webster defines "merger" as the "absorption by a

corporation of one or more others; also: any of various methods of combining two or more organizations (such as business concerns)."

b. The referenced testimony does not say that Washington Gas is in "need" of strengthening, however, AltaGas looks forward to working with Washington Gas to share best practices and identify opportunities to further improve Washington Gas's operations. The Merger will also strengthen Washington Gas's access to capital to fund planned and future investments in utility infrastructure to ensure safe, reliable and affordable service to Washington Gas's customers.
c. The term was used because Mr. Harris is confident that the Merger will strengthen Washington Gas.
d. See the response to OPC 2-55.
e. See the Direct Testimony of Colleen Starring at pages 4-11.
f. AltaGas is not aware of any state or federal utility commission ever finding that such a condition was necessary or appropriate, nor of any utility having in place such a mechanism, voluntarily or involuntarily.

Response of the Applicants
Maryland Public Service Commission – Case No. 9449
In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.

Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: David Harris and John O'Brien

Response date: July 21, 2017

OPC 10-21: Harris 19: "[T]he business of WGL in combination with our existing U.S. business establishes a significant foothold in areas with growth potential."

a. Define "foothold."

b. Define "significant."

c. Define "areas."

d. Define "growth potential," and indentify the subject of any growth.

e. Do you agree thatthis "foothold" gained by owning another state-regulated utility, all else equal, will give AltaGas an advantage over competitors that do not own a state-regulated utility? Please explain your response

f. Do you agree that this "foothold" would be less "significant" if WGL's main asset was not a government-regulated utility? Please explain your response

Response:

a. "Foothold" is defined by Merriam-Webster as: "a position usable as a base for further advance."
b. "Significant" is defined by Merriam-Webster as: "having meaning."
c. "Areas" is defined by Merriam-Webster as: "the scope of a concept, operation, or activity."
d. "Growth potential" means the potential for growth. See the Direct Testimony of John O'Brien at pages 9-11 ("Opportunities for Post-Merger Growth of U.S. Businesses").
e. No, AltaGas's growth potential does not impede the growth potential of any other company, nor does AltaGas's ownership of another state-regulated utility provide a competitive advantage relative to competitors that do not own a state-regulated utility. Rather, there are practical advantages to having more extensive U.S. business operations where, as discussed in the Direct Testimony of David Harris at pages 6-7, the merger partners have similar business lines, skill sets, and social values. That similarity is a substantial factor in the Applicants' conclusion that the Merger will "strategically position

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Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: David Harris

Response date: July 21, 2017

OPC 10-22: Harris 2: "[T]he Merger will help both companies to successfully grow to meet the future clean energy demands of our customers."

a. Given that Washington Gas has a defined service territory whose product and geographic boundaries are fixed by law, define "grow" as used in this sentence.

b. Identify all current obstacles to Washington Gas's ability to "grow," and how this acquisition brings solutions to those obstacles for which solutions are not presently available to Washington Gas. For purposes of this question, assume Washington Gas's sole responsibility is to provide cost-effective gas service within its franchised territories.

c. Do you agree that WGL's goal in this transaction was to get more value for its shareholders? Please identify where the desire to "grow" is set forth in the WGL Proxy Statement or in WGL's strategy documents leading up to the signing of the Merger Agreement.

d. Do you agree that, since WGL shareholders are being bought out, they have no interest in WGL's "growth" post-acquisition? Please explain your response

Response:

a. "Grow" in the context of this sentence relates to AltaGas and WGL Holdings. "Grow" is defined by Merriam-Webster to mean "increase; expand." In this context, it can include serving more customers, and offering more innovative customer-benefitting products and services.
b. The referenced testimony does not contend that there are obstacles to Washington Gas's ability to grow.
c. AltaGas is not in a position to assume what WGL Holdings' goal was with respect to this transaction. However, as discussed in the Direct Testimony of David Harris at page 8, "AltaGas understands the importance that this transaction not only delivers benefits to

customers and ensures that Washington Gas continues to be a strong, successful local natural gas distribution company after the Merger, but also assures stakeholders, including regulators, that those benefits will be accomplished. In fact, these were central topics of discussion from my first meeting with Terry McCallister, the Chairman of the Board and Chief Executive Officer of WGL and Washington Gas."

d. AltaGas agrees that post-Merger, WGL Holdings' current shareholders will have no economic interest in WGL unless they invest in AltaGas.

