

NARUC Winter Committee Meeting

# Mergers and Ring Fencing Issues: An Oregon Perspective

Oregon Public Utility Commission  
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# What is Ring Fencing?

- **Purpose** – To **isolate** the utility from negative financial impacts created by affiliates:
  - To ensure the utility maintains a strong credit rating and is able to attract capital.
  - To prevent the utility from cross-subsidizing non-regulated utilities.
  - To ensure regulators' access to accurate information

# Overview

- **Customers expect utilities to be protected from non-utility business risks.**
- **Utilities need strong financial ratings to operate efficiently and acquire needed resources.**
- **Ring fencing can provide such protection.**
- **Ring fencing isolates the utility from the financial status of its affiliates.**

# Rating Agency's View on Regulatory Regulation

## Standard & Poor's

- Rating agencies weigh heavily state regulatory policies.

**“Any action that state regulators take that provides support (whether legal, regulatory, financial or operational) to the utility and/or isolates the utility (most importantly financial obligations) from its parent company will be positive for credit.”**

# Rating Agency's View on Regulatory Regulation (continued)

## Standard & Poor's

- **Parent company's nonregulated businesses matter.**
- **Utilities can be insulated by:**
  - Restricting dividends;
  - Restricting loans to affiliates; and
  - Fair pricing of transactions with affiliates.

# Oregon Statutes and Rules

- **Oregon's statutes and administrative rules enable effective ring fencing provisions.**
  - PGE was able to maintain investment grade ratings even after Enron filed bankruptcy.
    - Nine notch differential between PGE's and Enron's long-term debt rating.
  - PacifiCorp has similar ring fencing provisions.
  - Other States may not have the same authority.

## Oregon Statutes and Rules (continued)

### Oregon Revised Statutes

Oregon Revised Statutes protect customers from potential abuses in utility/affiliate transactions.

These statutes:

- **Define affiliated interest.**
- **Require approval before an utility may guarantee another's (long-term) indebtedness.**
- **Require approval of stock and bond issuance.**

## Oregon Statutes and Rules (continued)

### Oregon Revised Statutes

- **Require approval for the purchase of property or stocks of one utility by another.**
- **Require approval for utilities to contract with affiliated interests, when the utility is the buyer of goods, services, and assets.**
- **Oregon Transfer Pricing Policy (Rule):**
  - Services provided by affiliate to utility
    - Priced at lower of cost and market.
  - Services provided by utility to affiliate
    - Priced at higher of cost or market.

# Oregon Statutes and Rules (continued)

## Oregon Revised Statutes

- **Require approval for mergers and acquisitions of Oregon utilities.**

### **Any acquisition or merger requires:**

- Net Benefit for Utility customers.
- No harm to Oregon citizens on a whole.

# Oregon Ring Fencing - PGE

- **PGE is Oregon's largest utility and serves 767,000 customers.**
- **Since 1997, Commission has reviewed five applications to acquire PGE:**
  - UM 814 – Enron Merger (Approved)
  - UM 967 – Sierra Pacific Acquisition (Approved; Never completed due to SEC requirements)
  - UM 1045 – NW Natural Acquisition (Withdrawn due to Enron's bankruptcy filing)
  - UM 1121 – TPG Acquisition (Denied)
  - UM 1206 – PGE Stock Distribution (Approved)

## Oregon Ring Fencing – PGE (continued)

### Portland General Electric - Enron

#### ➤ Ring fencing conditions included:

1. Full access to information requirements and review of inter-corporate transactions involving PGE.
2. Maintain separate long-term debt and preferred stock ratings.
3. Common equity portion of at least 48%.
4. PGE must notify the Commission of certain dividends and distributions to Enron

## Oregon Ring Fencing – PGE (continued)

### Portland General Electric – Enron

5. Prohibition on allocations or direct charges from Enron to PGE without Commission authorization.
6. Restrictions on Enron's access to PGE's power, natural gas assets, or excess pipeline capacity.
7. Not allowed to seek a higher cost of capital than it would have been authorized absent the merger.

## Oregon Ring Fencing – PGE (continued)

### Additional Ring Fencing Approved

#### ➤ **The Golden Share**

- Commission approved the issuance of a \$1.00 Par Junior Preferred Stock.
- Created an “independent director.”
- Prevented Enron from forcing PGE to file for bankruptcy.
- Avoided future downgrades of PGE's bond ratings due to Enron's bankruptcy.

## Oregon Ring Fencing – PGE (continued)

### Oregon Electric Utility Company's proposed acquisition of PGE

- **Application was denied by the Commission. Concerns included potential harms resulting from:**
  - Harms Related to Oregon Electric's Long-term Debt
  - Short-Term Ownership
  - Transaction Terms were not Final
  - Lack of Transparency – Parent was a private investment firm

## Oregon Ring Fencing – PGE (continued)

### Portland General Electric – Stock Distribution

- **Enabled PGE to again be a publicly traded utility.**
  - PGE approved to issue 62,500,000 shares of new PGE common stock and cancel existing stock owned by Enron.
- **Ring fencing provisions included mirrored those already in place for PGE, except where no longer applicable.**
  - Notice of dividends concurrent with public announcement.
  - Minimum equity requirements are reduced as the percentage of equity held by the “Reserve” is reduced.

# Oregon Ring Fencing - PacifiCorp

## PacifiCorp

- **Second largest Oregon utility and serves approximately 527,000 customers.**
- **Recent mergers/acquisitions involving PacifiCorp:**
  - UM 918 – Scottish Power
  - UM 1209 – Mid-America Energy Holding Company

## Oregon Ring Fencing – PacifiCorp (continued)

### PacifiCorp – Scottish Power

#### ➤ Ring fencing conditions adopted:

1. Maintain separate accounting system.
2. Keep all financial books and records at its Portland, Oregon headquarters.
3. Access to records of ScottishPower pertaining to transactions to PacifiCorp and all its affiliated interest.
4. Authority to audit accounting records of ScottishPower and its unregulated subsidiaries that are bases for charges to PacifiCorp.

## Oregon Ring Fencing – PacifiCorp (continued)

### PacifiCorp – Scottish Power

5. Maintain a minimum common equity ratio of 35% (ramping up to 40%)
6. Maintain separate long-term debt and preferred stock ratings and provide notice of certain distributions from PacifiCorp to Scottish Power.
7. PacifiCorp not allowed to seek a higher cost of capital than it would have been authorized absent the merger.

**A pre-merger order placed a \$200,000,000 (aggregated) ceiling on loans that PacifiCorp could make to affiliates.**

# Oregon Ring Fencing Conclusions

- Ring fencing evolves over time.
  - Separation of books and records;
  - Greater specificity to Minimum Equity Requirements; and
  - Golden Share (PGE), Independent Director (PacifiCorp).