FILED 9/19/2023
DOCUMENT NO. 05270-2023
FPSC - COMMISSION CLERK

1 BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

2

In the Matter of:

3 DOCKET NO. 20230023-GU

4 Petition for rate increase by Peoples
Gas Systems, Inc.

5 ______________________________________/

DOCKET NO. 20220219-GU

6

Petition for approval of 2022 depreciation

7 study by Peoples Gas Systems, Inc.

______________________________________/

8 DOCKET NO. 20220212-GU

9 Petition for approval of depreciation rate
and subaccount for renewable natural gas

10 facilities leased to others by Peoples
Gas Systems, Inc.

11 ______________________________________/

12 VOLUME 7 - PAGES 1088 - 1304

13 PROCEEDINGS: HEARING

14 COMMISSIONERS
PARTICIPATING: CHAIRMAN ANDREW GILES FAY

15 COMMISSIONER ART GRAHAM
COMMISSIONER GARY F. CLARK

16 COMMISSIONER MIKE LA ROSA
COMMISSIONER GABRIELLA PASSIDOMO

17

DATE: Thursday, September 14, 2023

18

TIME: Commenced: 9:00 a.m.

19 Concluded: 9:22 p.m.

20 PLACE: Betty Easley Conference Center
Room 148

21 4075 Esplanade Way
Tallahassee, Florida

22

REPORTED BY: DEBRA R. KRICK

23 Court Reporter

24 APPEARANCES: (As heretofore noted.)

25

1 I N D E X

2 WITNESS: PAGE

3 KENNETH D. MCONIE

4 Examination by Mr. Wahlen 1091
Prefiled Direct Testimony inserted 1094
5 Prefiled Rebuttal Testimony inserted 1125
Examination by Ms. Christensen 1140
6 Examination by Mr. Moyle 1175
Examination by Mr. Sandy 1199
7 Further Examination by Mr. Wahlen 1202

8 LANE KOLLEN

9 Examination by Ms. Wessling 1205
Prefiled Direct Testimony inserted 1207
10 Examination by Mr. Sandy 1277
Further Examination by Ms. Wessling 1299

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

EXHIBITS CONTINUED

NUMBER:		ID	ADMITTED
191	PGS response to OPC Interrogatory No. 95	1142	1204
192	Tampa Electric's 10-Q report dated 9/30/2022 - Excerpt	1144	1204
193	TECO Form 10-K Annual Report 12/31/22 - Excerpt	1145	1204
194	TECO Form 10-Q Quarterly Report 3/31/22 - Excerpt	1146	1204
195	TECO Form 10-Q Quarterly Report 6/30/22 - Excerpt	1147	1204
196	TECO December 31, 2022 Earnings Surveillance Report	1158	1204
197	OPC Interrogatories Nos. 215 and 216 (CEL #141)	1163	1204
198	OPC Interrogatory No. 100 (CEL #133)	1167	1204
21	As identified in the CEL		1203
31	As identified in the CEL		1203
35-62	As identified in the CEL		1204

1 P R O C E E D I N G S
2 (Transcript follows in sequence from Volume
3 6.)
4 CHAIRMAN FAY: Okay. Mr. Wahlen, move back
5 over to you for Mr. McOnie, does that sound --
6 MR. WAHLEN: Yes. Mr. Chairman, Peoples Gas
7 calls Ken McOnie.
8 MS. CHRISTENSEN: Mr. Chairman, could I have
9 just, like, five minutes?
10 CHAIRMAN FAY: Yes.
11 (Brief recess.)
12 CHAIRMAN FAY: All right. Welcome back, Mr.
13 McOnie, Mr. Wahlen.
14 MR. WAHLEN: Thank you, Mr. Chairman.
15 Whereupon,
16 KENNETH D. MCONIE
17 was called as a witness, having been first duly sworn to
18 speak the truth, the whole truth, and nothing but the
19 truth, was examined and testified as follows:
20 EXAMINATION
21 BY MR. WAHLEN:
22 **Q Mr. McOnie, were you sworn yesterday?**
23 A Yes, I was.
24 CHAIRMAN FAY: Mr. McOnie, make sure your mic
25 is on, you will see a green light on.

1 THE WITNESS: Yes, I was.
2 BY MR. WAHLEN:
3 **Q Thank you.**
4 **Would you please state your full name today?**
5 A My name is Ken McOnie.
6 **Q And who is your current employer and what is**
7 **your business address?**
8 A Current employer is Emera, Inc. The business
9 address is 5151 Terminal Road Halifax, Nova Scotia.
10 **Q And did you prepare and cause to be filed in**
11 **this docket, on April 4th, 2023, prepared direct**
12 **testimony consisting of 28 pages?**
13 A Yes, I did.
14 **Q And did you also prepare and cause to be filed**
15 **in this docket, on July 20th, direct -- prepared direct**
16 **-- prepared rebuttal testimony consisting of 12 pages?**
17 A Yes, I did.
18 **Q Do you have any additions or corrections to**
19 **your direct or rebuttal testimony?**
20 A No, I do not.
21 **Q If I were to ask you the questions contained**
22 **in your prepared direct and rebuttal testimony today,**
23 **would your answers be the same as those contained**
24 **therein?**
25 A Yes, they would.

1 **Q Thank you.**

2 MR. WAHLEN: Mr. Chairman, Peoples requests

3 that the prepared direct and rebuttal testimony of

4 Mr. McOnie be inserted into the record as though

5 read.

6 CHAIRMAN FAY: Okay. Show it entered.

7 MR. WAHLEN: Thank you.

8 (Whereupon, prefiled direct testimony of

9 Kenneth D. McOnie was inserted.)

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

D10-665

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

D10-665

PEOPLES GAS SYSTEM, INC.
DOCKET NO. 20230023-GU
WITNESS: MCONIE

TABLE OF CONTENTS

PREPARED DIRECT TESTIMONY AND EXHIBIT

OF

KENNETH D. MCONIE

FINANCIAL INTEGRITY.. 4

IMPORTANCE OF CREDIT RATINGS................................. 7

2023 TRANSACTION.. 13

CAPITAL STRUCTURE, EQUITY RATIO AND COST-OF-DEBT............. 20

SUMMARY.. 28

EXHIBIT.. 29

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **PREPARED DIRECT TESTIMONY**

3 **OF**

4 **KENNETH D. MCONIE**

5

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

7

8 **A.** My name is Kenneth D. McOnie. My business address is Emera
9 Place, 5151 Terminal Road, Halifax, Nova Scotia, Canada. I am
10 Vice President Tax and Treasurer for Emera Incorporated
11 ("Emera"), which is the parent company of Emera U.S. Holdings,
12 Inc., which is the parent company of TECO Energy, Inc. ("TECO
13 Energy" or the "parent company"), which is the parent company
14 of TECO Gas Operations, Inc., which is the parent company of
15 Peoples Gas System, Inc. ("Peoples" or the "company").

16

17 **Q.** Please describe your duties and responsibilities in that
18 position.

19

20 **A.** I am responsible for Emera's treasury and tax functions. My
21 team is responsible for establishing and maintaining
22 effective working relations with the investment and banking
23 communities, and for the administration of the Canadian-based
24 tax group. My team is also responsible for forecasting

1 interest rates for the company.

2

3 **Q.** Please summarize your educational background and business

4 experience.

5

6 **A.** I received a Bachelor of Commerce degree from Saint Mary's

7 University and a Master of Business Administration with a

8 concentration in Finance and International Business from

9 Dalhousie University. I also hold the Chartered Professional

10 Accountant certification. I have been working with Emera for

11 more than 20 years in roles with increasing responsibility

12 and have been Treasurer for over 10 years.

13

14 **Q.** What are the purposes of your prepared direct testimony in

15 this proceeding?

16

17 **A.** My direct testimony explains why it is important for Peoples

18 to maintain its financial integrity. More specifically, I

19 will: (1) explain the important role strong credit ratings

20 play in providing unimpeded access to capital with reasonable

21 terms and costs; (2) demonstrate the importance of the

22 requested rate relief to maintain Peoples' financial

23 integrity; (3) describe the transfer of Peoples' gas

24 operations and assets from Tampa Electric Company ("Tampa

25 Electric") to Peoples and its impact on the company's capital

1 structure and borrowing activities; (4) explain the company's
2 proposed capital structure for the test year and how the
3 company forecasted short-term and long-term debt for the test
4 year; and (5) explain why the company's proposed equity ratio
5 of 54.7 percent (investor sources) is prudent and appropriate
6 to maintain the company's financial integrity.
7
8 **Q.** Have you prepared an exhibit to support your prepared direct
9 testimony?
10
11 **A.** Yes. Exhibit No. KDM-1, entitled "Exhibit of Kenneth D.
12 McOnie" was prepared under my direction and supervision and
13 accompanies my prepared direct testimony. My exhibit consists
14 of these five documents:
15

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

24
25 The contents of my exhibit and the MFR schedules referenced

1 in them were derived from the business records of the company
2 and are true and correct to the best of my information and
3 belief.
4
5 **FINANCIAL INTEGRITY**
6 **Q.** What is financial integrity?
7
8 **A.** Financial integrity refers to a relatively stable condition
9 of liquidity and profitability in which the company can meet
10 its financial obligations to investors while maintaining the
11 ability to attract investor capital as needed on reasonable
12 terms, conditions, and costs.
13
14 **Q.** How is financial integrity measured?
15
16 **A.** Financial integrity is a function of financial risk, which
17 represents the risk that a company may not have adequate cash
18 flows to meet its financial obligations. The level of cash
19 flows and the percentage of debt, or financial leverage, in
20 the capital structure is a key determinant of financial
21 integrity. As such, as the percentage of debt in the capital
22 structure increases so do the fixed obligations for the
23 repayment of that debt. Consequently, as financial leverage
24 increases the level of financial distress (financial risk)
25 increases as well. Therefore, the percentage of internally

1 generated cash flows compared to these financial obligations
2 is a primary indicator of financial integrity and is relied
3 upon by rating agencies when they assign debt ratings.
4
5 **Q.** Why is financial integrity important to Peoples and its
6 customers?
7
8 **A.** As a regulated utility, Peoples has an obligation to provide
9 gas service to customers in accordance with its tariff, and
10 the statutes and rules regulating its activities. Meeting
11 customer demand for gas service requires the company to make
12 significant investments in utility property, plant, and
13 equipment, both planned and unplanned, which makes the gas
14 business very capital intensive. As explained by Peoples'
15 witness Rachel B. Parsons in her prepared direct testimony,
16 Peoples expects to invest over one billion dollars to serve
17 customers from January 1, 2022 to December 31, 2024.
18
19 Peoples' customers benefit directly from the company's
20 infrastructure investments. The State of Florida is growing
21 rapidly, and as it does Peoples must: invest in new mains,
22 laterals, service lines, and meters; hire team members to
23 operate and maintain a growing system; and spend money
24 building, upgrading, and moving the company's gas
25 distribution infrastructure to accommodate third-party

1 construction. Maintaining a strong financial position allows
2 the company to finance infrastructure investments in support
3 of an improved system at a lower cost than would otherwise be
4 possible.
5
6 Financial integrity is also important to ensure access to
7 capital. Peoples' responsibility to serve is not contingent
8 upon the health or the state of the financial markets. In
9 times of constrained access to capital and depressed market
10 conditions, only those utilities exhibiting financial
11 integrity can attract capital under reasonable terms
12 providing significant and potentially critical flexibility.
13 Since Peoples builds infrastructure to meet customer demands,
14 it has a limited ability to adjust the timing and amount of
15 major capital expenditures to align with economic cycles or
16 wait out market disruptions.
17
18 The strength of Peoples' balance sheet and its financial
19 flexibility are important factors influencing its ability to
20 finance major infrastructure investments as well as manage
21 unexpected events. Financial integrity is essential to
22 supporting the company's need for capital. As I explain later
23 in my direct testimony, beginning in 2023 Peoples will be
24 competing in a global market for capital, which will amplify
25 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?

1 **A.** The term "credit rating" refers to letter designations
2 assigned by credit rating agencies that reflect their
3 independent assessment of the credit quality of entities that
4 issue publicly traded debt securities. Credit ratings are
5 like the grades a student receives on his or her report card
6 – an A is better than a B letter grade – likewise an AAA is
7 better than a BBB level credit rating. Credit ratings reflect
8 the informed and independent views of firms that study
9 borrowers and market conditions and impact the interest rates
10 borrowers must pay when accessing borrowed funds from both
11 banks and capital markets. In general, a higher credit rating
12 means a lower credit spread and a lower credit rating means
13 a higher credit spread. The credit spread is the charge added
14 to the underlying variable rate benchmark for overnight funds
15 in the case of short-term bank borrowing and U.S. treasury
16 bonds in the case of long-term debt offerings. Peoples invests
17 capital to serve customers and strong debt ratings will ensure
18 that Peoples will have adequate credit quality to raise the
19 capital necessary to meet these requirements.
20
21 **Q.** Why are strong ratings important considering the company's
22 future capital needs?
23
24 **A.** A strong credit rating is important because it affects a
25 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.

1 Given the high capital requirements, obligation to serve
2 existing and new customers, and significant requirements for
3 unsecured commercial credit that gas utilities have, non-
4 investment grade ratings are unacceptable. Peoples needs to
5 have a financial profile that will support a strong credit
6 rating.
7
8 **Q.** Can the financial credit market be foreclosed by unforeseen
9 events extraneous to the utility industry?
10
11 **A.** Yes. There have been times when financial credit markets have
12 been closed or challenged due to unforeseen events. Market
13 instability resulting from the sub-prime mortgage problems
14 affected liquidity in the entire financial sector causing a
15 financial recession, and there were periods of time in 2008
16 and 2009 when the debt markets were effectively closed to all
17 but the highest rated borrowers. This is a good example of
18 how access to the marketplace can be shut off for even
19 creditworthy borrowers by extraneous, unforeseen events, and
20 it emphasizes why a strong credit rating is essential to
21 ongoing, unimpeded access to the capital markets.
22
23 **Q.** How are credit ratings determined?
24
25 **A.** Generally, the process the rating agencies follow to

1 determine ratings involves an assessment of both business
2 risk and financial risk. Business risk is typically
3 determined based on the combined assessment of industry risk,
4 country risk, and competitive position. Financial risk is
5 based on financial ratios covering cash flow/leverage
6 analysis. These two factors are combined to arrive at an
7 overall credit rating for a company. Business risk and
8 financial risk are more fully discussed and described in the
9 direct testimony of witness, Dylan W. D'Ascendis.
10
11 **Q.** How does regulation affect ratings?
12
13 **A.** The primary business risk the rating agencies focus on for
14 utilities is regulation, and each of the rating agencies have
15 their own views of the regulatory climate in which a utility
16 operates. The exact assessments of the rating agencies may
17 differ but the principles they rely upon for their independent
18 views of the regulatory regime are similar. Essentially, the
19 principles, or categories, that shape the views of the rating
20 agencies as they relate to regulation are based upon the
21 degree of transparency, predictability, and stability of the
22 regulatory environment; timeliness of operating and capital
23 cost recovery; regulatory independence; and financial
24 stability.
25

1 According to the rating agencies the maintenance of
2 constructive regulatory practices that support the
3 creditworthiness of the utilities is one of the most important
4 issues rating agencies consider when deliberating ratings.
5 Regulation in Florida has historically been supportive of
6 maintaining the credit quality of the state's utilities, and
7 that has benefited customers by allowing utilities to provide
8 for their customers' needs consistently and at a reasonable
9 cost. This has been one of the factors that has helped Florida
10 utilities maintain pace with the growth in the state, which
11 has been essential to economic development. A key test of
12 regulatory quality is the ability of companies to earn a
13 reasonable rate of return over time, including through
14 varying economic cycles, and to maintain satisfactory
15 financial ratios supported by good quality of earnings and
16 stability of cash flows. Regulated utilities cannot
17 materially improve or even maintain their financial condition
18 without regulatory support. Thus, the regulatory climate has
19 a large impact on the company, its customers, and its
20 investors.
21
22 **Q.** What are Peoples' current credit ratings?
23
24 **A.** As explained in the next portion of my direct testimony,
25 Peoples has not been borrowing money by directly accessing

1 capital markets, and therefore does not presently have rated
2 debt. However, Peoples will be directly accessing capital
3 markets in 2023 to obtain short- and long-term debt capital
4 and will be going through the process of establishing its own
5 credit rating(s) in 2023.
6
7 **2023 TRANSACTION**
8 **Q.** Please describe the recent changes to Peoples' legal
9 structure.
10
11 **A.** On June 16, 1997, Peoples was acquired by TECO Energy, Inc.
12 and merged into Tampa Electric. Peoples operated as a division
13 of Tampa Electric from 1997 to the end of 2022.
14
15 Effective January 1, 2023, the assets, liabilities, and
16 equity of the Peoples Gas System, a division of Tampa Electric
17 Company were transferred into a separate corporation named
18 Peoples Gas System, Inc., which is a wholly owned subsidiary
19 of newly formed gas operations holding company, TECO Gas
20 Operations, Inc., which is a subsidiary of TECO Energy, Inc.
21 I will refer to this transaction as the "2023 Transaction" in
22 the remainder of my direct testimony.
23
24 The business reasons for the 2023 Transaction, why it was
25 prudent, and how it will benefit customers are explained by

1 Peoples' witness Helen J. Wesley in her prepared direct
2 testimony.
3
4 **Q.** When the company operated as a division of Tampa Electric,
5 did Peoples make short- and long-term borrowing arrangements
6 with unaffiliated, third-party lenders?
7
8 **A.** No. From 1997 to 2022, Tampa Electric borrowed enough money
9 on a short- and long-term basis to meet the debt capital needs
10 of Peoples and a portion of Tampa Electric's short- and long-
11 term debt was allocated to the Peoples division on an intra-
12 company basis.
13
14 **Q.** How did Peoples obtain equity capital when it was operated as
15 a division of Tampa Electric?
16
17 **A.** Peoples obtained equity capital from TECO Energy, Inc.
18
19 **Q.** What happened to the debt and equity on the books of the
20 Peoples division of Tampa Electric during the 2023
21 Transaction?
22
23 **A.** The equity on the books of the Peoples division of Tampa
24 Electric as of December 31, 2022 (approximately $991 million)
25 was transferred to Peoples effective January 1, 2023. The

1 Peoples division's allocation of Tampa Electric's outstanding
2 unsecured notes (approximately $570 million) and outstanding
3 short-term borrowings (approximately $166 million) as of
4 December 31, 2022 were converted into an Intercompany Debt
5 Agreement with Tampa Electric on January 1, 2023, with
6 interest rates on each allocation being maintained
7 accordingly. The amount due to Tampa Electric under the
8 Intercompany Debt Agreement on January 1, 2023 was
9 approximately $736 million.
10
11 **Q.** Why didn't Peoples pay off or retire its allocation of Tampa
12 Electric's outstanding unsecured notes and outstanding short-
13 term borrowings as of December 31, 2022 as part of the 2023
14 Transaction?
15
16 **A.** The Intercompany Debt Agreement is an interim measure to
17 bridge Peoples to the establishment of its own revolving
18 credit facility with a syndicate of bank lenders and to its
19 first long-term bond issuance. To achieve both of these events
20 in the most cost-effective manner, Peoples needs to have its
21 own independent credit rating and wants to access the market
22 at a favorable time. As a part of this process, Peoples will
23 be seeking indicative assessments from the rating agencies
24 based upon its business and financial risk relative to its
25 regulatory and operating environment to determine its overall

1 credit rating. As discussed later in my direct testimony, the
2 indicative assessments will be based on Peoples' regulatory
3 environment and financial projections as submitted in the
4 current rate case for the 2024 test year. Absent these
5 milestones, Peoples could not cost effectively pay off or
6 retire its allocation of Tampa Electric's outstanding
7 unsecured notes and outstanding short-term borrowings on
8 December 31, 2022.
9
10 **Q.** Now that it is a separate, stand-alone corporation, how will
11 Peoples obtain equity capital?
12
13 **A.** Peoples will obtain equity capital from its parent, TECO
14 Energy.
15
16 **Q.** Now that it is a separate, stand-alone corporation, how will
17 Peoples obtain debt capital?
18
19 **A.** During 2023, Tampa Electric will provide short-term debt
20 funding to Peoples through the Intercompany Debt Agreement at
21 Tampa Electric's prevailing cost of short- and long-term debt
22 borrowings. The Intercompany Debt Agreement will remain
23 outstanding until Peoples pays Tampa Electric all principal
24 and interest due on the Intercompany Debt Agreement. As
25 reflected in its 2023 budget, Peoples expects that its short-

1 and long-term obligations under the Intercompany Debt
2 Agreement will total approximately $910 million by the time
3 the agreement is paid off.
4
5 By the end of 2023, Peoples will also: (1) establish its own
6 independent credit rating(s); (2) make short- and long-term
7 borrowing arrangements with its lenders; and (3) pay off its
8 obligations under the Intercompany Debt Agreement with Tampa
9 Electric.
10
11 **Q.** Is Peoples required to complete the external debt financing
12 activities by December 31, 2023?
13
14 **A.** Yes. The company must begin securing its own debt capital by
15 borrowing from lenders and pay off the Intercompany Debt
16 Agreement by December 31, 2023 so the asset transfer will be
17 considered a non-taxable event for U.S. federal income tax
18 purposes. Given this requirement and its importance to being
19 considered a non-taxable event, Peoples will, in parallel
20 with this general rate proceeding, be working as
21 expeditiously as possible to undertake and complete all
22 possible preparatory financing activities necessary to be in
23 a position to establish the company's bank syndicated
24 revolving credit facility for short-term borrowing and to
25 complete its first long-term debt offering during 2023.

1 **Q.** What is the process for Peoples to obtain its own, stand-
2 alone credit rating from rating agencies?
3
4 **A.** Peoples intends to engage Moody's, S&P Global and Fitch
5 (collectively, the "rating agencies") during the second
6 quarter of 2023 to assess the credit worthiness of Peoples
7 and assign an indicative rating as part of the rating
8 evaluation service provided by each of the rating agencies.
9 The indicative rating will be based on several factors and
10 assumptions, with one of the most important being the outcome
11 of Peoples' current base rate proceeding.
12
13 As a part of the process, Peoples will be required to provide
14 the rating agencies with information regarding the company's
15 strategy, regulatory environment and financial projections
16 based on the current rate case and 2024 test year. The
17 resulting rating will be indicative and will not be for public
18 disclosure as it can only be finalized at the conclusion of
19 this rate proceeding. At that time, the rating agencies will
20 assess the outcome of this case relative to the previous
21 information provided to them from both a business and
22 financial risk perspective and assign a final credit rating.
23 Maintaining Peoples' equity ratio at 54.7 percent with a
24 midpoint ROE of 11.0 percent should support credit rating
25 parameters for the BBB+ level being targeted by the company.

1 **Q.** Can the company predict the credit ratings it will likely
2 receive from credit rating agencies?
3
4 **A.** The company cannot predict what its forthcoming credit
5 ratings will be but is targeting an indicative BBB+ credit
6 rating to provide access to debt capital at reasonable
7 interest rates. As discussed below, the company has
8 considered the impact of this in its projected cost of
9 borrowing short- and long-term debt in 2023 budgeted and the
10 projected 2024 test years.
11
12 **Q.** What impact will paying off the Intercompany Debt Agreement
13 and replacing it with external debt have on the company's
14 borrowing costs?
15
16 **A.** Replacing the Intercompany Debt Agreement with external debt
17 will increase the company's borrowing costs, because the
18 long-term debt allocated to Peoples under the Intercompany
19 Debt Agreement was entered into by Tampa Electric when long-
20 term debt rates were lower than the interest rates the company
21 expects to be in effect when it completes its first long-term
22 debt offering during 2023. The company estimates that the
23 impact of this debt replacement in 2023 and the 2024 test
24 year will be to increase the cost of long-term debt from 3.97
25 percent in 2022 to 5.54 percent in 2024.

1 **CAPITAL STRUCTURE, EQUITY RATIO AND COST-OF-DEBT**

2 **Q.** What is the overall cost-of-capital being proposed by Peoples
3 in this proceeding?
4
5 **A.** As explained in the direct testimony of Rachael Parsons, the
6 company's proposed cost-of-capital is 7.42 percent. The 7.42
7 percent proposed cost-of-capital is based on a return on
8 equity of 11.0 percent, which is supported in the prepared
9 direct testimony of witness Dylan W. D'Ascendis, and an
10 investor sources capital structure ratio of 54.7 percent
11 equity and 45.3 percent total debt. The proposed cost-of-
12 capital reflects short-term debt costs of 4.85 percent and
13 long-term debt costs of 5.54 percent. The proposed cost-of-
14 capital also includes customer deposits at a cost of 2.53
15 percent, Investment Tax Credits at a weighted cost of 8.49
16 percent and Accumulated Deferred Income Taxes at zero cost.
17
18 **Q.** How does the company's proposed 54.7 percent equity ratio
19 compare with the allowed capital structure in Peoples' last
20 general base rate proceeding?
21
22 **A.** The proposed capital structure equity ratio of 54.7 percent
23 is consistent with the approved capital structure as approved
24 by the Florida Public Service Commission ("Commission") Order
25 No. PSC-2020-0485-FOF-GU in Docket No. 20200051-GU ("2020

1 Agreement”).

2

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

7

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

15

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

18

19 **A.** Peoples’ proposed equity ratio of 54.7 percent is reasonable
20 and prudent as it has a direct impact on the level of cash
21 flows and the percentage of debt giving rise to the financial
22 leverage in the capital structure, which is a key determinant
23 of financial integrity. Financial integrity is a function of
24 financial risk, or the risk that a company may not have
25 adequate cash flows to meet its financial obligations, and

1 this is one of the primary indicators relied upon by rating
2 agencies when they assign debt ratings. The requested 54.7
3 percent equity ratio will also place Peoples in a prudent and
4 responsible financial position to fund its capital program
5 and continue providing safe and reliable gas service to its
6 customers.
7
8 **Q.** What equity infusions from TECO Energy for 2023 and 2024 are
9 necessary to achieve the proposed 54.7 percent equity capital
10 structure?
11
12 **A.** As discussed in the direct testimony of witness Parsons, the
13 2023 and 2024 budgeted equity infusions are $135 million and
14 $140 million, respectively. These planned equity infusions
15 are based on the company's planned capital structure needs,
16 its planned capital expenditures and business requirements,
17 and a targeted equity ratio of 54.7 percent.
18
19 **Q.** How did the company determine the short-term debt cost rate
20 for the 2024 projected test year?
21
22 **A.** The short-term debt cost rate of 4.85 percent is based on the
23 estimated cost of the company's credit facilities, which
24 rates are based on the Secured Overnight Financing Rate
25 ("SOFR") plus credit spreads and program fees. The short-term

1 debt cost rate assumes that Peoples achieves terms and
2 conditions like Tampa Electric's revolving credit facility
3 and Peoples is successful in achieving its targeted BBB+
4 credit rating.
5
6 **Q.** How does the company's proposed 4.85 percent cost of short-
7 term debt compare with the cost of debt in the Peoples 2020
8 general base rate proceeding?
9
10 **A.** The short-term cost of debt in the 2020 general base rate
11 proceeding approved by the Commission in the 2020 Agreement
12 was 1.15 percent.
13
14 **Q.** What are the main drivers for the increase in the short-term
15 cost of debt in the 2024 test year?
16
17 **A.** The main driver for the increase in the short-term cost of
18 debt is the underlying overnight borrowing rate, which has
19 increased by approximately 425 basis points for SOFR since
20 the last general base rate proceeding as shown on Document
21 No. 2 of my exhibit. The Federal Reserve has been increasing
22 the overnight borrowing rate to moderate the high inflation
23 rates experienced in 2022 and has signaled its intent to
24 continue increasing the overnight rate into 2023 because the
25 current inflationary period has not yet ended and has been

1 more persistent than the Federal Reserve expected. The
2 persistent nature of inflation has contributed to the
3 volatility of interest rates experienced to date and as
4 reflected in future forecasts as economists attempt to
5 predict the Federal Reserve's approach to determining and
6 setting the overnight borrowing rate.
7
8 **Q.** How did the company determine the cost and amount of long-
9 term debt to be included in the capital structure?
10
11 **A.** As shown on MFR Schedule G-3, page 8, the long-term debt cost
12 rate of 5.54 percent is based on forecasted debt issuance of
13 $825 million during 2023 and $100 million in 2024. The $825
14 million inaugural debt issuance during 2023 is forecasted to
15 occur using three tranches of differing terms including: (i)
16 $325 million of 5-year notes at 5.40 percent, (ii) $300
17 million of 10-year notes at 5.47 percent, and (iii) $200
18 million of 30-year notes at 6.00 percent. Although the
19 company cannot predict the specific time of year this will
20 occur, the company budgeted the 2023 issuance to occur on
21 September 30, 2023. The 2024 issuance assumes a June 30
22 financing date for $100 million of 10-year notes at 5.37
23 percent. When developing the forecasted debt issuance and
24 cost rate, the company considered its targeted equity ratio
25 and assumed ongoing drawn amounts on the company's credit

1 facilities related to the company's normal course of business
2 and liquidity requirements.
3
4 The long-term cost of debt is based upon the underlying U.S.
5 Treasury ("UST") rates sourced from Bloomberg (Document No.
6 3 of my exhibit- Forecasted U.S. Treasury Rates) plus the
7 average forecasted credit spread for a typical gas
8 distribution company with a BBB+ credit rating. To mitigate
9 the long-term cost of debt and future refinancing risk,
10 Peoples has forecasted three debt issuance tranches for 5, 10
11 and 30 years.
12
13 **Q.** How does the company's proposed 5.54 percent cost of long-
14 term debt compare with the cost of debt in the Peoples 2020
15 general base rate proceeding?
16
17 **A.** The long-term cost of debt in the 2020 general base rate
18 proceeding approved by the Commission in the 2020 Agreement
19 was 3.85 percent.
20
21 **Q.** What are the main drivers for the increase in the long-term
22 cost of debt in the 2024 test year?
23
24 **A.** The underlying UST rates have increased across the curve due
25 primarily to the Federal Reserve hiking interest rates a

1 cumulative 425 basis points since the beginning of 2022
2 bringing the Federal Funds Rate to 4.50 percent from 0.25
3 percent as shown on Document No. 4 of my exhibit- U.S.
4 Treasury Rates 2020 to 2022. As a result, the yield curve
5 continued to invert further as the policy of monetary
6 tightening to combat inflation pushed shorter term rates
7 higher, while the long end remained anchored due to the
8 prospect for slower economic growth. Recently, the Federal
9 Reserve announced it is prepared to raise interest rates until
10 it thinks inflation has been sufficiently beaten back even if
11 this sends the economy into recession. This means that
12 interest rates may go higher and that the hiking cycle
13 undertaken by the Federal Reserve will persist for a longer
14 period. However, the Federal Reserve's outlook and approach
15 to interest rate actions will continue to be contingent upon
16 inflation and how quickly it subsides.
17
18 **Q.** How is refinancing risk mitigated by issuing three tranches
19 of debt?
20
21 **A.** As shown on Document No. 5 of my exhibit, the underlying UST
22 rates have increased across the yield curve due primarily to
23 the Federal Reserve hiking interest rates a cumulative 425
24 basis points since the beginning of 2022. However, as
25 mentioned previously, the long end of the curve, or 30 year

1 UST, has remained anchored at approximately 4.00 percent
2 relative to its long-term average of 4.45 percent. It is
3 reasonable to expect a certain level of mean-reversion over
4 a business cycle or longer period, so issuing three tranches
5 of debt for terms of 5, 10 and 30 years would be prudent.
6 This positioning of three tranches across the curve will
7 provide a proper balance of cost and refinancing risk in the
8 current interest rate environment and will be achieved by
9 issuing a 30 year note, because the proposed issuance is in
10 line with its long-term average and mitigates the risk of a
11 continued rising rate environment. Additionally, having 5
12 and/or 10 year notes should afford Peoples with the
13 opportunity to refinance at interest rates more reflective of
14 their respective long-term averages in the future.
15
16 **Q.** What other mechanism does the company propose to address its
17 proposed long-term debt rate in this case?
18
19 **A.** Peoples believes the introduction of a Long-Term Debt Rate
20 True-Up Mechanism will provide a fair one-time adjustment to
21 base rates reflecting the actual long-term debt cost achieved
22 in 2023. The Long-Term Debt Rate True-Up Mechanism is more
23 fully discussed and described in the direct testimony of
24 witness Parsons.
25

1 **SUMMARY**

2 **Q.** Please summarize your prepared direct testimony.