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In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.

Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: David Harris, Shaun Toivanen, William Ford

Response date: July 21, 2017

OPC 10-24: Harris 6: "While AltaGas is already a strong and substantially U.S. oriented company, we believe that WGL and the Greater Washington, D.C. metropolitan area will be the U.S. platform from which the combined company will drive our future growth." Harris 10: "The Merger provides a broader platform ... to continue to expand the combined company's gas distribution portfolio...."

a. Describe AltaGas's goals for future acquisitions. The description should address: frequency of acquisitions, type of targets, size of transactions, and location of acquisition targets.

b. Is AltaGas insisting that this Commission's approval contain no condition that limits, or requires Commission approval of, AltaGas's future acquisitions, regardless of their frequency, size, type of target, or method of financing?

c. If the answer to the immediately preceding question is anything other than an unqualified "yes," describe with precision the types of Commission conditions regarding future acquisitions that (a) AltaGas would tolerate; or (b) if imposed, would cause AltaGas to withdraw from this transaction.

d. Identify the percentage of WGL's total revenues that Washington Gas contributed in 2016. Provide the source of this information.

e. Identify the percentage of AltaGas's total revenues that Washington Gas would have contributed in 2016 had Washington Gas been owned by AltaGas. Provide the source of this information.

f. AltaGas "expects to continue investing in attractive high growth jurisdictions and is focused on achieving a balanced mix of energy infrastructure assets over the medium to long term." Application, App. B (AltaGas 2016 Annual Report) at 11.

(1) Will AltaGas commit to limit its future acquisitions such that the percentage of AltaGas's total revenues that Washington Gas will contribute does not fall below some minimum percentage?

(2) Does AltaGas insist on having no limit on how small a role Washington Gas plays in AltaGas's total revenue picture?

Response:

a. AltaGas has no other planned acquisitions. AltaGas will evaluate any future M&A opportunities on a case by case basis as they arise. See also the Direct Testimony of John O'Brien at pages 9-11 ("Opportunities for Post-Merger Growth of U.S. Businesses").

b. The Applicants have not proposed such a condition. See also the response to OPC 10-16.

c. See the response to subpart (b). AltaGas firmly believes that the Application, as submitted, meets the statutory test for merger approval. If the Commission determined that additional conditions were required, AltaGas would need to evaluate the specific terms of the Commission's order, in its entirety, in order to determine whether to accept those terms and close the Merger.

d. Washington Gas contributed 47.31% of WGL Holdings, Inc.'s total operating revenues in calendar year 2016. Source: WGL Holdings, Inc, Form 10-K for the Fiscal Year Ending September 30, 2016 and WGL Holdings, Inc Form 10-Q for the Quarter Ended December 31, 2016.

e. Assuming the acquisition of WGL Holdings had been completed Washington Gas would have contributed 28% of total AltaGas Revenue in 2016. This was sourced by taking the 2016 annualized revenue numbers from both company's financial reports and converted at the Bank of Canada annual average exchange rate in 2016.

f. (1) See response to OPC 10-16. There is no such limit applicable to WGL Holdings or any parent company of or investor in any Maryland utility company. Moreover, AltaGas has a demonstrated history of operating its companies safely, reliably, and prudently. As explained in the Direct Testimony of David Harris at page 5: "AltaGas also employs disciplined financing and maintains a focus on risk management. AltaGas's businesses are underpinned by highly contracted earnings, predictable and stable cash flows, and low risk assets. For example, in 2016, approximately 77% of AltaGas's earnings were generated from regulated utilities and contracted power."

(2) There is no such limit applicable to WGL Holdings or any parent company of or investor in any Maryland utility company. AltaGas' strategy is to execute opportunities created by the renaissance of natural gas in North America and the increasing global demand for clean energy by owning and operating a diversified mix of assets in gas, power and utilities.

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Maryland Public Service Commission – Case No. 9449
In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.

Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: David Harris

Response date: July 21, 2017

OPC 10-33: Harris: Regarding the risk to Washington Gas and its customers of future acquisitions by AltaGas:

a. For how long after acquiring WGL will you commit to wait before seeking AltaGas's next acquisition?

b. Is it true that after making an acquisition of a regulated utility, the acquirer must "digest" such acquisition before attempting another one?

c. After making an acquisition, to what extent is it necessary or desirable to defer additional acquisitions until the most recent one is digested?

d. With respect to the attractiveness and risks associated with potential acquisition targets, what is the importance of, and how will AltaGas take into account, the following factors (each of which the response should define, as AltaGas understands the term): (To see these terms in context, see AltaGas's response to MD OPC 1-22 Attachment 01 p.pdf 4/13.)

i. split between regulated and non-regulated

ii. whether target's non-regulated activities are far afield from the regulated activities, in terms of type of business

iii split between electricity and gas

iv. incremental leverage capacity

v. organic growth

Response of the Applicants
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Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: David Harris

Response date: July 21, 2017

OPC 10-39: Harris: In determining whether the purchase price was affordable and appropriate, describe what role each of the following possible factors played and what weighting or dollar value AltaGas assigned to them:

a. the opportunity to earn equity-level returns on WGL equity financed with AltaGas's lower-cost debt

b. the expectation that AltaGas will earn a return from its investment in WGL that exceeds AltaGas's internal required return

c. the expectation that Washington Gas's actual returns on equity will exceed its commission-authorized returns, over some period of time

d. the expectation that Washington Gas will retain some of the merger-related cost reductions due to regulatory lag or regulatory error

e. the expectation that AltaGas can use Washington Gas's low-risk profitability to raise debt capital at lower cost

f. the expectation that Washington Gas's executives can offer advice or services that will make AltaGas's other affiliates more profitable

g. the expectation that Washington Gas's employees can offer advice or services that will make AltaGas's other affiliates more profitable

h. the expectation that Washington Gas's presence in the Washington, D.C. area will give the post-acquisition company a competitive advantage in pursuing unregulated business opportunities

i. the expectation that Washington Gas will have opportunities to rate-base new investments in its infrastructure

j. other factors

Response: AltaGas considered a number of factors to determine whether to pursue a merger with WGL Holdings and to determine a reasonable price to offer WGL Holdings' shareholders for the purchase of their shares. Please see the documents produced in response to Staff 1-72 for analyses in this respect. Additionally, please see the Direct Testimony of David Harris at pages 6-7. Most of the specific factors listed in the request appear to be based on incorrect assumptions, in which case AltaGas did not consider these factors. AltaGas did consider the factors identified in subparts (i) and (j), however it is not feasible to assign a specific portion of the dollar value of the final offer price to any one factor.

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Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: David Harris

Response date: July 21, 2017

OPC 10-42: Harris: Do you agree that one reason why WGL is attractive to AltaGas is that Washington Gas has a large backlog of capital expenditure projects, which when rate-based will be source of relatively low-risk profit for AltaGas?

Response: AltaGas does not agree that Washington Gas has a large "backlog" of capital expenditure projects. To the extent the request is asking whether AltaGas took into consideration Washington Gas's projected returns on investments in its distribution infrastructure, then yes, AltaGas considered that factor.

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Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: Ellen Lapson

Response date: July 21, 2017

OPC 10-51: Lapson 4: "... [A]s a result of the post-merger corporate structure, Washington Gas will be more insulated from exposure to WGL's non-utility businesses than the current status."

a. Do you agree that regarding the referenced features of the "post-merger corporate structure," WGL and Washington Gas could have instituted such features themselves without AltaGas's acquisition--either voluntarily or under Commission order? Please explain your response.

b. Has WGL's and Washington Gas's failure to institute such features put Washington Gas's ratepayers at any risk?

Response:

a. Ms. Lapson agrees that WGL Holdings could voluntarily institute ring-fencing structures without the proposed merger with AltaGas. With regard to "under Commission order", Ms. Lapson has no knowledge or opinion as to the authority of the Commission to order WGL Holdings to implement a change in its corporate structure to insulate the utility from WGL Holdings.

b. In preparing her testimony, Ms. Lapson did not study or reach an opinion as to whether the lack of such features has caused Washington Gas' customers to bear any risk.

