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April 4, 2023

ELECTRONIC FILING

Mr. Adam J. Teitzman, Commission Clerk
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Docket 20230023-GU, Petition for Rate Increase by Peoples Gas System, Inc.

Dear Mr. Teitzman:

Attached for filing on behalf of Peoples Gas System, Inc. in the above-referenced docket is the Direct Testimony of Kenneth D. McOnie and Exhibit No. KDM-1.

Thank you for your assistance in connection with this matter.

(Document 11 of 18)

Sincerely,

J. Jeffry Wahlen

cc: Charles J. Rehwinkel, Public Counsel
Jon Moyle, FIPUG
Major Thompson, OGC
Ryan Sandy, OGC

JJW/ne
Attachment

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 20230023-GU

IN RE: PETITION FOR RATE INCREASE

BY PEOPLES GAS SYSTEM, INC.

PREPARED DIRECT TESTIMONY AND EXHIBIT

OF

KENNETH D. MCONIE

TABLE OF CONTENTS

PREPARED DIRECT TESTIMONY AND EXHIBIT

OF

KENNETH D. MCONIE

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

PREPARED DIRECT TESTIMONY

OF

KENNETH D. MCONIE

Q. Please state your name, address, occupation and employer.

A. My name is Kenneth D. McOnie. My business address is Emera Place, 5151 Terminal Road, Halifax, Nova Scotia, Canada. I am Vice President Tax and Treasurer for Emera Incorporated (“Emera”), which is the parent company of Emera U.S. Holdings, Inc., which is the parent company of TECO Energy, Inc. (“TECO Energy” or the “parent company”), which is the parent company of TECO Gas Operations, Inc., which is the parent company of Peoples Gas System, Inc. (“Peoples” or the “company”).

Q. Please describe your duties and responsibilities in that position.

A. I am responsible for Emera’s treasury and tax functions. My team is responsible for establishing and maintaining effective working relations with the investment and banking communities, and for the administration of the Canadian-based tax group. My team is also responsible for forecasting interest rates for the company.

Q. Please summarize your educational background and business experience.

A. I received a Bachelor of Commerce degree from Saint Mary’s University and a Master of Business Administration with a concentration in Finance and International Business from Dalhousie University. I also hold the Chartered Professional Accountant certification. I have been working with Emera for more than 20 years in roles with increasing responsibility and have been Treasurer for over 10 years.

Q. What are the purposes of your prepared direct testimony in this proceeding?

A. My direct testimony explains why it is important for Peoples to maintain its financial integrity. More specifically, I will: (1) explain the important role strong credit ratings play in providing unimpeded access to capital with reasonable terms and costs; (2) demonstrate the importance of the requested rate relief to maintain Peoples’ financial integrity; (3) describe the transfer of Peoples’ gas operations and assets from Tampa Electric Company (“Tampa Electric”) to Peoples and its impact on the company’s capital structure and borrowing activities; (4) explain the company’s proposed capital structure for the test year and how the company forecasted short-term and long-term debt for the test year; and (5) explain why the company’s proposed equity ratio of 54.7 percent (investor sources) is prudent and appropriate to maintain the company’s financial integrity.

Q. Have you prepared an exhibit to support your prepared direct testimony?

A. Yes. Exhibit No. KDM-1, entitled “Exhibit of Kenneth D. McOnie” was prepared under my direction and supervision and accompanies my prepared direct testimony. My exhibit consists of these five documents:

Document No. 1	List of Minimum Filing Requirements Co-sponsored by Kenneth D. McOnie
Document No. 2	Historic Secured Overnight Financing Rate 2021 to 2023
Document No. 3	Forecasted U.S. Treasury Rates
Document No. 4	U.S. Treasury Rates 2020 to 2022
Document No. 5	Thirty Year History of U.S. Treasury Rates and Averages

The contents of my exhibit and the MFR schedules referenced in them were derived from the business records of the company and are true and correct to the best of my information and belief.

FINANCIAL INTEGRITY

Q. What is financial integrity?

A. Financial integrity refers to a relatively stable condition of liquidity and profitability in which the company can meet its financial obligations to investors while maintaining the ability to attract investor capital as needed on reasonable terms, conditions, and costs.

Q. How is financial integrity measured?

A. Financial integrity is a function of financial risk, which represents the risk that a company may not have adequate cash flows to meet its financial obligations. The level of cash flows and the percentage of debt, or financial leverage, in the capital structure is a key determinant of financial integrity. As such, as the percentage of debt in the capital structure increases so do the fixed obligations for the repayment of that debt. Consequently, as financial leverage increases the level of financial distress (financial risk) increases as well. Therefore, the percentage of internally generated cash flows compared to these financial obligations is a primary indicator of financial integrity and is relied upon by rating agencies when they assign debt ratings.

Q. Why is financial integrity important to Peoples and its customers?

A. As a regulated utility, Peoples has an obligation to provide gas service to customers in accordance with its tariff, and the statutes and rules regulating its activities. Meeting customer demand for gas service requires the company to make significant investments in utility property, plant, and equipment, both planned and unplanned, which makes the gas business very capital intensive. As explained by Peoples' witness Rachel B. Parsons in her prepared direct testimony, Peoples expects to invest over one billion dollars to serve customers from January 1, 2022 to December 31, 2024.