3

4 **A.** Peoples' proposed equity ratio of 54.7 percent (investor
5 sources) is reasonable and will help Peoples maintain the
6 financial integrity needed to raise capital in financial
7 markets on reasonable terms and conditions for the benefit of
8 customers. The company's plan for raising short- and long-
9 term debt in 2023 and 2024 is reasonable and properly
10 reflected in the company's minimum filing requirement
11 schedule for the projected 2024 test year. The company's
12 forecasted short- and long-term debt rates for the projected
13 2024 test year are reasonable for use setting rates in this
14 proceeding, and the company's forecasted long-term debt rates
15 can be trued up to actual using the mechanism described in
16 witness Parsons' direct testimony. The Commission should
17 approve the proposals for ratemaking reflected in my prepared
18 direct testimony.

19

20 **Q.** Does this conclude your prepared direct testimony?

21

22 **A.** Yes.

23

24

25

1 (Whereupon, prefiled rebuttal testimony of
2 Kenneth D. McOnie was inserted.)
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

E6-217

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 20230023-GU

PETITION FOR RATE INCREASE
BY PEOPLES GAS SYSTEM, INC.

REBUTTAL TESTIMONY AND EXHIBIT

OF

KENNETH D. MCONIE

E6-217

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **REBUTTAL TESTIMONY**

3 **OF**

4 **KENNETH D. MCONIE**

5

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

7

8 **A.** My name is Kenneth D. McOnie. My business address is Emera
9 Place, 5151 Terminal Road, Halifax, Nova Scotia, Canada. I
10 am Vice President Tax and Treasurer for Emera Incorporated
11 ("Emera"), which is the parent company of Emera U.S.
12 Holdings, Inc., which is the parent company of TECO Energy,
13 Inc. ("TECO Energy" or the "parent company"), which is the
14 parent company of TECO Gas Operations, Inc., which is the
15 parent company of Peoples Gas System, Inc. ("Peoples" or
16 the "company").

17

18 **Q.** Are you the same Kenneth D. McOnie who filed direct
19 testimony in this proceeding?

20

21 **A.** Yes, I am.

22

23 **Q.** What are the purposes of your rebuttal testimony?

24

25 **A.** The purpose of my rebuttal testimony is to address three

1 points asserted by Office of Public Counsel ("OPC") witness
2 Lane Kollen associated with the impact of the 2023
3 Transaction on the company's requested rate increase. I
4 will also respond to OPC witness David J. Garrett's proposal
5 on Peoples' equity ratio. My rebuttal testimony includes
6 evidence on four points.
7
8 First, the Florida Public Service Commission ("FPSC" or
9 "Commission") has a long history of allowing utilities to
10 recover their projected long and short term borrowing costs
11 through customer rates, and the Commission should not
12 depart from this practice in this case.
13
14 Second, it seems odd for witness Kollen to say that Peoples
15 paying the market-based costs of short-term and long-term
16 debt results in a subsidy in favor of Tampa Electric and
17 its customers. To the extent that the 2023 Transaction
18 benefits Tampa Electric and its customers in the short term,
19 OPC should also recognize that Tampa Electric's historical
20 practice of borrowing on behalf of its gas division (Peoples
21 Gas System) benefitted the customers of Peoples through
22 lower interest rates and avoided stand-alone expenses such
23 as independent audit and credit rating agency fees. Except
24 for interest rate differences associated with credit rating
25 differences, Peoples and Tampa Electric will over time

1 borrow at approximately the same interest rates, because
2 the long-term debt issued at historically low interest
3 rates and enjoyed by the customers of both utilities will
4 over time be replaced with new debt at the then current
5 market rates. OPC and the Commission did not attempt to
6 allocate the "benefits" of combined borrowing and avoided
7 audit and rating agency fees during the 26 years since
8 Peoples became part of Tampa Electric and should not do so
9 now.
10
11 Third, contrary to witness Kollen's assertion, Peoples,
12 Tampa Electric and Emera did evaluate whether to continue
13 the historical borrowing arrangement between the two
14 utilities or preserve the allocation of lower cost long-
15 term debt to Peoples as part of the 2023 Transaction, but
16 decided that entering into an Intercompany Debt Agreement
17 during 2023 ("IDA") and Peoples issuing its own short-term
18 and long-term debt to repay the IDA in 2023 and fund future
19 capital needs was the best long-term solution for Peoples
20 and its customers.
21
22 Finally, I will explain why the Commission should approve
23 Peoples' equity ratio as proposed in its initial filing.
24
25 **Q.** Have you prepared an exhibit supporting your rebuttal

1 testimony?

2

3 **A.** Yes. Exhibit No. KDM-2, entitled "Rebuttal Exhibit of
4 Kenneth D. McOnie," was prepared under my direction and
5 supervision and accompanies my rebuttal testimony. The
6 contents of my rebuttal exhibit were derived from the
7 business records of the company and are true and correct to
8 the best of my knowledge and belief. My rebuttal exhibit
9 consists of one document:

10 Document No. 1 Peoples' Historical Investor Sources
11 Equity Ratio (1998 to 2022)

12

13 **I.**

14 **PEOPLES FORECASTED MARKET-BASED**
15 **SHORT-TERM AND LONG-TERM BORROWING COSTS**
16 **SHOULD BE RECOVERED THROUGH BASE RATES**

17 **Q.** Have the Commission and other utility regulatory
18 authorities historically allowed the utilities under their
19 jurisdiction to recover their forecasted, market-based
20 long-term borrowing cost through base rates?

21

22 **A.** As part of the ratemaking process, the FPSC has consistently
23 concluded that the long-term debt costs included in the
24 projected test year should reflect the expected cost of
25 debt for the entity funding the utility's rate base in the

1 test year, and not the historical cost of debt that had
2 funded rate base by past owners of the utility. Peoples is
3 not aware of a single recent instance in which the FPSC set
4 customer rates using an historical long-term debt rate
5 approved in a prior rate case rather than a current market-
6 based long-term debt rate reflecting expected borrowing
7 costs in the test year.
8
9 **Q.** Has Peoples proposed to recover its forecasted, market-
10 based short-term and long-term borrowing costs through base
11 rates in this proceeding, subject to its proposed Long-Term
12 Debt True Up Mechanism?
13
14 **A.** Yes. The short-term and long-term debt rates are the
15 expected embedded cost of the debt included in the company's
16 2024 projected test year adjusted capital structure. To
17 ensure that customers do not pay any more than the actual
18 long-term debt costs on Peoples' 2023 issuances relative to
19 the forecasted long-term debt rate, the company is
20 proposing the Long-Term Debt Rate True-Up Mechanism
21 discussed on page 75 of the direct testimony of witness
22 Rachel B. Parsons.
23
24 **Q.** How do you think the credit markets and credit rating
25 agencies would view a decision that does not allow Peoples

1 to recover its forecasted, market-based short-term and
2 long-term borrowing costs through base rates?
3
4 **A.** Energy utilities such as Peoples have typically been
5 characterized by very low business risk and stable
6 financial metrics based on supportive regulatory
7 frameworks. Higher ratings for energy utilities are
8 typically justified by the low variability inherent in
9 their business risks due to constructive regulatory
10 oversight. A departure from past precedents by not allowing
11 the recovery of market-based interest rates would impact
12 rating agency assessments of the regulatory environment and
13 the company's cash flow generating ability respectively.
14
15 The degree of regulation and related decisions can severely
16 restrict or assist a regulated company such as Peoples.
17 Since the forecasted short-term and long-term borrowing
18 costs are market-based, a disallowance could potentially be
19 seen as an extreme position. The precedent this would set
20 would not necessarily be limited to this rate proceeding
21 alone. Such a precedent may be assessed in the context of
22 the overall regulatory environment and related business
23 risk, both now and in the future, in a jurisdiction
24 historically characterized as fair and constructive.
25

II.

OPC'S EFFORTS TO AVOID INTER-COMPANY SUBSIDIES AND ALLOCATE BENEFITS SHOULD BE REJECTED

Q. Will the company's proposed issuance of short-term and long-term debt in 2023 to repay its obligations under the IDA cause the customers of Peoples to subsidize Tampa Electric and its customers?

A. No. Although I am not an economist, I do not think Peoples paying market-based borrowing costs based on its credit profile and Tampa Electric paying market-based borrowing costs based on its credit profile will result in a subsidy in favor of either utility.

Q. To the extent that Tampa Electric will hypothetically "benefit" from Peoples repaying the IDA, should the Commission attempt to allocate that benefit between Tampa Electric and Peoples in this proceeding?

A. No. Peoples became a division of Tampa Electric when it was purchased by TECO Energy, Inc. in 1997. From then until the 2023 Transaction, Tampa Electric secured short-term and long-term debt for its electric and gas operations (Peoples Gas System) and allocated a portion of that debt and related interest costs to Peoples. Peoples did not borrow money on

1 a stand-alone basis or incur incremental independent audit
2 and credit rating fees during that 26-year period. To the
3 extent that "benefited" the customers of Peoples over the
4 years, OPC and the Commission did not attempt to allocate
5 the value of those "benefits" between Tampa Electric and
6 Peoples and should not do so now.
7
8 **III.**
9 **THE COMPANIES CONSIDERED OTHER OPTIONS**
10 **Q.** As part of the planning for the 2023 Transaction, did Emera,
11 Tampa Electric, and Peoples consider whether to continue
12 the historical borrowing arrangement between the two
13 utilities or preserve the allocation of lower cost long
14 term debt to Peoples as part of the 2023 Transaction?
15
16 **A.** Yes, but only briefly during the early stages of discussions
17 about a possible asset transfer. Both options were
18 considered and were deemed to be sub-optimal relative to
19 the plan for debt ultimately included in the 2023
20 Transaction.
21
22 **Q.** Why?
23
24 **A.** An objective of the 2023 Transaction was to insulate Peoples
25 and Tampa Electric from the contagion risk of the other

1 respective affiliate through legal, operating, and
2 financial structures. The effectiveness of insulating
3 provisions as protective measures can be uncertain and,
4 unfortunately, the strength of such measures is typically
5 only determined if they are tested during times of distress.
6 Specifically, during financial distress, including
7 bankruptcy, it would be beneficial to have provisions that
8 could prove to be instrumental in insulating either
9 Peoples' or Tampa Electric's credit quality.
10
11 Peoples has implemented organizational changes to
12 structurally isolate itself from its Tampa Electric
13 affiliate. Peoples already has its own separate management
14 team, maintains its own separate accounting records, and
15 adheres to the affiliate code of conduct with respect to
16 arm's length transactions with affiliates. These changes
17 will contribute to making Peoples more bankruptcy remote
18 from Tampa Electric. Peoples establishing its own borrowing
19 arrangement and ceasing its reliance on Tampa Electric as
20 a creditor/capital provider was also viewed as the best way
21 to further the goal of promoting bankruptcy remoteness,
22 especially relative to the option of maintaining the
23 historical borrowing arrangement.
24
25

E6-226

1 **IV.**

2 **THE COMMISSION SHOULD APPROVE**

3 **PEOPLES' PROPOSED EQUITY RATIO**

4 **Q.** Do you agree with OPC's proposal to reduce Peoples' equity
5 ratio?
6
7 **A.** No. The capital structure proposed by Peoples is important
8 to ensuring the long-term financial integrity of the
9 company. The test year equity ratio of 54.7 percent is
10 consistent with the capital structure as previously
11 approved by the Commission and entirely consistent with two
12 Florida-based peers given the 55.1 percent approved equity
13 ratio for Florida Public Utilities and the 59.7 percent
14 equity ratio approved for Florida City Gas. Further, as
15 Peoples' witness Dylan W. D'Ascendis explains, the
16 company's 54.7 percent equity ratio is consistent with its
17 peers and appropriate for ratemaking purposes as it is both
18 typical and important for utilities to have significant
19 proportions of common equity in their capital structures.
20 A more highly leveraged capital structure with a lower
21 overall authorized return will render it more difficult for
22 the company to achieve credit metrics sufficient to support
23 its targeted rating of BBB+.
24
25 Credit rating agencies view the regulatory environment as

1 a key consideration in determining the creditworthiness of
2 an energy utility. The regulator determines an appropriate
3 capital structure and defines the allowed return on equity
4 ("ROE"), and these are two of the key variables that go
5 into building up a utility's revenue requirement and by
6 extension the debt level and cash flow generating
7 capability of the company. As such, a change to either or
8 both will have an impact on the company's financial metrics
9 and creditworthiness. Peoples' obligation to serve its
10 customers and the significant capital expenditure
11 requirements needed to maintain and grow its system is
12 better served by stronger financial integrity. Therefore,
13 the maintenance of the requested capital structure, coupled
14 with an appropriate ROE, should lead to adequate coverage
15 ratios, and provide the financial strength and credit
16 parameters necessary to achieve the company's targeted
17 credit rating and assure access to capital.
18
19 **Q.** How does Peoples' proposed 54.7 percent equity ratio for
20 2024 compare to its actual equity ratio in prior years?
21
22 **A.** As shown on Document No. 1 of my rebuttal exhibit, Peoples'
23 proposed 54.7 percent equity ratio for 2024 is at or below
24 its actual equity ratio for the past 12 years. Peoples'
25 actual equity ratio was 53.55 percent in 2002, but otherwise

1 has been above 54 percent during that period. OPC's proposal
2 to reduce Peoples' equity ratio to 49 percent is
3 inconsistent with the equity ratio actually maintained by
4 the company since 1998 and should be rejected.
5
6 **Q.** Does this conclude your rebuttal testimony?
7
8 **A.** Yes, it does.
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

1 BY MR. WAHLEN:

2 **Q Mr. McOnie, did you also prepare and cause to**

3 **be filed with your direct testimony an exhibit marked**

4 **KDM-1 consisting of five documents?**

5 A Yes.

6 **Q Did you also prepare and cause to be filed**

7 **with your rebuttal testimony an exhibit marked KDM-2**

8 **consisting of one document?**

9 A Yes.

10 MR. WAHLEN: Mr. Chairman, just for

11 completeness, we will note that Exhibits KDM-1 and

12 2 have been identified on the comprehensive exhibit

13 list as Exhibits 21 and 31.

14 CHAIRMAN FAY: Okay.

15 BY MR. WAHLEN:

16 **Q Mr. Mr. McOnie, would you please summarize**

17 **your testimony?**

18 A Yes. Thank you.

19 Good morning, Commissioners, and thank you for

20 the opportunity to address you today. Also, I

21 wanted to thank everybody for the courtesy of

22 letting me go out of order as well.

23 My direct testimony explains why the

24 Commission should approve the company's proposed 54

25 percent equity ratio, our proposed short-term debt

1 rate of 4.85 percent, and our proposed long-term
2 debt rate of 5.54 percent. I explain the
3 importance of maintaining the company's financial
4 integrity, the requirement for the company to
5 obtain its own independent credit rating, and the
6 financing activities the company will undertake to
7 repay the intercompany loan agreement.
8 The 2023 Transaction will result in Peoples
9 raising its own debt based on their specific needs
10 and timing, and subject to their own risk profile
11 and credit rating.
12 My rebuttal testimony explains why the
13 Commission should approve the company's
14 market-based short-term and long-term debt cost
15 rates, and why the 2023 Transaction results in the
16 borrowing activities of Peoples and Tampa Electric
17 being fair, independent and market-based for each
18 company's customer groups. It also shows that the
19 company's proposed 54.7 percent equity ratio is
20 reasonable relative to the equity ratios the
21 company has maintained since 1998.
22 That concludes my summary. Thank you.
23 **Q Thank you.**
24 MR. WAHLEN: Mr. McOnie is available for
25 cross-examination.

1 CHAIRMAN FAY: Okay. Great.
2 And, Mr. McOnie, you were here earlier when I
3 explained our process to Mr. Garrett, correct?
4 THE WITNESS: Yes.
5 CHAIRMAN FAY: Okay. Great.
6 Ms. Christensen, when you are ready.
7 MS. CHRISTENSEN: Thank you.
8 EXAMINATION
9 BY MS. CHRISTENSEN:
10 **Q And good morning, Mr. McOnie.**
11 A Good morning.
12 **Q You are the Treasurer of Emera, is that**
13 **correct?**
14 A Yes.
15 **Q And you discuss in your prefiled direct**
16 **testimony PGS and the credit ratings financial**
17 **integrity, the 2023 financial transaction, which I'll**
18 **call the spinoff, and the short- and long-term debt for**
19 **the test year, is that correct?**
20 A Yes.
21 **Q And on page four of your prefiled direct**
22 **testimony, at lines 16 and 18 -- and if you want to get**
23 **there, just let me know when you are there.**
24 A I am sorry, the pages, again?
25 **Q Page four of your prefiled direct testimony,**

1 **lines 16 through 18.**
2 A Yes, I am there.
3 **Q Okay. You state that the financial integrity**
4 **is a function of financial risk, which represents the**
5 **risk that a company may not have adequate cash flow to**
6 **meet its financial obligations, is that right?**
7 A That's correct.
8 **Q And then if you turn to page six of your**
9 **testimony, lines one through four, you talk about**
10 **maintaining a strong financial position allows the**
11 **company to finance infrastructure investment in support**
12 **of an improved system at a lower cost than would**
13 **otherwise be possible; is that correct?**
14 A Yes.
15 **Q And would you agree that it would be important**
16 **for a company to keep financing costs as low as**
17 **possible, because these costs are passed on to**
18 **customers, correct?**
19 A Yes, I would agree.
20 **Q And PGS will be accessing its own financing in**
21 **the capital markets after the spinoff, is that correct?**
22 A Yes, after the 2023 Transaction.
23 MS. CHRISTENSEN: Okay. I am going to ask
24 that OPC 86 be passed out, and that's PGS's
25 response to OPC Interrogatory No. 95.

1 CHAIRMAN FAY: Okay. And we will be marking
2 this 191.
3 (Whereupon, Exhibit No. 191 was marked for
4 identification.)
5 BY MS. CHRISTENSEN:
6 **Q And, Mr. McOnie, you are familiar with this**
7 **discovery response, correct?**
8 A Yes, I am.
9 **Q Okay. And you would agree that prior to the**
10 **spinoff, TECO accessed the capital markets on behalf of**
11 **PGS, correct?**
12 A Correct.
13 **Q And when TECO issued long-term debt, that**
14 **long-term debt was issued to meet the financing**
15 **requirements not only of Tampa Electric's electric**
16 **operations, but also for PGS's division, correct?**
17 A Yes.
18 **Q And in every rate case filed by Tampa Electric**
19 **for its electric operations, and for PGS's division**
20 **since it acquired PGS, Tampa Electric allocated the**
21 **total Tampa Electric debt between Tampa Electric and PGS**
22 **based on their respective actual legacy debt financing**
23 **issued to finance their respective capital needs; is**
24 **that correct?**
25 A Yes.

1 **Q And a portion of long-term debt allocated to**
2 **PGS were at the same interest rates and the portion**
3 **allocated to Tampa Electric's electric operations, is**
4 **that right?**
5 A Yes, it is.
6 **Q Okay. And the portion of the short-term debt**
7 **allocated to PGS was based on Tampa Electric's credit**
8 **facilities for both its electric operations and the PGS**
9 **division, correct?**
10 A Yes.
11 **Q And the short-term debt allocation to Tampa**
12 **Electric's electric operations and the PGS divisions**
13 **were the same -- were at the same interest rate, is that**
14 **right?**
15 A Yes. That's right.
16 **Q Okay. So Tampa Electric's credit rating prior**
17 **to the spinoff would have controlled and resulted in the**
18 **same interest rates on the debt issued by Tampa Electric**
19 **for the electric operations and for the PGS division,**
20 **correct?**
21 A Yes.
22 MS. CHRISTENSEN: Okay. And I am going to ask
23 that OPC Exhibit 87, which is a excerpt from Tampa
24 Electric's 10-Q report dated 9/30/2022 be passed
25 out.

1 CHAIRMAN FAY: Okay. That will be 192 Chris.
2 (Whereupon, Exhibit No. 192 was marked for
3 identification.)
4 BY MS. CHRISTENSEN:
5 **Q Mr. McOnie, as the Treasurer, you are familiar**
6 **with the Security Exchange reporting forms, correct?**
7 A I am.
8 **Q Okay. And you are familiar with the 10-Q that**
9 **was reported for Tampa Electric on 9/30/2022?**
10 A I would have been at the time.
11 **Q Okay. And I just want you to turn to the page**
12 **-- it's pages, and at the bottom it says 27. Can you**
13 **take a look at that page if you just open it up? Do you**
14 **see that?**
15 A Yes, I see that.
16 **Q Okay. And under the credit ratings of senior**
17 **unsecured debt as of September 30, 2022, can you read**
18 **the credit ratings of the senior unsecured debt for me?**
19 A S&P Triple B plus, Moody's A3, Fitch A.
20 **Q And can you tell me, by credit rating agency,**
21 **what the credit ratings outlook were as of September**
22 **30th, 2022?**
23 A S&P stable, Moody's stable, Fitch stable.
24 **Q Okay. Thank you. And that's all for that**
25 **document.**

1 MS. CHRISTENSEN: I would ask that OPC 88 be
2 passed out, and this is an excerpt from the form
3 10-K Annual Report TECO.
4 CHAIRMAN FAY: Okay. 193.
5 (Whereupon, Exhibit No. 193 was marked for
6 identification.)
7 BY MS. CHRISTENSEN:
8 **Q And, Mr. McOnie, if you could take a look at**
9 **this document. Is this a document that you are familiar**
10 **with?**
11 A Yes, it is.
12 **Q Okay. Wonderful.**
13 **Okay. And if you could open up to the first**
14 **page of this exhibit, and look to the top. Can you read**
15 **the first header on this page?**
16 A TEC may be subject to risks relating to its
17 separation from PGS.
18 **Q Okay. And would you agree that this section**
19 **of the 10-Q essentially describes the risk related to**
20 **the spinoff that was taking place, or set to take place**
21 **on January 1st, 2023, related to spinning off the PGS**
22 **division?**
23 A Yes.
24 **Q Okay. And one of those risks related to the**
25 **tax-free transaction, or the tax-free nature of the**

1 **transaction for tax purposes?**
2 A I am sorry, could you repeat the question?
3 **Q Certainly.**
4 **One of the risks was whether or not the**
5 **spinoff would be considered a tax-free transaction by**
6 **the U.S. federal income tax for -- excuse me -- for U.S.**
7 **federal income tax purposes, correct?**
8 A Yes. I see that in the third paragraph now.
9 **Q Okay. And if you can, flip to the third page**
10 **of this document. Do you see the subheading credit**
11 **ratings?**
12 A At the bottom of the page, yes.
13 **Q Okay. And would you agree that the credit**
14 **ratings outlook changed from stable to negative for all**
15 **three rating agencies as of December 31st, 2022?**
16 A Yes, I agree.
17 **Q Okay. And I am done with that document.**
18 **Thank you.**
19 MS. CHRISTENSEN: I would ask to pass out OPC
20 document 89.
21 CHAIRMAN FAY: Okay. 194.
22 (Whereupon, Exhibit No. 194 was marked for
23 identification.)
24 MS. CHRISTENSEN: Thank you.
25 BY MS. CHRISTENSEN:

1 **Q And this is a 10-Q form from the period March**
2 **31st, 2023. And are you -- Mr. McOnie, are you familiar**
3 **with this excerpt from the 10-Q for Tampa Electric?**
4 A Yes.
5 **Q Okay. And if you flip to the second page,**
6 **page 22 of that report, would you agree that the credit**
7 **ratings outlook continued to be negative for all three**
8 **agencies?**
9 A Yes. And that will continue to be the case
10 for a 12- to 18-month period.
11 MS. CHRISTENSEN: Okay. And I just had one
12 more form to be passed out and that was OPC 90.
13 CHAIRMAN FAY: Okay. 195.
14 (Whereupon, Exhibit No. 195 was marked for
15 identification.)
16 MS. CHRISTENSEN: Thank you.
17 BY MS. CHRISTENSEN:
18 **Q Add and I think you just said this, but you**
19 **can confirm this. This is for the period of June 30th,**
20 **2023. And I think your previous statement, but you**
21 **would agree the credit ratings outlook continued to be**
22 **negative for all three rating agencies, correct?**
23 A Yes. That's correct.
24 **Q Okay. Now, let me draw your attention to page**
25 **eight of your prefiled direct testimony, lines 11**

1 **through 13. You are there?**

2 A Yes, I am there.

3 **Q Wonderful.**

4 **In this portion of your testimony, you say**

5 **that, in general, a higher credit rating means a lower**

6 **credit spread, and a lower credit rating means a higher**

7 **credit spread; is that correct?**

8 A Yes. That's correct.

9 **Q In other words, a higher credit rating --**

10 **well, in other words, the higher the credit rating, the**

11 **lower the interest rates on loans, and the lower the**

12 **credit rating, the higher interest rates on loans; would**

13 **that be a correct assessment?**

14 A I would be more specific and say, the higher

15 the credit spread, the underlying benchmarks they move

16 and they are variable, so depending on what your

17 comparator is, the all-in rate, your starting point,

18 that is, the all-in rate could be higher or lower,

19 depending on the interest rate environment you are in.