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In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.

Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: Ellen Lapson

Response date: July 21, 2017

OPC 10-55: Lapson 6: WGL "can look to AltaGas to raise money in the capital market to make investments in shares of Washington Gas."

a. Do you agree AltaGas has made no binding commitment to do so? If not, please explain your response.

b. Do you agree WGL has no power to make AltaGas do so? If not, please explain your response.

c. Do you agree the Commission has no power to make AltaGas do so? If not, please explain your response.

Response:
a. Ms. Lapson agrees that no such commitment has been made. Please see the response to OPC 10-49a.

b. Ms. Lapson is not aware whether as a legal issue WGL Holdings can "make AltaGas do so." Her quoted statement, however, was with reference to the practical realities of how AltaGas would be able to support WGL Holdings versus WGL Holdings standing alone.

c. Ms. Lapson does not have any detailed knowledge of the Maryland utility code and therefore has no opinion.

Response of the Applicants
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Discovery request submitted by: Office of People's Counsel

Discovery request set number: Tenth Set

Response prepared by or under the direction of: John Reed

Response date: July 21, 2017

OPC 10-75: Reed 11: The transaction provides "long-lasting protection against any adverse consequences for Washington Gas customers...."

a. Do you agree that the description of the "protection" as "long-lasting" is not accurate because the Application limits the offer of protection against adverse effects on capital costs to five years? If not, please explain your response.

b. Do you agree the protection should last as long as AltaGas's indirect ownership of Washington Gas lasts? If not, please explain your response

Response:

a. No. As noted at the end of Commitment 38 "Nothing in this condition will restrict the Commission from disallowing such capital cost increases from recovery in Washington Gas's rates, including after the period during which Washington Gas must provide supporting documentation." All of the remedies available to the Commission to protect customers during the five-year period will also be available to it after the five-year period.

b. No. Mr. Reed believe that the five-year commitment is reasonable. Mr. Reed also believe that the Commission's responsibility for determining what are reasonable costs when establishing WGL's revenue requirement is not limited to five years.

vi. bolt-on growth opportunities

vii. ages of the top 5 executives

viii. likelihood of future rate base growth

ix. bond ratings

x. location

xi. target management's receptivity (and here, explain why such receptivity would matter if the target's board has a fiduciary obligation to maximize shareholder wealth)

e. When choosing acquisition targets, is one attractive feature a target's geographic proximity to other possible acquisition targets? If so, why? If not, why not?

f. (a) After acquiring WGL, is it possible that AltaGas would seek to sell a minority stake in either WGL or Washington Gas, so as to create more funds with which to acquire additional utilities? (b) Has AltaGas ever considered such a strategy? (c) If the Commission, as a condition on the pending acquisition, were to prohibit or impose limits on such action, would AltaGas withdraw its proposal?

g. Why is "growth" so important to AltaGas? Why is it not desirable to remain at its current size, paying dividends from stable businesses to its shareholders?

h. Does Mr. Harris have a view about the size at which AltaGas will have experienced too much growth? Or is his view that there is no theoretical limit on the growth that AltaGas can experience?

i. Do you agree that in determining whether WGL and other utilities or utility holding companies are attractive acquisition targets, an important factor for AltaGas is whether the acquisition will improve AltaGas's business risk profile and financial risk profile? Please explain your response.

j. Do you agree that AltaGas finds it attractive to own companies that have a monopoly over services that are essential to customers' lives?

k. Do you agree that in all the internal materials provided in discovery by AltaGas regarding acquisition strategy, there is not a single reference to improving customers' well-being as a reason for considering an acquisition> If not, please identify such reference(s).

l. Does AltaGas expect future acquisitions to occur through bilateral negotiations, or rather through auction processes? Explain.

m. In considering future acquisitions, including the acquisition of WGL, what is the meaning and relevance of the phrase "unlocking uncapitalized balanced sheet value"?

n. In considering future acquisitions, what does the term "dry powder" refer to, in the context of evaluating bond ratings and utility balance sheets?

o. Does a low-interest rate environment make it more attractive for AltaGas to buy utilities and utility holding companies like Washington Gas and WGL?

p. Is one of the reasons acquiring WGL and other utilities is attractive is the ability to earn equity-level returns on equity purchased with lower-cost debt?

