DISSENTING OPINION OF CHAIRMAN W. KEVIN HUGHES

For the reasons stated below, I respectfully dissent from the Commission's Order approving the merger of AltaGas Ltd. and WGL Holdings, Inc. and Washington Gas Light Company. Maryland law and Commission precedent state that this acquisition must affirmatively answer the following question: is the transaction structured not to harm the utility's ratepayers?[1] In my view, the proposed merger fails to meet the statutory "no harm" standard and therefore, should be denied. The merger approved by the majority also fails to provide adequate benefits to existing Washington Gas customers and should be denied on that basis as well.

I. THE MERGER PRESENTS A SIGNIFICANT RISK OF HARM TO WASHINGTON GAS AND ITS CUSTOMERS

A. WGL and Washington Gas are Larger and Financially Stronger than AltaGas

Washington Gas has been referred to in these proceedings as a "homegrown utility," and for good reason.[2] It was chartered by Congress in 1848 and began providing gas service to the nation's capital before the invention of telephones or automobiles, or the residential use of electricity.[3] It is a financially healthy company. It boasts strong credit ratings and earnings prospects, and remains WGL's largest asset and most

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[1] CEF/EDF, 100 Md. P.S.C. at 363. (note for record: CEG/EDF; *In the Matter of the Application of the Merger of FirstEnergy Corp. and Allegheny Energy, Inc.*, 102 Md. P.S.C. 11 (2011) ("FE/Allegheny").
[2] B. Oliver Direct at 10.
[3] In contrast, the majority of the 570,000 customers served by AltaGas' regulated affiliates result from a 2012 acquisition of SEMCO, which has approximately 300,000 customers. Harris Direct at 3; Staring Direct at 1.

substantial source of earnings.[4] Its parent company, WGL Holdings' stock price has more than doubled from $40.03 on March 3, 2014 to $82.38 on March 1, 2018.[5]

Washington Gas is a strong and battle-tested utility. It has over 1.1 million customers, about two times the customer base of the combined regulated utilities presently owned by AltaGas. And it has 13,582 miles of transmission and distribution piping in its service territory.[6] WGL testified that its financial strength will allow it to meet its existing capital requirements as a regulated gas utility in Maryland, and continue with its five-year plan for unregulated expansion absent the merger with AltaGas.

By comparison, the record demonstrates that AltaGas does not share the financial strengths of WGL and Washington Gas. The Office of People's Counsel, Commission's Technical Staff, and AOBA have all raised serious concerns regarding AltaGas' financial condition. Here are several high-level indicators of those concerns:

- In each of the past five fiscal years, AltaGas has reached well beyond its reported net earnings per share to pay its dividends – a concerning practice that AltaGas expects to continue post-merger,[7] and one fairly characterized as non-traditional for utilities.[8]

- That trend has accelerated, with an increasing dividend payout ratio from 2013 to 2016 (99% to 207%).[9]

- Because AltaGas has repeatedly paid out more in dividends than it has earned, AltaGas has zero Accumulated Retained Earnings.[10]

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[4] B. Oliver Direct at 10 and 11.
[5] See Yahoo Finance Quotes (viewed March 31, 2018): https://finance.yahoo.com/quote/WGL/history?p=WGL
[6] Chapman Direct at 4. In Maryland, Washington Gas has 468,793 customers and 6,089 miles of piping. *Id.*
[7] OPC Exhibit 1; AOBA Reply Brief at 4.
[8] AltaGas' financial approach of using a cash-flow metric for measuring dividend payouts is inconsistent with traditional regulatory and investment analyses for utilities and reflects AltaGas' primarily non-utility orientation. B. Oliver Surrebuttal at 11-12. That approach is a stark contrast to that of WGL Holdings, which has been more measured over time. B. Oliver Direct at 12-14.
[9] OPC Initial Brief at 14.
[10] OPC Initial Brief at 11; Arndt Surrebuttal at 9; See also AOBA Initial Brief at 5.

- AltaGas has a substantial accumulated deficit that is trending upward: $600.4 million from December 12, 2016 to $828.5 million as of September 30, 2017 – a 38% increase over only 9 months.[11]

- AltaGas' has a markedly lower credit rating – at least two notches – compared to each WGL and Washington Gas,[12] which risks an increase in the cost of debt and is a broad indication of the financial strength of the company, including the ability to raise capital.