20 **Q Okay. But generally speaking, as a general**

21 **proposition with the change to spread, the higher -- the**

22 **higher the credit rating plus spread, the lower the**

23 **interest rates, and then vice-versa, the lower the**

24 **credit rating and spread, the higher the interest rates**

25 **will be because of the risk?**

1 A Yes, if the underlying benchmark is at the
2 same point in time. I am just -- it's the time
3 reference that --
4 **Q Okay.**
5 A -- if it's on the same day, and you are
6 applying the same spreads to the same underlying USD
7 benchmark, you are correct.
8 **Q Okay. And with that caveat, I will accept**
9 **that answer.**
10 **Would you agree that the spinoff of PGS from**
11 **TECO has had a negative impact on TECO's credit rating**
12 **based on those 10-Ks and 10-Qs that we just reviewed?**
13 A No.
14 **Q Well, would you agree that from the period of**
15 **January 1st, 2023, through at least June 30th of 2023,**
16 **the outlook for each of those -- by each of the rating**
17 **agencies has gone from stable to a negative outlook,**
18 **correct?**
19 A Yes. And if I may provide more of an
20 explanation.
21 Tampa Electric is part of the Emera family of
22 companies. Emera was placed on negative outlook due to
23 the legislative action in Nova Scotia that pertained to
24 Bill 212, I believe, that capped Nova Scotia Power rates
25 rate increase at 1.8 percent per filed document. Each

1 of the rating agencies viewed the political interference
2 extremely negative to the regulatory process.
3 In addition to that, the credit metrics were
4 down from the higher gas prices at Tampa Electric, and
5 there was an under-recovery period during -- leading
6 into the end of 2022. So these two factors combined,
7 along with the delay in cash flows from the Labrador
8 Island link, caused each of the rating agencies to place
9 Emera on negative outlook. Because Tampa Electric is
10 one of our group of families, it's rating agency
11 practice to put the entire group on negative outlook.
12 **Q However, when we looked at the 10-K, there as**
13 **section in the 10-K that we reviewed that did talk about**
14 **the potential risk of the spinoff of PGS, correct?**
15 A It -- yes.
16 **Q Okay. Now, let me turn your attention to page**
17 **12 of your prefiled testimony, starting at line 24, and**
18 **it kind of goes through to the next page, 13, line five.**
19 **And in this portion of your testimony, you**
20 **talked about PGS not having direct access to capital**
21 **markets, so PGS does not have a credit rating or a rated**
22 **debt yet, is that correct?**
23 A Yes.
24 **Q And on page 18 of your direct testimony, and I**
25 **was looking at lines four through 19. This portion of**

1 **your testimony, you discuss seeking an indicative rating**
2 **from the three agent rating agencies, S&P, Moody's and**
3 **Fitch, correct?**
4 A Yes.
5 **Q You would agree that PGS is a smaller company**
6 **than TECO, correct?**
7 A Yes.
8 **Q And a small -- as a smaller company, you would**
9 **expect PGS to have a lower credit rating than when it**
10 **was part of -- when it was a division of TECO, correct?**
11 A No, that's incorrect.
12 I don't know exactly which section it is, but
13 witness D'Ascendis states in his testimony that rating
14 agencies make no adjustment for size of the entity,
15 which is why you have to do a size adjustment for his
16 cost of equity analysis in risk.
17 **Q Okay. But he also noted, and I think you**
18 **would agree, that smaller companies generally are**
19 **considered more risky than larger companies, correct?**
20 A Correct, from an equity perspective, which is
21 the context I believe he was discussing if you -- if you
22 do go back and read his testimony with respect to his
23 comment on rating agencies not making such an
24 adjustment.
25 **Q Well, I think, since Mr. D'Ascendis has**

1 **already testified, we know what his opinion is.**

2 **Regarding the size of the company that does --**

3 **that is reflected, though, you would agree, in the**

4 **credit rating, because they have to take into account**

5 **the cash flow and the ability of the company to generate**

6 **cash, correct? And the smaller the company, the cash**

7 **flows are going to be smaller, correct?**

8 A No, it's all relative. The smaller the

9 company, the smaller the amount of debt. So it's -- the

10 cash flow metrics they run are cash flow to debt.

11 **Q Okay. Well, let's look at page 18, line 25.**

12 **On this, you say: PGS is targeting a Triple B Plus**

13 **credit rating, is that correct?**

14 A Yes.

15 **Q And that would be an S&P rating, is that**

16 **correct, the Triple B Plus?**

17 A Triple B Plus is part of their nomenclature,

18 along with Fitch, I believe, does the plus. But it was

19 a way for referring to it at present. The two agencies

20 that we are seeking indicative right ratings from are

21 Fitch and Moody's.

22 **Q Okay. And you claim that this target is based**

23 **on, in part, on the ROE with a midpoint of 11 percent?**

24 A Yes.

25 **Q And -- but currently, PGS's ROE is 9.9 with**

1 **100-basis-point range, with a 54.7 equity ratio,**
2 **correct?**
3 A Yes.
4 **Q And you would agree that PGS is not expecting**
5 **customers to pay a higher than market ROE to support a**
6 **specific credit rating due to the spinoff in 2023,**
7 **right?**
8 A No, because I believe the ROE is being
9 determined based on market factors, and how to attract
10 capital from equity investors and/or the shareholder, so
11 it's part of the business risk component. The financial
12 risk, or the leverage, it's a direct output of your
13 equity thickness and your ROE. So it just determines
14 what the cash -- the ultimate cash flow level is with
15 respect to the debt.
16 **Q So I think, in your response, you are agreeing**
17 **with me, that PGS isn't expecting us, or the customers**
18 **to pay a higher ROE just to support a specific credit**
19 **rating?**
20 MR. WAHLEN: Can I inquire?
21 CHAIRMAN FAY: Mr. Wahlen, go ahead.
22 MR. WAHLEN: This is a question about return
23 on equity, and our return on equity witness has
24 testified. Mr. McOnie is not our return on equity
25 witness. I am not sure how this is relevant to his

1 testimony.
2 CHAIRMAN FAY: Ms. Christensen, go ahead. You
3 are specifically trying to tie the credit rating
4 agencies' analysis?
5 MS. CHRISTENSEN: Exactly. And he also
6 brought up Mr. D'Ascendis' testimony from yesterday
7 regarding ROE. I am just trying to clarify that
8 the company is not expecting -- and it's also part
9 of his testimony. He actually cites to the ROE and
10 a specific equity ratio. I am just trying to
11 clarify that that's not -- they are not expecting
12 us to pay that particular ROE to get a certain
13 credit rating.
14 CHAIRMAN FAY: Yeah, I am going to allow it.
15 He did bring up Mr. D'Ascendis' testimony. And
16 just be mindful, of course, Ms. Christensen, he is
17 not the expert on that, but as it relates to
18 correlation to the ratings, I think that's fair.
19 BY MS. CHRISTENSEN:
20 **Q Do you need me to repeat the question?**
21 A No. I have had some time to think, and I
22 think what may help is a further explanation, if you
23 will indulge me.
24 What will be submitted to the rating agencies
25 for an indicative rating is a forecast that is entirely

1 based upon the submission as filed to the FPSC. The
2 rating agency will take that submission and look at
3 awarded ROEs across the country and, in all likelihood,
4 they will also look at the two most recent decisions
5 made for FPUC and Florida City Gas. They will then make
6 their own informed judgment as to what they think the
7 ROE, or what the ultimate rate case may return as a
8 final decision, which is why I was saying I am not
9 expecting customers to pay 11 percent. I am awaiting,
10 because that's why the rating will be indicative. They
11 won't be able to formalize it until this concludes, and
12 we know the result. At which time they will put in the
13 actual results from this case, and it will be based on
14 the actual results.
15 **Q Okay. So essentially, the credit rating will**
16 **follow whatever the appropriate ROE is, you would agree**
17 **with that?**
18 A I would say the will -- in their model, they
19 will look at what impact the ROE has on the cash flow
20 metrics.
21 **Q Okay. Looking on page 15 of your direct**
22 **testimony, and lines 17 through 18, you say that PGS**
23 **will establish its own revolving credit facilities with**
24 **a syndicate of bank lenders, is that correct?**
25 A Yes. That's correct.

1 **Q What type of market is a syndicate of bank**
2 **lenders? Is that public or private?**
3 A It's essentially the existing syndicate of
4 banks. It's revolving credit facility. So Tampa
5 Electric's current facility that has approximately 10
6 banks in it, it will likely be a subset of those banks.
7 I don't know that it will have all 10 in it, but it's
8 the bank market.
9 **Q Okay. So that's essentially a private market,**
10 **it's not traded publicly -- or not directly --**
11 A Yeah, I don't -- I -- honestly, I would say
12 it's a syndicated credit facility is the product. It's
13 -- it's loans offered by the bank.
14 **Q Okay. Do you expect to access, for your 2023**
15 **long-term and short-term debt, from these syndicate of**
16 **bank lenders?**
17 A The short-term debt, yes.
18 **Q Okay. Does that also include the long-term**
19 **debt?**
20 A No, it does not.
21 **Q Okay. And where will you be accessing the**
22 **long-term debt from?**
23 A The long-term debt will be accessed via the
24 private placement market.
25 **Q Okay. And that is private?**

1 A It is, yes.
2 **Q Okay. And does it cost more or less to borrow**
3 **from a private market than the public market?**
4 A It -- I would say it costs a little bit -- I
5 shouldn't say a little bit. It costs more.
6 **Q Okay. And PGS has access -- or PGS had access**
7 **to a public market when they were part of TECO, correct?**
8 A Yes. That's correct.
9 **Q Okay. On page 14 of your direct testimony,**
10 **starting at line 24, and then you kind of go over to the**
11 **top of page 15 through line nine. You talk about the**
12 **intercompany debt agreement on January 1st, 2023 --**
13 A Yes.
14 **Q -- of approximately $736 million, is that**
15 **correct?**
16 A Yes, it is.
17 **Q Okay. And you talk about the unsecured notes**
18 **of approximately seven -- or 570 million. This is PGS's**
19 **share of the long-term debt at the Tampa Electric**
20 **interest rates, is that correct?**
21 A Yes.
22 **Q And then you have approximately 166 million of**
23 **short-term debt allocated to PGS at Tampa Electric's**
24 **interest rate, is that correct?**
25 A Yes.

1 MS. CHRISTENSEN: I would ask to have OPC 92
2 passed out.
3 CHAIRMAN FAY: 196, Ms. Christensen.
4 MS. CHRISTENSEN: Yeah. Thank you.
5 (Whereupon, Exhibit No. 196 was marked for
6 identification.)
7 MS. CHRISTENSEN: And OPC --
8 CHAIRMAN FAY: Ms. Christensen, just give a
9 second to make sure everybody has got this in front
10 of them.
11 MS. CHRISTENSEN: Sure.
12 CHAIRMAN FAY: You can go ahead. Thank you.
13 MS. CHRISTENSEN: Thank you.
14 BY MS. CHRISTENSEN:
15 **Q OPC 92 is the earnings surveillance report for**
16 **PGS year ending December 31st, 2022. And you would have**
17 **some familiarity with this document, correct?**
18 A I do not.
19 **Q Okay. Is this a document that's regularly**
20 **filed on behalf of the company with the Commission, if**
21 **you are aware?**
22 A Oh, sorry, I thought you were explaining it to
23 me.
24 **Q No. No. I am asking you -- I mean, I guess**
25 **the question is, you have no reason to doubt that this**

1 **is a true and accurate reflection of the earnings**
2 **surveillance report that was filed by Peoples Gas as of**
3 **-- what is this -- December 31st, 2022?**
4 A I have no reason to doubt.
5 **Q Okay. Let me turn your attention to Schedule**
6 **4, which I think -- I believe is about the fifth page of**
7 **this document.**
8 **CHAIRMAN FAY: I am sorry, what page did you**
9 **say, Ms. Christensen?**
10 MS. CHRISTENSEN: It's Schedule 4, which I
11 think is about the fifth page, but it could be
12 before that, since it's double sided, or at least
13 mine is.
14 CHAIRMAN FAY: Okay. Got it. Thank you.
15 BY MS. CHRISTENSEN:
16 **Q And if you can look at Schedule 4, that has**
17 **the -- let me see -- it has the cost rate for debt**
18 **indicated in there, correct? If you look at the low,**
19 **midpoint and high point, it has the cost of debt for**
20 **long-term debt, short-term debt, do you see that?**
21 A Yes, I do.
22 **Q Okay. Great.**
23 **And would you agree that the short-term cost**
24 **rate is 0.39 percent?**
25 A Yes.

1 **Q And would you also agree that the long-term**
2 **debt cost rate is 3.81 percent, correct?**
3 A Yes, as reported here.
4 **Q Okay. Now, let me draw your attention to the**
5 **MFRs, Schedule G, and I am not sure -- I probably have**
6 **to learn how to push out documents.**
7 **CHAIRMAN FAY: Maybe Ms. Wessling could help**
8 **you there.**
9 MS. CHRISTENSEN: I am sorry. Hold on.
10 It is schedule, MFR, Schedule G-3, page one
11 and two of 11, which is K277 through 278. And I
12 need to get myself there too as well. It was K277
13 through 278. Okay.
14 CHAIRMAN FAY: Thank you, Ms. Wessling.
15 MS. CHRISTENSEN: Everybody is there?
16 Wonderful.
17 Okay. On page one --
18 CHAIRMAN FAY: Do you have that? I am sorry.
19 I just want to make sure PGS has it. Are you
20 there?
21 MR. WAHLEN: Yes. Thank you.
22 MS. CHRISTENSEN: Okay. Great.
23 CHAIRMAN FAY: Go ahead.
24 BY MS. CHRISTENSEN:
25 **Q So looking at page, I guess K277, or that's**

1 **MFR, Schedule G-3, page one and two. I am looking at**
2 **page one. And the short-term cost rate used in 2023 is**
3 **4.22 percent, is that correct?**
4 A I believe this is a question that's best for
5 Rachel Parsons. She would have calculated this. It
6 looks like it might be based on an average, so I can't
7 say with certainty.
8 **Q Okay. If you are looking at the cost rate**
9 **section of this, I am not asking you necessarily how it**
10 **was calculated, but it does say in there that that's the**
11 **cost rate that's being used, correct?**
12 A Yes.
13 **Q Okay. And I just want you to confirm, if you**
14 **look in the long-term debt, 4.58 percent, that's the**
15 **cost rate that's being used for long-term debt in the**
16 **2023, I guess it's historical test year plus one, is**
17 **that correct?**
18 A Yes. That's what it states here.
19 **Q And can you read footnote two on this page for**
20 **me out loud?**
21 A Excuse me a second.
22 **Q Sure. It's the one with the double asterisks.**
23 **And if you are having difficulty reading it, I can read**
24 **it, and you can let me know if you agree with me,**
25 **whichever is easier.**

1 A It's the -- oh, the first star, the first note
2 star?
3 **Q Nine double asterisks one.**
4 A The double asterisks.
5 Includes the intercompany debt with Tampa
6 Electric associated with the loan agreement entered into
7 on January 1st, 2023, and is assumed to be refinanced --
8 it cuts -- sorry -- on September 30th, 2023, components
9 of intercompany debt will be reflected in FERC accounts
10 223, 226 and 233.
11 **Q Okay. And now let's see if we can flip over**
12 **to the next page, page two of 11, and this is, if I am**
13 **correct, the projected test year ending 12/31/2024.**
14 **Can you confirm that the short-term debt rate**
15 **used in -- or cost rate used in this is 4.85 percent?**
16 A Yes.
17 **Q And can you also confirm that the long-term**
18 **debt rate, or debt cost rate, is 5.54 percent?**
19 A Yes.
20 **Q Okay. And would you agree that these interest**
21 **cost rates are significantly higher in the projected**
22 **test year than they were in 2022, right before the**
23 **spinoff?**
24 A Yes.
25 MS. CHRISTENSEN: Okay. Now, I would ask to

1 have OPC 93 passed out.
2 CHAIRMAN FAY: We'll mark this as 197.
3 MS. CHRISTENSEN: Thank you.
4 (Whereupon, Exhibit No. 197 was marked for
5 identification.)
6 BY MS. CHRISTENSEN:
7 **Q I am going to also ask you, Mr. McOnie, if you**
8 **can go back to page 17 of your direct testimony. And**
9 **let me know when you are there.**
10 A I am at my direct testimony on page 17, I have
11 the --
12 **Q Okay. Wonderful.**
13 **And I am looking at lines 14 through 18 of**
14 **that part of your testimony. And in your response to**
15 **Interrogatory 216, which is the last page of that**
16 **exhibit, in both of that, you say that the company has**
17 **to pay off its intercompany debt by December 31st, 2023,**
18 **for this transaction -- and that would be the 2023**
19 **spinoff -- to be considered a nontaxable event; is that**
20 **correct?**
21 A Yes.
22 **Q Okay. And let's look at your response to**
23 **Interrogatory 215, which was part of the exhibit that**
24 **was just passed out.**
25 **And in response to this interrogatory, you**

1 **also, I believe, agree that if you fail to pay off the**
2 **intercompany debt, the potential capital gains tax would**
3 **be 150 million, correct?**
4 A Yes.
5 **Q And would you agree that you need to secure**
6 **outside debt, or outside financing before the end of the**
7 **another to meet this payoff requirement by December**
8 **31st, 2023?**
9 A Yes. That's correct.
10 **Q And on page 24 of your direct testimony, and I**
11 **am specifically looking at lines 13 to approximately 18.**
12 **You discuss, in 2023, PGS will obtain long-term debt in**
13 **three traunches in September -- on September 30th of**
14 **2023, is that correct?**
15 A Yes, that was the target at the time.
16 **Q Okay. You were saying that's the target at**
17 **the time. And I think you talk about there is a couple**
18 **of different traunches that you anticipated, and there**
19 **was a traunch -- or you said in total, you would be**
20 **issuing 823 million of debt for the new company on**
21 **September 30th. And I think you just indicated that**
22 **that -- the September 30th may not be the current goal**
23 **date, can you tell us what the current debt for issuing**
24 **these -- this debt would be?**
25 A Yes, it would be late October, sometime in

1 November or December.

2 **Q Okay. And I think you had said you expected**

3 **today issue 325 million of that in five-year notes 5.4**

4 **percent, is that correct?**

5 A The 825 million and the three traunches here

6 were part of the forecasting exercise we went through.

7 You had to pick certain amounts to be in each traunch,

8 and these three would average 5.57, then combined with

9 the 100 million issuance in 2024 at 5.37 gets you to

10 your 5.54 percent rate.

11 To be clear, these are proxies. When we go to

12 market, they don't necessarily need to be five, 10, 30

13 and 10-year.

14 **Q Okay. Well, I am just trying to get an update**

15 **of where you are at. So I was going to ask, do you**

16 **still expect to issue the 325 million of five-year notes**

17 **at the 5.4 percent? I think you said it may not be**

18 **exactly in that amount or in that five-year notes, is**

19 **that correct?**

20 A That's correct.

21 **Q Okay. Do you have an update of what**

22 **combination of traunches you will be seeking in the late**

23 **October, early November timeframe?**

24 A We will know at that time. It's in the

25 approach to the market that you determine where the

1 demand is on the curve and how you can optimize that for
2 Peoples and its customers.
3 **Q Okay. So as of today, you don't have any**
4 **better information than what was in your testimony?**
5 A As of -- as of today, I have no update to the
6 information that's in my testimony, aside from to let
7 the Commission know, and let the people here know, that
8 when we go out, this was meant to be a proxy to estimate
9 the potential financing cost for the purposes of this
10 rate submission. When we go to market to optimize, our
11 agent will be talking to all the various institutions,
12 and they will be saying, we are willing to go it across
13 the curve. There will be some combination of the debt
14 that will be issued to best achieve of this targeted
15 rate.
16 **Q Okay. Do you -- do you expect that you will**
17 **still be able to achieve, in whatever combination the**
18 **debt is issued, a overall average 5.7 percent interest**
19 **rate on the long-term debt?**
20 A Yes, I do.
21 **Q Okay. On page 18 of your testimony, I think**
22 **you -- at lines nine through 16, you talk about that PGS**
23 **will have to provide the rating agencies with**
24 **information regarding the company's strategy, regulatory**
25 **environment and financial projections based on the**

1 **current rate case in the 2023 test year, is that**
2 **correct?**
3 A I don't mean to correct you, but 2024 test
4 year.
5 **Q Oh, 2024, excuse me.**
6 A Yes.
7 **Q Would you agree that it's unlikely that a**
8 **commission decision on the rate case will be made even**
9 **before your anticipated late October, early November**
10 **debt issuance?**
11 A It's possible.
12 **Q Okay. And is it just as possible that you**
13 **won't have that decision before you go out to market and**
14 **seek to obtain this long-term financing?**
15 A The market prefers certainty, so to the extent
16 that we can have that certainty in the form of the
17 decision, it's more helpful to get the best pricing.
18 **Q Okay. But there is no assurity that it can be**
19 **done before the end of October, you would agree with**
20 **that?**
21 A It depends on -- it depends on this process.
22 MS. CHRISTENSEN: Okay. Let me ask that OPC
23 interrogatory -- or OPC 94 be passed out.
24 CHAIRMAN FAY: Mark this 198.
25 (Whereupon, Exhibit No. 198 was marked for

1 identification.)
2 BY MS. CHRISTENSEN:
3 **Q Okay. And you have a copy of that response in**
4 **front of you?**
5 A I do.
6 **Q Okay. You would agree that the impact of the**
7 **spinoff due to intercompany debt payoff and higher**
8 **interest rates are approximately 9 million based on the**
9 **assumed market conditions, is that correct?**
10 A Yes. That's correct.
11 **Q Okay. And you would agree that the spinoff,**
12 **then, would directly increase the -- increase PGS's**
13 **expenses in the rate case by this approximately $9**
14 **million, correct?**
15 A Yes, I believe that's correct, to be confirmed
16 by witness Parsons.
17 **Q Fair enough.**
18 **And you would also agree that this is**
19 **generally considered a harm to PGS's customers, not a**
20 **benefit at this time?**
21 A I -- no, I would not.
22 **Q Let's look at page 26 of your direct**
23 **testimony, lines 19 through 24.**
24 **You briefly discuss a one-time long-term debt**
25 **true-up mechanism for the 2023 debt issuance, is that**

1 **correct?**

2 A Yes, I do.

3 **Q Okay. Do you -- and you do not mention in**

4 **this testimony any base rate case where the Commission**

5 **has allowed a one-time debt adjustment after a base rate**

6 **case, correct?**

7 A Yes.

8 **Q Okay. Would you agree that it's -- that it is**

9 **unusual circumstances where PGS is yet to issue any debt**

10 **on its own so that the actual long-term debt rate is not**

11 **known at this time in this type of a base rate case?**

12 A Could you rephrase the question? I am --

13 **Q I will certainly attempt to rephrase it.**

14 **You would agree that this is an unusual**

15 **circumstances, where, because it's a new spinoff, there**

16 **has been no established long-term debt rate that could**

17 **be used in a rate case?**

18 A Yes, I would, which is the reason for the

19 introduction of the long-term debt true-up mechanism.

20 We were of the view that we weren't trying -- we don't

21 try to make money by forecasting the interest rate and

22 then coming in under it or anything, so we wanted to

23 just pass through to the customers; if it came in lower,

24 it's to the customers, if it came in hire, we just

25 wanted it to be to a true reflection of what we

1 ultimately achieved.

2 **Q Okay. I am going to turn your attention to**

3 **your rebuttal testimony, page four, please. And looking**

4 **at the bottom of page -- I guess the bottom of page**

5 **four, you start to have a conversation there, and then**

6 **flowing on to the top of page five.**

7 **You say: Long-term debt cost is the projected**

8 **test -- or in the projected test year, should reflect**

9 **the expected cost of debt, not the historical cost of**

10 **debt of past owners, right?**

11 A Yes.

12 **Q Would you agree that the past owners in this**

13 **case is an affiliate of PGS, essentially TECO?**

14 A Yes.

15 **Q And you would agree that PGS operated as a**

16 **division of this affiliate, TECO, for 27 years, correct?**

17 A Yes.

18 **Q And when Emera bought TECO, they continued to**

19 **operate in this manner for approximately five additional**

20 **-- or five of those years?**

21 A Yes.

22 **Q And when Tampa Electric issued debt to finance**

23 **the PGS division of capital investments, this debt was**

24 **the obligation of PGS, and the interest rate expense was**

25 **recovered by PGS from its customers, not Tampa**

1 **Electric's customers, correct?**
2 A Yes.
3 **Q So PGS had not only the obligation to repay**
4 **that interest rate, but also the right to the interest**
5 **rate, including the low cost of debt that was issued**
6 **while it was a division of Tampa Electric, if any, of**
7 **that specific interest rate, correct?**
8 A Yes.
9 **Q And when a long-term interest rate is**
10 **projected in a test year, this projection includes the**
11 **cost rate impacts of the embedded historical debt**
12 **issuances, correct?**
13 A Could you rephrase?
14 **Q Certainly. When the long-term interest rates**
15 **is projected in a test year, in this case, you are using**
16 **a forecasted test year --**
17 A Yes.
18 **Q -- this projection includes the cost rate**
19 **impacts of the embedded historical debt issuances,**
20 **correct?**
21 A No, not in this case, because if you are
22 referring to the embedded historical issuances, it's the
23 issuance that preceded the 2023 Transaction, the
24 embedded rate. The new rate is PGS issuing the debt as
25 its own entity.

1 **Q And I would agree with you, this case is**
2 **unusual because you have the spinoff, and you have the**
3 **intercompany debt, correct -- the intercompany debt**
4 **obligation that was created because of the spinoff,**
5 **correct?**
6 A Yes, it needs to be paid off.
7 **Q But in a normal base rate case, such as the**
8 **prior PGS base rate case, you would agree that the**
9 **embedded historical long-term debt would be used and**
10 **project forward into the test year, correct?**
11 A No, I wouldn't.
12 **Q Let me ask you this: Since the spinoff and**
13 **the related intercompany debt agreement, PGS is**
14 **required, pursuant to that agreement, and solely as a**
15 **result of the spinoff, to pay off the historical debt by**
16 **the end of 2023 so that the 2024 projected test year**
17 **cost rates do not include the impact of the historic**
18 **debt, correct?**
19 A Yes.
20 **Q So you would agree that PGS's customers are**
21 **losing the benefit of the impact of this lower cost**
22 **historical debt -- or lower cost historical cost rates**
23 **in the projected 2024 test year, correct?**
24 A Yes.
25 **Q And due to the spinoff, and the need to pay**

1 **off the intercompany -- okay, and this is due to the**
2 **fact that you have a spinoff and you need to pay this**
3 **intercompany debt off by December 31st, 2023, correct?**
4 A Yes. That's correct.
5 **Q Okay. On page nine of your rebuttal**
6 **testimony, looking at specifically lines six through**
7 **nine, you discuss isolating PGS from the risk of**
8 **bankruptcy with the spinoff. You would agree that the**
9 **spinoff does not protect PGS from the risk of bankruptcy**
10 **at the parent level, is that correct?**
11 A No, I would not -- or, no, I don't agree with
12 that.
13 **Q Okay. You would not agree that if Emera were**
14 **to have financial difficulties or distress, that that**
15 **would not impact PGS as a company?**
16 A I don't believe so. There is no -- the cross
17 event of default in the loan documentation as it exists
18 with Tampa Electric, an event of default at the
19 operating subsidiary constitutes an event of default at
20 the parent, but the opposite doesn't hold true.
21 **Q Okay. Let's look at page 11 of your rebuttal**
22 **testimony, lines 12 through 17.**
23 **You discuss achieving the company's targeted**
24 **credit rating through the requested capital structure**
25 **and ROE, correct?**

1 A Yes. That's correct.
2 **Q You would agree that the spinoff would likely**
3 **cause PGS to have a lower credit rating than it would**
4 **have had before the spinoff, right?**
5 A It didn't have a credit rating before the
6 spinoff.
7 **Q It would have a lower credit rating than it**
8 **would have had as part of TECO, correct?**
9 A Yes.
10 **Q Okay. And you would agree that a lower credit**
11 **rating as a result of the spinoff is a harm from the**
12 **spinoff, not a benefit?**
13 A I would -- I would not agree with that. I
14 think the credit rating will be representative of what
15 the true business risk and financial risk is of Peoples
16 and a true reflection of the cost of capital for Peoples
17 on a go-forward basis.
18 MS. CHRISTENSEN: Okay. Can I have one
19 moment?
20 CHAIRMAN FAY: Yeah.
21 MS. CHRISTENSEN: I have no further questions.
22 CHAIRMAN FAY: Okay. Mr. Moyle?
23 MR. MOYLE: I would -- I know we have to take
24 lunch, it's 12:30. If we do that now, I can pick
25 up after lunch with him.

