

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC JOINT APPLICATION OF PNG)	
COMPANIES LLC, DRAKE MERGER SUB INC.,)	
AND DELTA NATURAL GAS COMPANY, INC.)	CASE NO.
FOR APPROVAL OF AN ACQUISITION OF)	2017-00125
OWNERSHIP AND CONTROL OF DELTA)	
NATURAL GAS COMPANY, INC.)	

ORDER

On March 17, 2017, PNG Companies LLC (“PNG”), Drake Merger Sub Inc. (“Drake”), and Delta Natural Gas Company, Inc. (“Delta”) jointly filed an application (“Application”) for approval by the Commission of the acquisition by PNG of ownership and control of Delta pursuant to KRS 278.020(6) and 278.020(7). On May 5, 2017, an amended joint application (“Amended Application”) was filed to add SteelRiver Infrastructure Fund North America LP (“SRIFNA”) and SteelRiver LDC Investments LP (“SRLDCI”), the ultimate parent entities of PNG, as additional applicants requesting approval to acquire indirect ownership and control of Delta (all of the applicants are collectively referred to as “Joint Applicants”). The acquisition of ownership and control of Delta will result from the merger of Drake, a wholly owned subsidiary of PNG, with and into Delta, which will be the surviving corporation in the merger and will become a wholly owned subsidiary of PNG.

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention (“Attorney General”), is the only intervenor in this matter.¹ Three rounds of discovery were completed. A formal hearing was held on June 8, 2017. Joint Applicants filed responses to post-hearing data requests and post-hearing briefs. The Attorney General filed his Final Comments. This matter now stands submitted to the Commission for a decision.

OVERVIEW OF THE TRANSACTION

Joint Applicants included with their Application the Agreement and Plan of Merger (“APM”), pursuant to which Drake will be merged with and into Delta, with Delta being the surviving entity. Delta will become a direct, wholly owned subsidiary of PNG as a result of the merger. Joint Applicants propose to pay Delta’s shareholders \$30.50 for each issued and outstanding share of Delta’s Common Stock. PNG intends to finance the proposed transaction through a combination of operating cash flow, borrowings under its existing credit facilities, and equity contributions.² It is not requesting approval of financing as part of this proceeding.

Delta is a Kentucky corporation that provides natural gas utility service and is subject to the jurisdiction of the Commission. It has approximately 39,000 customers in 23 counties in central and eastern Kentucky. In addition to its regulated natural gas distribution business, Delta owns three unregulated subsidiary companies, Delta Resources, Inc., Delgasco, Inc., and Enrpro, Inc. Drake, a Kentucky corporation, was formed to carry out the proposed transaction. PNG is a Delaware limited liability

¹ By Order entered on April 20, 2017, the Commission denied a motion to intervene filed by the Kentucky Laborers District Council.

² Application, Direct Testimony of Preston D. Poljak at 5.

company whose ultimate parent entities are SRIFNA, an investment fund focused on infrastructure assets, and SRLDCI, an investment fund focused on local gas distribution assets. PNG manages the day-to-day business of operating companies that provide natural gas to over 700,000 retail customers in Pennsylvania, West Virginia, and Kentucky.

After the proposed transaction closes, Delta's current board of directors will be replaced by a subset of current PNG directors and one independent director chosen by Delta's pre-acquisition directors. On July 11, 2017, Joint Applicants informed the Commission that the following individuals will serve as members of Delta's post-closing board of directors: Glenn R. Jennings, who currently serves as Delta's president and chief executive officer; Rodney L. Short, who has served on Delta's board since 2015; Morgan K. O'Brien, who is president and executive officer of PNG; Ruth DeLost-Wylie, who is senior vice president, chief information officer, and chief administrative officer of PNG; Preston Poljak, who is senior vice president and chief financial officer of PNG; Joseph Gregorini, who is PNG's senior vice president and chief operating officer; and John McGuire, chief legal officer of SRIFNA and SRLDCI.

PNG states that following the closing of the transaction, it may transfer ownership of the three unregulated Delta subsidiaries directly to PNG or may merge them into Delta. It further states that it will continue to allocate costs to the unregulated subsidiaries consistent with Delta's existing Cost Allocation Manual.³

³ Application at 8–9.

JOINT APPLICANTS' COMMITMENTS

PNG has made the following specific post-merger commitments with respect to the proposed transaction as outlined in Section 1.7 of the APM:

1. PNG intends to maintain the surviving entity's headquarters in Winchester, Kentucky following the closing;
2. PNG intends to operate the surviving entity under the name "Delta Natural Gas" and use its current logo;
3. PNG intends to maintain Delta's historic levels of community involvement, charitable contributions, low-income funding, and economic-development efforts in Delta's current operating areas; and
4. PNG will provide compensation, benefits, and severance protection to non-executive employees of Delta as set out in the APM.