Peoples' customers benefit directly from the company's infrastructure investments. The State of Florida is growing rapidly, and as it does Peoples must: invest in new mains, laterals, service lines, and meters; hire team members to operate and maintain a growing system; and spend money building, upgrading, and moving the company's gas distribution infrastructure to accommodate third-party construction. Maintaining a strong financial position allows the company to finance infrastructure investments in support of an improved system at a lower cost than would otherwise be possible.

Financial integrity is also important to ensure access to capital. Peoples’ responsibility to serve is not contingent upon the health or the state of the financial markets. In times of constrained access to capital and depressed market conditions, only those utilities exhibiting financial integrity can attract capital under reasonable terms providing significant and potentially critical flexibility. Since Peoples builds infrastructure to meet customer demands, it has a limited ability to adjust the timing and amount of major capital expenditures to align with economic cycles or wait out market disruptions.

The strength of Peoples’ balance sheet and its financial flexibility are important factors influencing its ability to finance major infrastructure investments as well as manage unexpected events. Financial integrity is essential to supporting the company’s need for capital. As I explain later in my direct testimony, beginning in 2023 Peoples will be competing in a global market for capital, which will amplify the importance of a strong balance sheet and reasonable rates of return on its ability to attract capital. Financial strength and flexibility enable Peoples to have ready access to capital with reasonable terms and costs for the long-term benefit of its customers.

Q. How will the company’s proposed base rate increase affect Peoples’ financial integrity?

A. The requested base rate increase will place Peoples in a prudent and responsible financial position to fund its capital program and continue providing safe and reliable gas service to its customers. To raise the required capital, the company must be able to provide fair returns to investors commensurate with the risks they assume. Having a strong financial position will ensure that Peoples has a reliable stream of external capital and will allow the company’s capital spending needs to be met in a cost-effective and timely manner. Uninterrupted access to the financial markets will provide Peoples with the capital it needs on reasonable terms so it can continue to improve and protect the long-term interests of its customers.

IMPORTANCE OF CREDIT RATINGS

Q. What are credit ratings and why are they important?

A. The term "credit rating" refers to letter designations assigned by credit rating agencies that reflect their independent assessment of the credit quality of entities that issue publicly traded debt securities. Credit ratings are like the grades a student receives on his or her report card – an A is better than a B letter grade – likewise an AAA is better than a BBB level credit rating. Credit ratings reflect the informed and independent views of firms that study borrowers and market conditions and impact the interest rates borrowers must pay when accessing borrowed funds from both banks and capital markets. In general, a higher credit rating means a lower credit spread and a lower credit rating means a higher credit spread. The credit spread is the charge added to the underlying variable rate benchmark for overnight funds in the case of short-term bank borrowing and U.S. treasury bonds in the case of long-term debt offerings. Peoples invests capital to serve customers and strong debt ratings will ensure that Peoples will have adequate credit quality to raise the capital necessary to meet these requirements.

Q. Why are strong ratings important considering the company's future capital needs?

A. A strong credit rating is important because it affects a company's cost of capital and access to the capital markets.

Credit ratings indicate the relative riskiness of the company's debt securities. Therefore, credit ratings are reflected in the cost of borrowed funds. All other factors being equal (*i.e.,* timing, markets, size, and terms of an offering), the higher the credit rating, the lower the cost of funds. Companies with lower credit ratings have greater difficulty raising funds in any market, but especially in times of economic uncertainty, credit crunches, or during periods when large volumes of government and higher-grade corporate debt are being sold.

Given the capital-intensive nature of the utility industry, it is critical that utilities maintain strong credit ratings sufficiently above the investment grade threshold to retain uninterrupted access to capital. The impact of being investment grade versus non-investment grade is material. For example, a company raising debt that has non-investment grade (“speculative grade”) credit ratings will be subject to occasional lapses in availability of debt capital, onerous debt covenants and higher borrowing costs. In addition, companies with non-investment grade ratings are generally unable to obtain unsecured commercial credit and must provide collateral, prepayment, or letters of credit for contractual agreements such as long-term gas transportation and fuel purchases.

Given the high capital requirements, obligation to serve existing and new customers, and significant requirements for unsecured commercial credit that gas utilities have, non-investment grade ratings are unacceptable. Peoples needs to have a financial profile that will support a strong credit rating.

Q. Can the financial credit market be foreclosed by unforeseen events extraneous to the utility industry?

A. Yes. There have been times when financial credit markets have been closed or challenged due to unforeseen events. Market instability resulting from the sub-prime mortgage problems affected liquidity in the entire financial sector causing a financial recession, and there were periods of time in 2008 and 2009 when the debt markets were effectively closed to all but the highest rated borrowers. This is a good example of how access to the marketplace can be shut off for even creditworthy borrowers by extraneous, unforeseen events, and it emphasizes why a strong credit rating is essential to ongoing, unimpeded access to the capital markets.