1 CHAIRMAN FAY: Sure. We can break, and then
2 we will -- let's see, let's plan on being back here
3 at, let's say 1:45.
4 MR. MOYLE: I appreciate that. Thank you.
5 CHAIRMAN FAY: Okay. All right. With that,
6 we will break for lunch.
7 MR. MOYLE: Thank you.
8 (Lunch recess.)
9 CHAIRMAN FAY: All right. If everyone could
10 grab their seats.
11 Okay. Mr. McOnie, just make sure you have got
12 your light on there.
13 THE WITNESS: Yes.
14 CHAIRMAN FAY: Okay. Thank you.
15 All right. We will move into cross from Mr.
16 Moyle.
17 MR. MOYLE: Thank you, Mr. Chair.
18 EXAMINATION
19 BY MR. MOYLE:
20 **Q Good afternoon.**
21 A Good afternoon.
22 **Q You are presently, as we sit here today, the**
23 **VP for Tax and Treasury for Emera, is that right?**
24 A Yes. That's correct.
25 **Q Okay. And as part of that job, you are an**

1 **officer of the company?**

2 A No, I am not, not officially, I don't believe.

3 **Q So a VP is -- that doesn't translate into an**

4 **officer?**

5 A I think EVP does, I am not -- but the

6 definition of officer, I am not exactly sure, Jon,

7 sorry.

8 **Q Okay. That's fine.**

9 **Do you go to the board meetings of Emera?**

10 A I do not.

11 **Q Are you involved in preparing material for**

12 **board meetings?**

13 A From time to time, yes.

14 **Q Okay. I have had a discussion with counsel,**

15 **and there was a document yesterday -- you have been here**

16 **for the proceeding, have you not?**

17 A I have.

18 **Q Okay. So we went through a handful of**

19 **confidential documents, and there was one that dealt**

20 **with interest expense. And I just want to ask you a**

21 **question based on something in that document, and I just**

22 **I will make a reference to it for the record. It's**

23 **Exhibit 167, which I believe is already in evidence,**

24 **previously identified as OPC No. 3, page 08, it had also**

25 **bold No. 38. You have that in front of you in your --**

1 **you want to look at it. I am not asking that you have**
2 **to do that, but if you want to, you can.**
3 A And what was the page?
4 **Q It's OPC 08?**
5 A OPC.
6 **Q And the big black number in the middle of the**
7 **document is 38.**
8 A You can proceed. I don't -- I am not finding
9 it here.
10 **Q The statement says: For the purposes of**
11 **estimating interest rates in 2023, it is assumed that**
12 **PGS's debt will be rated at least one notch below Tampa**
13 **Electric's rating due to a different business profile.**
14 **And as we sit here today, you don't have anything to**
15 **disagree with that, I mean, that's a true and accurate**
16 **statement?**
17 A That probably -- yes, it's the targeted credit
18 rating that we are pursuing, which is Triple B Plus. It
19 doesn't mean that we are limited to Triple B Plus if the
20 rating agencies, once they go through the business risk
21 and financial risk, they may return with an indicative
22 rating of a low as well.
23 **Q Right. But this doesn't have any reference to**
24 **any ratings. I mean, ratings can move up, ratings can**
25 **move down based on a variety of factors, correct?**

1 A That's correct.

2 **Q Including factors beyond the control of an**
3 **entity. If the economy starts getting in bad shape from**
4 **a macro standpoint, that could potentially affect**
5 **ratings as well, could it not?**

6 A I think what you are -- yes -- I will say yes.
7 I think what you are talking about is if a sector comes
8 under stress, such as the financial or banking sector.

9 **Q Right. And we, you know, have had some**
10 **discussions about what's anticipated, and this the**
11 **statement provided to the board, did you -- do you know**
12 **if you had a role in putting together this material for**
13 **that board meeting that took place?**

14 A I wouldn't have had a role in putting together
15 the material. I was likely the source of concluding
16 that PGS may arrive at a Triple B Plus rating.

17 **Q Yeah. And to be clear, it didn't -- again, it**
18 **didn't say the number. It just said, we think we are**
19 **going to be at least one notch blow Tampa Electric's**
20 **rating?**

21 A Yes.

22 **Q And that's consistent with your view?**

23 A Yes, it is.

24 **Q You were asked questions by OPC, and I just**
25 **want to make sure I understand this point. The -- on**

1 **page eight, 11, line 11 -- you don't need to go there --**
2 **but in your testimony, you say the higher the rating the**
3 **lower the credit spread?**
4 A Yes.
5 **Q And some us have said, the higher the rating,**
6 **the -- you pay a lower amount of interest. Is that**
7 **essentially the same thing?**
8 A It is. There is two parts to your all-in
9 interest rate, and it's your underlying benchmark, which
10 is -- it can be U.S. Treasuries and the term you choose,
11 like five, 10, 30, or somewhere in between. And then
12 there is the credit spread, and the two are added
13 together to arrive at your interest rate.
14 **Q And just so the way it works generally, the**
15 **treasury number is sort of a baseline number, and then**
16 **adjustments are made with respect to other entities**
17 **based on their business risk and their financial risk?**
18 A That's right.
19 **Q And with respect to, say, a difference in one**
20 **notch, based on your experience, how many basis points**
21 **would that represent, probably within a range? Can you**
22 **just take a stab at that, please?**
23 A I could, like, a long-term average, I would
24 say 15 to 25 basis points, but I would, like a lot of
25 things in life, I would say it depends.

1 **Q Right. Okay. So -- but at a general level,**
2 **15 to 25 would not be out of the ordinary to see with**
3 **respect to, you know, a Triple B Plus compared to a**
4 **Double B, Double B is a little lower?**
5 A No. That's -- you are going a few scales
6 below. From Triple B Plus to Double B, you would go
7 through Triple B Flat, Triple B Minus, Double B Plus,
8 Double B, so you would have four notches. But once you
9 step through from investment grade to non-investment
10 grade, it's a big jump. So the 15 to 25 wouldn't apply.
11 Generally, if you go non-investment grade, you are
12 probably starting anywhere from 250 to 350 basis points
13 more.
14 **Q Okay. And where -- right now, Tampa Electric**
15 **has Triple B Plus, is that right?**
16 A Tampa Electric has three ratings, Triple B
17 Plus with S&P, A3 with Moody's and I believe A or A Low
18 with Fitch, so they are a split rating.
19 **Q And those are all investment grade?**
20 A Yes. Triple B Minus and above is investment
21 grade.
22 **Q And there was -- there has been discussion**
23 **about the -- and you have it in your testimony -- the**
24 **2023 Transaction, and there is a cost of approximately**
25 **$10 million, 9.75, associated with this transaction; is**

1 **that right?**

2 A Yes. I have heard that number.

3 **Q And the lion's share of that cost relates to**

4 **anticipated payment of interest expense by PGS**

5 **ratepayers that is different than what would have been**

6 **paid under the prior corporate structure, is that right?**

7 A Yes, I would say approximately 7.1 million of

8 it is the repricing of the 570 million long-term debt

9 that needs to be exchanged. The other debt, the 255

10 million is really subject to similar market rates as to

11 what Tampa Electric would experience.

12 **Q And so if we were just briefly going to total**

13 **up to the 9.5, 7.1 on long-term --**

14 A 7.1 plus 1.8 related to the rating

15 differential and short-term debt change. And then I

16 think the other part, the buildup to -- of the 750,000,

17 I would defer to witness Parsons later, because I think

18 it has to do with audit fees and a treasury analyst, if

19 I remember correctly, but I would prefer for her to

20 speak to that.

21 **Q Okay. And would you have the detail, or would**

22 **this be a witness Parsons question, like, you all got a**

23 **private letter ruling, I am sure that was not an**

24 **inexpensive legal --**

25 A I think that would be a witness Parsons

1 question.

2 **Q So with respect to those costs, you were here**

3 **yesterday when President Wesley was asked questions**

4 **about all of the documents that had been provided to the**

5 **Board, and she said there was nothing in the documents**

6 **that directly addressed the benefits to ratepayers, do**

7 **you recall that?**

8 A Yes. I listened to witness Wesley's

9 testimony.

10 **Q Yeah. How is the company proposing that this**

11 **9.75 million cost be shared by the ratepayers in the**

12 **company?**

13 A I believe the one-time -- and that was

14 answered by witness Wesley, I believe, but I -- like my

15 understanding of what she said, are the one-time

16 nonrecurring costs would be borne by Emera, and the

17 recurring go forward cost of financing activities for

18 Peoples Gas would be borne by the company.

19 **Q So using the numbers we just talked about, how**

20 **much of those numbers would be recurring?**

21 A I thought that full amount was recurring, but

22 I will defer -- I will put this question to witness

23 Parsons if you are going to want a breakdown of

24 recurring and nonrecurring.

25 **Q Yeah. I am just trying to understand how much**

1 **Emera is picking up, how much you are asking the**
2 **ratepayers to pick up and get the recurring number, so I**
3 **will ask did witness Parsons.**
4 A I understand.
5 **Q Thank you.**
6 **With respect to the private letter ruling and**
7 **the income tax question, that's a roughly $100 million**
8 **issue, is it not?**
9 A I believe the number that's been quoted is 150
10 million.
11 **Q 150 million. And, for example, if you don't**
12 **get your document in, that's a potential $150 million**
13 **liability that would have to be addressed?**
14 A That's my understanding.
15 **Q And who would -- who would that fall to?**
16 **Would that fall to the PGS ratepayers, Emera, the TECO**
17 **entity? How would that, if it came to be, and I know**
18 **that we all hope it doesn't come to be, but if it did,**
19 **how would it -- who would it fall on?**
20 A Yes, that's a question for witness Parsons as
21 well.
22 **Q I am going to switch gears to capital**
23 **structure and a little bit of ROE conversation.**
24 **100 basis points of ROE, is that -- would you**
25 **agree that's worth approximately $20 million in terms of**

1 **revenue?**

2 A I am trying do the math in my head. I will

3 say yes, but --

4 **Q Okay. And I want to -- that was my only**

5 **question on ROE.**

6 **With respect to the capital structure, you are**

7 **suggesting that the capital structure, as it's existed**

8 **for sometime, is maintained, approximately a 55**

9 **percent-45 percent, 55 percent being equity, 45 percent**

10 **being debt, is that right?**

11 A That's right. I won't -- for the 54.7 and the

12 45.3, yes.

13 **Q In your professional life and background,**

14 **capital structure is something you are comfortable with**

15 **and familiar with, you are providing testimony on it**

16 **hear today, correct?**

17 A Yes.

18 **Q Okay. Do you have an understanding, in my**

19 **mind, analogous to interest rates, that capital**

20 **structure can be affected by external conditions and can**

21 **be changed based on external conditions?**

22 A I will have to say such as?

23 **Q Well, interest rates are subject to change**

24 **based on external conditions, correct?**

25 A Yes.

1 **Q For example, the situation in Ukraine and, I**
2 **mean, events happen that have an economic impact, and**
3 **that can affect interest rates.**
4 **So my question is, is that with respect to**
5 **capital structure, do external events, you know, global**
6 **events, disasters, does that also have the ability to**
7 **effect risk with respect to capital structure and**
8 **suggest adjustments to capital structure may be in order**
9 **given outside circumstances?**
10 A I think there is a lot in that question there,
11 and I don't know where to start or how to finish without
12 -- but I think what you are asking is there can be
13 events that give rise to an immediate require for
14 liquidity that, by and large, is generally debt
15 financed. So these emergency situations could put a
16 burden on a company and place it in financial distress
17 in a hurry. So that's one element of the risk you are
18 talking about.
19 I think another thing is, from quarter to
20 quarter, the capital structure will change, and
21 typically, like it's -- it's a quarterly average or a
22 year-end, it's a point in time estimate. So it will
23 change due to operating characteristics over the course
24 of the year. And then if the company itself is
25 experiencing burden and needs to drop on emergency

1 facilities, or get emergency funds, it could change the
2 structured at that time.
3 **Q Okay. And your first area to look for money**
4 **before short-term debt would probably be capital surplus**
5 **that you have, or contingency funds, cash on hand,**
6 **right?**
7 A If you maintained -- if you maintained cash
8 the balance sheet.
9 **Q Do you all?**
10 A Not at the Peoples Gas level.
11 **Q Okay. A couple more just general questions**
12 **with respect to risk.**
13 **Part of the role is to interact with the**
14 **credit agencies, right?**
15 A Yes.
16 **Q And I asked a question of a couple of other**
17 **witnesses, I am hoping I found the right one. You may**
18 **are have received this from the President yesterday.**
19 **Do you know the rating agencies, how they view**
20 **risk of electric operating companies as compared to LDCs**
21 **like PGS, and which one -- if they consider one to have**
22 **more inherent risk, from a business standpoint, not from**
23 **a financial standpoint?**
24 A I understand. I understand. And especially
25 with rating agencies, I don't know that, at times, you

1 are going to get a black and white answer with respect
2 to one sector, like a vertically integrated utility has
3 more risk than a gas distribution, because they look at
4 numerous factors. And I think the risks that could face
5 either sector are different at different points in time.
6 So for example, lately, the rating agencies
7 have looked at vertically integrated utilities with the
8 coal exposure and decarbonization, and how much of a
9 risk does that expose -- that create for capital
10 requirements in the future. So they could say that has
11 more risk.
12 Then they look at other companies from a
13 business risk perspective, and it could be a gas
14 distribution company in New York where there was a
15 recent moratorium on new gas hookups, which sort of
16 limits their ability to create or generate new revenues.
17 I think the other thing with respect to gas
18 distribution companies is there is a perspective related
19 to fuel transition, that gas is a transition fuel, and
20 it could be next after coal and decarbonization.
21 So when you talk to rating agencies, I hate to
22 generalize. They are fundamentally dour people, and the
23 glass is always half empty. Hopefully none of them are
24 watching me right now. Sorry.
25 **Q There are reports they would go through and**

1 **say, this company has nuclear assets, we perceive that**
2 **as risk. I mean, there are operational --**
3 A Yes.
4 **Q -- risks as well, correct?**
5 A Yes, that's -- absolutely. The political
6 interference, you heard me reference it earlier, that's
7 a huge stroke of the pen type risk for a regulated
8 utility.
9 **Q And the reference to the political risk, you**
10 **had referenced a 1.8-percent limit that was being**
11 **considered by a governmental body in Canada, right?**
12 A The government legislated it.
13 **Q So it actually took place?**
14 A It actually took place.
15 **Q And did it say that -- was it a limit on the**
16 **ability to increase rates to ratepayers?**
17 A Yes.
18 **Q Did they apply it to corporate subsidiaries?**
19 A No. The result of that, so you will know, the
20 impact of S&P practically immediately downgraded Nova
21 Scotia Power two notches. So generally what I would
22 say, sort of related to this, is capital flows to where
23 capital is treated fairly, and one of the main
24 components of that fair treatment is a consistent, fair,
25 practical regulator, and no, I will call it, political

1 interference in the process.

2 I think we've become unwant -- unwantedly, if

3 that's a word, the poster child for that. Like, I think

4 S&P made an example of Nova Scotia Power to so how

5 important not having political interference in the

6 process is.

7 **Q Does that action that you just described, the**

8 **1.8-percent limit on rate increases, does that flow**

9 **through to the corporate children of Emera in terms of**

10 **negative impacts on things like interest rates?**

11 A No, because each entity has its own rating, as

12 we are discussing in this.

13 Peoples Gas is the only entity at present

14 that's a division of another one of our operating subs.

15 We typically, as witness Wesley said, we try to put a

16 box around the risk and isolate each of the entities

17 from.

18 **Q Just a few more questions.**

19 **When -- I had asked you about what 100 basis**

20 **points represents for ROE. Could you tell me what one**

21 **percentage point change in the capital structure would**

22 **represent in terms of savings to ratepayers?**

23 A No. I think -- I know that -- I think the

24 weighted average cost of capital submitted for this is

25 7.42 percent. But again, for those types of

1 sensitivities, I think it would be witness Parsons.
2 **Q Okay. And you would agree, generally**
3 **speaking, that equity is more expensive than debt,**
4 **correct?**
5 A Yes.
6 **Q And just to translate that, I guess, so an**
7 **adjustment, if as Public Counsel is proposing to say,**
8 **you know, five percentage points, let's take the equity**
9 **portion down by five percentage points, that would enure**
10 **to the benefit, from a financial standpoint, of**
11 **ratepayers with respect to what would have to be paid?**
12 A Well, I --
13 **Q Just looking at that piece alone.**
14 A Well, yes and no, because I think you could
15 look at it in isolation like that. I think to look at
16 it not considering the impact it would have in your
17 credit rating, I think 49 percent and nine percent gets
18 you metrics that you are likely Triple B Flat, possibly
19 less. And the reason I say that is there is a
20 quantitative element to it, and the qualitative aspect
21 to it is how the rating agencies will view the business
22 risk related to a decision of that nature.
23 **Q You would agree that if that played out and**
24 **there was a ratings adjustment that, from a purely**
25 **economic standpoint, if you went to a ratepayer and a**

1 **ratepayer was making an economic decision, and they were**
2 **confronted with, well, would you rather pay more in**
3 **interest cost because there is a rating issue and now**
4 **you have to pay higher interest costs, or would you**
5 **rather pay less because there has been an adjustment in**
6 **the debt to equity ratio, that it would just be a**
7 **mathematical calculation for them, and to say, which**
8 **would I have to pay more or less for?**
9 A It could be, but I don't know that you would
10 know where you may end up on the rating scale with such
11 an action. I don't know what your ultimate cost of debt
12 would be.
13 **Q Okay. Historically, with respect to equity**
14 **investment, in the regulatory space, there is not equity**
15 **investment that is made by third parties, correct? It**
16 **all comes from the parent down to the operating company**
17 **with respect to equity? There is not an opportunity**
18 **typically for, you know, a pension fund, or something**
19 **like that, to go in and take an equity piece of a**
20 **company like Emera?**
21 A No, that's incorrect.
22 So we have a lot of institutions that have
23 shareholdings in Emera, so the pension funds
24 institutions, they invest in shares of Emera, we raise
25 the equity at the Emera level and it's translated.

1 **Q I should not have said Emera. I should have**
2 **said PGS.**
3 A Yeah. No, not at PGS. It's indirect through
4 Emera, and we are raising equity funds on the base of
5 the family of companies.
6 **Q Right. So no third parties can get into the**
7 **operating subsidiaries but for through the corporate**
8 **parent that's publicly traded?**
9 A And again, I will say not through the public
10 markets. But there was a recent trend in the past
11 several years where pension funds that couldn't take
12 down large enough stakes were bought into operating
13 subsidiaries like at the 15-percent level. So from time
14 to time, companies do avail themselves of these, I will
15 call them asset or share transactions, where they get a
16 passive player. They usually want a board seat, and
17 company remains the operator.
18 So it's not a no, nay, never response like
19 the, you can. It's really up to the company if they
20 want to engage in those types of investors or
21 partnerships, I will call them.
22 **Q Thank you.**
23 **Do you know if regulators have approved those**
24 **type of limited passive investments by third parties**
25 **into operating companies?**

1 A I think in the case where they've occurred, by
2 and large, I would say, yes, they have, because I know
3 some exist. Oftentimes, you get access to some
4 expertise, like if, depending on the pension fund and
5 what they are responsible for. And the other thing is,
6 oftentimes, having that separate person on your board
7 from a governance perspective is helpful to show
8 independence.
9 **Q Okay. You punt a lot of the interest**
10 **adjustment mechanism to witness Parsons in your**
11 **testimony?**
12 A Yes.
13 **Q But just with respect to risk, you would agree**
14 **that interest adjustment mechanism would reduce risk**
15 **exposure for Peoples, would it not?**
16 A Yes. The rating agencies would probably view
17 it as a cash flow stabilization mechanism, not -- not
18 unlike fuel recoveries or the hurricane. So it would be
19 viewed as credit positive, in my opinion.
20 **Q And so that translates into the scale with**
21 **respect to things like capital structure and ROE that**
22 **would suggest maybe a lowering pressure on the ROE piece**
23 **and the equity piece, would you not, if it's reducing**
24 **risk?**
25 A It could. I think it's difficult to know how

1 much it would, but I think it would factor into it. I
2 think -- you know, I think what we need to be cognizant
3 of is the rating agencies look at other peers and the
4 results. And they will be closely looking at the recent
5 Florida peers, and they will do more complicated math
6 than I do quickly. But I multiplied through, on a
7 simplistic straightforward illustrative basis, the
8 equity thickness by the return, the ROE that was
9 granted, and I -- if I remember correctly, like, in both
10 cases for FPUC and Florida City Gas, the number came out
11 to be 5.65 or 5.66, and then I put it over our 54.7 as a
12 denominator, and it worked out to 10.33 percent.
13 And so they will do some sort of triangulation
14 like that to see, like, how fair the result -- and I
15 know we have expert witnesses, so I am not trying to get
16 over my skis, but I am saying there will be some sort of
17 science they will do over and above just the simple cash
18 mechanisms. They will do a peer comparison. They will
19 look at the nature of the decision.
20 **Q Right. The peer comparison basis, that -- you**
21 **would agree, every case is decided on its own facts, and**
22 **everybody has unique risk profiles?**
23 A I do agree.
24 **Q And the other two that you are referencing,**
25 **they don't have a debt adjustment mechanism, do they?**

1 A No, they don't.

2 **Q And you are aware that the Commission has**

3 **previously, to the extent that there is something that**

4 **goes into a rate case that reduces risk, that they could**

5 **look at making a corresponding adjustment to ROE?**

6 A I will say, yes, I am aware, and I think it

7 only makes sense.

8 **Q Okay. On your rebuttal testimony, there was**

9 **one sentence that I wanted to draw your attention to.**

10 **It's on page nine, line 16.**

11 A Okay.

12 **Q And it -- it's the reference to making PGS**

13 **more bankruptcy remote from Tampa Electric?**

14 A Yes.

15 **Q What were you -- what were you conveying**

16 **there? I interpreted that as Tampa Electric**

17 **potentially, if things go bad there, opposes a**

18 **significant risk of drawing down PGS with it if there**

19 **was a bankruptcy. Is that what you are communicating?**

20 **Or I just didn't really understand what you were driving**

21 **at there.**

22 A Yes. And I am wondering whether further

23 explanation is required, because I don't want to explain

24 too much, if you want more of an explanation, but I will

25 say yes.

1 **Q So what I just articulated as to how I read it**
2 **was consistent with what you were intending to convey?**
3 A It is, but there is another part too, I think
4 longer term.
5 So right now, PGS is, I think, 15 or 16
6 percent of the combined rate base. And what would
7 happen is the risk of one of these events is likely,
8 like when people go to invest in the bond, they are
9 looking at both entities. And when you have that 85-15
10 split, something bad in Tampa Electric has a
11 disproportionate impact on the 15 percent; and
12 similarly, something good here, it would take a lot of
13 good to offset that if the bad events occurred.
14 When I take that further, because I don't want
15 to just think about shareholders, part of this -- the
16 whole reason for this, I heard Tim say it, but Tampa --
17 Peoples has grown, and Peoples' customer base now is
18 exam 40 percent of the total. So you have got 15
19 percent of the rate base and 40 percent of the
20 customers.
21 So the determination of what the proper risk
22 price should be for investors, there is another side of
23 it that I think the Commission has to deal with, is,
24 well, what's fair for a 40-60 split and the impact each
25 entity can have on each other? And I would say, at 15

1 percent, Peoples Gas' ability to influence the whole is
2 somewhat diminished.
3 So it's more fair for the customers of Peoples
4 to have the growth, like, they can be rewarded for the
5 double digit growth they are experiencing, and we have
6 been talking about it, and part of it is definitely a
7 function of the size. 100 million at Peoples Gas over
8 the denominator of the rate base gets you a higher
9 growth than 100 million at Tampa Electric. And
10 customers can some -- that can be conveyed in the
11 capital markets when they are paying for a growth story,
12 a solid safety story, and that's part of it too, Jon.
13 **Q Okay. And essentially, the decision with**
14 **respect to the 2023 Transaction, I mean, what we are**
15 **talking about has already been done. It's just now a**
16 **question of whether the company is able to recover its**
17 **nonrecurring costs associated with it and, going**
18 **forward, recurring costs, and if it is recurring costs,**
19 **is there a split between the company and the ratepayers;**
20 **is that fair?**
21 A No, I -- if I understand your question, the
22 nonrecurring costs, I don't believe we are seeking to
23 recover --
24 **Q That's right.**
25 A -- it's a recurring cost.

1 **Q So that part is correct, whether you get the**
2 **recurring costs, and if so, if there is a split?**
3 A Yes.
4 **Q Okay. And then the final point that I just**
5 **want to make is with respect to the capital structure --**
6 **I am a history major, so history has some importance,**
7 **but with respect to an analytical, a rigorous analytical**
8 **process, historical references, I mean, they are**
9 **significant to you?**
10 A So I don't understand the question, if there
11 is a question. If you ask me if I want to hear a
12 historical reference --
13 **Q I read your testimony to say, part of the**
14 **reason the Commission should give you the 55 percent --**
15 A Oh, yes.
16 **Q -- capital structure is because that's what's**
17 **been done previously.**
18 A Yes.
19 **Q To me, that's akin to our ROE exhibit by**
20 **saying --**
21 A Yes.
22 **Q -- you should award 9.5 percent, because**
23 **that's what's been done across the country.**
24 A I understand. I think I was trying to
25 illustrate fairness from the perspective of the company.

1 We were look to have the right level of
2 capital structure for our growth plan, for access to
3 markets to maintain our financial integrity to achieve
4 the target rating or possibly better. And what I was
5 trying to illustrate with the historical is we are not
6 outside the bound. I think you capital structure should
7 reflect where you actually manage your capital structure
8 to, and so I was trying to illustrate that's what's been
9 done over time, even though some of the time predates
10 me.
11 **Q Right. As part of your responsibilities, do**
12 **you oversee the financial operations of SeaCoast?**
13 A No. Not at all.
14 **Q No? And you would agree, they have a**
15 **significantly different capital structure?**
16 A I heard it in testimony the other day, but I
17 have been -- I have been primarily, if not solely,
18 focused on Peoples Gas, the regulated entity.
19 **Q Thank you for your time.**
20 A Thank you.
21 CHAIRMAN FAY: Okay. Staff?
22 MR. SANDY: Yes, Mr. Chair.
23 EXAMINATION
24 BY MR. SANDY:
25 **Q Mr. McOnie, it's fair to say that the utility**

1 **has yet to receive an indicative rating from any of the**
2 **rating agencies thus far, is that correct?**
3 A Yes, it is.
4 **Q Okay. Are you aware of when they will receive**
5 **such rating?**
6 A I am. Coincidentally, we were -- is today the
7 15th or the 14th? It's the 15th, I believe.
8 **Q It looks like it's the 14th all day long.**
9 A Okay, 14th. We were supposed to meet with
10 them today. And when Idalia rescheduled these hearings
11 we have the meeting with Fitch on Monday. We've asked
12 them to work towards a mid to late October indicative
13 rating. We have a meeting with Moody's the week after,
14 on the 25th, I believe.
15 **Q And have they given you any sense of what they**
16 **will be recommending?**
17 A No. We haven't met with them yet. We've
18 spoken with the commercial people. We sent them the
19 financial models. They will only -- and they won't give
20 us a sense. They will provide us with the indicative
21 rating letter after they go to credit committee, but
22 first they need to have the management meeting with us,
23 which is the next milestone in the process.
24 MR. SANDY: If I could have one moment.
25 MR. MOYLE: Mr. Chair, I just would note for

1 the record, I mean, obviously any findings of fact
2 are made, this is a hearsay issue on this.
3 CHAIRMAN FAY: Okay. Noted.
4 BY MR. SANDY:
5 **Q Once the utility has issued its long-term**
6 **debt, and if a true-up mechanism is approved through the**
7 **Commission as part of this rate case, will the**
8 **information you receive from Moody's or Fitch, will that**
9 **be included in the information that is provided in the**
10 **true-up process?**
11 A So, yes is the short answer. The longer
12 answer is the indicative rating will be based on the
13 assumptions provided to them. To borrow a programming
14 phrase, garbage in/garbage out, and we are not providing
15 them with garbage, but I am using that as an example
16 that we are providing them with what we believe will
17 occur. The financial forecast they have is based on 100
18 percent of the rate fueling as filed, so it will have
19 the long-term debt true-up mechanism.
20 The rating agencies, based on their only
21 internal experiences, their only internal observations
22 of outcomes of rate cases, will likely assign some sort
23 of, I will call it a discount to that. I think they
24 should be very informed by the recent Florida peer
25 decisions that were received here, but they will likely

1 broaden it a little bit to other parts of the states,
2 would be my guess, or my educated guess.
3 MR. SANDY: I have got no further questions,
4 Mr. Chair. Thank you.
5 CHAIRMAN FAY: Okay. Commissioners?
6 Okay. Redirect?
7 MR. WAHLEN: Thank you, Mr. Chair.
8 FURTHER EXAMINATION
9 BY MR. WAHLEN:
10 **Q Mr. McOnie, Mr. Moyle asked you if 100 basis**
11 **points of return on equity was worth about $20 million.**
12 **Do you remember that?**
13 A Yes, I do.
14 **Q Would you agree, subject to check, and subject**
15 **to double check by witness Parsons, that it's really**
16 **worth about $15.2 million?**
17 A Yes.
18 **Q Okay. The long-term debt true-up mechanism**
19 **that we've talked about today is a one-time true-up,**
20 **correct?**
21 A That's correct.
22 **Q So it's not going to operate like a clause,**
23 **correct?**
24 A That correct.
25 **Q And do you think the fact that it's a one-time**

1 **true-up would moderate the impacted that that would have**
2 **on the company's risk profile?**
3 A I think it could with respect to an assessment
4 of the regulatory regime by the rating agencies, because
5 it would be viewed as a positive outcome, and supportive
6 from a credit worthiness perspective commission.
7 **Q But it's not like a long-term cost recovery**
8 **clause?**
9 A No. It's more of a qualitative factor that
10 may improve your business risk component.
11 **Q And are you a return on equity expert?**
12 A I am not.
13 **Q Thank you.**
14 **CHAIRMAN FAY: Okay. Mr. Wahlen, exhibits?**
15 MR. WAHLEN: Would like to enter Exhibits 21
16 and 31 into the record.
17 CHAIRMAN FAY: Okay. Without objection, show
18 21 and 31 entered into the record.
19 (Whereupon, Exhibit Nos. 21 & 31 were received
20 into evidence.)
21 MR. WAHLEN: And may Mr. McOnie be --
22 CHAIRMAN FAY: OPC.
23 MR. WAHLEN: We have more exhibits to do.
24 Sorry.
25 CHAIRMAN FAY: That's all right.