- AltaGas' stock price has declined sharply in recent years: a 42% drop from $42.26 on March 3, 2014 to $24.35 on March 1, 2018.[13]

AOBA and other parties note that the actions necessary to finance AltaGas' acquisition of WGL will further weaken the company's finances.[14] The large acquisition premium[15] that benefits WGL shareholders has left AltaGas heavily leveraged,[16] as demonstrated by AltaGas funding the acquisition through non-traditional means such as subscription receipts and temporary bridge loans.[17] Furthermore, while the merger approved by the majority adds over $57 million in additional benefits as compared to the original application, these added commitments will result in additional financial strains on the company.

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[11] Arndt Post-Settlement Testimony at 4.
[12] Witness Lapson Rebuttal at Exhibit EL-07 provides the following specific credit ratings. S&P rated AltaGas at BBB (with "Outlook Negative"), while WGL and Washington Gas were rated at "A". Fitch rated AltaGas as BBB, while WGL was rated at "A-" and Washington Gas was rated at "A". Moody's rated WGL as A3 and Washington Gas as A1 but did not rate AltaGas.
[13] OPC Post-Settlement Brief at 5. See Yahoo Finance Quotes (viewed March 31, 2018): https://finance.yahoo.com/quote/ALA.TO/history?p=ALA.TO
[14] Oliver Post-Settlement Testimony at 41.
[15] The acquisition premium is the premium paid by AltaGas to WGL over the market price of WGL's publicly traded stock. OPC witness Arndt calculates the total acquisition premium to be $1.27 billion of which $846.9 million is related to Washington Gas' share and $332 million is related to Maryland's share of Washington Gas. OPC Exhibit 18. (Arndt Surrebuttal) at 24, lines 16-21.
[16] Staff Initial Brief at 15.
[17] OPC reflected that AltaGas must offer a "virtually risk-free investment with an above-average interest rate" to attract capital. OPC Initial Brief at 31.

B. The Acquisition of WGL by AltaGas Imposes Impermissible Financial Risks to Washington Gas Customers

While no merger is without risk,[18] in contrast to previous mergers, this Application presents a significant risk of harm to Washington Gas and its consumers in contravention of the requirements of PUA § 6-105.[19] These harms have not been mitigated by the proposed partial settlement agreement ("Settlement Agreement") or through the majority's merger conditions.

First, the credit rating of WGL and Washington Gas will likely *drop* at least one, and perhaps two notches as a result of this merger.[20] The Joint Applicants acknowledge as much;[21] however, they insist that credit rating agencies had already projected a decline in WGL's credit rating due to its financing of large scale capital projects.[22] On that point, the record evidence is persuasive that the credit rating of the combined post-merger company would be *lower* than would be the credit rating of WGL alone absent the merger with AltaGas. Furthermore, the potential for slight harm absent the merger does not in any way minimize, let alone negate, the more likely potential for greater harm post-merger.

Second, as discussed at length during these proceedings, credit rating agencies expressed particular concern about the impact of the proposed merger on WGL.

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[18] FE/Allegheny, 102 Md. P.S.C. at 35; Exelon, 106 Md. P.S.C. at 123.

[19] The initial Application did not include the added risk of harm to existing Washington Gas customers associated with stranded "gas expansion" efforts proposed in the Settlement and included in the majority's Order.

[20] In a post-merger environment, analysts project that WGL's and WG's respective credit ratings would decrease from A- to BBB+ and A to A-, respectively. See Joint Applicants Reply Brief at 37.

[21] "Given that AltaGas has lower issuer credit ratings relative to the ratings of WGL and Washington Gas, the merger would likely cause all three credit rating agencies to reduce the ratings of WGL and Washington Gas in order to narrow the gap." Lapson Direct at 15.

[22] The decline was characterized by the Joint Applicants as a negative outlook by two of the three ratings agencies. See Lapson Direct at 11. However, the certainty of this decline is called into doubt, as Ms. Lapson testified that a negative outlook is "a mild statement by the credit rating agencies that does not mean that there is some particular action that is going to take place." T. 976 (Lapson).