Q. How are credit ratings determined?

A. Generally, the process the rating agencies follow to determine ratings involves an assessment of both business risk and financial risk. Business risk is typically determined based on the combined assessment of industry risk, country risk, and competitive position. Financial risk is based on financial ratios covering cash flow/leverage analysis. These two factors are combined to arrive at an overall credit rating for a company. Business risk and financial risk are more fully discussed and described in the direct testimony of witness, Dylan W. D'Ascendis.

Q. How does regulation affect ratings?

A. The primary business risk the rating agencies focus on for utilities is regulation, and each of the rating agencies have their own views of the regulatory climate in which a utility operates. The exact assessments of the rating agencies may differ but the principles they rely upon for their independent views of the regulatory regime are similar. Essentially, the principles, or categories, that shape the views of the rating agencies as they relate to regulation are based upon the degree of transparency, predictability, and stability of the regulatory environment; timeliness of operating and capital cost recovery; regulatory independence; and financial stability.

According to the rating agencies the maintenance of constructive regulatory practices that support the creditworthiness of the utilities is one of the most important issues rating agencies consider when deliberating ratings. Regulation in Florida has historically been supportive of maintaining the credit quality of the state’s utilities, and that has benefited customers by allowing utilities to provide for their customers’ needs consistently and at a reasonable cost. This has been one of the factors that has helped Florida utilities maintain pace with the growth in the state, which has been essential to economic development. A key test of regulatory quality is the ability of companies to earn a reasonable rate of return over time, including through varying economic cycles, and to maintain satisfactory financial ratios supported by good quality of earnings and stability of cash flows. Regulated utilities cannot materially improve or even maintain their financial condition without regulatory support. Thus, the regulatory climate has a large impact on the company, its customers, and its investors.

Q. What are Peoples’ current credit ratings?

A. As explained in the next portion of my direct testimony, Peoples has not been borrowing money by directly accessing capital markets, and therefore does not presently have rated debt. However, Peoples will be directly accessing capital markets in 2023 to obtain short- and long-term debt capital and will be going through the process of establishing its own credit rating(s) in 2023.

2023 TRANSACTION

Q. Please describe the recent changes to Peoples' legal structure.

A. On June 16, 1997, Peoples was acquired by TECO Energy, Inc. and merged into Tampa Electric. Peoples operated as a division of Tampa Electric from 1997 to the end of 2022.

Effective January 1, 2023, the assets, liabilities, and equity of the Peoples Gas System, a division of Tampa Electric Company were transferred into a separate corporation named Peoples Gas System, Inc., which is a wholly owned subsidiary of newly formed gas operations holding company, TECO Gas Operations, Inc., which is a subsidiary of TECO Energy, Inc. I will refer to this transaction as the "2023 Transaction" in the remainder of my direct testimony.

The business reasons for the 2023 Transaction, why it was prudent, and how it will benefit customers are explained by

Peoples’ witness Helen J. Wesley in her prepared direct testimony.

Q. When the company operated as a division of Tampa Electric, did Peoples make short- and long-term borrowing arrangements with unaffiliated, third-party lenders?

A. No. From 1997 to 2022, Tampa Electric borrowed enough money on a short- and long-term basis to meet the debt capital needs of Peoples and a portion of Tampa Electric’s short- and long-term debt was allocated to the Peoples division on an intra-company basis.

Q. How did Peoples obtain equity capital when it was operated as a division of Tampa Electric?

A. Peoples obtained equity capital from TECO Energy, Inc.

Q. What happened to the debt and equity on the books of the Peoples division of Tampa Electric during the 2023 Transaction?

A. The equity on the books of the Peoples division of Tampa Electric as of December 31, 2022 (approximately $991 million) was transferred to Peoples effective January 1, 2023. The

Peoples division’s allocation of Tampa Electric’s outstanding unsecured notes (approximately $570 million) and outstanding short-term borrowings (approximately $166 million) as of December 31, 2022 were converted into an Intercompany Debt Agreement with Tampa Electric on January 1, 2023, with interest rates on each allocation being maintained accordingly. The amount due to Tampa Electric under the Intercompany Debt Agreement on January 1, 2023 was approximately $736 million.

Q. Why didn’t Peoples pay off or retire its allocation of Tampa Electric’s outstanding unsecured notes and outstanding short-term borrowings as of December 31, 2022 as part of the 2023 Transaction?

A. The Intercompany Debt Agreement is an interim measure to bridge Peoples to the establishment of its own revolving credit facility with a syndicate of bank lenders and to its first long-term bond issuance. To achieve both of these events in the most cost-effective manner, Peoples needs to have its own independent credit rating and wants to access the market at a favorable time. As a part of this process, Peoples will be seeking indicative assessments from the rating agencies based upon its business and financial risk relative to its regulatory and operating environment to determine its overall credit rating. As discussed later in my direct testimony, the indicative assessments will be based on Peoples' regulatory environment and financial projections as submitted in the current rate case for the 2024 test year. Absent these milestones, Peoples could not cost effectively pay off or retire its allocation of Tampa Electric's outstanding unsecured notes and outstanding short-term borrowings on December 31, 2022.