1 MS. CHRISTENSEN: I would ask to have 191
2 through 198 admitted into the record.
3 CHAIRMAN FAY: Okay. 191 through 198, showing
4 no objection, those are entered into the record.
5 (Whereupon, Exhibit Nos. 191-198 were received
6 into evidence.)
7 CHAIRMAN FAY: All right. Mr. Wahlen.
8 MR. WAHLEN: May Mr. McOnie be excused?
9 CHAIRMAN FAY: Mr. McOnie, thank you for
10 taking the time to be here. We know some of the
11 witnesses weren't able to make it here with our
12 change in schedule, and so we appreciate you
13 traveling.
14 THE WITNESS: No. Thank you for having me
15 here.
16 (Witness excused.)
17 CHAIRMAN FAY: All right. So I think next we
18 were going to move to witness Kollen, OPC, you are
19 ready?
20 Okay. We will give Mr. Kollen a minute to get
21 set up and then we will start with him.
22 We will swear you in, Mr. Kollen, were you not
23 here originally when we swore in the other
24 witnesses?
25 THE WITNESS: I was not.

1 CHAIRMAN FAY: Okay. If not, raise your right
2 hand.
3 Whereupon,
4 LANE KOLLEN
5 was called as a witness, having been first duly sworn to
6 speak the truth, the whole truth, and nothing but the
7 truth, was examined and testified as follows:
8 THE WITNESS: Yes.
9 CHAIRMAN FAY: Okay. Great. Have a seat.
10 And make sure for your testimony you have got your
11 green light on there. Push that button. Okay.
12 Great. Thank you so much.
13 Ms. Wessling, whenever you are ready.
14 MS. WESSLING: Thank you.
15 EXAMINATION
16 BY MS. WESSLING:
17 **Q And good afternoon, Mr. Kollen.**
18 A Good afternoon.
19 **Q Couple please state your full name and your**
20 **business address for the record?**
21 A Yes, my name is Lane Kollen. My business
22 address is 570 Colonial Park Drive, Suite 305, Roswell,
23 Georgia, 30075.
24 **Q Thank you.**
25 **Did you cause to be time some prefiled direct**

1 **testimony consisting of 64 pages in Docket No. 202302 --**
2 **excuse me -- 0023-GU?**
3 A Yes.
4 **Q And do you have any corrections to your**
5 **testimony?**
6 A No.
7 **Q If I were to ask you the same questions today,**
8 **would your answers be the same?**
9 A Yes.
10 MS. WESSLING: I would ask that the testimony
11 of Lane Kollen be entered into the record as though
12 read.
13 CHAIRMAN FAY: Okay. Show it entered.
14 (Whereupon, prefiled direct testimony of Lane
15 Kollen was inserted.)
16
17
18
19
20
21
22
23
24
25

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

IN RE:	**PETITION FOR RATE INCREASE BY PEOPLES GAS SYSTEM, INC.**	))	**DOCKET NO. 20230023-GU**

CONFIDENTIAL
(REDACTED)

DIRECT TESTIMONY

AND EXHIBITS

OF

LANE KOLLEN

ON BEHALF OF THE

OFFICE OF PUBLIC COUNSEL

JUNE 2023

TABLE OF CONTENTS

I. QUALIFICATIONS AND SUMMARY 3

II. THE 2023 TRANSACTION IMPOSES EXCESSIVE COSTS ON PGS AND SUBSIDIZES TAMPA ELECTRIC COMPANY DURING ITS RATE STAYOUT PERIOD AND BEYOND 6
- A. The 2023 Transaction Was Structured To Benefit Emera and Tampa Electric Company, But Does So By Imposing Excessive Costs On The Company And Its Customers 6
- B. The 2023 Transaction Improperly Increases The Company's Cost Of Debt To Benefit Emera and Tampa Electric Company And May Result In The Company's Customers Subsidizing Tampa Electric Company's Customers 15

III. THE FORECAST TEST YEAR REFLECTS EXCESSIVE COSTS BASED ON A BUDGET DEVELOPED AND APPROVED SPECIFICALLY FOR THE RATE CASE, NOT IN THE NORMAL COURSE OF BUSINESS 21
- A. The Budgets Developed And Approved For The Rate Case Reflect Excessive Costs 21
- B. The Test Year Capital Expenditures Are Excessive And Unreasonable 24
- C. The Test Year Staffing, Payroll Expense, And The Related Benefits And Payroll Taxes Expenses Are Excessive And Unreasonable 27
- D. The Trended Payroll Expense Is Excessive And Unreasonable 33
- E. The Test Year Administrative And General Expense Is Excessive And Unreasonable Due To The Company's Failure To Increase The Account 922 Credit For A&G Expenses Capitalized To Match The Trended Increases In The Other A&G Expense Accounts 36
- F. The Test Year Storm Damage Expense Accrual Is Excessive And Unreasonable 39
- G. The Test Year Revenue Requirement Incorrectly Accounts for The Revenues For The Brightmark, New River, and Alliance RNG Projects 41
- H. The Test Year Property Tax Expense Is Excessive And Unreasonable 43

IV. DEPRECIATION RATES AND EXPENSE ARE EXCESSIVE 46
- A. The Company's Depreciation Study Date Does Not Match The Test Year And Results In Excessive And Unreasonable Depreciation Rates And Expense 46
- B. Quantifications Of Adjustments To Reduce Depreciation Expense Using OPC Witness Garrett's Recommended Depreciation Rates, Using The Company's Depreciation Study Date, And Using The OPC Depreciation Study Date 52
- C. A More Rapid Amortization Of The Theoretical Depreciation Reserve Surplus Will Mitigate The Proposed Rate Increase And Promote Intergenerational Equity Regardless Of Whether The Commission Uses The Company's Depreciation Study Date Or The OPC Depreciation Study Date 53
- D. The Company's Proposal To Utilize The Theoretical Depreciation Reserve Surplus To Enhance Its Post Test Year Earnings Is Flawed And Will Harm Customers In Order To Benefit Emera 57

V. QUANTIFICATION OF ADJUSTMENTS TO REFLECT OPC WITNESS GARRETT'S RECOMMENDED CAPITAL STRUCTURE AND COST OF EQUITY 60

- **A. Quantification of Adjustment To Reflect Mr. Garrett's Capital Structure Recommendations 60**
- **B. Quantification of Adjustment To Reflect Mr. Garrett's Return On Equity Recommendation 60**
- **C. Quantification of Adjustment To Capital Structure For Changes To ADIT Resulting From OPC Recommendations That Affect Rate Base 60**
- **D. Summary of Cost of Capital Based on OPC Recommendations Compared to the Company's Proposals 61**
- **E. The Proposed Long Term Debt Interest True-Up Mechanism Is Essential, But Requires Customer Safeguards 62**

DIRECT TESTIMONY OF LANE KOLLEN

1 **I. QUALIFICATIONS AND SUMMARY**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Lane Kollen. My business address is J. Kennedy and Associates, Inc.
4 ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia 30075.

5 **Q. DESCRIBE YOUR EDUCATION AND PROFESSIONAL EXPERIENCE.**

6 A. I earned a Bachelor of Business Administration degree in accounting and a Master of
7 Business Administration degree from the University of Toledo. I also earned a Master of
8 Arts degree in theology from Luther Rice University. I am a Certified Public Accountant,
9 with a practice license, Certified Management Accountant, and Chartered Global
10 Management Accountant. I am a member of numerous professional organizations,
11 including the American Institute of Certified Public Accountants, Institute of Management
12 Accounting, Georgia Society of CPAs, and Society of Depreciation Professionals.

13 I have been an active participant in the utility industry for more than forty years,
14 initially as an employee of a company that installed underground cablevision and telephone
15 wire from 1974 to 1976, then as an employee of The Toledo Edison Company in various
16 accounting and planning positions from 1976 to 1983, and thereafter as a consultant in the
17 industry. I have testified as an expert on planning, ratemaking, accounting, finance, tax,
18 and other issues in proceedings before regulatory commissions and courts at the federal
19 and state levels on hundreds of occasions.

1 I have testified before the Florida Public Service Commission ("FPSC" or
2 "Commission") in numerous dockets, including base rate, storm cost, fuel adjustment
3 clause, acquisition, and territorial proceedings involving Peoples Gas System, Inc.
4 ("Company" or "PGS"), Florida Power & Light Company ("FPL"), Duke Energy Florida
5 ("DEF"), Florida Public Utilities Company, Gulf Power Company, Talquin Electric
6 Cooperative, Tampa Electric Company, the City of Tallahassee, and the City of Vero
7 Beach.[1]

8 **Q. ON WHOSE BEHALF ARE YOU PROVIDING TESTIMONY IN THIS**
9 **PROCEEDING?**

10 A. I am providing testimony on behalf of the citizens of the State of Florida, and specifically
11 the Company's customers. Kennedy and Associates was retained by the Florida Office of
12 Public Counsel ("OPC") to review and make recommendations in response to the
13 Company's Petition, claimed base revenue requirement, requested rate increase, and
14 supporting documentation in this consolidated proceeding.

15 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

16 A. The purpose of my testimony is to address, make recommendations, and quantify the
17 effects of my recommendations as the result of my review of the Company's claimed base
18 revenue requirement and requested rate increase, as well as to quantify the effects of the
19 recommendations made by OPC witness David Garrett regarding the Company's

---

[1] I have attached a more detailed description of my qualifications and appearances as an expert in Exhibit LK-1.

1 depreciation rates, capital structure, and cost of equity on the claimed base revenue
2 requirement and requested rate increase.

3 **Q. BRIEFLY DESCRIBE THE MAGNITUDE OF THE COMPANY'S REQUEST.**

4 A. The Company seeks a base rate increase of $139.272 million, an increase of 40.2%
5 compared to the present base revenues of $346.067 million. The requested base rate
6 increase is partially offset by a reduction of $11.648 million in the BS/CFI rider revenues
7 due to the transfer of the BS/CFI costs to the base revenue requirement.

8 **Q. PROVIDE A SUMMARY OF YOUR TESTIMONY.**

9 A. I recommend a base rate increase of no more than $42.903 million. This is a reduction of
10 at least $96.369 million in the Company's claimed base revenue requirement and requested
11 rate increase based on my review and recommendations on specific issues that I
12 subsequently address in greater detail and based on the recommendations made by Mr.
13 Garrett regarding the Company's depreciation rates, capital structure, and cost of equity.
14 The issues that I and Mr. Garrett address and the effects of our recommendations are
15 summarized on the following table.[2]

[2] OPC plans to provide the calculations supporting the amounts on the following table and cited elsewhere throughout my testimony in an Excel workbook in live format and with all formulas intact shortly after my testimony is filed in response to the Company's request.

1

PEOPLES GAS SYSTEM, INC.
REVENUE REQUIREMENT RECOMMENDED BY OPC - BASE RATES
DOCKET NO. 20230023-GU
TEST YEAR ENDING DECEMBER 31, 2024
($ MILLIONS)

	Adjustment Before Gross Up	Gross-Up Factor	Adjustment After Gross Up
Base Rate Increase Requested by Company Per Filing			139.272
Operating Income Adjustments:			
Remove Incremental O&M Expenses Associated with the 2023 Transaction	(0.798)	1.00787	(0.804)
Reduce Depreciation Expense to Reflect Reduction in Projected Capital Expenditures	(0.897)	1.00787	(0.905)
Reduce Payroll and Related Expenses for Reduction in Projected Staffing Increases	(9.686)	1.00787	(9.762)
Remove Increase to Office Supplies and Expenses for Employee Additions	(1.153)	1.00787	(1.162)
Reduce Payroll and Related Expenses for Reduction in Projected 2023 and 2024 Pay Raises	(1.903)	1.00787	(1.918)
Reduce A&G Expense Due to Increased Capitalization of A&G Expenses	(2.125)	1.00787	(2.142)
Reduce Requested Storm Cost Accrual	(0.300)	1.00787	(0.302)
Remove Revenue Deficiencies Included in Test Year for Three RNG Tariff Projects	(1.300)	1.00787	(1.310)
Remove Excessive Property Tax Expense	(2.562)	1.00787	(2.583)
Reduce Depreciation Expense to Reflect Depr. Study Date as of Beginning of Test Year	(0.625)	1.00787	(0.630)
Reduce Depreciation Expense To Reflect OPC Recommended Depreciation Rates	(7.257)	1.00787	(7.314)
Reflect Amortization of Theoretical Reserve Surplus Outside of Depreciation Expense	(17.625)	1.00787	(17.763)
Rate Base Adjustments:			
Reduce Projected Capital Expenditures and Related Plant Additions			(2.963)
Adjust A/D - To Reflect Depr. Study Date as of Beginning of Test Year			0.028
Adjust A/D - OPC Recommended Depreciation Rates			0.323
Adjust A/D - To Reflect Amortization of Theoretical Reserve Surplus			0.783
Capital Structure and Rate of Return Adjustments:			
Restate LTD, STD, and Related Debt Rates to Remove Effects of 2023 Transaction			($8.895)
Adjust Capital Structure			(11.402)
Set Return on Equity at 9.0%			(27.115)
Adjust ADIT Related to Depreciation and Amortization Adjustments			(0.532)
Total OPC Adjustments			**($96.369)**
Maximum Base Rate Increase After OPC Adjustments			**$42.903**

2

3 The Company's requested increase is excessive and due, in part, to the Company's
4 discretionary actions and forecast costs timed so that the effects are included in the claimed
5 revenue requirement for the test year in this proceeding. The Commission has the
6 opportunity and ability to reduce the sheer magnitude of the Company's requested increase
7 by reducing or excluding these excessive costs from the revenue requirement.

8 I address and recommend that the Commission exclude the effects of the "2023
9 Transaction," a discretionary and unjustified action taken by Emera Inc. ("Emera"), TECO
10 Energy, Inc. ("TECO") and Tampa Electric Company to "spinout" PGS from its prior

status as a division within Tampa Electric Company to its new and present status as a separate legal entity effective as of January 1, 2023. This action and other related discretionary actions taken by the three affiliate entities were deliberately implemented to benefit Emera, the parent company of TECO, but significantly increased the Company's cost structure. The increased PGS cost structure will harm PGS customers not only in this proceeding but also in future rate proceedings absent Commission action to protect PGS customers from the effects of the 2023 Transaction.

I address and recommend that the Commission reduce other costs forecast by the Company that are excessive, including capital expenditures, plant in service additions, and the payroll and related expenses forecast for 2023 and 2024. The plant in service additions are excessive because they have not been reduced to reflect the Company's historic pattern of underspending its capital expenditures budgets and forecasts. The payroll and related expenses are excessive because they reflect the addition of a significant number of projected new employees carefully timed to be added at the end of 2023 and the beginning of 2024 without reductions for efficiency savings due to the implementation of a new Work and Asset Management System ("WAM"), sufficient reductions to contractor expenses, or reductions to reflect the Company's historic pattern of fewer actual employees than its full-time equivalent ("FTE") employee budgets and forecasts.

I address and recommend that the Commission reduce various other expenses that reflect excessive growth in the forecast test year compared to the historic expense levels, due, in part, to the Company's use of inappropriate methodologies to forecast these expenses.

1 I also address and recommend that the Commission determine new depreciation
2 rates based on a depreciation study date at the beginning of the test year when new
3 depreciation rates go into effect rather than determine new depreciation rates based on the
4 depreciation study date at the end of the test year as proposed by the Company. The use
5 of a depreciation study date at the beginning of the test year correctly matches the
6 depreciation rates and expense to the test year. Mr. Garrett also addresses this issue.
7 In addition, I quantify the effects on the requested rate increase of Mr. Garrett's
8 depreciation rate recommendations.
9 Further, I address and recommend that the Commission reduce the magnitude of
10 the requested increase through its discretion to approve the accelerated amortization of a
11 substantial depreciation reserve surplus.
12 Finally, I quantify the effects on the requested rate increase of Mr. Garrett's capital
13 structure and return on equity recommendations.

14
15 16 17 18
II. THE 2023 TRANSACTION IMPOSES EXCESSIVE COSTS ON PGS AND SUBSIDIZES TAMPA ELECTRIC COMPANY DURING ITS RATE STAYOUT PERIOD AND BEYOND

19 20 21 22
A. The 2023 Transaction Was Structured To Benefit Emera and Tampa Electric Company, But Does So By Imposing Excessive Costs On The Company And Its Customers

23 **Q. BRIEFLY DESCRIBE THE 2023 TRANSACTION.**

24 A. The Company was acquired by TECO in 1997 and merged into Tampa Electric Company
25 as a separate operating division. TECO subsequently was acquired by Emera. In 2022,
26 after several years of consideration, Emera decided to spinout the Peoples Gas division into

1 a separate corporate entity. Emera unilaterally implemented the 2023 Transaction on
2 January 1, 2023.
3 Emera structured and timed the 2023 Transaction to benefit its financial
4 performance both in the near-term and in the long-term. This includes Emera's plans to use
5 the Company's standalone status to facilitate future utility acquisitions and to improve the
6 valuation of the Company on a standalone basis for future sale or other disposition if and
7 when such a sale or disposition would benefit Emera and its shareholders.
8 The Commission had no statutory authority to approve or otherwise address the
9 structure or results of the 2023 Transaction before it was implemented. However, the
10 Commission does have the authority to address the effects of the 2023 Transaction for
11 ratemaking purposes in this proceeding and future proceedings in order to protect
12 customers from the adverse impacts of the 2023 Transaction.

13 **Q. WHO ARE THE FINANCIAL WINNERS AND LOSERS DUE TO THE 2023**
14 **TRANSACTION?**
15 A. The financial winners are and will continue to be Emera, TECO, and Tampa Electric
16 Company. The financial loser initially is PGS until base rates are reset in this proceeding,
17 but will be PGS customers in 2024 and for the foreseeable future if the Commission allows
18 the 2023 Transaction costs to be imposed on PGS customers.
19 The 2023 Transaction transfers cost-based benefits to Tampa Electric Company
20 that historically were allocated to PGS. Emera, TECO, and Tampa Electric Company will
21 retain the entirety of these benefits until Tampa Electric Company's base rates are reset.
22 Tampa Electric Company's customers may receive all or some of these benefits when
23 Tampa Electric Company's base rates are reset in a future base rate proceeding. The most

1 significant of these initial benefits is the interest rate savings on lower cost debt that will
2 be reallocated from PGS and its customers to Tampa Electric Company after December
3 31, 2023 and potentially to Tampa Electric Company's customers at some date after
4 December 31, 2024.
5 The 2023 Transaction imposes additional costs on PGS due to lost economies of
6 scale that it achieved as a division of Tampa Electric Company. These costs include the
7 payroll and other costs related to significant increases in PGS staffing as well as other
8 incremental costs due to its new status as a standalone entity owned by TECO.
9 The 2023 Transaction imposes costs on PGS due to the financial objectives of
10 Emera, its upstream affiliate owner, to acquire additional natural gas utilities and to
11 increase the value of PGS for a possible sale, spinoff, or other restructuring in the future.

12 **Q. HAS THE COMPANY PRESENTED A BUSINESS CASE THAT QUANTIFIES**
13 **THE BENEFITS AND COSTS ON PGS AND ITS CUSTOMERS OF THE 2023**
14 **TRANSACTION?**
15 A. No. OPC specifically asked the Company for "a copy of all analyses performed by or on
16 behalf of the Company, and before the actual separation, of each and every cost and benefit,
17 both qualitative and quantitative, of a legal separation of the Company from Tampa Electric
18 Company on the Company itself and on its customers." The Company provided no
19 business case that quantified "each and every cost and benefit" of the 2023 Transaction. In
20 response to this request, the only analysis that it provided was a highly confidential legal
21 memorandum addressed to Scott Balfour, the President and Chief Executive Officer of
22 Emera dated June 22, 2019. This memorandum provided the results of a legal "due

1 [redacted]
2 [redacted][3]
3 [redacted]
4 [redacted]
5 [redacted]
6 [redacted]
7 [redacted]
8 [redacted]
9 [redacted]
10 [redacted]
11 [redacted].[4]
12 [redacted]
13 [redacted]
14 [redacted]
15 [redacted]
16 [redacted]
17 [redacted]
18 [redacted][5]
19 [redacted]
20 [redacted].[6] [redacted]

[3] Highly confidential response memorandum attachment to OPC's POD No. 46 at page 1 of memorandum (Bates page 024951). I have attached a copy of this response as my Exhibit LK-2.
[4] *Id.* at pages 3-4 of memorandum (Bates pages 024953-024954).
[5] *Id.* at page 5 of memorandum (Bates pages 024955).
[6] *Id.* at page 13 of memorandum (Bates pages 024963).

1 [redacted]
2 [redacted]
3 [redacted]
4 [redacted]
5 [redacted][7]

6 **Q. DID THIS LEGAL MEMORANDUM ADDRESS AND QUANTIFY THE**
7 **FINANCIAL AND RATEMAKING COSTS TO PGS CUSTOMERS OR THE**
8 **FINANCIAL BENEFITS TO TAMPA ELECTRIC COMPANY OR THE**
9 **POTENTIAL FUTURE RATEMAKING BENEFITS TO ITS CUSTOMERS?**
10 A. No. Although the legal memorandum was drafted to address "considerations" for the
11 potential separation of PGS from Tampa Electric Company, it did not address or quantify
12 the financial and ratemaking costs to PGS customers or the initial financial benefits to
13 Tampa Electric Company or the potential ratemaking benefits to its customers after
14 December 31, 2024.

15 **Q. WHY IS THAT IMPORTANT?**
16 A. The 2023 Transaction was planned, studied, and implemented to achieve Emera financial
17 objectives without consideration of the harms or measures to mitigate the harms from the
18 potential transaction to PGS customers either in 2019, when the legal memorandum was
19 drafted, or in 2023, when the actual transaction was implemented. Neither Emera nor PGS
20 addressed these harms through potential transaction structures that could have avoided
21 harm to PGS customers or through appropriate hold harmless conditions that would ensure

---

[7] *Id.* at page 10 of memorandum (Bates pages 024960).

1 that the permanent increase in costs due to the transaction were offset by permanent
2 increases in quantitative benefits. Even after acknowledging and quantifying at least some
3 of the increased costs caused by the 2023 Transaction in response to OPC discovery,[8] PGS
4 still has not offered to hold its customers harmless from these costs in this proceeding or
5 in future proceedings. To the contrary, the Company's only response to these harms is a
6 statement that the separation may allow it to achieve some benefits in future years and that,
7 if it is able to do so, then customers will receive the benefits in those future years.[9]

8 **Q. IS THAT AN ACCEPTABLE OUTCOME?**

9 A. No. PGS customers should not be required to pay for Emera's financial engineering or to
10 subsidize Tampa Electric Company's customers. The 2023 Transaction should not have
11 been implemented unless the quantifiable benefits exceeded the quantifiable costs to PGS
12 customers. The only way evident at this time for the Commission to hold Emera
13 accountable for the effects of implementing the 2023 Transaction is to disallow the increase
14 in PGS costs so that its customers are held harmless, not only in the test year in this
15 proceeding, but also in the test years in future proceedings.

16 **Q. THE COMPANY CLAIMS THAT THE 2023 TRANSACTION AND THE**
17 **PAYMENT OF THE INTERCOMPANY DEBT WERE NOT TIMED TO**
18 **COINCIDE WITH THE EFFECTIVE DATE OF RATES RESULTING FROM**
19 **THIS PROCEEDING.[10] DO YOU AGREE?**

---

[8] Second revised response to OPC IRR No. 100. I have attached a copy of the narrative portion of this response and the summary page from the electronic attachment as my Exhibit LK-3.

[9] Responses to OPC POD No. 46 and OPC IRR No. 97(a). See Exhibit LK-2 for the narrative portion of the response to OPC POD No. 46. I have attached a copy of the response to OPC IRR No. 97 as my Exhibit LK-4.

[10] Response to OPC IRR No. 97(b). See Exhibit LK-4.

1 A. No. Neither the 2023 Transaction structure itself nor the timing of the transaction were
2 accidental. The 2023 Transaction was a substantial corporate restructuring implemented
3 by Emera that required extensive planning and the assistance of outside advisors. The
4 implementation of the 2023 Transaction was timed so that the increases in the PGS cost of
5 debt and other costs resulting from the 2023 Transaction charged to expense in 2023 would
6 be minimized, but the amounts charged to expense in 2024 would be fully reflected in the
7 revenue requirement in this proceeding.

8 Emera began planning the separation of PGS from Tampa Electric Company at
9 least as early as 2019, according to the date of the legal memorandum the Company
10 provided in response to OPC discovery and that I previously described. However, Emera
11 did not proceed with the separation prior to filing its 2020 base rate case in Docket No.
12 20200051-GU, which relied on a 2021 test year. The Commission Order in that proceeding
13 was issued on December 10, 2020. In that Order (Order No. PSC-2020-0485-FOF-GU),
14 the Commission approved a Stipulation among the Company and other parties to reset base
15 rates that would remain unchanged for the next three calendar years 2021 through 2023.

16 Instead, Emera subsequently decided to proceed with the spinout of PGS and to
17 implement the transaction on January 1, 2023. Based on the Stipulation approved by the
18 Commission in Docket No. 20200051-GU, the first date the Company could recover the
19 incremental costs resulting from a separation from Tampa Electric Company in its base
20 revenues would be January 1, 2024. Emera chose to implement the separation on January
21 1, 2023 and set the termination date for the Intercompany Debt Agreement at December
22 31, 2023, thus ensuring that the increase in costs would be fully included in the test year
23 used to determine revenue requirements.

1 **Q. Will the 2023 Transaction increase the Company's costs due to lost economies of**
2 **scale?**
3 A. Yes. The Company on a standalone entity basis will incur greater costs due to the 2023
4 Transaction. These incremental costs include the increase in interest expense and debt-
5 related fees that I previously addressed, and increases in employees necessary to perform
6 certain functions independently of Tampa Electric Company, such as standing up a new
7 supply chain organization, among others.