Response:

a. While AltaGas is committed to the successful integration of the AltaGas and WGL corporate families, AltaGas will continue to evaluate potential M&A opportunities on a case by case basis as they arise. Therefore, AltaGas is not prepared to make such a commitment.

b. Whether a potential acquisition is appropriate in any given circumstance will depend on a multitude of factors. The specific factual circumstances would have to be considered in any given case.

c. See subpart b. above.

d. The factors evaluated and the weight attributed to those factors will depend on the specific factual circumstances under consideration.

e. Whether geographic proximity to other potential acquisition targets would be an attractive feature would depend on the specific factual circumstances under consideration.

f. (a) AltaGas has no plans to sell a minority stake in either WGL Holdings or Washington Gas.

(b) No.

(c) Such a condition is not necessary given the statutory requirements related to change-of-control. If the Commission determined that such a condition was required, AltaGas would need to evaluate the specific terms of the Commission's order, in its entirety in order to determine the appropriate course of action.

g,h. AltaGas's vision is to be a leading North American diversified energy infrastructure company. Please refer to AltaGas's 2016 Annual Report page 6-7 for AltaGas's vision and objective, and AltaGas's strategy.

i. In determining business investment decisions, AltaGas focuses on assets underpinned by contracts with strong counterparties and regulated assets, both of which provide stable returns and long–life cash flows. Integral to AltaGas's strategy is financial discipline and effective risk management, to achieve a balanced mix of energy infrastructure assets in the gas, power and utility segments over the medium to long term. Adhering to these fundamental elements allow AltaGas to achieve a well-balanced business portfolio and financial strength.

j. See response to i) above, as well as direct testimony of Mr. David M. Harris, page 10 line 3 to 13.

k. AltaGas disagrees with the statement. See AltaGas's 2016 Annual Report (pages 6-7, AltaGas' vision and objective; AltaGas strategy). AltaGas's number one core value is to operate in a safe and reliable manner. Superior service, safety and reliability are integral to AltaGas's customer value proposition. In addition, the merger commitments that have been proposed are tailored to provide meaningful assistance to customers and local communities, improving customers' well-being.

l. AltaGas will evaluate any future M&A opportunities on a case by case basis as they arise.

m. This term was used by JP Morgan in a presentation to AltaGas. This is not a defined financial term, and as a result, AltaGas cannot speak for JP Morgan as to precisely what they meant by such a term.

n. See response to part m) above.

o. The interest rate environment is one factor that AltaGas considers in assessing whether and how to engage in M&A activity.

p. AltaGas pursues mergers, acquisitions and other investments in low risk, long life energy assets, focusing on regulated assets and on assets underpinned by contracts with strong counterparties, both of which provide stable utility like returns and long life cash flows. AltaGas already has a substantial gas utilities business, and has established a reputation of operating top performing, high-quality natural gas utilities that enjoy high customer satisfaction ratings, all while ensuring safety for its customers, its employees and the environment.

the combined company for [the] future, creating new opportunities to deliver customer-benefitting infrastructure and technologies and improve workforce development."

f. See response to 10-21(e).

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the combined company for [the] future, creating new opportunities to deliver customer-benefitting infrastructure and technologies and improve workforce development."

f. See response to 10-21(e).

Response of the Applicants
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In the Matter of the Merger of AltaGas Ltd. and WGL Holdings, Inc.

Discovery request submitted by: Office of People's Counsel

Discovery request set number: Thirteenth Set

Response prepared by or under the direction of: Shaun Toivanen

Response date: August 1, 2017

OPC 13-17: What is the expected interest cost rates of any (1) long-term debt and (2) short-term debt expected to be used in the acquisition of WGL?

Response: AltaGas expects interest rates for debt issued in relation to the acquisition of WGL Holdings to be a function of the market rates at the time of issuance.