Q. Now that it is a separate, stand-alone corporation, how will Peoples obtain equity capital?

A. Peoples will obtain equity capital from its parent, TECO Energy.

Q. Now that it is a separate, stand-alone corporation, how will Peoples obtain debt capital?

A. During 2023, Tampa Electric will provide short-term debt funding to Peoples through the Intercompany Debt Agreement at Tampa Electric's prevailing cost of short- and long-term debt borrowings. The Intercompany Debt Agreement will remain outstanding until Peoples pays Tampa Electric all principal and interest due on the Intercompany Debt Agreement. As reflected in its 2023 budget, Peoples expects that its shortand long-term obligations under the Intercompany Debt Agreement will total approximately $910 million by the time the agreement is paid off.

By the end of 2023, Peoples will also: (1) establish its own independent credit rating(s); (2) make short- and long-term borrowing arrangements with its lenders; and (3) pay off its obligations under the Intercompany Debt Agreement with Tampa Electric.

Q. Is Peoples required to complete the external debt financing activities by December 31, 2023?

A. Yes. The company must begin securing its own debt capital by borrowing from lenders and pay off the Intercompany Debt Agreement by December 31, 2023 so the asset transfer will be considered a non-taxable event for U.S. federal income tax purposes. Given this requirement and its importance to being considered a non-taxable event, Peoples will, in parallel with this general rate proceeding, be working as expeditiously as possible to undertake and complete all possible preparatory financing activities necessary to be in a position to establish the company’s bank syndicated revolving credit facility for short-term borrowing and to complete its first long-term debt offering during 2023.

Q. What is the process for Peoples to obtain its own, stand-alone credit rating from rating agencies?

A. Peoples intends to engage Moody's, S&P Global and Fitch (collectively, the "rating agencies") during the second quarter of 2023 to assess the credit worthiness of Peoples and assign an indicative rating as part of the rating evaluation service provided by each of the rating agencies. The indicative rating will be based on several factors and assumptions, with one of the most important being the outcome of Peoples' current base rate proceeding.

As a part of the process, Peoples will be required to provide the rating agencies with information regarding the company's strategy, regulatory environment and financial projections based on the current rate case and 2024 test year. The resulting rating will be indicative and will not be for public disclosure as it can only be finalized at the conclusion of this rate proceeding. At that time, the rating agencies will assess the outcome of this case relative to the previous information provided to them from both a business and financial risk perspective and assign a final credit rating. Maintaining Peoples' equity ratio at 54.7 percent with a midpoint ROE of 11.0 percent should support credit rating parameters for the BBB+ level being targeted by the company.

Q. Can the company predict the credit ratings it will likely receive from credit rating agencies?

A. The company cannot predict what its forthcoming credit ratings will be but is targeting an indicative BBB+ credit rating to provide access to debt capital at reasonable interest rates. As discussed below, the company has considered the impact of this in its projected cost of borrowing short- and long-term debt in 2023 budgeted and the projected 2024 test years.

Q. What impact will paying off the Intercompany Debt Agreement and replacing it with external debt have on the company’s borrowing costs?

A. Replacing the Intercompany Debt Agreement with external debt will increase the company’s borrowing costs, because the long-term debt allocated to Peoples under the Intercompany Debt Agreement was entered into by Tampa Electric when long-term debt rates were lower than the interest rates the company expects to be in effect when it completes its first long-term debt offering during 2023. The company estimates that the impact of this debt replacement in 2023 and the 2024 test year will be to increase the cost of long-term debt from 3.97 percent in 2022 to 5.54 percent in 2024.

CAPITAL STRUCTURE, EQUITY RATIO AND COST-OF-DEBT

Q. What is the overall cost-of-capital being proposed by Peoples in this proceeding?

A. As explained in the direct testimony of Rachael Parsons, the company's proposed cost-of-capital is 7.42 percent. The 7.42 percent proposed cost-of-capital is based on a return on equity of 11.0 percent, which is supported in the prepared direct testimony of witness Dylan W. D'Ascendis, and an investor sources capital structure ratio of 54.7 percent equity and 45.3 percent total debt. The proposed cost-of-capital reflects short-term debt costs of 4.85 percent and long-term debt costs of 5.54 percent. The proposed cost-of-capital also includes customer deposits at a cost of 2.53 percent, Investment Tax Credits at a weighted cost of 8.49 percent and Accumulated Deferred Income Taxes at zero cost.

Q. How does the company's proposed 54.7 percent equity ratio compare with the allowed capital structure in Peoples' last general base rate proceeding?

A. The proposed capital structure equity ratio of 54.7 percent is consistent with the approved capital structure as approved by the Florida Public Service Commission ("Commission") Order No. PSC-2020-0485-FOF-GU in Docket No. 20200051-GU ("2020

Agreement”).

Q. How does the company’s proposed equity ratio of 54.7 percent compare to the equity ratios recently approved by the Commission for the gas operations of Florida Public Utilities Company (“FPUC”) and Florida City Gas?

A. The Commission recently approved a 55.1 percent equity ratio for FPUC and Commission Staff recently recommended a 59.7 percent equity ratio for Florida City Gas. Peoples’ proposed equity ratio compares favorably to these equity ratios. Peoples proposed equity ratio is also consistent with the equity ratio actually maintained by the company for the past few years.