8 **Q. HAS THE COMPANY CALCULATED THE EFFECTS OF SOME OF THE LOST**
9 **ECONOMIES OF SCALE?**
10 A. Yes. The Company calculated the increased costs from the 2023 Transaction at $9.693
11 million in response to OPC discovery as summarized in the following table.[11] However,
12 the Company's calculation does not include all increased costs. Specifically, the calculation
13 does not include the forecast increases in employees and the related payroll and other
14 expenses that it will incur. Nor does it include the potential additional cost of new long-
15 term debt if the debt rating agencies downgrade PGS by more than one-notch. At the end
16 of the first quarter of 2023, Emera management informed its Board that the PGS debt rating
17 on a standalone basis would be "at least one notch below Tampa Electric's rating."[12] In
18 December 2022, Moody's Investor Service issued an "Update" in which it changed Tampa
19 Electric Company's "outlook" from stable to negative and noted that the "planned"

[11] Second revised response to OPC IRR No. 100. See Exhibit LK-3.
[12] Confidential Response to OPC POD 95 at Bates No. 38.

1 transaction to spinout PGS from Tampa Electric Company was "modestly credit
2 negative."[13]

3

PEOPLES GAS SYSTEM, INC.
COMPANY COMPUTED EFFECTS OF THE 2023 TRANSACTION
$ MILLIONS

Source: Response to OPC INT No. 100 (Revised on 5.19.23)		Expense Gross-Up	After Gross-Up
Additional Return on Rate Base - (Includes All Gross Ups)	(8.895)	1.00000	(8.895)
Additional Cost of Audited Standalone Financial Statements - O&M Expense	(0.346)	1.00787	(0.349)
Additonal Rating Agency Fees - O&M Expense	(0.350)	1.00787	(0.353)
Additional Treasury Analyst Position - O&M Expense (Payroll & Benefits) & PR Taxes	(0.102)	1.00787	(0.103)
Additional Costs of the 2023 Transaction as Computed by the Company	(9.693)		(9.699)

4

5 **Q. WHAT IS YOUR RECOMMENDATION?**

6 A. As I noted above, the Commission does not have authority to approve mergers or spinout
7 transactions for electric or gas utilities. The Commission, however, has broad powers to
8 take steps to protect customers from the negative effects of mergers or spinout transactions,
9 such as the 2023 Transaction. I recommend that the Commission hold PGS customers
10 harmless against the increased costs that are specifically due to the 2023 Transaction.

11 I recommend that the Commission disallow the increase in costs specifically due to
12 the 2023 Transaction included in the test year and that the Commission continue to do so
13 in future proceedings unless and until the Company achieves quantifiable benefits that
14 exceed those costs. These costs include, but are not limited to, the increase in the cost of
15 capital due to the higher cost debt issued by PGS, increases in payroll and related costs due

[13] Confidential response to OPC POD 14 at Bates 9558.

1 to increases in staffing resulting from diseconomies of scale, increases in other costs, such
2 as credit and other fees, and increases in other costs incurred due to the Company's legal
3 status as a separate standalone entity.

4 **Q. WHAT ARE THE EFFECTS OF YOUR RECOMMENDATIONS?**

5 A. I address and quantify the effects in the subsequent sections of my testimony. However,
6 at a minimum, the Commission should disallow the $9.693 million in incremental costs
7 that the Company has identified and quantified in response to OPC discovery prior to the
8 date of my testimony.[14] This equates to a revenue requirement reduction of $9.699 million
9 after gross-up for Commission assessment fees and bad debt expense.

10 **B. The 2023 Transaction Improperly Increases The Company's Cost Of Debt To Benefit**
11 **Emera and Tampa Electric Company And May Result In The Company's Customers**
12 **Subsidizing Tampa Electric Company's Customers**
13

14 **Q. DESCRIBE IN DETAIL HOW THE 2023 TRANSACTION INCREASED THE**
15 **COMPANY'S COST OF DEBT.**

16 A. There are several reasons that the 2023 Transaction increased the Company's cost of debt
17 included in the test year revenue requirement: a reallocation of the entirety of the existing
18 lower cost debt from PGS to Tampa Electric Company; the cost of issuing higher cost
19 replacement debt; and the incremental costs of issuing debt on a standalone basis, including
20 the higher costs due to lower credit ratings on a standalone basis compared to Tampa

[14] *Id.* However, as I previously noted, the Company's calculation does not include the effects of a long-term debt downgrades by the credit rating agencies of more than one notch or other increases in costs that I subsequently address, including substantial increases in team members and the related payroll and other expenses.

1 Electric Company and the incremental costs of credit rating agency and credit facility fees
2 on a standalone basis.

3 Emera structured the 2023 Transaction to require PGS to issue its own debt on or
4 before the end of 2023 pursuant to the terms on an Intercompany Debt Agreement between
5 Tampa Electric Company and PGS. Prior to the 2023 Transaction, Tampa Electric
6 Company issued all long-term debt and short-term debt sufficient to meet the debt
7 financing requirements for both its electric business and its PGS gas business. The debt
8 then was allocated by debt issue between the electric business and the PGS division based
9 on the respective electric and gas financing requirements each year.

10 The 2023 Transaction upended this historic allocation of the debt issued for the
11 respective electric and PGS gas businesses and prospectively reallocates the existing debt
12 actually issued for the PGS gas business to Tampa Electric Company's electric business.
13 The 2023 Transaction requires PGS to issue new and significantly higher cost debt to
14 "repay" the entirety of its share of the Tampa Electric Company debt, thus stripping PGS
15 of the benefits of the much lower-cost debt that specifically had been issued to meet its
16 actual financing requirements since it was acquired by Tampa Electric Company in 1997.[15]
17 This reallocation of the existing debt will result in a structural increase in PGS' costs due
18 solely to the 2023 Transaction until the all the underlying debt issues mature.

19 The 2023 Transaction reallocation of the existing lower cost debt to Tampa Electric
20 Company transfers the benefits of this existing lower cost debt from PGS to Emera, TECO,
21 and Tampa Electric Company and harms PGS customers. The 2023 Transaction and the
22 related reallocation of the existing debt was timed to coincide with the test year in this

[15] Response to OPC IRR No. 95. I have attached a copy of this response as my Exhibit LK-5.

1 proceeding and to extend through Tampa Electric Company's base rate stayout period
2 pursuant to the stipulation approved by the Commission in Docket No. 20210034-EI and
3 possibly beyond the stayout period.

4 If the Commission allows the benefit of this lower cost debt to be reallocated from
5 PGS to Tampa Electric Company for ratemaking purposes and the cost of the new higher
6 cost debt to be recovered from PGS customers, then Emera, TECO, and Tampa Electric
7 Company will receive and retain a net benefit of approximately $7.1 million annually for
8 Emera shareholders until Tampa Electric Company's base rates are reset at some date after
9 December 31, 2024.

10 In addition to the increase in the PGS cost of debt from the reallocation of its share
11 of the lower cost existing debt to Tampa Electric Company, PGS will incur higher costs to
12 issue the new debt of approximately $1.8 million annually to "repay" Tampa Electric
13 Company and to issue new debt to meet its future financing requirements. These additional
14 annual costs are due to a lower credit rating compared to Tampa Electric Company and due
15 to the incremental costs for standalone credit rating agency fees and commitment and other
16 fees for a standalone credit facility.

17 **Q. HAS THE COMPANY PROVIDED ANY EVIDENCE OF SAVINGS IN**
18 **FINANCING COSTS IN SUPPORT OF ITS ASSURANCES THAT THE 2023**
19 **TRANSACTION WILL BE BENEFICIAL TO PGS CUSTOMERS,[16]?**

20 A. No. To the contrary, the Company acknowledges that the 2023 Transaction will increase
21 financing costs to PGS and its customers, not reduce its financing costs. This is true, not

[16] Direct Testimony of Helen J. Wesley at pp. 37 and 39.

1 only for the test year in this proceeding, but also for the foreseeable future, because the
2 higher cost of debt will result in a permanent increase in the PGS cost structure until all the
3 new debt fully matures 30 years from now.[17]

4 **Q. TO IMPLEMENT THE 2023 TRANSACTION, DID THE COMPANY CONSIDER**
5 **ALTERNATIVES TO THE INTERCOMPANY DEBT AGREEMENT THAT**
6 **COULD HAVE PRESERVED THE PGS ALLOCATION OF THE LOWER-COST**
7 **DEBT BEYOND THE END OF 2023?**

8 A. Apparently not. The Intercompany Debt Agreement does not maintain the same terms and
9 conditions for repayment as the underlying debt, but requires PGS to repay its allocated
10 share of the debt on or before December 31, 2023.

11 The Company was asked in OPC discovery why it did not consider a separate
12 intercompany loan from Tampa Electric Company to PGS in order to preserve the PGS
13 allocation of the lower cost debt beyond the end of 2023 in lieu of the temporary allocation
14 of the debt pursuant to the Intercompany Debt Agreement. The Company provided a
15 lengthy response describing the origins of the lower cost debt and how the Intercompany
16 Debt Agreement was structured to follow the prior allocations and terms and conditions of
17 the underlying debt. This response not only failed to address the question, but also failed
18 to note that the Intercompany Debt Agreement extended only through the end of 2023 and
19 that it did not follow the prior allocations and terms and conditions of the underlying debt
20 after the termination of the Intercompany Debt Agreement on December 31, 2023.[18]

---

[17] Schedule-G-3-03.
[18] Response to OPC IRR No. 220. I have attached a copy of this response as my Exhibit LK-6.

1 **Q. THE COMPANY CLAIMS THAT ITS REQUESTED COST OF DEBT IS THE**
2 **MARKET RATE THAT IT EXPECTS TO PAY FOR THE NEW DEBT AND THAT**
3 **IT IS ENTITLED TO RECOVER THIS COST, SUBJECT TO ITS PROPOSED**
4 **TRUE-UP MECHANISM.[19] IS THE COMPANY ENTITLED TO RECOVER THE**
5 **COST OF THIS NEW DEBT?**
6 A. No. The Company's claim relies on a series of interrelated and compounded false
7 arguments, specifically, that it was not entitled to its share of the lower cost debt actually
8 issued to finance PGS rate base investments since 1997, that the 2023 Transaction could
9 not have been structured to preserve this benefit for PGS customers, that its customers are
10 obligated to pay the increased cost of the new debt, that Tampa Electric Company is entitled
11 to retain the benefits of the PGS share of the lower cost debt until its base rates are reset,
12 and that Tampa Electric Company's customers are entitled to this savings in the form of a
13 subsidy from the PGS customers when Tampa Electric Company's base rates are reset in
14 2025.

15 **Q. DOES THE COMPANY'S CLAIM THAT IT IS REQUIRED TO REPAY THE**
16 **INTERCOMPANY DEBT BY DECEMBER 31, 2023 PURSUANT TO AN IRS**
17 **PRIVATE LETTER RULING JUSTIFY THE COMPANY'S REQUESTED COST**
18 **OF DEBT?**
19 A. No. As a fundamental matter, the requirement to repay the intercompany debt by
20 December 31, 2023 is due to the 2023 Transaction and would not exist but for the
21 transaction and but for the Intercompany Debt Agreement as a component of the

[19] Response to OPC IRR No. 132. I have attached a copy of this response as my Exhibit LK-7.

1 transaction. The Commission is not required to recognize the higher cost of the new debt
2 for ratemaking purposes, regardless of the structure of the 2023 Transaction and regardless
3 of the PLR. The IRS has no statutory authority, nor does the PLR itself direct the
4 Commission, to provide recovery of the Company's requested cost of debt.

5 In addition, in its request for PLR, and contrary to the Company's numerous claims
6 otherwise, Tampa Electric Company did not expressly ask for and the IRS did not
7 specifically rule on the timing of the repayment of the intercompany debt pursuant to the
8 Intercompany Debt Agreement. The timing of the repayment of the debt pursuant to the
9 Intercompany Debt Agreement was simply a fact recited by the Company in its request,
10 which then was repeated by the IRS in the PLR.

11 In any event, the fundamental issue is that Emera structured the 2023 Transaction,
12 including the Intercompany Debt Agreement, for its benefit and it is a fact that this structure
13 will harm PGS customers. The structure of the 2023 Transaction and the consequences of
14 its implementation are not justification for ratemaking recovery of the higher debt costs
15 requested by PGS in this proceeding.

16 **Q. WHAT IS YOUR RECOMMENDATION?**

17 A. I recommend that the Commission set the Company's cost of debt to retain the savings
18 from the lower cost debt previously allocated to it regardless of the Company's actual cost
19 of debt for the new debt issued to replace the former allocation. This is necessary to
20 eliminate the harm from Emera's financial engineering, from its attempt to retain the
21 savings throughout the remainder of Tampa Electric Company's three-year base rate
22 stayout, and from its attempt to set PGS customer rates at excessive levels in order to
23 subsidize Tampa Electric Company's customer rates for the foreseeable future. These

1 harms to PGS customers can and should be excluded from recovery for ratemaking
2 purposes.

3 **Q. WHAT IS THE EFFECT OF YOUR RECOMMENDATION?**

4 A. The effect is a $8.895 million reduction in the revenue requirement due to the lower cost
5 of debt included in the cost of capital. The Company provided the quantification of this
6 amount in response to OPC discovery.[20]

7 **III. THE FORECAST TEST YEAR REFLECTS EXCESSIVE COSTS BASED ON**
8 **A BUDGET DEVELOPED AND APPROVED SPECIFICALLY FOR THE RATE**
9 **CASE, NOT IN THE NORMAL COURSE OF BUSINESS**
10

11 **A. <u>The Budgets Developed And Approved For The Rate Case Reflect Excessive Costs</u>**
12

13 **Q. DESCRIBE THE COMPANY'S DEVELOPMENT OF THE CAPITAL**
14 **EXPENDITURE AND OPERATING BUDGETS FOR 2024 FOR PURPOSES OF**
15 **THIS RATE CASE.**

16 A. The Company developed capital expenditure budgets and operating budgets for 2024
17 specifically for this rate case prior to and outside the normal timeline for the Company's
18 actual capital expenditure and operating budgets.[21] Company witness Rachel Parsons
19 states in her direct testimony that "Peoples 2024 projected test year was developed using
20 the same process used to develop the company's annual budgets, including capital
21 expenditures."[22] Ms. Parsons further states that "[t]he company's Board of Directors
22 approved Peoples' 2024 budget in March 2023."[23]

[20] Second revised response to IRR 100. See Exhibit LK-3.
[21] Response to OPC IRR No. 81. I have attached a copy of this response as my Exhibit LK-8.
[22] Direct Testimony of Rachel Parsons at 17.
[23] Direct Testimony of Rachel Parsons at 19.

1 The capital expenditure and operating budgets for 2024 were not developed and
2 approved in the normal course of the company's budgeting process. Although Ms.
3 Parson's testimony might seem to suggest otherwise, the Company's actual budget process
4 in the normal course of business does not commence until June of the year preceding the
5 budget year and the actual capital expenditure and operating budgets are not approved by
6 the Company's board of directors until November of the year preceding the budget year.[24]
7 The actual capital expenditure and operating budgets for 2024 will not be developed or
8 approved until later this year.

9 **Q. WHY IS THE DISTINCTION BETWEEN BUDGETS DEVELOPED**
10 **SPECIFICALLY FOR THIS RATE CASE PROCEEDING AND BUDGETS**
11 **DEVELOPED IN THE NORMAL COURSE OF BUSINESS IMPORTANT IN THIS**
12 **PROCEEDING?**

13 A. It is important because the forecasts for 2024 were developed specifically for this rate case
14 proceeding, and were not actually developed in the normal course of business for
15 management and accountability purposes. Rather, the forecasts for 2024 were developed
16 to support the requested rate increase and incorporate assumptions and methodologies that
17 bias upward the Company's requested increase compared to the assumptions and
18 methodologies that might be incorporated in the actual budgets that will not be developed
19 until later this year and will not be approved until November this year.

20 **Q. DO YOU HAVE EVIDENCE THAT THE FORECASTS USED IN THE LAST**
21 **BASE RATE CASE PROCEEDING REFLECTED EXCESSIVE OPERATING**

[24] Response to OPC IRR No. 81. See Exhibit LK-8.

1 **EXPENSES IN THE TEST YEAR COMPARED TO THE COMPANY'S ACTUAL**
2 **OPERATING EXPENSES AFTER THE COMMISSION ISSUED ITS ORDER IN**
3 **THAT PROCEEDING?**

4 A. Yes. The Company's actual O&M expense in 2021 was $6.349 million, or 5.2%, less than
5 the Company forecasted for the 2021 test year in its last base rate case, Docket No.
6 20200051-GU, as shown on the following table.[25] In other words, the Company's claimed
7 revenue requirement and the resulting revenues to recover the forecast expenses were
8 greater than the actual expenses PGS incurred after the base revenue increase was
9 implemented.

PEOPLES GAS SYSTEM, INC.
SUMMARY OF O&M EXPENSE PROJECTIONS VS ACTUAL FOR 2021
$ MILLIONS

Sources: Schedules E-6 at page 4

	Projected 2021 from DN 20200051-GU	Actual 2021 from DN 20230023-GU
Total Non-Gas O&M Expense		140.031
Less: DSM - Accts 907-910	*	(16.998)
Less: Regulatory Debits Acct 407.3	*	(8.277)
Jurisdictional Non-Gas O&M Expense	121.106	114.756
Actual Amount Less than Projected - 2021		(6.349)
Actual Percentage Less than Projected - 2021		-5.2%

* This amount was removed already to reflect jurisdictional O&M expense.

10

11 **Q. WHAT IS YOUR RECOMMENDATION IN THIS PROCEEDING?**

[25] I obtained the forecast data for the 2021 test year from Schedule E-6 at page 4 of the Company's filing in the 2020 rate case proceeding and the actual data for 2021 on a ratemaking basis from Schedule E-6 at page 4 in this proceeding.

1 A. I recommend that the Commission carefully review the assumptions and methodologies
2 used for the forecasts of capital expenditures and plant in service additions in 2023 and
3 2024 and the assumptions and methodologies used to forecast other rate base components
4 and operating expenses in 2023 and 2024, including trended expenses and non-trended
5 expenses.

6 **Q. DO YOU ADDRESS SPECIFIC CONCERNS WITH THE ASSUMPTIONS AND**
7 **METHODOLOGIES THAT THE COMPANY USED FOR THE FORECASTS IN**
8 **2023 AND 2024 AND THAT AFFECT THE REVENUE REQUIREMENT FOR THE**
9 **TEST YEAR?**
10 A. Yes. I address numerous specific concerns with the assumptions and methodologies used
11 by the Company that inappropriately increased the revenue requirement for the test year in
12 the subsequent sections of my testimony.

13 **B. The Test Year Capital Expenditures Are Excessive And Unreasonable**
14

15 **Q. DESCRIBE THE COMPANY'S CAPITAL EXPENDITURES AND THE**
16 **RELATED PLANT ADDITIONS IN 2023 AND 2024.**
17 A. The Company forecasts capital expenditures of $397.069 million in 2023 and $362.365
18 million in 2024.[26] The Company forecasts plant additions of $521.913 million in 2023 and
19 $257.585 million in 2024.[27]

---

[26] Response to OPC IRR No. 92. This includes $32.649 million and $48.249 million in capital expenditures in 2023 and 2024, respectively, related to the FGT to Jacksonville Export Facility for which the costs were not included in rate base since the project is not expected to be in service until 2025. I have attached a copy of this response as my Exhibit LK-9.

[27] Schedule-G1-05 for 2023 and Schedule-G1-07 for 2024. See also Exhibit No. RBP-1 Document No. 6 attached to the Direct Testimony of Rachel B. Parsons.

1 **Q. AS A PRACTICAL MATTER, DOES THE COMPANY TYPICALLY**
2 **UNDERSPEND ITS CAPITAL EXPENDITURE BUDGETS?**
3 A. Yes. The Company actually underspent its capital expenditure budgets in each of the most
4 recent five years, including the 2022 base year. On average, the Company actually
5 underspent its capital expenditure budgets by 2.6% to 15.9%, or a weighted average of
6 6.5%, over those five years. In 2018, its actual capital expenditures were 12.0% less than
7 its budgeted capital expenditures. In 2019, the actual expenditures were 15.9% less than
8 the budgeted expenditures. In 2020, the actual expenditures were 3.2% less than the
9 budgeted expenditures. In 2021, the actual expenditures were 2.6% less than the budgeted
10 expenditures. In 2022, the actual expenditures were 3.8% less than the revised budgeted
11 expenditures.[28]

12 **Q. WHY IS THE COMPANY'S EXPERIENCE IN UNDERSPENDING ITS CAPITAL**
13 **EXPENDITURE BUDGETS RELEVANT IN THIS PROCEEDING?**
14 A. It is relevant because the evidence demonstrates that the Company overstates its future
15 capital expenditures and its future plant additions in the actual budget process in the normal
16 course of business. In this rate case, that means the forecast plant in service included in
17 rate base is excessive and unreasonable and will result in excessive and unreasonable base
18 revenues unless the Commission expressly recognizes the Company's historic pattern of
19 underspending its capital expenditure budgets and adjusts downward the forecast capital
20 expenditures and plant in service included in rate base.

[28] Response to OPC IRR No. 82. I have attached a copy of this response as my Exhibit LK-10.

1 The Company historically underspends its actual capital expenditure budgets used
2 by its management and board of directors to manage its business by an average of 6.5%
3 each year. This annual underspend compounds over multiple years. The Company's actual
4 experience portends similar underspending in actual capital expenditures in 2023 and 2024
5 compared to the capital expenditure budgets developed specifically for this rate case.

6 As I noted in the prior section of my testimony, the budgets developed specifically
7 for this rate case were not developed in the normal course of business for management and
8 the board of directors to manage the business, but rather were developed to support a base
9 rate increase. Due to the nature of the capital expenditure budgets developed specifically
10 for this rate case, the evidence is that the actual underspend likely will be even greater than
11 the actual underspend on the actual capital expenditure budgets.

12 **Q. WHAT IS YOUR RECOMMENDATION?**

13 A. I recommend that the Commission reduce the forecast capital expenditures and forecast
14 plant additions to rate base by 6.5% in each year 2023 and 2024. As I noted previously the
15 capital expenditures in 2023 carry forward into 2024 and are cumulative in the test year,
16 so both forecast years need to be adjusted downward based on the most recent five year
17 history of underspending the capital expenditures budgets.

18 **Q. WHAT IS THE EFFECT OF YOUR RECOMMENDATION?**

19 A. The effect is a $3.868 million reduction to the claimed base revenue requirement. This
20 amount is comprised of a $2.963 million reduction in the return on rate base, based on a
21 reduction in rate base of $33.331 million, and a $0.905 million reduction in depreciation
22 expense after gross-up for Commission assessment fees and bad debt expense.

1 **C.** **The Test Year Staffing, Payroll Expense, And The Related Benefits And Payroll**
2 **Taxes Expenses Are Excessive And Unreasonable**
3

4 **Q. DESCRIBE THE COMPANY'S FORECAST INCREASES IN EMPLOYEES AND**
5 **THE RELATED NON-TRENDED PAYROLL AND OTHER EXPENSES IN 2023**
6 **AND 2024.**

7 A. The Company proposes significant increases in employees (referred to in the Company
8 witness testimonies as "team members") in November 2023 and additional significant
9 increases in January 2024.[29] The Company included a total of 90 new employees in 2023,
10 69 of which it forecast in November 2023 and the other 19 (net of 2 vacancies) in January
11 through March of 2023.[30] Of the new employees in 2023, 6 of them were due to the 2023
12 Transaction, including 5 in the Company's new supply chain function, and 1 in the treasury
13 function.[31] The Company included another 64 new employees in 2024, all of them on
14 January 1, 2024, except for 4 in March 2024 and another 4 in June 2024.[32]

15 The Company included an increase of $11.596 million in non-trended expenses due
16 to the increased employees in the test year compared to the base year, comprised of $7.663
17 million in non-trended payroll expenses;[33] $0.613 million in related payroll tax expenses;[34]
18 another $2.167 million in related pension, other benefits, and short-term incentive
19 compensation expenses;[35] and yet another $1.153 million in account 921 for "increased
20 employee expenses and materials and supplies to support headcount."[36]

---

[29] Schedule G-2 page 19c-19e.
[30] *Id.*
[31] *Id.* In addition, descriptions of new positions included in Company's labor budget provided in response to OPC IRR No. 13. I have attached a copy of this response as my Exhibit LK-11.
[32] *Id.*
[33] *Id.*
[34] Response to OPC IRR No. 202. I have attached a copy of this response as my Exhibit LK-12.
[35] *Id.*
[36] Schedule G-2 page 19b line 11.

1 **Q. HOW DOES THE FORECAST FOR DECEMBER 2024 COMPARE TO THE**
2 **COMPANY'S ACTUAL EMPLOYEES AT THE BEGINNING OF 2022?**
3 A. The Company forecast 840 employees at the end of the test year (net of 23 vacancies)
4 compared to actual 630 employees in the beginning of the base year, an increase of 210
5 employees, or 33.3% over that three-year period, two years of which are forecast.

6 **Q. HOW DO THE FORECASTS FOR 2023 AND 2024 COMPARE TO THE**
7 **COMPANY'S ACTUAL EMPLOYEES IN 2019, 2020, 2021, 2022, AND TO DATE**
8 **THROUGH MARCH 2023?**
9 A. They are significantly greater. The Company forecasts 830 total employees in January and
10 February 2024, 834 total employees in each month from March through May 2024, and
11 840 employees in each month from June 2024 through December 2024.[37] In 2019, the
12 Company's actual employees ranged from a low of 569 in March to a high of 606 in
13 December.[38] In 2020, the Company's actual employees ranged from a low of 601 in
14 February to a high of 625 in October.[39] In 2021, the Company's actual employees ranged
15 from a low of 611 in May to a high of 633 in November. In 2022, the Company's actual
16 employees ranged from a low of 628 in March to a high of 711 in November. In 2023
17 through March, the Company's actual employees ranged from a low of 704 in February to
18 a high of 709 in January.[40]

[37] Response to OPC IRR No. 11. I have attached a copy of this response as my Exhibit LK-13.
[38] Response to OPC IRR No. 21. I have attached a copy of this response as my Exhibit LK-14.
[39] *Id.*
[40] Response to OPC IRR No. 8. I have attached a copy of this response as my Exhibit LK-15.

1 **Q. WHAT ARE THE COMPANY'S CLAIMED REASONS FOR THESE**
2 **SIGNIFICANT STAFFING AND RELATED COST INCREASES?**
3 A. The Company claims that the increases in staffing and related payroll and other expenses
4 are necessary to meet business requirements, including continued system growth,[41]
5 replacement of contractors with employees,[42] and the needs of the Company as a
6 standalone entity due to the 2023 Transaction.

7 **Q. DO THE COMPANY'S CLAIMS WITHSTAND CLOSER SCRUTINY?**
8 A. No. First, regardless of business requirements, the addition of employees is discretionary
9
10 [43]
11
12
13

14 Second, the Company already is staffed for continued growth in customers and the
15 related infrastructure. The employees devoted to new construction are sufficient if growth
16 remains relatively constant from year to year. Increases in employees for new construction
17 are necessary only if construction requirements due to growth increase year over year. In
18 other words, if growth is 5% each year, then the existing employees devoted to new
19 construction simply maintain that same level of new construction year after year; no new
20 employees are necessary unless growth increases beyond the historic growth. The number

---

[41] Direct Testimony of Christian Richard at 62.
[42] Direct Testimony of Timothy O'Conner at 33.
[43] Confidential response to OPC POD No. 95. I have provided copies of select pages from this response as my Exhibit LK-16.

1 of employees necessary for new construction does not increase at the rate of growth each
2 year.
3 Third, the Company did not reduce contractor expense by an amount that justifies
4 the forecast increase in new employees. The Company reduced contractor expense by a
5 non-trended adjustment of only $1.135 million in the test year, less than 10% of the
6 $11.596 million increase in expense due to new employees.[44] Further, even that 10% may
7 not have been due to the Company's new employees displacing contractor employees. This
8 is due to the fact that contractor expense does not consist solely of services (employee
9 costs); depending on the contractor and the scope of work, it may include materials and
10 supplies, equipment, subcontractors, and other costs. The Company acknowledges that
11 "there is not a one-for-one correlation between internal and external resources."[45] The
12 Company budgets contractor expense "by dollars and not by the number of full-time
13 equivalents ("FTEs"), as it does internal employees."[46] The Company did not and cannot
14 demonstrate that even a subset of the increased employee expenses actually were offset by
15 a reduction in contractor employees and the related expenses.[47] I have summarized the
16 Company's headcount and contractor O&M expense since 2018 in the following table,
17 which actually shows large increases in both.

[44] Schedule G-2 page 19b line 3.
[45] Response to OPC IRR No. 203. I have attached a copy of this response as my Exhibit LK-17.
[46] Response to OPC IRR Nos. 180, 181. I have attached a copy of these responses as my Exhibit LK-18.
[47] Response to OPC IRR Nos. 7, 186, 203, and 238. I have attached a copy of the response to OPC IRR Nos. 7, 186, and 238 as my Exhibit LK-19. See Exhibit LK-17 for IRR 203.