PNG further committed in the APM that, prior to the merger becoming effective, it will discuss with Delta's five executive officers new service agreements for their continued provision of services to the surviving entity. PNG also stated its intention to appoint an independent director, approved by Delta's current Board of Directors, to Delta's Board of Directors after the transaction has closed.⁴

In the Application, PNG committed that costs associated with the proposed transaction will not have the effect of increasing Delta's rates for gas service; that neither Delta nor its ratepayers, directly or indirectly, will incur any additional costs, liabilities, or obligations in conjunction with the acquisition of Delta by PNG; and that

⁴ Application, Direct Testimony of Morgan K. O'Brien at 14.

Delta will not incur any additional indebtedness or pledge any assets to finance any part of the purchase price paid by PNG for Delta stock.⁵

During the course of this proceeding, PNG confirmed and clarified in greater detail its commitments to Delta and its customers and the Commission, which are listed specifically by the Attorney General in his Final Comments with references to the record developed through discovery.⁶ The Attorney General stated that the commitments and representations regarding PNG's post-closing processes and governance of Delta are necessary to protect Delta's customers, and that they should be included in a Final Order finding that PNG has the financial, technical, and managerial abilities to provide reasonable service to Delta's ratepayers.⁷

DISCUSSION

Joint Applicants requested that the Commission approve the proposed transaction pursuant to KRS 278.020(6) and KRS 278.020(7).

Approval Pursuant to KRS 278.020(6)

KRS 278.020(6) provides that:

No person shall acquire or transfer ownership of, or control, or the right to control, any utility under the jurisdiction of the commission by sale of assets, transfer of stock, or otherwise, or abandon the same, without prior approval by the commission. The commission shall grant its approval if the person acquiring the utility has the financial, technical, and managerial abilities to provide reasonable service.

⁵ Application at 11.

⁶ Attorney General's Final Comments at 2-5.

⁷ *Id.* at 2, 5.

PNG has provided evidence to show that it is a financially strong company. In support of its statement that it is a creditworthy entity with investment-grade credit ratings, it provided copies of the most recent Moody's Investors Service and Standard & Poor's reports on PNG Companies, LLC.⁸ PNG stated that Delta will not be required to guarantee the credit of any PNG affiliates, pledge any of its assets, grant liens or encumbrances, or incur additional indebtedness to finance this transaction or to finance the debt or purchases of its affiliates, and that it would agree that Delta would maintain a maximum debt capitalization ratio of 55 percent.⁹ The Commission expects that PNG's strong record in accessing capital from financial markets will be a benefit to Delta and its customers, and that its policy of ring-fencing investments,¹⁰ which it will apply to Delta, will insulate Delta's regulated utility operations from any risk that could be represented by other investments of SRIFNA.¹¹

PNG has extensive experience in operating regulated natural gas distribution utilities. It is the parent company of utilities that serve 700,000 gas customers in Pennsylvania and West Virginia, and 2,950 farm tap customers in eastern Kentucky. PNG will continue to employ Delta's current employees and will operate from Delta's existing offices under the Delta name and logo. PNG states that its acquisition of Delta will benefit Delta and its customers in the following ways:

⁸ Response to Commission Staff's First Request for Information to Joint Applicants ("Staff's First Request"), Item 17.

⁹ Attorney General's Final Comments at 3.

¹⁰ The October 27, 2016 Moody's Investors Service report filed in response to Staff's First Request, Item 17, states on page 2 that Moody's considers the practice of ring-fencing as credit positive for PNG Companies' utilities.

¹¹ Amended Application, Direct Testimony of John McGuire at 4-5.

- Improving the level of customer service and providing tools to better manage Delta's resources by leveraging PNG's significant technology investments in the areas of customer service, gas control, operation management, and accounting/human resource management.
- Providing the level of capital necessary to ensure the timely and effective continuation of Delta's pipeline-replacement program.
- Expanding the opportunity for customers to have access to natural gas services within Delta's footprint and engaging with underserved communities to see where those opportunities would make sense.
- Providing Delta employees with the most state-of-the-art tools in order to continue to improve the safety of providing services to the current and future Delta customers.
- Expanding Delta's partnerships and working relationships with economic development leaders within the communities and within government to help drive and support the further success and growth of the communities within the Delta footprint.¹²

Approval Pursuant to KRS 278.020(7)

KRS 278.020(7) provides, in relevant part, that the Commission shall approve a proposed acquisition of control upon a finding that the proposed transaction is "made in accordance with law, for a proper purpose and is consistent with the public interest."

Here, PNG contends that the proposed transaction has received all necessary company and government approvals, and therefore will be made in accordance with the

¹² Application, Direct Testimony of Morgan K. O'Brien at 11–12.

law. The proposed transaction has been approved by Delta's shareholders, PNG's Board of Managers, and Drake's Board of Directors.¹³ The Hart-Scott-Rodino antitrust review of the proposed transaction, the only necessary regulatory approval other than the Commission's approval, has been completed.¹⁴ PNG and Delta have committed to make all required post-closing federal and state regulatory filings on a timely basis.

