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ORDER NO. 89291

IN THE MATTER OF THE MERGER OF ALTAGAS LTD. AND WGL HOLDINGS, INC.	* * * * * * *	BEFORE THE PUBLIC SERVICE COMMISSION OF MARYLAND CASE NO. 9449

Issue Date: October 3, 2019

ORDER ON ALTAGAS' REPORT ON FINANCIAL CONDITION

On April 15, 2019, the Maryland Public Service Commission ("Commission") granted the Maryland Office of People's Counsel's ("OPC") motion to require AltaGas Ltd. ("AltaGas") to file a report with the Commission describing its current financial condition and risks.[1] Although the Commission concluded that AltaGas was in compliance with the conditions attached to the approval of its purchase of WGL Holdings, Inc. ("WGL Holdings") and Washington Gas Light Company ("Washington Gas"),[2] the Commission required AltaGas to file this report to address several concerns regarding its financial state post-acquisition.[3] This Order accepts the report and denies the additional reporting requirements requested by OPC and Commission Staff.

A. AltaGas' Report on Current Financial Condition and Risks

On June 14, 2019, AltaGas filed its "Report on Current Financial Condition and Risks" in compliance with the April 15 Order. This Report stated that AltaGas had

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[1] Order No. 89092 (April 15 Order). The Commission ordered that AltaGas file its report within 60 days.
[2] AltaGas, WGL Holdings and Washington Gas are collectively referred to herein as "the Applicants."
[3] Order No. 89092 at pgs. 3-4.

experienced a strong first quarter ("Q1") of 2019, realizing CA$466 million in EBITDA, a 109% increase over Q1 of 2018.[4] Additionally, AltaGas reduced debt by CA$1.7 billion and completed the Ridley Island Propane Export Terminal project, Canada's first marine propane export facility.[5] The Report indicates that AltaGas is on pace to fund its strategic capital plan, which it expects will improve the company's competitive position within its "midstream" and utility businesses.[6]

According to the Report, AltaGas remains on target to improve its financial strength by executing non-core asset sales, de-leveraging its balance sheet,[7] and focusing on the company's core assets. After reducing debt by CA$1.7 billion in Q1 2019, AltaGas' overall net debt balance was approximately CA$8.4 billion.[8] AltaGas intended to reduce an additional CA$1.5-2 billion through the end of 2019, including the sale of WGL Midstream's interest in the Stonewall Gas Gathering System for approximately CA$0.37 billion completed on May 31, 2019.[9] AltaGas also stated that several additional sales processes were underway.[10] The Report indicates that AltaGas is on track to reduce debt by CA$3 billion, maintain an investment-grade rating and fund its approximately CA$1.3 billion capital expenditure program in 2019.[11]

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[4] AltaGas Report at pg. 2. EBITDA is "Earnings before Interest, Taxes, Depreciation and Amortization". As a publicly traded Canadian company, AltaGas' financial reports as well as its filings with the Commission use the denomination of Canadian dollars. As of the date of this Order, one Canadian dollar converts to approximately US $0.75. All amounts in this Order are in Canadian Dollars.
[5] AltaGas Report at pg. 2.
[6] *Id.*
[7] De-leveraging in this context refers to reducing debt either by raising capital or selling assets to erase debt from a company's balance sheet.
[8] AltaGas Report at pgs. 2-3.
[9] *Id.* at pg. 3.
[10] *Id.*
[11] *Id.* at pg. 2.

The Report also describes AltaGas' general operational, market and regulatory risks associated with operating and developing natural gas, liquefied natural gas and associated power systems and facilities.[12]

Regarding the post-acquisition financial developments raised in OPC's motion, AltaGas stated that its dividend reduction was necessary to provide the company with flexibility and to strengthen its balance sheet and that the decline in stock price likely reflected this dividend cut.[13] Notwithstanding, the Report states that Washington Gas' credit rating remains two notches higher than AltaGas post-merger, demonstrating the success of the ring-fencing conditions the Commission imposed in its decision approving the merger.[14]

B. OPC Comments

On July 23, 2019, OPC submitted written comments on AltaGas' Report. OPC notes that the 109% increase in AltaGas' EBITDA from Q1 of 2018 through Q1 of 2019 was largely due to earnings from Washington Gas.[15] OPC states that AltaGas' strategy to finance the acquisition of WGL Holdings with debt caused the financial strain and lower credit ratings from late 2018 into 2019. OPC further concludes that AltaGas' new business strategy to emphasize utility and midstream business rather than power generation assets

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[12] For details of these risks as well as its risk-mitigation efforts, AltaGas refers to pages 41-43 of its 2018 Annual Report.

