IN RE: Petition of PPL Corporation, PPL Rhode Island Holdings, LLC, National Grid USA, and The Narragansett Electric Company for Authority to Transfer Ownership of The Narragansett Electric Company to PPL Rhode Island Holdings, LLC and Related Approvals

Docket No. D-21-09

SURREBUTTAL TESTIMONY OF
MATTHEW I. KAHAL

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

DECEMBER 9, 2021
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SURREBUTTAL TESTIMONY OF MATTHEW I. KAHAL

I. OVERVIEW AND SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.
A. My name is Matthew I. Kahal. I am employed as an independent consultant retained in this matter by the Advocacy Section of the Division of Public Utilities and Carriers (“Division Advocacy Section”). My business address is 1108 Pheasant Xing, Charlottesville, VA 22901.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS DOCKET?
A. Yes. I submitted direct testimony filed on November 3, 2021 on behalf of the Division Advocacy Section addressing financial policy/cost of capital issues associated with the proposed acquisition of Narragansett Electric Company (“Narragansett” or “the Company”) from National Grid USA by PPL Corporation (“PPL”), referred to in my testimony as the “Transaction.”

Q. WHAT WERE THE MAIN CONCLUSIONS AND RECOMMENDATIONS SET FORTH IN YOUR DIRECT TESTIMONY?

1 Direct Testimony of Matthew I. Kahal (“Kahal Direct Test.”).
A. My direct testimony recognizes the Rhode Island’s standard for approving a change of ownership and control of a utility is that the change must be shown to be “consistent with the public interest,” which also means an expectation of no net harm to utility customers.² My testimony notes that utility mergers, unlike mergers among unregulated companies, inevitably impose merger-related risks on utility customers, rather than those risks being absorbed by shareholders.³ This is because the utility being acquired is regulated on a cost of service basis, which means that if the merger results in higher costs, there is a substantial risk that such costs will be passed on to customers through the ratemaking process rather than being absorbed by shareholders. Thus, if a merger is to meet the “no net harm” public interest standard, there must be a showing that the post-acquisition risks for customers, both in terms of the cost and quality of service, are convincingly addressed and mitigated. Often, this requires protective approval conditions and commitments to the regulator by the prospective new owner.

In my direct testimony, I find that the proposed Transaction fails to meet Rhode Island’s “no net harm” to customers and “consistent with the public interest” standards.⁴ This is due to the absence of protective conditions and commitments, both in the filed Petition and data responses, and as set forth in the testimony of other Division Advocacy Section witnesses. Those witnesses explain the concerns and customer risks resulting from the loss of scale economies and synergies that Narragansett enjoys today through its affiliation with National Grid USA. The testimony of the Division

² Kahal Direct Test. at 6:7-9.
³ This observation sets aside the critical public interest and antitrust issue for unregulated mergers of potential impairment to competition and market function. That issue does not arise in the context of this proposed Transaction.
⁴ Kahal Direct Test. at 11:19-12:3.
Advocacy Section witnesses also raises concerns regarding potential adverse impacts on Narragansett customers resulting from transition costs. I therefore recommend in my direct testimony that the Division deny approval of the proposed Transaction.

In the event, however, that the Division is inclined to approve the Transaction, my direct testimony recommends that an approval be accompanied by several conditions addressing issues of financial policy. These include enforceable conditions to: (1) implement a set of “ring fencing” measures to protect Narragansett’s financial integrity and prevent affiliate abuse; (2) address on a prompt basis liquidity and short-term debt needs; (3) exclude goodwill from Narragansett’s ratemaking capital structure; (4) maintain a minimum common equity ratio of 48 percent (calculated on a regulatory basis) for at least five years post-closing; and (5) issue future Narragansett long-term debt in the form of secured debt if determined to be feasible, practicable and cost effective. Unfortunately, most of these very straight-forward commitments were either absent from the Petition or explicitly rejected by PPL.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. On November 23, 2021, the Petitioners submitted the Pre-Filed Rebuttal Testimony of Tadd Henninger, Vice President – Finance and Treasurer of PPL Corporation. His testimony discusses Narragansett’s planned financial policies under PPL ownership and responds to my proposed approval conditions. Mr. Henninger appears to commit PPL to a set of ring-fencing measures similar (though not identical) to much of what I recommend. In addition, he states that Narragansett will participate in a new PPL Credit Facility that can serve as a source for short-term debt. He further states that

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5 Id. at 12:3-13:8.