PEOPLES GAS SYSTEM, INC.
HEADCOUNT VS O&M CONTRACTOR EXPENSE

	Headcount Year End	O&M Contractor Expense $ Millions
2018 Actual	579	14.496
2019 Actual	606	14.829
2020 Actual	623	14.125
2021 Actual	624	16.081
2022 Actual	708	20.169
2023 Forecast	777	18.287
2024 Forecast	840	21.223

Note: The O&M contractor expense does not include additional expense forecast in 2023 and 2024 associated with the Alliance contract.

1

2 **Q. DID THE COMPANY REFLECT ANY REDUCTION IN EMPLOYEES FOR**
3 **EFFICIENCIES FROM THE NEW WORK AND ASSET MANAGEMENT**
4 **SYSTEM ("WAMS")?**

5 A. No. The Company incurred $34.4 million in capital costs for the new WAMS, yet it claims
6 that this new system will not result in any savings whatsoever from efficiencies in the test
7 year.[48]

8 **Q. AS A PRACTICAL MATTER, DO THE COMPANY'S ACTUAL EMPLOYEES**
9 **REFLECT SIGNIFICANT VACANCIES COMPARED TO THE EMPLOYEES**
10 **THAT ARE BUDGETED?**

[48] Direct Testimony of Christian C. Richard at 49-52.

1 A. Yes. The Company's actual employees reflect significant vacancies compared to the
2 employees budgeted. In 2021, the actual average monthly employees were 8% less than
3 the budget.[49] In 2022, the actual average monthly employees were 10% less than budget.[50]
4

5 **Q. ARE THE FORECAST INCREASES IN EMPLOYEES OF THIS MAGNITUDE**
6 **OR THE FORECAST EMPLOYEES REASONABLE?**

7 A. No. The forecast increase in employees and the forecast employees in the test year
8 compared to the base year and prior years are unreasonable and excessive. The increases
9 are discretionary and are not justified by business requirements. They are not justified by
10 customer growth. They are not justified by reductions in contractor expenses. They do not
11 reflect efficiencies from WAM or any other efficiencies. They do not reflect the
12 Company's historic vacancy experience where the actual employees are significantly less
13 than the budget employees. However, they do reflect increases due to the 2023
14 Transaction.

15 **Q. WHAT IS YOUR RECOMMENDATION?**

16 A. I recommend that the Commission reject the increases in employees and the related
17 expenses, with limited exceptions where the increases in the related expenses are offset by
18 reductions in allocations of shared services costs from Tampa Electric Company and in the
19 instance of the new treasury analyst position costs that are applicable to the 2023
20 Transaction costs that I have recommended to be removed in a separate adjustment above.
21 I also recommend the removal of $1.153 million in account 921 costs for the increased

[49] Response to OPC IRR No. 8. See Exhibit LK-15.
[50] *Id.*

1 employee expenses and materials and supplies that were added by the Company to support
2 these headcount increases.

3 **Q. WHAT IS THE EFFECT OF YOUR RECOMMENDATION?**

4 A. The effect is a $9.686 million reduction in payroll and related expenses and another $1.153
5 in account 921 costs. These amounts are before the necessary gross-ups for Commission
6 assessment fees and bad debt expense.

7 **D. <u>The Trended Payroll Expense Is Excessive And Unreasonable</u>**
8

9 **Q. DESCRIBE THE METHODOLOGY USED BY THE COMPANY TO TREND THE**
10 **PAYROLL EXPENSES FROM THE BASE YEAR TO THE TEST YEAR.**

11 A. The Company calculated the trended payroll expenses for the test year starting with the
12 historic calendar year 2022 as the base year, then escalated the base year payroll expenses
13 by 5.0% for 2023 and then escalated that result by another 5.0% for 2024.[51] The Company
14 did not distinguish between non-union and union payroll for the trended payroll expenses
15 and did not use the known contractual union contractual payroll increases for 2023 and
16 2024 for this purpose.[52]

17 **Q. HOW DO THE COMPANY'S 5.0% ESCALATION FACTORS FOR TRENDED**
18 **PAYROLL EXPENSES IN 2023 AND 2024 COMPARE TO PRIOR YEARS**
19 **ACTUAL NON-UNION SALARIES AND WAGES INCREASES?**

---

[51] Schedule G2 pages 12a-19a. Trend rate assumptions and calculations for 2023 and 2024.
[52] *Id.*

1 A. The 5.0% escalation factors for trended payroll expenses in 2023 and 2024 are significantly
2 greater than the actual non-union payroll expense increases of 3.75% in 2022, 2.70% in
3 2021, 2020, and 2019, and 3.0% in 2018.[53]

4 **Q. HOW DO THE COMPANY'S 5.0% ESCALATION FACTORS FOR TRENDED**
5 **PAYROLL EXPENSES IN 2023 AND 2024 COMPARE TO THE CONTRACTUAL**
6 **INCREASES SET FORTH IN THE UNION CONTRACTS FOR THOSE YEARS?**

7 A. The 5.0% escalation factors for trended payroll expenses in 2023 and 2024 also are
8 significantly greater than the contractual union increases for 2023 and 2024, which range
9 from 2.75% to 3.0% in each of those years for all bargaining units, other than for IBEW
10 2072 (covering electrical worker employees in the Lakeland, Daytona, and Eustis service
11 areas). The IBEW 2072 contractual increases in 2023 range from 5.3% to 13.8% depending
12 on the employee classification.[54]

13 **Q. HOW DO THE COMPANY'S 5.0% ESCALATION FACTORS FOR TRENDED**
14 **PAYROLL EXPENSES IN 2023 AND 2024 COMPARE TO ITS GENERAL**
15 **INFLATION ESCALATION FACTORS?**

16 A. The 5.0% escalation factors for trended payroll expenses in 2023 and 2024 are significantly
17 greater than the 2.8% and 2.2% trended general inflation escalation factors for those two
18 years, respectively.

[53] Response to OPC IRR 18. I have attached a copy of this response and the Excel spreadsheet attachment as my Exhibit LK-20.

[54] *Id.*

1 **Q. ARE THE COMPANY'S 5.0% ESCALATION FACTORS FOR TRENDED**
2 **PAYROLL EXPENSES IN 2023 AND 2024 REASONABLE?**
3 A. No. They are excessive and significantly greater than both the Company's actual historic
4 payroll increases and its general inflation assumptions. They are the same 5.0% in each
5 year even though its general inflation escalation declines in 2024 compared to 2023. They
6 also are excessive and significantly greater than the contractual payroll increases scheduled
7 for union employees in 2023 and 2024, except for the IBEW 2072 increases in 2023 that I
8 previously noted.

9 **Q. WHAT IS YOUR RECOMMENDATION?**
10 A. I recommend that the Commission utilize 4.0% and 3.0% escalation factors for trended
11 payroll expenses in 2023 and 2024, respectively. These escalation rates are greater than
12 the 2.8% and 2.2% general inflation assumptions, but are consistent with the reduction in
13 2024 in the general inflation assumption. They are consistent with the Company's historic
14 practice of tracking general inflation for non-union and union employees over multiple
15 years, and they are consistent with the scheduled union contractual increases in 2023 and
16 2024.

17 **Q. WHAT ARE THE EFFECTS OF YOUR RECOMMENDATION?**
18 A. The effect is a $1.903 million reduction in payroll and payroll related expenses and a
19 reduction in the claimed base revenue requirement of $1.918 million after gross-up for
20 Commission assessment fees and bad debt expense.

21 **E. <u>The Test Year Administrative And General Expense Is Excessive And Unreasonable</u>**
22 **<u>Due To The Company's Failure To Increase The Account 922 Credit For A&G</u>**

1 **<u>Expenses Capitalized To Match The Trended Increases In The Other A&G Expense</u>**
2 **<u>Accounts</u>**
3

4 **Q. DESCRIBE THE ACCOUNT 922 CREDIT FOR A&G ALLOCATION TO**
5 **CAPITAL.**

6 A. The A&G expense accounts are prescribed and defined in the FERC Uniform System of
7 Accounts ("USOA"). The A&G expense accounts include 920 (administrative and general
8 salaries) and 921 (office supplies and expense), and 922 (administrative expenses
9 transferred – credit), among others.

10 Account 922 (administrative and general expenses transferred – credit) is defined
11 in the USOA as "[t]his account shall be credited with administrative expenses recorded in
12 accounts 920 and 921 which are transferred to construction costs or non-utility accounts."
13 Account 922 is used to credit these two A&G expense accounts for an allocation to capital
14 (capital expenditures) so that the net of the three accounts is the expense recorded for
15 administrative and general salaries and related office supplies and expense, excluding the
16 credit to capital expenditures.

17 The A&G credit allocated to capital expenditures in turn is capitalized to the
18 relevant construction projects included in construction work in progress ("CWIP"), and
19 ultimately, is included in plant in service after the construction is completed and the CWIP
20 is closed to plant. In this manner, the A&G included in plant in service is deferred and
21 subsequently expensed through depreciation over the service lives of the assets. Thus, it
22 is important that the A&G credit allocated to capital expenditures be calculated in a manner
23 that is consistent with the A&G included in CWIP and then plant in service.

1 **Q. DESCRIBE HOW THE COMPANY FORECAST THE ACCOUNT 922 CREDIT**
2 **FOR A&G ALLOCATION TO CAPITAL.**

3 A. The Company forecast the account 922 credit for A&G allocation to capital as $11.000
4 million. This is the same amount that it recorded in the base year.[55] The Company made
5 no attempt to increase the A&G allocation to capital to synchronize and match the increase
6 in the forecast capital expenditures in the test year compared to the base year or to increase
7 the A&G allocation to capital to synchronize and match the increase in the forecast A&G
8 expense in accounts 920 and 921 in the test year compared to the base year.

9 **Q. IS THIS APPROPRIATE?**

10 A. No. The account 922 credit for A&G allocation to capital should increase as capital
11 expenditures increase and as A&G expenses increase. The Company significantly
12 increased the capital expenditures and the A&G expense in the test year compared to the
13 base year. Yet the Company held the account 922 credit for A&G allocation to capital
14 constant in the test year compared to the base year, thus overstating the A&G expense
15 among the three accounts on a net basis in the test year.

16 **Q. IS THE COMPANY'S METHODOLOGY FOR THE ACCOUNT 922 CREDIT FOR**
17 **A&G ALLOCATION TO CAPITAL CONSISTENT WITH ITS METHODOLOGY**
18 **FOR ITS ALLOCATIONS OF PAYROLL AND OTHER COSTS TO CAPITAL?**

[55] Schedule G-2 page 19b of 31, line 13. Response to OPC IRR No. 185. I have attached a copy of this response as my Exhibit LK-21.

1 A. No. The Company utilized its historic O&M expense and capital ratios to allocate these
2 costs in the test year. The Company's A&G allocations to capital should be consistent with
3 its other allocations between expense and capital.

4 **Q. WHAT ARE THE COMPANY'S FORECAST INCREASES IN A&G EXPENSE**
5 **AND CAPITAL EXPENDITURES IN THE TEST YEAR COMPARED TO THE**
6 **BASE YEAR?**

7 A. The Company forecasts an increase in A&G accounts 920 and 921 expense in the test year
8 compared to the base year of 34.9%.[56] This increase includes the additional payroll
9 expense associated with employee team member additions. The increase in these accounts
10 without the additional payroll expense is 19.3%. The Company also forecasts an increase
11 in capital expenditures in the test year compared to the base year of 11.4%. [57]

12 **Q. WHAT IS YOUR RECOMMENDATION?**

13 A. I recommend that the Commission increase the A&G allocation to capital to reflect both
14 the increase in capital expenditures and the increase in A&G expense in the test year
15 compared to the base year.

16 **Q. WHAT IS THE EFFECT OF YOUR RECOMMENDATION?**

17 A. The effect is a $2.125 million increase in the account 922 credit for A&G allocation to
18 capital and a $2.142 million reduction to the claimed base revenue requirement after gross-
19 up for Commission assessment fees and bad debt expense. The Commission should be
20 mindful that this "frozen" Account 922 credit could be indicative that the same or a similar

[56] Schedule G-2 page 17 of 31.
[57] Response to OPC IRR 185. See Exhibit LK-21.

1 approach many have been used to forecast the allocations of affiliate costs or charitable
2 contributions, donations, sponsorships and image and institutional advertising to capital
3 and/or non-regulated operations. Although I have not focused on these other allocations
4 or proposed specific adjustments beyond the account 922 issue, I would support additional
5 adjustments if the Company does not demonstrate that it has properly indexed adjustments
6 to expense in these and other areas.

7 **F. The Test Year Storm Damage Expense Accrual Is Excessive And Unreasonable**
8

9 **Q. DESCRIBE THE COMPANY'S PROPOSED INCREASE TO THE STORM**
10 **DAMAGE EXPENSE ACCRUAL.**

11 A. The Company seeks to increase its annual storm damage expense accrual to $0.500 million
12 from the $0.380 million approved in the prior base rate proceeding, an increase of $0.120
13 million. The Company based its request on the actual costs of six storms incurred over the
14 last 14 years, including the costs of Hurricane Michael and Hurricane Ian. The total cost
15 of these six storms was $5.453 million, with a 14-year annual average of $0.390 million.[58]
16 The Company incurred no storm costs in 9 of those 14 years.[59]

17 **Q. IS THIS APPROPRIATE?**

18 A. No. The Company's calculation methodology is flawed because it includes the costs of
19 Hurricane Michael. The costs of Hurricane Michael were recovered through a surcharge,
20 not charged to the storm reserve. The costs of Hurricane Ian included in the Company's
21 calculation also could have been recovered through a surcharge, but the Company chose

[58] Exhibit No. RBP-1 Document No. 7.
[59] *Id.*

1 not to do so. The costs of Hurricane Michael comprised $3.281 million and the costs of
2 Hurricane Ian comprised $1.590 million of the $5.453 million total cost of the six storms
3 over the last ten years. The Commission allowed the Company to impose a surcharge for
4 the costs of Hurricane Michael. It is inappropriate to include the Hurricane Michael costs
5 in the 14-year average because it biases the result upward through an incorrect assumption
6 that it did not recover the costs of Hurricane Michael through a surcharge and another
7 incorrect assumption that it never will recover the costs of another hurricane of similar
8 magnitude through a surcharge.

9 **Q. WHAT IS THE ANNUAL AVERAGE STORM COST OVER THE 14 YEARS IF**
10 **THE COSTS OF MICHAEL ARE EXCLUDED?**

11 A. It drops to $0.155 million compared to the Company's calculation of $0.545 million over
12 10 years. This annual average still includes the costs of Hurricane Ian. It would drop to
13 $0.042 million if the costs of Hurricane Ian are excluded.

14 **Q. WHAT IS YOUR RECOMMENDATION?**

15 A. I recommend that the Commission authorize a storm damage expense accrual of $0.200
16 million, which reflects the annual average of $0.042 million excluding the costs of
17 Hurricane Ian, plus a ten-year amortization of the costs of Hurricane Ian due to its
18 magnitude and the Company's decision to forego recovery through a storm surcharge.

19 **Q. WHAT IS THE EFFECT OF YOUR RECOMMENDATION?**

20 A. The effect is a $0.300 million decrease in the Company's requested storm damage accrual
21 and a $0.302 million reduction to the claimed base revenue requirement after gross-up for
22 Commission assessment fees and bad debt expense.

1 **G.** **<u>The Test Year Revenue Requirement Incorrectly Accounts for The Revenues For The</u>**
2 **<u>Brightmark, New River, and Alliance RNG Projects</u>**
3

4 **Q. DESCRIBE THE REVENUES RECOVERED PURSUANT TO THE CONTRACTS**
5 **FOR THE BRIGHTMARK AND NEW RIVER RNG PROJECTS.**
6 A. The Company included the forecast revenues pursuant to these contracts in test year
7 revenues. The revenues pursuant to the contracts are based on levelization formulas that
8 annuitize the costs of the projects to the participants.

9 **Q. DO THE REVENUES FOR THE BRIGHTMARK AND NEW RIVER RNG**
10 **PROJECTS MATCH THE COSTS INCLUDED IN THE REVENUE**
11 **REQUIREMENT FOR THESE PROJECTS?**
12 A. No. The Company claims that the project revenues offset the project costs.[60] Although
13 that may be correct over the terms of the two contracts, there is a mismatch in the test year
14 between the revenues and the project costs included in the revenue requirement.[61] This
15 mismatch improperly increases the revenue requirement for all customers in the test year.
16 The mismatch is due to fact that the revenues from the participants included as a credit to
17 the revenue requirement are calculated on a levelized (annuitized) basis over the terms of
18 the contracts while the costs included in the revenue requirement are not levelized, but
19 instead reflect the traditional declining cost/revenue requirement curve as the plant in
20 service costs are depreciated for book and tax purposes. The levelized revenues are less

---

[60] Direct Testimony of Lew Rutkin, Jr. at 26-29.

[61] Confidential response to OPC IRR No. 198. I have attached a copy of this response and the summary worksheet tab from the electronic attachment as my Exhibit LK-23.

1 than the costs for these two contracts in the test year, resulting in a net revenue deficiency
2 that should not be recovered from all customers.

3 **Q. IS THERE A SIMILAR MISMATCH BETWEEN THE REVENUES AND COSTS**
4 **FOR THE ALLIANCE CONTRACT?**

5 A. Yes. However, the revenues exceed the costs for the Alliance contract, which results in a
6 net revenue surplus that should not be provided to all customers.

7 **Q. WHAT IS THE NET EFFECT OF THE MISMATCHES FOR THE THREE**
8 **CONTRACTS?**

9 A. The net effect is $1.300 million improperly included in the revenue requirement. The net
10 effect consists of $1.389 million less in revenues than the costs for the Brightmark contract,
11 $0.144 million less in revenues than the costs for the New River contract, and $0.233
12 million more in revenues than the costs for the Alliance contract.[62]

13 **Q. DOES THE COMPANY ACKNOWLEDGE THAT THERE IS A MISMATCH?**

14 A. Yes. The Company proposes that the mismatch be remedied through deferral accounting,
15 and that "if directed by the Commission to do so, it would not object."[63]

16 **Q. WHAT IS YOUR RECOMMENDATION?**

17 A. I recommend that the Commission reduce the Company's claimed revenue requirement by
18 $1.310 million, calculated as $1.300 million in net costs along with the gross-up for
19 Commission assessment fees and bad debt expense, to ensure that all customers are neither

[62] *Id.*
[63] Response to OPC IRR No. 199. I have attached a copy of this response as my Exhibit LK-23.

1 harmed nor benefited from these projects through the revenue requirement in this
2 proceeding.

3 In addition, I do not oppose the Company's proposal to use deferral accounting for
4 the mismatch, assuming that the deferrals are not included in rate base. The levelized
5 revenues already provide the Company with a return on rate base over the terms of the
6 contracts through the levelization formula, which embeds a rate of return on the revenue
7 deficiencies until they are fully recovered from the participants.

8 I note that my recommendation should not be construed to affirm or otherwise
9 support the inclusion of the three RNG projects above the line. My testimony only
10 addresses the accounting and ratemaking treatment *if the Commission allows the RNG*
11 *investment and expense above the line based on the information provided by the Company*
12 *in response to OPC discovery*. I understand the OPC intends to address this issue,
13 including the costs that were identified with each of the RNG projects in response to OPC
14 discovery, in the hearing and briefs.

15 **H. <u>The Test Year Property Tax Expense Is Excessive And Unreasonable</u>**
16

17 **Q. DESCRIBE THE COMPANY'S FORECAST PROPERTY TAX EXPENSE IN THE**
18 **TEST YEAR AND COMPARE IT TO THE PROPERTY TAX EXPENSE IN THE**
19 **BASE YEAR.**

20 A. The Company forecast property tax expense in the test year of $24.468 million, an increase
21 of $7.603 million, or 45.1% over the property tax expense of $16.865 million in the base
22 year. The valuation date is January 1 for each year for personal and real property that is

1 in-service on that date. CWIP is not subject to property tax. The Company provided its
2 calculation of the property tax expense for the test year in response to OPC discovery.[64]

3 **Q. DESCRIBE THE COMPANY'S CALCULATION OF THE PROPERTY TAX**
4 **EXPENSE ON TANGIBLE PERSONAL PROPERTY FOR THE TEST YEAR.**

5 A. The Company is taxed based on its tangible personal property ("TPP") and real property
6 valuations at January 1 each year. The largest of the two valuations is the TPP, which
7 comprises approximately 97% of the total property valuation and is taxed at a higher rate
8 than the real property. The Company developed the $1,379.617 million TPP valuation at
9 January 1, 2024 for the test year using the weighted results of a cost-based approach (net
10 book value) and an income approach (recent operating income divided by the cost of
11 capital). The Company then "adjusted" this valuation upward by 13.4% to $1,544.485
12 million for the test year based primarily on its experience in 2021, when its valuation at
13 January 1, 2021 was "adjusted" upward by 13.4% compared to its calculated valuation.
14 The Company then multiplied this "adjusted" valuation by the weighted property tax rates
15 for all taxing jurisdictions.[65]

16 **Q. IS IT APPROPRIATE TO ADJUST UPWARD THE COMPANY'S VALUATION**
17 **AT JANUARY 1, 2024 CALCULATED BASED ON ITS ACTUAL EXPERIENCE**
18 **IN 2021?**

19 A. No. The Company provided no evidence that its 2021 experience is or will be applicable
20 to the valuation at January 1, 2024 for the test year. The Company calculated the required

[64] Response to OPC POD No. 45. I have attached a copy of the narrative portion of this response and the worksheet tab CountyDetailEstimate as my Exhibit LK-24.

[65] *Id.*

1 valuation of $1,379.617 million using the weighted results of a cost-based approach and an
2 income approach times the weighted property tax rates for all taxing jurisdictions. There
3 is no justification to apply an adjustment to increase the calculated result by this result for
4 the 2024 test year based on an atypical adjustment for the 2021 tax year.

5 **Q. HAS THE COMPANY IDENTIFIED AN ERROR IN ITS PROFORMA**
6 **ADJUSTMENT CALCULATION TO INCREASE THE TPP VALUATION AND**
7 **PROPERTY TAX EXPENSE IN THE TEST YEAR BASED ON THE**
8 **"AJDUSTMENT" EXPERIENCED IN 2021?**

9 A. Yes. The Company acknowledged an error in its quantification of the "adjustment" in the
10 January 1, 2021 valuations in response to OPC discovery, which resulted in an error and
11 overstatement of the January 1, 2024 TPP valuation and property tax expense in the test
12 year. The Company acknowledged that the "adjustment" to the TPP valuation at January
13 1, 2021 actually was only 3.7%, not the 13.4% it originally calculated. The Company
14 calculated that the "adjustment" using the 3.7% applied the calculated TPP valuation at
15 January 1, 2024 instead of the original 13.4% would reduce its claimed property tax
16 expense in the test year by $2.008 million to $22.454 million from $24.462 million.[66]

17 **Q. WAS THERE AN ADJUSTMENT TO THE COMPANY'S CALCULATED**
18 **JANUARY 1, 2022 TPP VALUATION OF A MAGNITUDE SIMILAR TO THE**
19 **ADJUSTMENT TO THE COMPANY'S CALCULATED JANUARY 1, 2021 TPP**
20 **VALUATION?**

---

[66] Response to OPC IRR No. 241. I have attached a copy of the narrative portion of this response as my Exhibit LK-25

1 A. No. Although there was an "adjustment" upward to the TPP valuation in 2022, it was only
2 $8.524 million, an increase from $1,043.417 million to $1,051.941 million, or only 0.8
3 precent, much less than the corrected 3.7% adjustment upward in 2021.[67]

4 **Q. WHAT IS YOUR RECOMMENDATION?**

5 A. I recommend that the Commission utilize the Company's calculation of the property tax
6 expense based on the $1,379.617 million valuation at January 1, 2024 without the
7 adjustment based on its 2021 experience or an adjustment based on its experience in any
8 other year. The Company's adjustment to the valuation in 2024 based on its 2021
9 experience is unjustified and unreasonable. The "adjustment" in 2021 is much greater than
10 in 2022. Further, there is no evidence that such an "adjustment" based on experience in
11 prior years is or would be applicable in 2024; any such potential "adjustment" is unknown
12 by definition and is speculative at this time, even assuming the Company calculated such
13 an adjustment correctly.

14 **Q. WHAT IS THE EFFECT OF YOUR RECOMMENDATION?**

15 A. The effect is a $2.562 million reduction in the property tax expense and a $2.583 million
16 reduction in the base revenue requirement after gross-up for Commission assessment fees
17 and bad debt expense.

18 **IV. DEPRECIATION RATES AND EXPENSE ARE EXCESSIVE**
19

20 **A. <u>The Company's Depreciation Study Date Does Not Match The Test Year And Results</u>**
21 **<u>In Excessive And Unreasonable Depreciation Rates And Expense</u>**

---

[67] Response to OPC IRR No. 240. I have attached a copy of this response as my Exhibit LK-26.

1

2 **Q. Describe the Company's depreciation study based on a study date of December 31,**
3 **2024 and how the Company used the resulting depreciation rates to calculate the**
4 **depreciation expense in the test year.**
5 A. The Company retained Mr. Dane Watson to perform a depreciation study, which the
6 Company initially filed in Docket 20230023-GU ("depreciation proceeding") on
7 December 28, 2022. The Company referred to this study as the "2022 Depreciation Study"
8 in its Petition in the depreciation proceeding. That version of the "2022 Depreciation Study
9 is based on actual plant in service and depreciation reserves as of December 31, 2021 and
10 forecasted plant in service and depreciation reserves as of December 31, 2024."[68] Docket
11 20230023-GU was subsequently consolidated with this base rate case proceeding for
12 hearing purposes.
13 The Company subsequently filed a revised version of the 2022 Depreciation study
14 "to reflect actual plant in service, retirements, and accumulated depreciation balances as of
15 December 31, 2022 and a revised forecast for 2023 and 2024 as reflected in the MFRs filed
16 in the company's current base rate case."[69] The Company refers to the revised study as the
17 "Updated Study" in the cover letter for its filing.
18 Mr. Watson used a depreciation study date of December 31, 2024 at the direction
19 of the Company. Mr. Watson calculated the net plant by plant account based on plant data
20 provided by the Company based on its forecasts for December 31, 2024, including
21 accumulated depreciation based on its presently authorized depreciation rates for each

[68] Application in Docket 20230023-GU at paragraph 15.
[69] Response to Staff First Data Request 1 in Docket No. 20220219-GU. I have attached a copy of this response as my Exhibit LK-29.

1 month during the test year. Mr. Watson also used the remaining service lives for each plant
2 account based on the number of years after December 31, 2024.
3 The Company then used the depreciation rates developed by Mr. Watson based on
4 the depreciation study date of December 31, 2024 to quantify depreciation expense for each
5 month in the test year starting in January 2024 and calculated the accumulated depreciation
6 and related ADIT included in rate base for the test year based on that calculated
7 depreciation expense, not the accumulated depreciation reflected in its depreciation study.

8 **Q. IS IT APPROPRIATE TO USE A DEPRECIATION STUDY DATE OF**
9 **DECEMBER 31, 2024 TO DEVELOP DEPRECIATION RATES THAT WILL BE**
10 **EFFECTIVE ON JANUARY 1, 2024?**

11 A. No. This is a fundamental conceptual and practical disconnect that biases upward the
12 Company's proposed depreciation rates. The Company's use of a December 31, 2024
13 depreciation study date creates a mismatch because the depreciation rates will be effective
14 on January 1, 2024. The mismatch is not merely an academic observation. The use of
15 inconsistent dates is a methodological flaw that actually results in excessive depreciation
16 rates and excessive depreciation expense in the test year.
17 The mismatch occurs because the plant in service that Mr. Watson used to calculate
18 the depreciation rates includes plant additions and retirements for the entirety of calendar
19 year 2024 despite the fact that none of that plant activity will have occurred prior to January
20 1, 2024 and despite the fact that the entirety of the plant activity will not have occurred
21 until December 31, 2024. The mismatch effectively annualizes the plant in service at
22 December 31, 2024 in the calculation of the depreciation rates, thus biasing upward the
23 depreciation rates in order to recover the plant in service forecast at December 31, 2024,

which then incorrectly increases the resulting depreciation expense starting in January 2024 based on the projected plant in service at December 31, 2024.