Q. Is Peoples’ proposed equity ratio of 54.7 percent reasonable and prudent for use in this proceeding?

A. Peoples’ proposed equity ratio of 54.7 percent is reasonable and prudent as it has a direct impact on the level of cash flows and the percentage of debt giving rise to the financial leverage in the capital structure, which is a key determinant of financial integrity. Financial integrity is a function of financial risk, or the risk that a company may not have adequate cash flows to meet its financial obligations, and this is one of the primary indicators relied upon by rating agencies when they assign debt ratings. The requested 54.7 percent equity ratio will also place Peoples in a prudent and responsible financial position to fund its capital program and continue providing safe and reliable gas service to its customers.

Q. What equity infusions from TECO Energy for 2023 and 2024 are necessary to achieve the proposed 54.7 percent equity capital structure?

A. As discussed in the direct testimony of witness Parsons, the 2023 and 2024 budgeted equity infusions are $135 million and $140 million, respectively. These planned equity infusions are based on the company's planned capital structure needs, its planned capital expenditures and business requirements, and a targeted equity ratio of 54.7 percent.

Q. How did the company determine the short-term debt cost rate for the 2024 projected test year?

A. The short-term debt cost rate of 4.85 percent is based on the estimated cost of the company's credit facilities, which rates are based on the Secured Overnight Financing Rate ("SOFR") plus credit spreads and program fees. The short-term debt cost rate assumes that Peoples achieves terms and conditions like Tampa Electric’s revolving credit facility and Peoples is successful in achieving its targeted BBB+ credit rating.

Q. How does the company’s proposed 4.85 percent cost of short-term debt compare with the cost of debt in the Peoples 2020 general base rate proceeding?

A. The short-term cost of debt in the 2020 general base rate proceeding approved by the Commission in the 2020 Agreement was 1.15 percent.

Q. What are the main drivers for the increase in the short-term cost of debt in the 2024 test year?

A. The main driver for the increase in the short-term cost of debt is the underlying overnight borrowing rate, which has increased by approximately 425 basis points for SOFR since the last general base rate proceeding as shown on Document No. 2 of my exhibit. The Federal Reserve has been increasing the overnight borrowing rate to moderate the high inflation rates experienced in 2022 and has signaled its intent to continue increasing the overnight rate into 2023 because the current inflationary period has not yet ended and has been more persistent than the Federal Reserve expected. The persistent nature of inflation has contributed to the volatility of interest rates experienced to date and as reflected in future forecasts as economists attempt to predict the Federal Reserve’s approach to determining and setting the overnight borrowing rate.

Q. How did the company determine the cost and amount of long-term debt to be included in the capital structure?

A. As shown on MFR Schedule G-3, page 8, the long-term debt cost rate of 5.54 percent is based on forecasted debt issuance of $825 million during 2023 and $100 million in 2024. The $825 million inaugural debt issuance during 2023 is forecasted to occur using three tranches of differing terms including: (i) $325 million of 5-year notes at 5.40 percent, (ii) $300 million of 10-year notes at 5.47 percent, and (iii) $200 million of 30-year notes at 6.00 percent. Although the company cannot predict the specific time of year this will occur, the company budgeted the 2023 issuance to occur on September 30, 2023. The 2024 issuance assumes a June 30 financing date for $100 million of 10-year notes at 5.37 percent. When developing the forecasted debt issuance and cost rate, the company considered its targeted equity ratio and assumed ongoing drawn amounts on the company’s credit facilities related to the company’s normal course of business and liquidity requirements.

The long-term cost of debt is based upon the underlying U.S. Treasury (“UST”) rates sourced from Bloomberg (Document No. 3 of my exhibit– Forecasted U.S. Treasury Rates) plus the average forecasted credit spread for a typical gas distribution company with a BBB+ credit rating. To mitigate the long-term cost of debt and future refinancing risk, Peoples has forecasted three debt issuance tranches for 5, 10 and 30 years.

Q. How does the company’s proposed 5.54 percent cost of long-term debt compare with the cost of debt in the Peoples 2020 general base rate proceeding?

A. The long-term cost of debt in the 2020 general base rate proceeding approved by the Commission in the 2020 Agreement was 3.85 percent.

Q. What are the main drivers for the increase in the long-term cost of debt in the 2024 test year?

A. The underlying UST rates have increased across the curve due primarily to the Federal Reserve hiking interest rates a cumulative 425 basis points since the beginning of 2022 bringing the Federal Funds Rate to 4.50 percent from 0.25 percent as shown on Document No. 4 of my exhibit– U.S. Treasury Rates 2020 to 2022. As a result, the yield curve continued to invert further as the policy of monetary tightening to combat inflation pushed shorter term rates higher, while the long end remained anchored due to the prospect for slower economic growth. Recently, the Federal Reserve announced it is prepared to raise interest rates until it thinks inflation has been sufficiently beaten back even if this sends the economy into recession. This means that interest rates may go higher and that the hiking cycle undertaken by the Federal Reserve will persist for a longer period. However, the Federal Reserve’s outlook and approach to interest rate actions will continue to be contingent upon inflation and how quickly it subsides.