Moody's and S&P stated that:

> Although AltaGas intends to use a mix of asset sales, additional equity, and incremental debt for the long-term financing of the transaction, we expect WGL, particularly its principal operating utility, Washington Gas, will be heavily relied upon to service the increased level of debt via upstream dividend payments as WGL will account for about 50% of a pro-forma consolidated AltaGas's financial results.[23]
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> The negative rating outlook on Washington Gas and WGL reflects the prospect for as much as a *four-notch downgrade* of the issuer credit rating on WGL to "BBB" if the company is acquired by AltaGas (italics added).[24]

The adverse assessment of the risks associated with WGL's post-merger cost of debt is only amplified by the rating agencies' commentary ascribing an increased level of debt via upstream dividend payments from WGL to AltaGas.[25] These risks and potential harms are easily foreseeable: given AltaGas' current financial condition, it is reasonable to expect that AltaGas will use WGL's profits to finance its operations and future acquisitions at the expense of Washington Gas' own needs and its customers.[26]

C. The Partial Settlement Agreement and Majority's Conditions Do Not Mitigate Risks of Harm

Although some of the risks of harm to Washington Gas customers caused by the acquisition are impossible to mitigate, it is clear that the settlement and the majority's conditions do not mitigate all harms. To start, no settling party – MEA, Montgomery County or Prince George's County – affirmatively indicated that the potential financial

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[23] Staff Initial Brief at 12.
[24] *Id*.
[25] Implementation of AltaGas' growth plan will likely involve tapping WG's profits to support AltaGas 8-10 percent dividend growth through 2021. Staff Initial Brief at 14.
[26] Staff Initial Brief at 15.

harms recognized during the Commission's hearings, were eliminated or mitigated by the conditions included in the Settlement Agreement.[27]

Further, although the ring fencing provision (Condition 37) is indeed a strong "platinum standard" provision that mitigates some harm after the point at which a bankruptcy would occur, it does not prevent harm that comes pre-bankruptcy. Those pre-bankruptcy harms include continued declines in earnings per share and stock prices, possible dividend cuts, reductions in capital and maintenance expenditures for Washington Gas, repeated rate increases, and declines in customer service.[28]

Similarly, Condition 41 does not eliminate or mitigate the harm to Washington Gas customers from adverse rate impacts due to increases in the company's cost of debt caused by the merger, despite my colleagues' strong assertions to the contrary. The amended condition requires that Washington Gas "shall demonstrate" that its customers are held harmless. Although that revised condition attempts to put the burden on Washington Gas to show that the cost of debt is the same as it otherwise would have been, the condition simply places the company and other stakeholders in the position of trying to prove hypotheticals about what would have happened absent the merger, which neither party can actually demonstrate. Thus, under the revised condition, the Commission may have to approve a cost of debt change because other stakeholders could not prove a negative.[29] To avoid this frustrating setup and the protracted litigation that

[27] For example, see Tr. 3028-3030 (Bannerman). Maryland law and Commission case law note that benefits and harms are *not* to be balanced against each other. See Exelon/CEG, 103 Md. P.S.C. at 45.

[28] Arndt Direct at 17.

[29] AOBA Witness Oliver testified on this specific point, "[I]f you're not sure what the outcomes will be, and if you can't predict with reasonable certainty how the Commission will make those determinations in the future, if you don't know what the peer group comparison will include, what companies, and how they'll be constructed and what the result, have a reasonable understanding of that result, then it's not an effective clause." Tr. 3074-3075 (B. Oliver).

will surely accompany it, the majority should have – at a minimum – required that cost of debt should be calculated based on Washington Gas' current bond rating.[30]

Lastly, the Settlement Agreement and majority Order should have set a higher minimum equity ratio, namely at 50 percent, to protect Washington Gas customers from financial harm. Staff Witness Lubow's testimony was quite clear that a 50 percent equity ratio floor is generally consistent with utilities holding "A" ratings, while a 48 percent equity ratio floor could result in a further downgrade to BBB+, that is, three to four notches lower than where Washington Gas was approximately one year ago."[31] Unfortunately, the majority failed to implement this simple safeguard as a condition, instead settling for a 48 percent floor.