6 Rebuttal Testimony of Tadd Henninger at 6:15-7:9 (“Henninger Rebuttal Test.”).
post-closing, Narragansett will submit this Credit Facility to the Division for its review and approval, although no information on timing is provided.\(^7\) The Division review process for this application can serve as an appropriate vehicle for addressing the liquidity and short-term debt sourcing issues I have raised, and I interpret Mr. Henninger’s testimony stating the plans to submit this application as being a firm commitment.

Unfortunately, Mr. Henninger rejects my other three recommended commitments, even though he does not appear to have any substantive disagreement with them. Specifically, he states Narragansett’s post-closing intention to maintain a common equity ratio of approximately 51 percent, but he refuses to commit to that planned figure or for that matter to any minimum common equity ratio for any period of time.\(^8\) He acknowledges that it is normal practice for all three PPL utilities to issue secured long-term debt (under first mortgage bond indentures), and he states that post-closing Narragansett will investigate doing the same. But again he refuses to make any commitment.\(^9\) Finally, he admits that it is standard practice for utilities to exclude goodwill from the ratemaking capital structure, and he states that post-closing he expects Narragansett to continue this long-standing practice. However, he is unwilling to commit to doing so, stating that PPL reserves the right to have Narragansett reflect goodwill in its ratemaking capital structure in the future if doing so at that time is deemed to be appropriate.\(^10\)

Q. PLEASE SUMMARIZE YOUR RESPONSE TO MR. HENNINGER.

\(^7\) *Id.* at 8:9-12.
\(^8\) *Id.* at 10:14-11:4.
\(^9\) *Id.* at 12:4-13.
\(^10\) *Id.* at 9:14-10:3.
A. Mr. Henninger’s rebuttal testimony is helpful in resolving the ring fencing and short-term debt issues that are posed by the Transaction, although some clarification is still needed. On the three remaining issues—minimum common equity ratio, the potential issuance of secured debt (if appropriate) and the ratemaking capital structure—there is little substantive disagreement between our respective testimonies. His descriptions of the planned financial policies for Narragansett track my recommendations closely. The problem is that on these three issues PPL is unwilling to provide any commitments—and offers only unenforceable statements of plans and intentions.

I therefore find that his Rebuttal Testimony does not support Division approval of this Transaction as being consistent with the public interest. I continue to recommend that the Division deny approval of the Transaction. These issues are discussed further in Section II of my Rebuttal Testimony.

II. DISCUSSION OF ISSUES

A. Ring Fencing

HOW DOES MR. HENNINGER’S COMMITMENT REGARDING RING-FENCING MEASURES COMPARE WITH YOUR RECOMMENDATION?

A. They are generally similar. On pages 16-17 of my direct testimony, I list eight recommended ring-fencing measures. Measures (7) and (8) pertain to short-term debt financing and the minimum common equity ratio which are issues discussed separately by Mr. Henninger and later in this surrebuttal testimony. At pages 6-7 of his Rebuttal Testimony, Mr. Henninger commits to implementing five ring-fencing measures which are similar to the first six of my ring-fencing measures. While Mr. Henninger’s five ring-fencing measures are acceptable, as far as they go, I include two measures that Mr. Henninger did not explicitly address (or dispute).
Specifically, I propose (in measure (4)) that Narragansett be precluded from lending funds to corporate affiliates on a long-term basis, and propose (in measure (5)) that Narragansett be restricted to using the proceeds from its long-term debt issues solely for the purposes of financing its utility investments and operations. Since Mr. Henninger did not contest these two measures, I assume PPL would not object to their inclusion in a set of ring-fencing protections.