Q. How is refinancing risk mitigated by issuing three tranches of debt?

A. As shown on Document No. 5 of my exhibit, the underlying UST rates have increased across the yield curve due primarily to the Federal Reserve hiking interest rates a cumulative 425 basis points since the beginning of 2022. However, as mentioned previously, the long end of the curve, or 30 year

UST, has remained anchored at approximately 4.00 percent relative to its long-term average of 4.45 percent. It is reasonable to expect a certain level of mean-reversion over a business cycle or longer period, so issuing three tranches of debt for terms of 5, 10 and 30 years would be prudent. This positioning of three tranches across the curve will provide a proper balance of cost and refinancing risk in the current interest rate environment and will be achieved by issuing a 30 year note, because the proposed issuance is in line with its long-term average and mitigates the risk of a continued rising rate environment. Additionally, having 5 and/or 10 year notes should afford Peoples with the opportunity to refinance at interest rates more reflective of their respective long-term averages in the future.

Q. What other mechanism does the company propose to address its proposed long-term debt rate in this case?

A. Peoples believes the introduction of a Long-Term Debt Rate True-Up Mechanism will provide a fair one-time adjustment to base rates reflecting the actual long-term debt cost achieved in 2023. The Long-Term Debt Rate True-Up Mechanism is more fully discussed and described in the direct testimony of witness Parsons.

SUMMARY

Q. Please summarize your prepared direct testimony.

A. Peoples' proposed equity ratio of 54.7 percent (investor sources) is reasonable and will help Peoples maintain the financial integrity needed to raise capital in financial markets on reasonable terms and conditions for the benefit of customers. The company's plan for raising short- and long-term debt in 2023 and 2024 is reasonable and properly reflected in the company's minimum filing requirement schedule for the projected 2024 test year. The company's forecasted short- and long-term debt rates for the projected 2024 test year are reasonable for use setting rates in this proceeding, and the company's forecasted long-term debt rates can be trued up to actual using the mechanism described in witness Parsons' direct testimony. The Commission should approve the proposals for ratemaking reflected in my prepared direct testimony.