D. The Compositions of the Governing Boards of AltaGas Do Not Adequately Represent the Interests of Washington Gas Customers

The Settlement and majority Order fail to address another notable concern raised by parties at the Commission's hearing; namely, that the compositions of AltaGas' influential governing boards do not mitigate potential and clearly foreseeable harms. The AltaGas Board of Directors and AltaGas Utility Holdings (U.S.) Inc. (AUHUS) Board of Directors - the Boards that will determine critical capital allocations to Washington Gas - will both have severely inadequate representation to protect the interests of Washington Gas customers. Despite representing about 50 percent of AltaGas' financial strength,

[30] Similarly, Condition 38, which in part requires the companies to report if AltaGas, WGL, or Washington Gas are downgraded by credit rating agencies and describe how Washington Gas intends to restore its credit ratings to investment grade in a "targeted timeframe," does not mitigate the harm of such a credit rating drop. The condition contains no specific timeframe for restoring Washington Gas' credit rating to investment grade and no enforcement mechanism to protect ratepayers if the companies fail to achieve this objective.

[31] Staff Post-Settlement Brief at 6.

WGL will have only one representative on AltaGas Board of Directors, and even that is not guaranteed.[32] Similarly, despite representing over 70% of AUHUS financial strength, Washington Gas will only have minority representation on the AUHUS Board of Directors.[33]

Because Washington Gas representatives are disproportionately outnumbered on both boards, the proposed governance structure fails to protect against one of the merger's foreseeable harms – that AltaGas will use Washington Gas' profits to finance other AltaGas activities to the detriment of Washington Gas customers. The majority Order points to Condition 16, which provides that the Washington Gas Board will have a majority of independent directors. Although that provision is an improvement from the original filing, it does nothing to mitigate the potential harm inflicted on Washington Gas customers by a growth-focused parent company like AltaGas.

In conclusion, WGL is a financially strong company with solid credit ratings and stable earnings. Despite short-term commitments to alleviate potential harms, a less fiscally resilient parent company could reduce funding available to Washington Gas for matters like infrastructure maintenance and asset replacement, and could ultimately increase the company's cost of service due to higher borrowing costs. Through their Application and the record in this proceeding, the Joint Applicants are asking this Commission to accept a parent company for Washington Gas that is financially less strong than its current parent, and without any evidence that Washington Gas is in financial distress or requires the merger in order to maintain quality of service, safety or

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[32] AOBA Post-Settlement Brief at 38. See Merger Condition 17.

[33] *Id.* Importantly, Washington Gas alone will be roughly equal in size to AltaGas' non-utility operations but have no direct representation on the AltaGas Board and only one WGL Holdings representative.

reliability. Because PUA § 6-105 requires the Commission to ensure that ratepayers are protected against "*any* increased risks of harm from this merger,"[34] and because the conditions included in the majority Order do not eliminate these risks, the acquisition of WGL by AltaGas should be denied.

II. THE MERGER PROVIDES INADEQUATE BENEFITS TO EXISTING WASHINGTON GAS CUSTOMERS

A. Washington Gas Will Not Receive Significant Operational Benefits from AltaGas and its Utilities

In recent merger cases, the Commission has placed great importance on the operational benefits that a new parent company can offer to a Maryland utility and its customers. In the case of the Exelon–Constellation and Exelon-Pepco Holdings, Inc. mergers, the Commission focused on improving reliability performance with better cost control, leveraging greater economies of scale through synergy savings, and enabling the pooling of resources to restore service to customers more quickly following major storms.[35] Also important was the sharing of "best practices" among distribution companies to increase day-to-day operational efficiencies and effectiveness. In approving these mergers, the Commission acknowledged the benefits of having a parent company "nationally recognized for its standards of excellence."[36]

Throughout our proceedings, AltaGas certainly has demonstrated that its largest utility SEMCO is a well run company. Nevertheless, it is a much smaller utility than

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[34] Exelon/CEG, 103 Md. P.S.C. at 45. (emphasis in original.)
[35] See *In the Matter of the Merger of Exelon Corporation and Constellation Energy Group, Inc.*, 103 MD PSC 22 (2012), Order No. 84698, Case No. 9271 ("Exelon/CEG"); *In the Matter of the Merger of Exelon Corporation and Pepco Holdings, Inc*., 106 MD PSC 95 (2015), Order No. 86990, Case No. 9361 ("Exelon/Pepco"); Exelon/Pepco, Order No. 86990 at 1-3.
[36] Order No. 86990 at 2-3.