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

Q. **WHAT IS MR. HENNINGER’S POSITION REGARDING GOODWILL IN THE RATEMAKING CAPITAL STRUCTURE?**

A. Mr. Henninger explains that post-Transaction there will be a total of about $1.7 billion in goodwill. About $1 billion of that will be from the acquisition premium resulting from this Transaction which will be reflected on the balance sheet of PPL Rhode Island rather than Narragansett. There will be another $0.7 billion which is presently on the Narragansett balance sheet, and under National Grid USA ownership this amount has been consistently removed from the ratemaking capital structure.  

Mr. Henninger seems to accept that the exclusion of goodwill from the ratemaking capital structure is a proper practice, but he is unwilling to commit that Narragansett under PPL ownership will follow that practice in the future. He states: “PPL will continue to exclude goodwill from this [capital structure] calculation so long as this treatment of goodwill remains consistent with the prevailing regulatory best practices with respect to ratemaking capital structure.”

He further explains that Narragansett under PPL ownership would not change this practice “unless the regulatory paradigm

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11 Henninger Rebuttal Test. at 8:16-19.
12 Id. at 9:6-9.
changes.”\textsuperscript{13} He does not explain what he means by a change in the “regulatory paradigm” or why this could possibly justify providing rate recovery (even in part) of goodwill, which is merely a non-cash accounting write-up which does not support either utility investment or utility operations.

Q. SINCE THE RATEMAKING CAPITAL STRUCTURE IS SUBJECT TO COMMISSION APPROVAL, WHY IS YOUR RECOMMENDED COMMITMENT NEEDED?

A. Mr. Henninger is stating that he expects to follow Narragansett’s past long-standing practice on capital structure, but, if circumstances change (e.g., a new paradigm), then PPL reserves the right to include goodwill as part of the ratemaking capital structure. The goodwill amounts either on PPL Rhode Island balance sheet or Narragansett’s own balance sheet post Transaction would be massive, and its inclusion would sharply increase the authorized rate of return on rate base by inflating the equity ratio. This could adversely and significantly increase customer rates as compared to Narragansett’s long-standing practice under National Grid USA ownership. Mr. Henninger accurately observes that the ratemaking capital structure in base rate cases is subject to Commission approval. However, there are two potential problems with leaving the discretion over capital structure calculation to PPL. First, Narragansett in a future base rate case could include some amount of goodwill in the capital structure without informing the Commission that it has done so and has made this change to methodology. Second, if in a base rate case PPL were to propose the change in methodology (i.e., include goodwill) and Commission decided to reject that proposed change as inappropriate, Narragansett could appeal the Commission’s decision on the

\begin{footnote}{\textsuperscript{13} Id. at 9:18-19.}
grounds that the goodwill it has included is part of its actual book equity. These possibilities expose utility customers to risks that are not present in the current structure.

Q. WHAT DO YOU RECOMMEND?

A. I recommend that as a condition of approval PPL must commit that Narragansett will follow its long-standing practice under National Grid USA ownership of excluding goodwill from the ratemaking capital structure. As with all of my recommendations, Narragansett retains the right to request a Division or Commission waiver or modification to this commitment upon an appropriate public interest showing. This should address Mr. Henninger’s concern regarding the unspecified changing “regulatory paradigm.”

C. The Need for a Minimum Common Equity Ratio

Q. MR. HENNINGER IS UNWILLING TO COMMIT TO A MINIMUM COMMON EQUITY RATIO DURING A FIVE-YEAR TRANSITION PERIOD. WHAT EXPLANATION DOES HE PROVIDE FOR THIS POSITION?

A. At page 10 of his Rebuttal Testimony, Mr. Henninger responds to my recommendation by stating that it is PPL’s intention that, post-Transition, Narragansett will maintain a common equity ratio of about 51 percent, consistent with the determination in its most recent base rate case. However, beyond this statement of “intention” he is unwilling to provide any enforceable commitment to the 51 percent level or to any other level of common equity. He seems to suggest that PPL’s expression of its intention and plans is sufficient assurance and that no enforceable commitment is needed. He provides no

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14 Id. at 10:7-10.
convincing explanation regarding why a minimum common equity ratio commitment is inappropriate or not needed.