Q. Does this conclude your prepared direct testimony?

A. Yes.

EXHIBIT

OF

KENNETH D. MCONIE

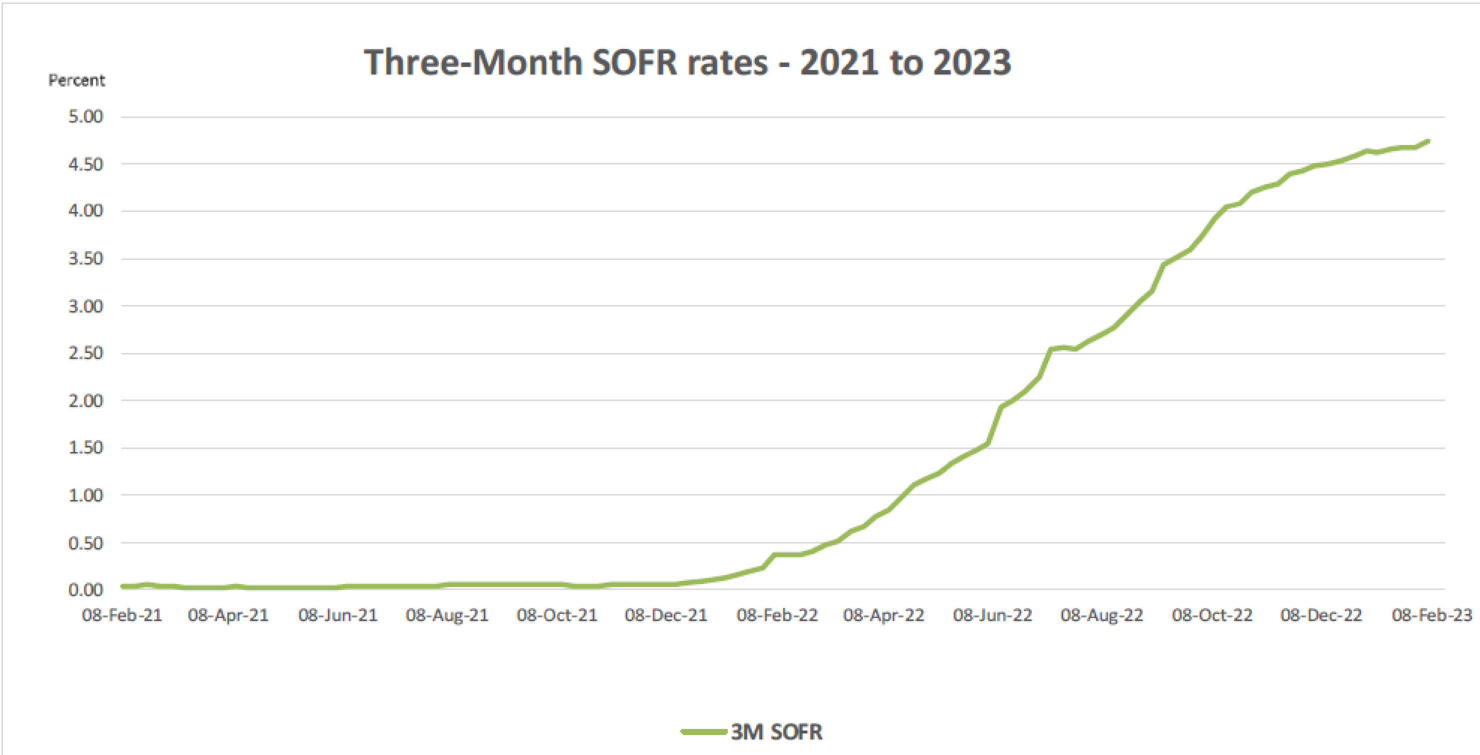
Table of Contents

List of Minimum Filing Requirements

Sponsored or Co-Sponsored by Kenneth D. McOnie

MFR Schedule	Page No.	MFR Title
G-6	P. 1	Projected Test Year - Major Assumptions

Historic SOFR 2021 to 2023



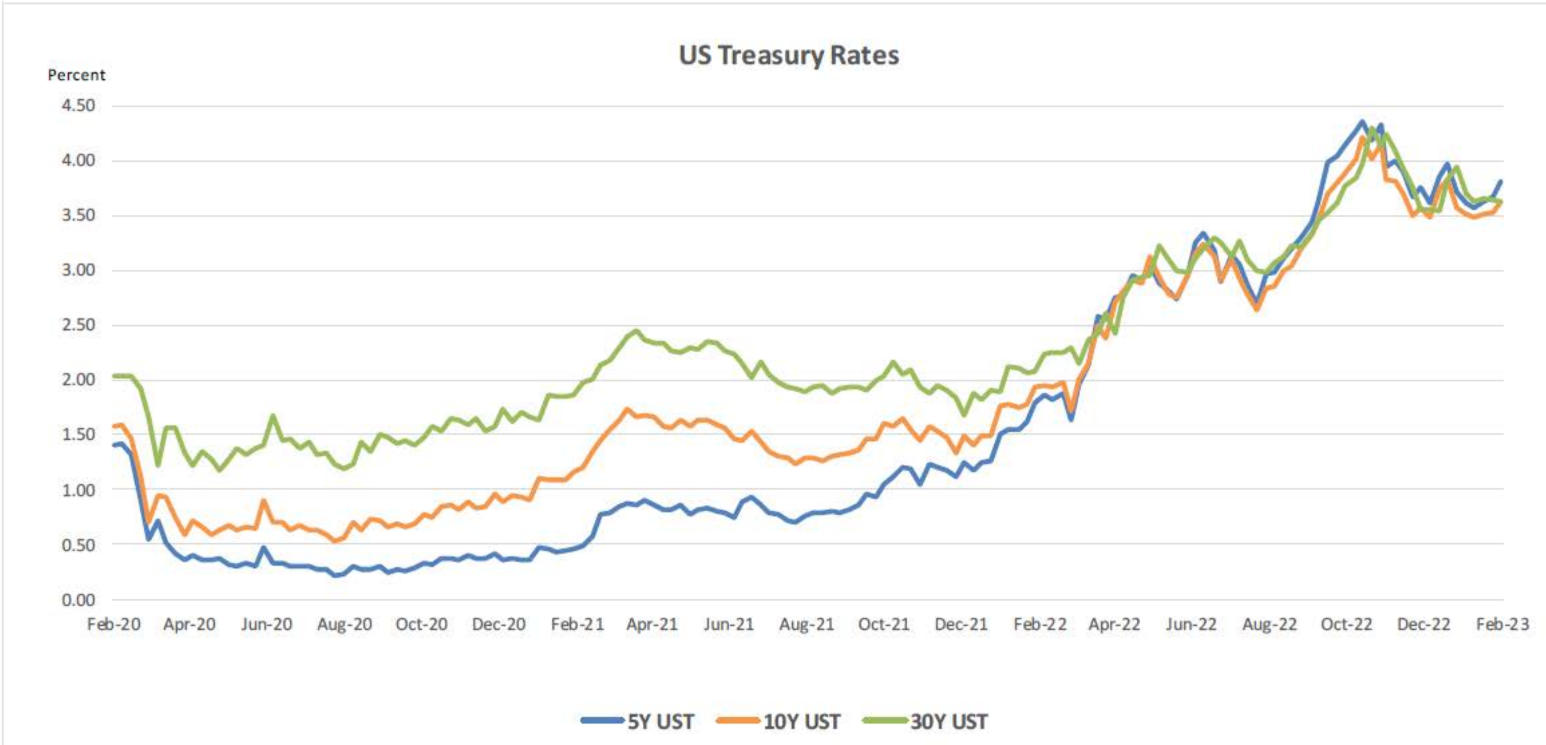
PEOPLES GAS SYSTEM, INC.
DOCKET NO. 20230023-GU
EXHIBIT NO. KDM-1
WITNESS: MCONIE
DOCUMENT NO. 2
PAGE 1 OF 1
FILED: 04/04/2023