[13] AltaGas Report at pg. 5.

[14] *Id.* at pgs. 6-7. The ring-fencing conditions are mostly contained within Condition 36, which creates a Special Purpose Entity ("SPE") for the purpose of owning Washington Gas' common stock and removing both Washington Gas and the SPE from the bankruptcy estate of AltaGas and its affiliates. The SPE is a wholly-owned subsidiary of WGL Holdings, and none of the assets of either Washington Gas or the SPE would be available to satisfy the debt or contractual obligations of non-ring fenced entities.

[15] OPC Comments at pg. 9.

is less risky.[16] However, OPC states that AltaGas has not provided the Commission with a capitalization target or its desired ratio of debt to equity.[17]

OPC claims that AltaGas is unlikely to achieve an "A" credit rating within the next five years based upon its forecasted FFO/debt ratios.[18] OPC also claims that AltaGas is using debt double-leverage to inject common equity into Washington Gas, thereby inflating the equity ratio of Washington Gas and increasing the overall cost of capital included in customer rates if the Commission does not address it in a future rate case.[19] Specifically, OPC requests the Commission to order Washington Gas to do the following in a future rate case:

(1) Adjust the actual cost of new debt to the cost of debt of an A-rated company;

(2) Quantify other credit costs imposed on Washington Gas' post-merger operations;

(3) Require AltaGas or WGL Holdings to reimburse Washington Gas for increased expenses or interest costs resulting from the merger; and

(4) Remove the impact of debt double leverage from its equity ratio.[20]

Finally, OPC asks the Commission to establish regular meetings between AltaGas, OPC, Staff and other interested parties to review the financial progress of AltaGas and Washington Gas.[21]

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16 *Id.* at pg. 11.
17 *Id.*
18 *Id.*
19 *Id.* at pg. 34. "Debt double-leverage" refers to a parent company issuing debt and then investing the proceeds as equity into a subsidiary.
20 OPC Comments at pgs. 34-35.
21 *Id.* In its February 28, 2019 Reply, OPC agreed with AltaGas' proposal that these meetings should occur on a quarterly basis. OPC Reply at pg. 3. The Commission's subsequent April 15, 2019 Order confirmed that the parties should confer on a quarterly basis. Order No. 89092 at pg.7.

C. Staff Comments

On July 24, 2019, Staff submitted its written comments on AltaGas' Report. Staff supports a semi-annual meeting between Staff, OPC, the Applicants and any other interested parties and requests that the Commission order the Applicants to provide the following documents prior to these meetings:

(1) Washington Gas' equity ratio calculation for the previous quarter as well as its six-month average;

(2) Copies of any credit reports for the Applicants issued in the previous quarter;

(3) Copies of the "strategic planning and financial forecast documents" approved by the Applicants' respective boards;

(4) The calculation of the FFO/debt ratio for the Applicants for the last three years as well as a three-year forecast;

(5) The Applicants' 10Q filing as well as their quarterly financial results; and

(6) A copy of Washington Gas' internal operating and financial report, including an analysis of actual capital expenditures compared to budget.[22]

D. AltaGas' Response to OPC and Staff's Comments

On August 30, 2019, AltaGas responded to OPC and Staff's Comments, arguing that neither party provided a reasonable basis to support their additional documentation requests. AltaGas' response also updated its financial condition through the second quarter ("Q2") of 2019. AltaGas claims "strong results" in Q2 2019, including executing on its non-core asset sales, de-leveraging its balance sheet and unlocking organic growth in its utility and midstream businesses.[23] During Q2 2019, AltaGas achieved normalized EBITDA of CA$203 million, a 22% increase over the same period in 2018.[24] In addition

[22] Staff Comments at pgs. 2-3.
[23] AltaGas Response at pgs. 4-5.
[24] *Id.* at pg. 5.

to the sale of the Stonewall Gas Gathering System for approximately CA$0.38 billion on May 31, 2019, AltaGas announced the sale of its U.S. distributed generation portfolio for approximately CA$0.94 billion, bringing total asset sales announced or completed in 2019 to CA$1.3 billion.[25] In the first half of 2019, AltaGas has reduced debt by approximately CA$2 billion and expects to reduce debt by another CA$1 billion by the end of the year.[26] AltaGas' 2019 funding plan for Washington Gas' capital projects remains unchanged.[27]

AltaGas further characterizes a number of OPC's observations and conclusions as "misguided". AltaGas acknowledges that much of its increased Q1 2019 EBITDA was attributable to Washington Gas' earnings, but its Q2 increase was more diverse.[28] Additionally, AltaGas has achieved its 2019 asset sales at high market valuations, including the announced sale of its U.S. distributed generation assets in Q2 of 2019.[29] AltaGas contends that OPC is simply re-litigating the extensive record regarding AltaGas' financial condition that the Commission developed prior to approving the merger.