**Q.** DO YOU CONTINUE TO SUPPORT THE IMPOSITION OF A MINIMUM COMMON EQUITY RATIO REQUIREMENT FOR A PERIOD OF FIVE YEARS POST CLOSING?

**A.** Yes. While I appreciate PPL’s statement of intention, as circumstances change, Narragansett’s balance sheet during the first several years following closing could unduly weaken absent a commitment by PPL to maintain a reasonable minimum common equity ratio. As the ultimate parent, PPL has the ability to weaken Narragansett financially either by draining cash through excessive dividend payments or by failing to provide equity capital when needed for utility investment. This could harm Narragansett’s credit quality and impair its ability to undertake needed capital spending. A minimum common equity ratio requirement and commitment is a basic financial protection which should accompany any Division approval of this Transaction.

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

**Q.** WHAT IS YOUR CONCERN REGARDING THE ISSUANCE OF LONG-TERM DEBT?

**A.** In my direct testimony at page 24 I noted the potential for substantial savings for Narragansett and its customers if it were to issue long-term debt as secured instead of unsecured.\(^{15}\) Secured debt for a given utility and debt tenor is normally rated higher by credit rating agencies and therefore carries a lower cost rate as compared to unsecured debt for the same utility. I therefore recommend that PPL investigate this issue for

\(^{15}\) Kahal Direct Test. at 23:20-24:9.
Narragansett and in future years issue secured long-term debt if it is determined to be cost effective, practicable and feasible.

Mr. Henninger notes that PPL’s three utility subsidiaries do indeed issue secured long-term debt and that PPL intends to investigate having Narragansett do so. He confirms that post closing “PPL will evaluate the costs, benefits, and constraints associated with” establishing a secured indenture for Narragansett which would enable it to issue secured first mortgage bonds in the future.\(^{16}\) After stating PPL’s intention to proceed with a secured indenture for Narragansett (if deemed feasible and cost effective), he appears to object to PPL reporting back to the Division or committing to anything pertaining to secured debt. He further argues that such a condition pertaining to the issuance of secured debt would be improper, claiming that there is no such corresponding obligation for Narragansett under National Grid USA ownership.\(^{17}\)

Q. WHAT IS YOUR RESPONSE TO MR. HENNINGER’S POSITION ON THIS ISSUE?

A. Mr. Henninger and I seem to be in agreement on the substantive question regarding whether the use of secured debt by Narragansett is potentially beneficial and should be investigated and pursued if deemed feasible and cost effective. The issue in this proceeding, however, is whether PPL should commit to doing so in connection with the Division approval of this Transaction. My recommended commitment appears to be entirely consistent with what PPL intends to do in any case. Such a commitment is important and entirely appropriate because it will help ensure that, under PPL ownership, Narragansett will finance its future capital investments at the lowest

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\(^{16}\) Henninger Rebuttal Test. at 12:10-11.

\(^{17}\) Id. at 13:7-9.
reasonable cost. As I demonstrated in my direct testimony (see page 24), secured debt can provide considerable savings for customers.\footnote{Kahal Direct Test. at 23:19-24:9.} It is particularly pertinent to identify potential cost savings from this Transaction given the very substantial risks that utility customers must bear if this Transaction is approved, as documented extensively by Division Advocacy Section witnesses.