As set forth above, PNG details how the proposed transaction will benefit Delta customers and thus satisfies the proper purpose criteria because the proposed transaction will permit Delta to continue to meet its commitment to provide reasonable service to Delta's customers.

Notably, PNG's arguments in support of a finding that the proposed transaction is consistent with the public interest turn primarily upon the commitments PNG has made to the Commission and to the Attorney General in its Application, Amended Application, and through discovery. For example, PNG avers that the proposed transaction is consistent with the public interest and will not adversely affect Delta's customers, that Delta will maintain the rates currently in effect, and that any modification of the rates will be in accordance with Kentucky law.

FINDINGS

The Commission, based on the evidence of record and being otherwise sufficiently advised finds that:

1. PNG has the financial, technical, and managerial abilities to provide reasonable utility service.

¹³ Delta's June 6, 2017 Response to the Attorney General's Initial Request for Information, Item No. 16; Application at 10.

¹⁴ June 8, 2017 Video Hearing Transcript ("VHT") at 9:15:00-9:16:00.

2. The proposed acquisition of the assets of Delta by PNG and the associated transfer of control resulting from this transaction is in accordance with law, for a proper purpose, and will be consistent with the public interest only if Joint Applicants adhere to the commitments discussed herein and developed through the processing of this proceeding.

3. The acquisition should be approved on the condition that the Chief Executive Officers of Joint Applicants shall file, within seven days of the date of this Order, a written acknowledgement accepting, and agreeing to be bound by, all of the commitments made during the course of this proceeding, as specifically enumerated in the Appendix to this Order.

4. To advance PNG's stated goal of maintaining a close relationship with the Commission,¹⁵ PNG should arrange for meetings between PNG's chief executive and the Commission and/or Commission Staff at least once a year.

IT IS THEREFORE ORDERED that:

1. PNG's acquisition of Delta is approved, subject to the filing within seven days of the date of this Order of the written acknowledgements described in Finding No. 3 above.

2. Within five days of consummation of the acquisition, PNG shall file a written notice setting forth the date of acquisition.

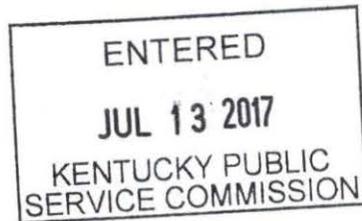
3. Within 20 days of the consummation of the acquisition, PNG shall file the journal entries it proposes to record the acquisition. The acquisition shall be recorded in accordance with the Uniform System of Accounts.

¹⁵ Application, Direct Testimony of Morgan K. O'Brien, page 5, lines 5-7.

4. Within 20 days of the completion of the acquisition, PNG shall file a signed and dated tariff adoption notice in accordance with 807 KAR 5:011, Section 11.

5. Any document filed in the future pursuant to ordering paragraphs 1 through 3 herein shall reference this case number and shall be retained in the utility's general correspondence file.

By the Commission



ATTEST:

A handwritten signature in blue ink, appearing to read "John D. Pyem".

Acting Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2017-00125 DATED **JUL 13 2017**

1. PNG commits to maintain Delta's headquarters in Winchester, Kentucky, following the closing of the acquisition.
2. PNG commits to operate the surviving entity under the name "Delta Natural Gas" and use its current logo.
3. PNG commits to maintain Delta's historic levels of community involvement, charitable contributions, low income funding, and economic development efforts in Delta's current operating areas.
4. PNG commits to provide compensation, benefits, and severance protection to non-executive employees of Delta as set out in the APM.
5. PNG commits to enter into discussions with each of Delta's five executive officers, Glenn Jennings, John Brown, Johnny Caudill, Brian Ramsey, and Matthew Wesolosky, regarding mutually agreeable terms for the executive officers to continue their employment with Delta after the proposed transaction closes.
6. PNG commits to provide copies of post-closing employment agreements with Delta executives Glenn Jennings, John Brown, Johnny Caudill, Brian Ramsey, and Matthew Wesolosky, their respective job titles and duties, if the Delta executives enter into employment agreements with PNG.
7. PNG commits to having an independent director on Delta's post-closing board of directors.

8. Joint Applicants commit that neither Delta nor its ratepayers, directly or indirectly, will incur any additional costs, liabilities, or obligations in conjunction with the acquisition of Delta by Joint Applicants.

9. Joint Applicants commit that they will not seek to recover costs associated with the transaction in Delta's rates.

10. Joint Applicants commit that they will not utilize push-down accounting in any manner arising from the transaction contemplated in this case.