Forecasted U.S. Treasury Rates

Forecasted US Treasury Rates (source: Bloomberg)						
Benchmark (Percent)	Dec-21	Q4-22	Q1-23	Q2-23	Q3-23	Q4-23
3-month (SOFR)	0.21	4.77	4.92	4.94	4.76	4.41
5-year	1.26	4.29	4.09	4.02	3.86	3.62
10-year	1.50	4.03	3.85	3.80	3.68	3.51
30-year	1.89	4.17	3.99	3.99	3.89	3.76

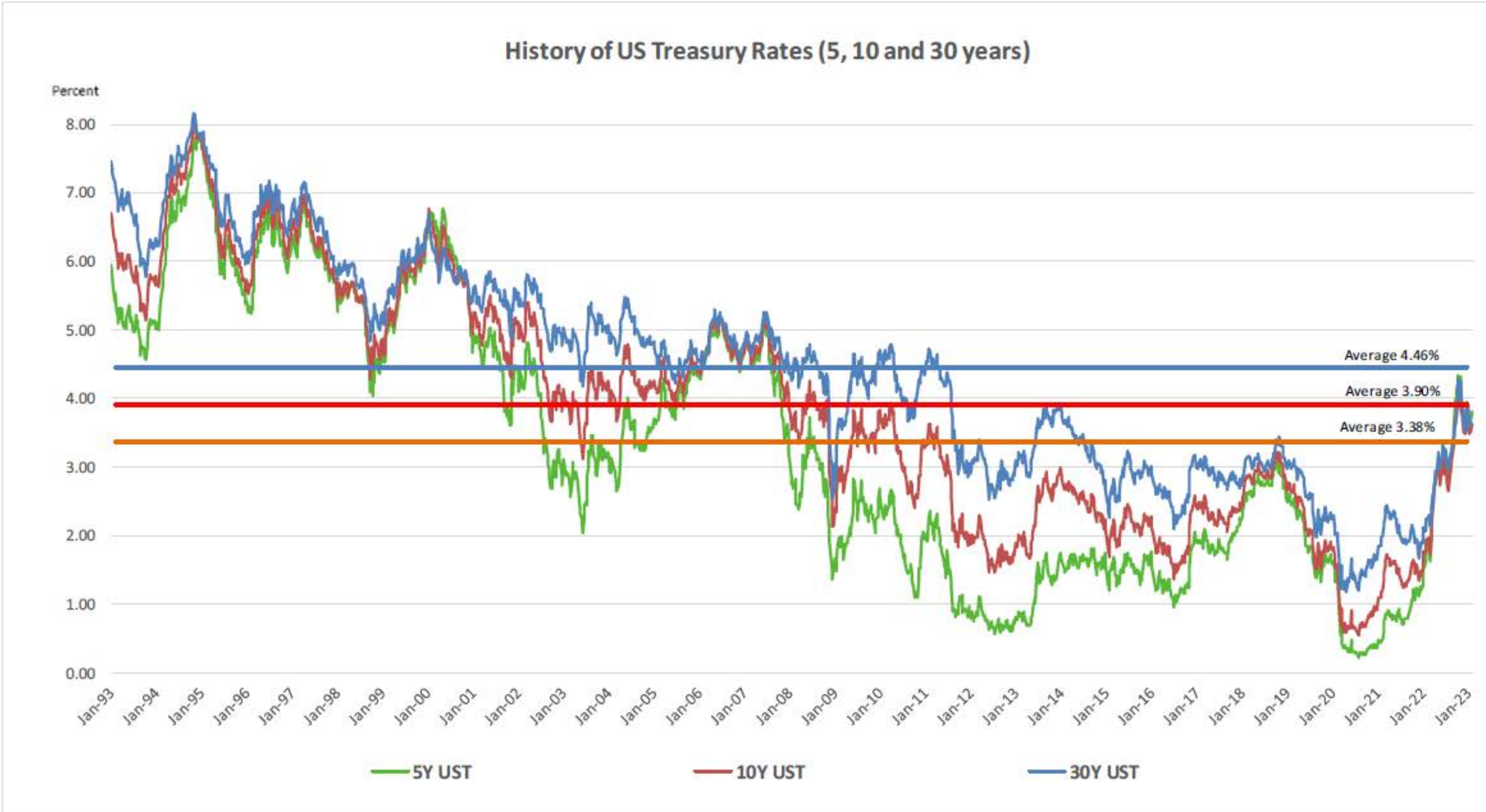
PEOPLES GAS SYSTEM, INC.
DOCKET NO. 20230023-GU
EXHIBIT NO. KDM-1
WITNESS: MCONIE
DOCUMENT NO. 3
PAGE 1 OF 1
FILED: 04/04/2023

U.S. Treasury Rates 2020 to 2022



PEOPLES GAS SYSTEM, INC.
DOCKET NO. 20230023-GU
EXHIBIT NO. KDM-1
WITNESS: MCONIE
DOCUMENT NO. 4
PAGE 1 OF 1
FILED: 04/04/2023

Thirity Year History of U.S. Treasury Rates and Averages



PEOPLES GAS SYSTEM, INC.
DOCKET NO. 20230023-GU
EXHIBIT NO. KDM-1
WITNESS: MCONIE
DOCUMENT NO. 5
PAGE 1 OF 1
FILED: 04/04/2023