Washington Gas, with approximately one-third the customer base. SEMCO is a largely rural utility located in Michigan[37] and because of its geographic separation, does not lend itself to the same mutual assistance and operational efficiency benefits that have aided Baltimore Gas & Electric, Pepco and Delmarva.[38] Moreover, AltaGas only acquired SEMCO in 2012 and as a parent company, does not have a track record in operating a large regulated urban utility in the United States. This is in stark contrast to the Exelon/PHI merger, in which Exelon had a demonstrated history of successfully operating large, urban, East Coast utilities.

While there is a great deal that Washington Gas can offer AltaGas utilities in terms of experience, operational excellence and best practices, there is less that AltaGas can offer Washington Gas in return. Certainly, AltaGas and its utilities possess operational strengths, but Washington Gas possesses those same strengths in abundance. And while AltaGas President and CEO Harris points to AltaGas' experience working in cold weather conditions in Alaska and Canada,[39] that is of limited value in the eastern Mid-Atlantic region where Washington Gas operates. Similarly, while SEMCO has experience with accelerated gas pipeline replacements, Washington Gas is in the fifth year of its own expansive and successful STRIDE pipeline replacement program. To summarize, the reliability, best practices, operational efficiencies and mutual assistance benefits that were so important in the Exelon-BGE and Exelon-PHI mergers, are not nearly as meaningful in this proposed merger.

[37] AltaGas' other U.S. gas utility, ENSTAR, is small with approximately 143,000 customers and located in Alaska.
[38] While Condition 44 requires AltaGas to credit Maryland customers not less than $800,000 per year in merger-related savings for 5 years, Staff witness Welchlin concludes that over half of these projected savings, including those related to functional alignment and contract services, are "accounting maneuver[s]," "unlikely to occur" or "largely speculative" (Staff Initial Brief at 17).
[39] Tr. at 195 (Witness Harris response to question from Commissioner Herman).

Finally, the importance of WGL maintaining a robust and well funded cybersecurity program cannot be overstated. Like other Maryland utilities, Washington Gas is on the front lines of the escalating war against cybersecurity threats. The Commission should insist that any parent company seeking to acquire a major utility like Washington Gas demonstrate that it is a national leader (or in the case of a foreign company, an international leader) in developing and implementing cybersecurity programs. While AltaGas should be commended for the steps it has taken on cybersecurity, it has not demonstrated, in the record of this case at least, that it is such a leader in the energy and utility sectors.[40] In fact, Condition 50, which was never discussed in our hearings, acknowledges some concerns in this area. The majority takes the step of prohibiting AltaGas from integrating its IT systems with Washington Gas until AltaGas "*achieves* an aggregate cybersecurity capability maturity comparable to or greater than Washington Gas" (emphasis added). Who determines if this condition has actually been met is unclear. Regardless, cybersecurity programs should be a benefit a parent company brings to a merger.

B. Direct Benefits to Existing Washington Gas Customers are Meager and Inadequate

PUA § 6-105(g)(3)(i) requires the Commission to determine whether the proposed merger "is consistent with the public interest, convenience, and necessity, including benefits and no harm to consumers". While the merger presents a significant risk of harm to Washington Gas customers and should be rejected on that basis, it also does not provide adequate and commensurate benefits to existing customers and fails this

[40] Tr. at 150-152 (exchange between Chairman Hughes and Witness Harris).

requirement of the § 6-105(g) test as well. The Commission has previously held that "benefits" must be "certain, measurable and incremental benefits to ratepayers."[41] This means that benefits must accrue to existing ratepayers, not residents or businesses that might become ratepayers sometime in the future. And certainly it does not include residents or businesses that live or are located outside a utility's service territory.

Under the merger conditions approved by the majority, Washington Gas customers will receive a one-time $50 rate credit totaling $30.5 million.[42] In comparison, the approved merger requires $22.88 million to go to Montgomery and Prince George's Counties for clean energy initiatives and $30.32 million to MEA for a Gas Expansion Fund.[43] Thus, of the $83.7 million in financial benefits, only $30.5 million, or 36 percent, is going directly to Washington Gas customers. This allocation is woefully inadequate in terms of direct customer benefits.