11. Joint Applicants commit that they will file an application and seek Commission approval prior to entering into any services agreement with Peoples Service Company.

12. Joint Applicants commit that all contractual and regulatory commitments entered into by Delta prior to the closing of the transaction will be honored.

13. Joint Applicants commit that Delta will give clear and conspicuous notice to its customers prior to any change in services resulting from the contemplated transaction.

14. Joint Applicants commit that Delta ratepayers will not be asked to contribute to costs associated with operating any PNG utility, including People's KY Gas, LLC.

15. Joint Applicants commit that Delta will not guarantee the credit of any affiliates if the transaction is approved.

16. Joint Applicants commit they will not seek recovery for any costs to achieve the transaction, or costs to achieve initial savings associated with the transition of Delta from a publicly traded company to a privately held company.

17. Joint Applicants commit that Delta will not be required to pledge any of its assets to finance the debt or any purchases of its affiliates.

18. Joint Applicants commit that Delta will not be required to grant liens or encumbrances, or otherwise pledge any of their assets to finance any or all of the costs of the transaction.

19. Joint Applicants commit that neither Delta nor its ratepayers will directly or indirectly incur any additional costs, liabilities, or obligations in conjunction with the proposed transaction in connection with the repayment and refinancing of closing indebtedness.

20. Joint Applicants commit that Delta will not be exposed to any increased insurance premiums in the event the Commission approves the transaction.

21. Joint Applicants commit that Delta will not be exposed to any additional contributions to any pension or medical plans, etc., for employees than it otherwise would not have faced but for the approval.

22. Joint Applicants commit to ring-fencing of Delta such that Delta would be insulated from Joint Applicants' non-utility lines of business.

23. Joint Applicants commit to limiting Delta's dividend payable to PNG to a level that maintains a maximum debt-to-capitalization ratio at the utility, excluding working capital borrowing, of 55 percent.

24. Joint Applicants commit that Delta will not (a) guarantee debt or credit facilities of any PNG affiliate; (b) mortgage utility assets on behalf of an affiliate; and (c) loan funds or otherwise extend credit to any affiliate.

25. Joint Applicants commit that, in the event an employee is terminated without cause prior to the termination of the “no impact period,” any severance paid to such an employee would be considered a transaction cost and would not be recovered through Delta’s rates.

26. Joint Applicants commit that Delta will not incur any additional indebtedness or pledge any assets to finance any part of the purchase price paid by PNG for Delta stock.

27. Joint Applicants commit that Delta will seek Commission approval pursuant to KRS 278.300 if Delta issues any securities or evidences of indebtedness with PNG.

28. Joint Applicants commit to provide the names of all directors of Delta’s post-closing board of directors, together with a short biographical description of each board member.

29. Joint Applicants commit to maintain a minimum debt-to-capitalization ratio of 40 percent provided that such commitment will not apply during the period between the exchange of notes with the existing Delta noteholders and the issuance of an intercompany note between PNG and Delta.

30. Joint Applicants commit that they will maintain Delta’s corporate office, and its books and records, within Delta’s service territory.

31. Joint Applicants commit that if PNG Companies, LLC and/or any of its affiliates are the sources for any charges to Delta, Joint Applicants agree to allow the Commission to audit the accounting records of those affiliates.

32. Joint Applicants commit they will not cross-subsidize between their regulated and non-regulated businesses.

33. Joint Applicants commit that the accounting and ratemaking treatments of Delta's excess deferred income taxes will not be affected by the transaction.

34. Joint Applicants commit that Delta's customers will experience no adverse change in service if the transaction is approved.

35. Joint Applicants commit that they will not achieve merger savings at the expense of degrading the adequacy and reliability of Delta's retail gas service.

36. Joint Applicants commit that costs pertaining to the lawsuits filed against Delta and others arising from the proposed transaction (including but not limited to attorney fees and any sums paid in settlements) are considered transaction costs and will not be recovered from Delta's ratepayers.

37. Joint Applicants commit that only shareholder funds will be used in providing grants or donations for economic development.

38. Joint Applicants commit that the proposed transaction will not result in any write-ups, write-offs, or restatements of financial results.

39. Joint Applicants commit that Delta ratepayers will not be responsible for any termination, and/or other fees or expenses paid should the contemplated transaction not be consummated.

40. Joint Applicants commit that no additional stock of any class will be issued as a condition of the transaction's consummation.

41. Joint Applicants commit that any costs associated with Delta's use of the SAP based Customer Information System will be capitalized and accounted for in the appropriate Federal Energy Regulatory Commission account.

42. Joint Applicants commit that any changes to the Delta Pipeline Replacement Program will be filed with the Commission and approval of any changes contemplated will be sought at that time.

43. Joint Applicants commit that Delta will not incur any additional indebtedness or pledge any assets to finance any part of the purchase price paid by PNG for Delta stock.

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