AltaGas attributes the decline of its and WGL Holdings' credit rating to BBB- in December of 2018 to S&P's forecast of AltaGas' adjusted funds from operations at approximately 10-11%, which S&P considered non-reflective of a BBB rating.[30] Finally, AltaGas rejects OPC's characterization of Washington Gas' equity capital as "debt

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[25] *Id.* at pgs. 5-6.
[26] *Id.* at pg. 6.
[27] *Id.*
[28] *Id.* at pg. 7.
[29] *Id.*
[30] *Id.* at pg. 8. In Order No. 88631, the Commission noted that S&P would likely rate WGL Holdings and Washington Gas with a negative outlook even without the merger. Specifically, the Commission stated that "the record demonstrates that WGLH and Washington Gas had a negative outlook even without the transaction due to WGL's aggressive plans to expand its non-regulated business, increase capital expenditures, and concerns about reliance on debt leverage to finance growth." (pg. 52).

disguised as capital", relying upon a "long-held corporate finance principle that cash is fungible and cannot be traced from a specific source to a specific use."[31]

AltaGas requests that the Commission reject OPC's recommendations as unnecessary in light of the existing conditions with which AltaGas is compliant. Additionally, the Commission's ongoing regulatory authority, including the future setting of rates, sufficiently ensures Washington Gas' financial stability. Nevertheless, AltaGas, WGL Holdings and Washington Gas indicate that they remain willing to meet with Staff, OPC and interested parties periodically to discuss their implementation and compliance with the Commission's merger order and conditions.

To facilitate these meetings, AltaGas offers to provide the following documentation to interested parties ahead of the meetings:

(1) The credit metrics and FFO/Debt ratio filed by AltaGas and Washington Gas pursuant to Condition 35;

(2) All credit reports released during the prior quarter;

(3) AltaGas' quarterly results presentations;

(4) Quarterly and annual financial reports for Washington Gas and AltaGas;[32] and

(5) The annual report of Washington Gas' capital expenditures beginning in 2020 pursuant to Condition 12.[33]

E. <u>Commission Decision</u>

The Commission accepts the June 14, 2019 Report in compliance with the requirements of Commission Order No. 89092. The Report and AltaGas' subsequent

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[31] *Id.* at pg. 9.
[32] Post-acquisition, WGL Holdings is only a holding company within AltaGas' organizational structure. Because Washington Gas is ring-fenced from WGL Holdings, AltaGas claims that providing WGL Holdings' financial statements would not be useful.
[33] Washington Gas expects this report to be generated annually.

comments describe its financial plan to reduce debt through non-core asset sales and by focusing on utility and midstream businesses.

The Commission finds OPC's recommendations regarding future Washington Gas rate cases to be premature at this time. If necessary, the Commission has the regulatory authority to address the issues raised by OPC within the context of a future rate case. The record provides no reason for the Commission to address these issues before Washington Gas has formally requested a change in its rates. Any party may raise any issues relevant to a future rate case once such a filing is made.

As stated in Order No. 89092, the Commission accepted OPC, Staff and the Applicants' agreement to meet on a quarterly basis to review the Applicants' implementation of the Commission's merger order and conditions. Prior to these meetings, OPC and Staff have requested that the Applicants provide documentation in addition to the five sets of documents that AltaGas has volunteered to produce. The record does not justify the disclosure to additional documentation beyond those imposed by the merger conditions. Therefore, the Commission denies OPC and Staff's request for additional records.

IT IS THEREFORE, this 3rd day of October, in the year Two Thousand and Nineteen, by the Public Service Commission of Maryland,

ORDERED: (1) That the Commission accepts AltaGas' June 14, 2019 "Report on Current Financial Condition and Risks" in compliance with Order No. 89092;

(2) That the Commission directs the parties to meet on a quarterly basis to discuss the implementation and compliance with the Commission's Order No. 88631;

(3) That OPC's recommendations related to future Washington Gas' rate cases are denied; and

(4) That Staff's request that AltaGas provide additional documentation prior to the parties' quarterly meetings is denied.

By Direction of the Commission

/s/ David J. Collins

David J. Collins
Acting Executive Secretary