I also disagree with Mr. Henninger’s argument that requiring such an approval condition is improper because there is no such corresponding secured debt requirement for Narragansett under continued National Grid USA ownership. While the circumstances and context of the proposed Transaction versus continued National Grid USA ownership differ somewhat, substantially the same issue was addressed in Narragansett’s most recent debt financing docket before the Division (Division Docket No. D-19-17). In that docket, Narragansett and the Division Advocacy Section reached a settlement agreement approved by the Division in December 2019.\footnote{\textit{In re. The Narragansett Elec. Co. d/b/a National Grid, Application for Auth. to Issue Long-Term Debt}, Report and Order, Division Docket No. D-19-17 (Dec. 20, 2019).} While the settlement provides flexibility, authorizing the issuance of either secured or unsecured long-term debt, paragraph 4 of that settlement states that in the event Narragansett does issue unsecured instead of secured long-term debt, Narragansett will be obligated to submit testimony in its next rate case that explains and justifies that decision. Moreover, the Division Advocacy Section would retain the right to challenge the rate recovery of any such unsecured debt cost premium.\footnote{\textit{Id.}, Settlement Agreement ¶ 4.} Hence, the Division-approved settlement in that docket does indeed establish both obligations for Narragansett and cost recovery exposure with respect to decisions about long-term debt. While not
precisely the same as my recommendation in this case on that issue (as the circumstances and context are quite different), I believe the present requirement for Narragansett is analogous to my proposed condition, in that both are attempts to achieve the same end result.

E. Clarification of Short-Term Debt Issues

Q. HOW HAS MR. HENNINGER ADDRESSED YOUR CONCERNS REGARDING NARRAGANSETT’S LIQUIDITY AND ACCESS TO SHORT-TERM DEBT POST TRANSACTION?

A. Mr. Henninger states that PPL is in the process of establishing a new Credit Facility in which Narragansett will be able to participate as a borrower and thereby access needed liquidity and short-term debt.\(^{21}\) This planned Credit Facility can serve as either a direct source of funds or as a backstop for a commercial paper program. He states that at this time PPL has no plans to create a new utility money pool arrangement in which Narragansett can participate, but “PPL will continue to evaluate and consider whether a money pool would be beneficial prospectively.”\(^{22}\) Any such new money pool agreement involving Narragansett would be submitted to the Division for its review and approval.\(^{23}\)

Post-closing, Narragansett will file an application with the Division for the review and approval of the planned new Credit Facility agreement.

Q. WHAT IS YOUR RESPONSE TO PPL’S PLANS CONCERNING THE PROVISION OF SHORT-TERM DEBT?

\(^{21}\) Henninger Rebuttal Test. at 14:4-13, 15:3-16:3.

\(^{22}\) Id. at 16:12-13.

\(^{23}\) Id. at 17:7-9.
A. I interpret Mr. Henninger’s statement regarding Narragansett’s intention to file and application for Division review and approval of a new Credit Facility agreement as a commitment that largely meets my concerns. While he does not specify the timing of this anticipated filing, I believe that it would be appropriate to specify a time period for that filing of up to six months after the Transaction closes (which date could be subject to modification by the Division for good cause). This resulting Division docket could be used as a forum for examining the various issues associated with Narragansett’s short-term debt practices under PPL ownership.

IV. CONCLUSION

Q. BASED ON YOUR REVIEW OF MR. HENNINGER’S REBUTTAL TESTIMONY, PLEASE SUMMARIZE YOUR MAIN CONCLUSIONS.

A. There are some areas of agreement between Mr. Henninger and myself on the substantive issues of financial policy. In particular, we are to a large extent in agreement on the need (and commitment) for certain ring-fencing measures for Narragansett. In addition, I believe that his testimony has adequately addressed the various potential issues associated with short-term debt. I interpret his proposal to file an application for Division review and approval of a Credit Facility agreement as a commitment to do so. Unfortunately, his rebuttal testimony fails to set forth the needed commitments regarding the exclusion of goodwill from the ratemaking capital structure, the use of secured long-term debt (if determined to be feasible and cost effective), and the commitment to maintain for a period of several years a reasonable minimum common equity ratio to protect Narragansett’s credit quality and financial strength. Such commitments would be needed in the event that the Division is inclined to approve the Transaction. I continue to recommend that the proposed Transaction
not be approved by the Division as it fails to meet Rhode Island’s “consistent with the public interest” and “no net harm” standard, as discussed in my testimony and that of other Division Advocacy Section witnesses.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.