To be certain, some existing customers will receive benefits from the programs offered by Montgomery and Prince George's counties. The $30.26 million Gas Expansion Fund, however, and AltaGas' commitment to spend up to $70 million in additional ratepayer funds on gas expansion projects,[44] will go to future customers and not to existing ones who should benefit from this merger. [45] Furthermore, existing

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[41] Exelon/CEG, 103 MD PSC at 45.
[42] While the Settlement Agreement reduced the rate credit to $21.7 million, the majority restored $8.8 million in credits for C&I customers and reduced funding going to the Settling Parties by $2.65 million for Prince George's County, $2.87 million for Montgomery County, and the entire $4.6 million for MEA to spend on existing C&I customers primarily in Southern Maryland. (See merger Condition 2 and Settling Parties Condition 2).
[43] The majority also reduced the amount going to MEA for gas expansion from $33 million under the Settling Parties agreement to $30.32 million. (See merger Condition 7).
[44] See Condition 10A.
[45] Condition 7 requires a majority of the $30.32 million in the Gas Expansion Fund be spent in the Washington Gas service territory. This means up to $15 million may be spent to benefit the customers of other gas utilities throughout Maryland.

customers will bear the risk of pipeline expansion projects that may result in stranded assets because of changing energy policies.[46] They may also bear the risk of uneconomic gas expansion projects resulting from AltaGas' $70 million expansion commitment, if the Commission approves the tariff changes suggested in Condition 10A.

Opposition to including $100 million in gas expansion conditions in the merger have been raised in public comments to the Commission by legislators, alternative energy suppliers and environmental groups.[47] The majority concludes that gas expansion is in the "public interest" citing "economic growth" and "improved environmental impact," but does not address the serious concerns raised by these stakeholders to the contrary. For instance, the majority disregards concerns raised by propane gas dealers that Maryland small businesses are financially harmed when the State subsidizes a competitor through natural gas expansion. Further, the majority recognizes that environmental groups oppose gas expansion as "contrary to the State's policy on greenhouse gas reduction and its commitment to clean energy," but states those concerns were raised outside the record and cannot be addressed. Given that the gas expansion proposal was made late in the proceedings, and after the close of the Commission's initial evidentiary hearings, the majority should have considered and addressed these environmental concerns in the context of the public interest test in PUA § 6-105(g).

The acquisition of WGL by AltaGas comes at a time when Washington Gas customers are facing the substantial burden of paying for the company's gas pipeline

[46] See Tr. at 2943-2946 (discussion between Chairman Hughes and MEA Director Tung)
[47] See letters in the public correspondence file for CN 9449 from Senator Thomas Mac Middleton, Sierra Club, Chesapeake Climate Action Network (and others), Ellen Valentino (Mid-Atlantic Petroleum Dealers Association and Mid-Atlantic Propane Gas Association), Michael Abercrombie (Cato) Michael Boulden (Boulden Brothers Propane), Burch Oil Company, J. Blacklock Wills (Wills Group), Frank Taylor (Taylor Gas Co.) and others.

replacement program, a multi-decade initiative called STRIDE. The General Assembly authorized STRIDE in 2013 to incentivize gas companies to replace aging and deteriorating cast iron and bare steel mains and services on an accelerated timeframe. STRIDE is not only important for public safety reasons, it also dramatically reduces methane emissions from leaking pipes and services that contribute to climate change.

In describing Washington Gas' expected request to authorize a second five-year STRIDE program, Company witness Chapman noted that the upcoming filing is "going to be larger than the initial first five-year filing as far as overall magnitude."[48] Washington Gas' first STRIDE program cost approximately $200 million over five years.[49] If approved, Washington Gas customers will bear these substantial infrastructure costs for decades to come. The Settling Parties could have partially mitigated future rate increases by requiring AltaGas to make a significant contribution (e.g., at a minimum, the $83.7 million cited above) to Washington Gas' future STRIDE initiatives. In my view, that would have been a direct benefit in keeping with PUA § 6-105(g) and in the best interest of existing customers.

W. Kevin Hughes
Chairman

[48] Tr. 2651 (Chapman).
[49] Case No. 9335, WGL STRIDE Application, November 7, 2013 (ML # 150543).