This methodological flaw due to the mismatch in the study date and the effective date of the depreciation rates is compounded by the use of shorter remaining service lives in the Company's depreciation study measured from December 31, 2024 rather than measured from January 1, 2024, the date that the depreciation rates will be applied. The shorter remaining service lives thus further upwardly bias the depreciation rates based on the assumption that the net plant costs will be recovered starting December 31, 2024 even though the depreciation rates will be effective starting January 1, 2024.

Q. PROVIDE AN ILLUSTRATION OF THE EFFECTS OF THE METHODOLOGICAL FLAW DUE TO THIS MISMATCH BETWEEN THE DEPRECIATION STUDY DATE AND THE DATE THE DEPRECIATION RATES WILL BE APPLIED TO CALCULATE DEPRECIATION EXPENSE.

A. Assume that the Company's gross plant in service at January 1, 2024 is $2,200 million and at December 31, 2024 is $2,560 million. Assume that the Company's net plant (gross plant in service less accumulated depreciation) at January 1, 2024 is $1,800 million and at December 31, 2024 is $2,100 million. Assume further that the average remaining service life at January 1, 2024 is 30 years and at December 31, 2024 is 29 years.

If the depreciation study date is January 1, 2024, then the calculated depreciation rate will be 2.73%, calculated as $1,800 million net plant/30 years average remaining service life divided by $2,200 million gross plant. If the depreciation study date is December 31, 2024, then the calculated depreciation rate will be 2.83%, calculated as

1 $2,100 million net plant/29 years average remaining service life divided by $2,560 million
2 gross plant.

3 In this illustration, the difference in depreciation expense between the two rates
4 calculated based on the two different study dates is $2.380 million, calculated as the $2,380
5 million average gross plant in service during the test year times the 0.1% difference in
6 depreciation rates (2.83% less 2.73%).

7 **Q. DOES THE COMPANY'S DEPRECIATION STUDY DATE OF DECEMBER 31,**
8 **2024 COMPLY WITH THE REQUIREMENT THAT "THE DEPRECIATION**
9 **STUDY PERIOD SHALL MATCH THE TEST YEAR IN THE COMPANY'S**
10 **MFRS"[70] SET FORTH IN THE 2020 SETTLEMENT AGREEMENT APPROVED**
11 **BY THE COMMISSION IN DOCKET 20200051-GU?**

12 A. No. The only depreciation study date that complies with the matching requirement set
13 forth in the settlement agreement is a study date of December 31, 2023 using the gross
14 plant in service, accumulated depreciation, and average remaining service lives at the start
15 of the test year.

16 The Company's study date of December 31, 2024 does not comply with this
17 matching requirement because it uses the present depreciation rates to calculate the
18 accumulated depreciation at December 31, 2024 for the depreciation study as if there were
19 no change in depreciation rates on January 1, 2024, but then applies the resulting new
20 depreciation rates developed using that false premise on January 1, 2024 to calculate
21 depreciation expense, accumulated depreciation, and ADIT in the test year.

[70] Stipulation and Settlement Agreement approved in Docket No. 20200051-GU at 4(d) on page 10.

1 **Q. WHAT IS YOUR RECOMMENDATION?**

2 A. I recommend that the Commission use a depreciation study date of December 31, 2023. It
3 is necessary to conceptually and practically match the depreciation study date with the
4 beginning of the test year when the resulting depreciation rate changes are applied to the
5 gross plant to calculate depreciation expense starting in January 2024.

6 The Company's proposed depreciation study date of December 31, 2024 biases
7 upward the proposed depreciation rates because it incorrectly calculates depreciation rates
8 on plant in service that does not exist at January 1, 2024 when the depreciation rates
9 become effective and because it incorrectly assumes that the average remaining service
10 lives are measured from December 31, 2024 and not from January 1, 2024 when the
11 depreciation rates become effective.

12 The depreciation study date of December 31, 2023 complies with the matching
13 requirement set forth in the settlement agreement approved by the Commission in Docket
14 20200051-GU. The Company's depreciation study date of December 31, 2024 does not.

15 **Q. WHAT IS THE EFFECT OF YOUR RECOMMENDATION TO USE A**
16 **DEPRECIATION STUDY DATE OF DECEMBER 31, 2023?**

17 A. The effect is a reduction in depreciation expense of $0.625 million and a reduction in the
18 base revenue requirement of $0.603 million, comprised of the reduction in depreciation
19 expense and the gross-up for Commission assessment fees and bad debt expense offset in
20 part by the related changes in the return on the reduction in accumulated depreciation.[71]

[71] There also is a related effect to ADIT in the determination of the cost of capital that is not included in this quantification. However, I included the resulting adjustment to ADIT, along with all other changes to ADIT, as part of a combined cost of capital adjustment.

Mr. Garrett calculated the depreciation rates using a depreciation study date of December 31, 2023 assuming no other changes to the methodologies or parameters reflected in the Company's Updated Depreciation Study. I used the depreciation rates using a study date of December 31, 2023 provided by Mr. Garrett to calculate the effects of this recommendation as the first in the series of depreciation expense adjustments that I and Mr. Garrett recommend.

B. Quantifications Of Adjustments To Reduce Depreciation Expense Using OPC Witness Garrett's Recommended Depreciation Rates, Using The Company's Depreciation Study Date, And Using The OPC Depreciation Study Date

Q. Describe your quantifications of the adjustments to reduce depreciation expense using Mr. Garrett's recommended depreciation rates.

A. I quantified depreciation expense and the related effects on accumulated depreciation and ADIT using Mr. Garrett's recommended depreciation rates based on the depreciation study date of December 31, 2023 that both Mr. Garrett and I recommend. I also quantified as an alternative the depreciation expense and the related effects on accumulated depreciation and ADIT using Mr. Garrett's recommended depreciation rates based on the Company's depreciation study date of December 31, 2024.

The depreciation rates and expense based on the depreciation study date of December 31, 2023 represent the OPC's primary recommendation and the effects of Mr. Garrett's recommendations on the Company's base revenue requirement shown on the table in the Summary section of my testimony are based on the OPC depreciation study date of December 31, 2023.

1 The depreciation rates and expense based on the Company's depreciation study
2 date of December 31, 2024 represent OPC's alternative, but disfavored, recommendation
3 only in the event that the Commission does not accept OPC's primary recommendation to
4 use a depreciation study date of December 31, 2023. I do not show the effects of Mr.
5 Garrett's recommendations on the Company's base revenue requirement of this alternative
6 recommendation on the table in the Summary section of my testimony.

7 **Q. WHAT ARE THE EFFECTS OF MR. GARRETT'S PROPOSED DEPRECIATION**
8 **RATES BASED ON THE TWO DIFFERENT DEPRECIATION STUDY DATES?**

9 **A.** The effect of Mr. Garrett's recommendations using the OPC depreciation study date
10 of December 31, 2023 is a reduction in depreciation expense of $7.257 million and a
11 reduction in the base revenue requirement of $6.991 million, comprised of the reduction in
12 depreciation expense grossed-up for Commission assessment fees and bad debt expense
13 offset in part by the related return on the reduction in accumulated depreciation.[72]

14 The effect of Mr. Garrett's recommendations using the Company's depreciation
15 study date of December 31, 2024 is a $7.369 million reduction in depreciation expense and
16 a $7.099 million reduction in the base revenue requirement, comprised of the reduction in
17 depreciation expense grossed-up for Commission assessment fees and bad debt expense
18 offset in part by the related return on the reduction in accumulated depreciation.[73]

19 **C.** **A More Rapid Amortization Of The Theoretical Depreciation Reserve Surplus Will**
20 **Mitigate The Proposed Rate Increase And Promote Intergenerational Equity**
21 **Regardless Of Whether The Commission Uses The Company's Depreciation Study**
22 **Date Or The OPC Depreciation Study Date**
23

[72] *Id.*
[73] *Id.*

1 **Q. DESCRIBE THE COMPANY'S TREATMENT OF THE THEORETICAL**
2 **DEPRECIATION RESERVE SURPLUS CALCULATED IN THE COMPANY'S**
3 **DEPRECIATION STUDY.**

4 A. The Company quantified a theoretical depreciation reserve surplus of $119.6 million at its
5 proposed depreciation study date of December 31, 2024 using present depreciation rates.
6 In its depreciation study, the Company effectively amortized the theoretical depreciation
7 reserve surplus over the remaining average service lives for each plant account, thus
8 reducing the depreciation rates for those plant accounts.[74] The Company quantified a
9 $5.285 million reduction in annual depreciation expense, or an equivalent average
10 amortization period of 22.6 years.[75] The Company also calculated an approximate $5.3
11 million net reduction in depreciation expense in the test year if the Commission were to
12 authorize a $10 million amortization of the theoretical deprecation reserve surplus under
13 the assumption that none of the surplus was used to reduce the proposed depreciation rates.
14 This calculation was based on the Company's depreciation study with a study date of
15 December 31, 2024 and all the parameters used therein by Mr. Watson.[76]

16 **Q. WHAT DOES THE THEORETICAL DEPRECIATION RESERVE SURPLUS**
17 **REPRESENT?**

18 A. The theoretical depreciation reserve surplus represents the accumulated excess recoveries
19 of depreciation expense from customers in prior years if the parameters and resulting
20 depreciation rates in the present depreciation study had been applied in prior years

[74] Direct Testimony of Dane A. Watson at 24.

[75] Response to OPC IRR No. 99. I have attached a copy of the narrative portion of this response as my Exhibit LK-28.

[76] *Id.*

1 compared to the actual depreciation expense reflected in accumulated depreciation as of
2 the depreciation study date.

3 **Q. WERE THE COMPANY'S PRIOR CUSTOMERS OR ITS FUTURE CUSTOMERS**
4 **HARMED THROUGH THE EXCESSIVE DEPRECIATION RATES AND**
5 **EXPENSE RECOVERED THROUGH BASE REVENUES IN PRIOR YEARS?**
6 A. The Company's prior customers were harmed due to excessive depreciation rates in prior
7 years. The Company's future customers are not harmed by excessive depreciation rates
8 and expense recovered through base revenues in prior years.

9 **Q. WHY DOES THIS MATTER?**
10 A. It matters because the prior customers who paid excessive rates in prior years should
11 receive the benefits of lower depreciation rates and base revenues in the near future to
12 reflect a shorter amortization period for the reserve surplus rather than allocating those
13 benefits to future customers over the next several decades.

14 **Q. WHAT IS YOUR RECOMMENDATION?**
15 A. I recommend that the Commission remove the theoretical depreciation reserve surplus from
16 the calculation of the depreciation rates and separately amortize the reserve surplus over
17 ten years. This achieves two regulatory objectives. The first is that it mitigates the massive
18 rate increase requested by the Company in this proceeding. The second is that it returns the
19 excessive depreciation expense recovered from customers in prior years to the customers
20 who paid that expense through their base rates. Mr. Garrett has recomputed the theoretical
21 depreciation reserve surplus to be $221.024 million using the OPC depreciation study date
22 of December 31, 2023 and his updated parameters. He has recomputed the theoretical

1 depreciation reserve surplus to be $186.552 million using the depreciation study date of
2 December 31, 2024 and his updated parameters.

3 **Q. WHAT IS THE EFFECT OF YOUR RECOMMENDATION?**

4 A. The effect of Mr. Garrett's recommendations using the OPC depreciation study date of
5 December 31, 2023 and my recommendation to amortize the surplus over 10 years is a net
6 reduction in depreciation expense of $17.625 million and a net reduction in the base
7 revenue requirement of $16.980 million. The net reduction in the base revenue requirement
8 is comprised of the reduction due to the amortization of the depreciation reserve surplus,
9 grossed-up for Commission assessment fees and bad debt expense; offset in part by an
10 increase in depreciation expense due to an increase in Mr. Garrett's depreciation rate
11 recommendations, also grossed-up for Commission assessment fees and bad debt expense;
12 and offset in part by the related return on the reduction in accumulated depreciation.[77]

13 The effect of Mr. Garrett's recommendations using the Company's depreciation
14 study date of December 31, 2024 and my recommendation to amortize the surplus over 10
15 years is a net reduction in depreciation expense of $14.351 million and a net reduction in
16 the base revenue requirement of $13.826 million. The net reduction in the base revenue
17 requirement is comprised of the reduction due to the amortization of the depreciation
18 reserve surplus, grossed-up for Commission assessment fees and bad debt expense; offset
19 in part by an increase in depreciation expense due to an increase in Mr. Garrett's
20 depreciation rate recommendations, also grossed-up for Commission assessment fees and

[77] There also is a related effect to ADIT in the determination of the cost of capital that is not included in this quantification. However, I included the resulting adjustment to ADIT, along with all other changes to ADIT, as part of a combined cost of capital adjustment.

1 bad debt expense; and offset in part by the related return on the reduction in accumulated
2 depreciation.[78]

3 **Q. WILL THE DEPRECIATION RESERVE AVAILABLE FOR AMORTIZATION**
4 **BE AFFECTED IF THE DADE COUNTY CONNECTOR PROJECT IS NOT IN**
5 **SERVICE BY THE END OF 2023?**

6 A. Yes. Paragraph 4(c)ii of the 2020 Stipulation and Settlement Agreement approved by the
7 Commission in Docket 20200051-GU prohibits the Company from amortizing $8.0 million
8 of the $34.0 million depreciation reserve surplus available for that purpose unless the Dade
9 County Connector project is in service by the end of 2023. If the project is not in service
10 by the end of 2023, then the accumulated depreciation used in the Company's depreciation
11 study and in OPC's depreciation studies is understated by $8.0 million and the theoretical
12 depreciation reserve surplus is understated by $8.0 million, all else equal. Earlier this year,
13 the Emera Board was informed that the project had been delayed and was not expected to
14 be in service until November 2023, less than 60 days before the end of this year. Unless
15 the Company can demonstrate to the Commission that this will in fact occur, the
16 depreciation reserve surplus available for amortization should be increased by $8 million,
17 all else equal.

18 **D. The Company's Proposal To Utilize The Theoretical Depreciation Reserve Surplus**
19 **To Enhance Its Post Test Year Earnings Is Flawed And Will Harm Customers In**
20 **Order To Benefit Emera**
21

[78] *Id.*

1 **Q. DESCRIBE THE COMPANY'S PROPOSAL TO UTILIZE THE THEORETICAL**
2 **DEPRECIATION RESERVE SURPLUS TO ENHANCE ITS POST TEST YEAR**
3 **EARNINGS.**

4 A. Although the Company proposes no reduction for a shorter amortization period in the base
5 revenue requirement, it proposed an amortization of the theoretical depreciation reserve
6 surplus using a "mechanism similar to that included in the settlement agreement for
7 Peoples' last base rate case" whereby it "was authorized to amortize a portion of the
8 company's theoretical reserve surplus as a credit to depreciation expense" in the years 2021
9 through 2023.[79]

10 **Q. WAS THERE ANY REDUCTION TO THE BASE REVENUE REQUIREMENT**
11 **FOR A SHORTENED AMORTIZATION PERIOD FOR THE THEORETICAL**
12 **DEPRECIATION RESERVE SURPLUS?**

13 A. No. The depreciation rates and depreciation expense amortized the theoretical depreciation
14 reserve surplus over the remaining service lives of the plant accounts. The settlement
15 agreement in the last base rate case allowed the Company to utilize $34.0 million of the
16 reserve surplus in its discretion to reduce its depreciation expense and increase its earnings
17 over that three-year stayout period. The Company's customers received no benefit from
18 this provision of the settlement agreement. This provision was a concession to the
19 Company for its benefit.

20 **Q. IS THIS PROPOSAL APPROPRIATE?**

---

[79] Response to OPC IRR No. 99. See Exhibit LK-28.

1 A. No. The Company's proposal is flawed and will harm customers in order to benefit Emera
2 by using a portion of the theoretical depreciation reserve surplus, not for the benefit of the
3 Company's customers, but to benefit the Company by allowing it to enhance its earnings
4 using amounts collected from customers in prior years due to excessive depreciation rates
5 and depreciation expense. I also note that Paragraph 12(b) of the 2020 Stipulation and
6 Settlement Agreement states that "[n]o Party will assert in any proceeding before the
7 Commission that this Agreement or any of the terms in the Agreement shall have any
8 precedential value." This specific proposal seems to be at odds with that prohibition.

9 **Q. WHY IS YOUR RECOMMENDATION TO INCLUDE THE EFFECTS OF A**
10 **SHORTENED AMORTIZATION PERIOD FOR THE THEORETICAL**
11 **DEPRECIATION RESERVE SURPLUS AS A REDUCTION TO THE BASE**
12 **REVENUE REQUIREMENT A BETTER APPROACH THAN THE COMPANY'S**
13 **PROPOSAL?**

14 A. The short answer is that my recommendation refunds the effects of excessive depreciation
15 rates and excessive depreciation expense recovered from the Company's customers in prior
16 years back to the Company's customers in contrast to the Company's proposal, which
17 allows the Company to retain a portion of these excess recoveries in a manner that would
18 benefit shareholders. Under the Company's proposal, customers never will receive refunds
19 for the portion of their excessive rates in prior years that the Company is allowed to retain.

20 **Q. WHAT IS YOUR RECOMMENDATION?**

21 A. I recommend that the Commission reject the Company's proposal. It is yet another
22 example of the Company's willingness to enrich Emera to the detriment of its customers.

V. QUANTIFICATION OF ADJUSTMENTS TO REFLECT OPC WITNESS GARRETT'S RECOMMENDED CAPITAL STRUCTURE AND COST OF EQUITY

A. Quantification of Adjustment To Reflect Mr. Garrett's Capital Structure Recommendations

Q. HAVE YOU QUANTIFIED THE EFFECTS OF MR. GARRETT'S CAPITAL STRUCTURE RECOMMENDATIONS?

A. Yes. The effect is a $11.402 million reduction in the base revenue requirement.

B. Quantification of Adjustment To Reflect Mr. Garrett's Return On Equity Recommendation

Q. WHAT IS THE EFFECT OF MR. GARRETT'S RETURN ON EQUITY RECOMMENDATION?

A. The effect of Mr. Garrett's return on equity recommendation is a $27.115 million reduction in the Company's base revenue requirement and requested base rate increase. This amount is incremental to the reductions in the revenue requirement that I quantified for Mr. Garrett's recommendations to modify the capital structure.

Q. HAVE YOU ALSO QUANTIFIED THE EFFECTS OF A 10 BASIS POINT CHANGE IN THE RETURN ON COMMON EQUITY?

A. Yes. Each 10 basis point change in the return on equity equals $1.356 million in the base revenue requirement and requested base rate increase. This is based on an equity ratio of 49.20% on a financial basis and 42.60% on a regulatory basis.

C. Quantification of Adjustment To Capital Structure For Changes To ADIT Resulting From OPC Recommendations That Affect Rate Base

1 **Q. HAVE YOU QUANTIFIED THE ADJUSTMENT TO REFLECT CHANGES TO**
2 **ADIT RESULTING FROM THE OPC RECOMMENDATION THAT AFFECT**
3 **RATE BASE?**
4 A. Yes. The rate base adjustments that I recommend and that result from the changes in
5 depreciation expense on a net basis increase the ADIT included in the capital structure and
6 reduce the base revenue requirement. More specifically, they increase ADIT by $6.465
7 million and reduce the base revenue requirement by $0.532 million.

8 **D. <u>Summary of Cost of Capital Based on OPC Recommendations Compared to the</u>**
9 **<u>Company's Proposals</u>**
10

11 **Q. SUMMARIZE THE OPC CAPITAL STRUCTURE AND COST OF CAPITAL**
12 **RECOMMENDATIONS.**
13 A. The following table compares the OPC recommendations to the Company's proposed
14 capital structure and cost of capital recommendations before income tax and after income
15 tax gross-ups.

PEOPLES GAS SYSTEM, INC.
COST OF CAPITAL
DOCKET NO. 20230023-GU

PGS Cost of Capital Per Filing

	Jurisdictional Adjusted Capital $ Millions	Capital Ratio	Component Costs	Weighted Avg Cost	Grossed-Up WACC
Long Term Debt	832.186	35.16%	5.54%	1.95%	1.96%
Short Term Debt	99.671	4.21%	4.85%	0.20%	0.21%
Customer Deposits	27.528	1.16%	2.53%	0.03%	0.03%
Deferred Income Tax	280.240	11.84%	0.00%	0.00%	0.00%
Investment Tax Credits	3.157	0.13%	8.49%	0.01%	0.01%
Common Equity	1,124.006	47.49%	11.00%	5.22%	7.05%
Total Capital	2,366.788	100.00%		7.42%	9.26%

PGS Cost of Capital Recommended by OPC

	Jurisdictional Adjusted Capital $ Millions	Capital Ratio	Component Costs	Weighted Avg Cost	Grossed-Up WACC
Long Term Debt	941.736	39.79%	4.61%	1.83%	1.85%
Short Term Debt	99.358	4.20%	3.81%	0.16%	0.16%
Customer Deposits	27.528	1.16%	2.53%	0.03%	0.03%
Deferred Income Tax	286.705	12.11%	0.00%	0.00%	0.00%
Investment Tax Credits	3.157	0.13%	6.73%	0.01%	0.01%
Common Equity	1,008.304	42.60%	9.00%	3.83%	5.18%
Total Capital	2,366.788	100.00%		5.87%	7.22%

1

2 **E. The Proposed Long Term Debt Interest True-Up Mechanism Is Essential, But**
3 **Requires Customer Safeguards**
4

1 **Q. DESCRIBE THE COMPANY'S PROPOSED LONG-TERM DEBT RATE TRUE-**
2 **UP ("LTDR TRUE-UP") MECHANISM.**
3 A. The Company proposes the LTDR True-Up mechanism as a protection for it and customers
4 due to the vast number of uncertainties associated with the inaugural long-term debt
5 issuance ("Inaugural Debt Issuance") envisioned in the Company's plans.[80] The timing of
6 the Inaugural Debt Issuance is expected to occur in 2023, but it may not be completed until
7 after the final hearing in this proceeding. The Company currently projects that the
8 Inaugural Debt Issuance for $825 million will take place on September 2023. This true-up
9 would allow for a one-time adjustment to base rates to reflect the actual costs of long-term
10 debt compared to the projected costs included in the Company's application, whether the
11 actual debt rates are higher or lower than projected. The Company commits that it would
12 calculate the true-up used to adjust base rates within 120 days after the date of the Inaugural
13 Debt Issuance and pass on the change through a limited-proceeding filing. The Company
14 also commits to defer any differences occurring between the time Commission approved
15 rates go into effect and the implementation of the LTDR True-Up mechanism and collect
16 or refund any such differences through the CI/BSR Rider in the subsequent year.

17 **Q. DO YOU AGREE THAT SUCH A MECHANISM SHOULD BE ADOPTED?**
18 A. Yes. The average long-term debt interest on the Company's new debt is unknown at this
19 time due to the continued uncertainty in interest rates based on the financial markets and
20 the actions of the Federal Reserve, the uncertainty in the Company's debt ratings, e.g.,
21 whether the ratings will be one or two notches less than the Tampa Electric Company's

[80] The Company's plans for the LTDR True-Up mechanism are detailed in the Direct Testimony of Rachel B. Parsons at 75-78.

1 ratings, and the uncertainty in the mixture of tenors on the new debt issuances to replace
2 and "repay" the historic and present allocation of debt issued in prior years by Tampa
3 Electric Company for the Company's financing requirements.
4 I note that my support for a true-up mechanism is limited to the unique and unlikely-
5 to-ever-recur circumstance of an electric utility spinning out a gas division. I do not believe
6 that this or any commission should rely on this unique circumstance as precedent to create
7 true-up mechanisms for costs that normally fluctuate. Utilities already are compensated
8 for such fluctuations in costs through the 200-basis point range in the return on equity that
9 the Commission has adopted in previous proceedings.

10 **Q. SHOULD SUCH A TRUE-UP PROTECT CUSTOMERS FROM THE EFFECTS**
11 **OF THE 2023 TRANSACTION?**

12 A. Yes. As I previously discussed, the Commission should disallow the incremental interest
13 expense and other financing costs due to the 2023 Transaction. The Commission should
14 ensure that the effects of this recommendation are not obviated through the proposed true-
15 up mechanism.

16 **Q. DOES THIS COMPLETE YOUR PREPARED DIRECT TESTIMONY?**

17 A. Yes. However I note that the fact that my testimony only addresses specific issues should
18 not be construed to mean that I concur in the balance of the Company's filing. I reserve
19 the right to revise my testimony based on subsequent and/or revised discovery responses
20 or changes in the Company's filing, including, but not limited to, additional corrections of
21 errors in its filing.

1 BY MS. WESSLING:

2 **Q And, Mr. Kollen, did your prefiled testimony**

3 **have 28 exhibits attached labeled LK-1 through LK-28?**

4 A Yes.

5 **Q And do you have any corrections to make to**

6 **your exhibits?**

7 A No.

8 **Q Mr. Kollen, would you please summarize your**

9 **testimony?**

10 A Yes.

11 Good afternoon, Commissioners.

12 The company seeks a base rate increase of

13 $139.3 million. That is an increase of a little bit

14 over 40 percent compared to the present base revenues of

15 $346 million. I recommend a base rate increase of no

16 more than 43 million. This is a reduction of at least

17 $96 million to the company's claimed base revenue

18 requirement and requested rate increase based upon my

19 review and recommendations on specific issues that I

20 address in greater detail. It also reflects the

21 recommendations made by Mr. Garrett regarding the

22 company's depreciation rates, capital structure, cost of

23 equity.

24 The issues that I and Mr. Garrett address and

25 the affects of our recommendations are summarized on the

1 table on page four of my testimony.
2 The company's requested increase is excessive,
3 and due, in part, to the company's discretionary actions
4 in forecast costs that are timed so that the affects are
5 fully included in the claimed revenue requirement for
6 the 2024 test year in this proceeding.
7 The Commission has the opportunity and ability
8 to reduce the sheer magnitude of the company's requested
9 increase by reducing or excluding these excessive costs
10 from the revenue requirement. I address and recommend
11 that the Commission exclude the affects of the 2023
12 Transaction, a discretionary and unjustified action
13 taken by Emera, TECO Energy and Tampa Electric to spin
14 out PGS from its prior status as a division within Tampa
15 Electric Company to its new and present status as a
16 separate legal entity effective on January 1, 2023.
17 This action, and other related discretionary
18 actions, taken by the three affiliate entities were
19 implemented to benefit Emera, the parent company of
20 TECO, but significantly increase the company's cost
21 structure. The increased PGS cost structure will harm
22 PGS customers not only in this proceeding, but also in
23 future rate proceedings absent Commission action to
24 protect PGS customers from the affects of the 2023
25 Transaction.

1 I recommend that the Commission reduce other
2 costs forecast by the company that are excessive,
3 including capital expenditures, plant in service
4 additions, and the payroll and related expenses forecast
5 for 2023 and 2024.
6 The plant in service additions are excessive
7 because have not been reduced to reflect the company's
8 historic pattern of underspending its capital
9 expenditure budgets and forecast.
10 The payroll and related expenses are excessive
11 because they reflect the addition of a significant
12 number of projected new employees carefully timed to be
13 added at the end of 2023 and the beginning of 2024,
14 without reductions for efficiency savings due to the
15 implementation of a new Work and Asset Management
16 system, which you have heard referred to as WAM,
17 sufficient reductions to contractor expenses, or
18 reductions to reflect the company's historic pattern of
19 actually employing fewer employees than the full-time
20 equivalent employee budgets and forecasts.
21 I recommend that the Commission reduce various
22 other expenses that reflect excessive growth in the
23 forecast test year compared to the historic expense
24 levels due, in part, to the company's use of
25 inappropriate methodologies to forecast these expenses.

1 In addition, I quantify the affects on the
2 requested rate increase of Mr. Garrett's depreciation
3 rate recommendations. Further, I address and recommend
4 that the Commission reduce the magnitude of the
5 requested increase through the accelerated amortization
6 of a substantial depreciation reserve surplus.
7 Finally, I quantify the affects on the
8 requested rate increase in Mr. Garrett's capital
9 structure and return on equity recommendations.
10 That completes the summary of my testimony.
11 Thank you.
12 MS. WESSLING: We would tender the witness for
13 cross-examination.
14 CHAIRMAN FAY: Okay. Mr. Wahlen.
15 MR. WAHLEN: No questions. Thank you.
16 CHAIRMAN FAY: Okay. Staff?
17 MR. SANDY: Yes, sir, Mr. Chair. Thank you.
18 EXAMINATION
19 BY MR. SANDY:
20 **Q Good afternoon, Mr. Kollen.**
21 A About afternoon.
22 **Q My name is Ryan Sandy. I am with the Office**
23 **of General Counsel. I do have a few questions for you.**
24 **In your witness testimony, you state a support**
25 **for the PGS true-up mechanism for long-term debt?**

1 A Yes, that's correct. But it's conditional
2 support, because the -- it's not precisely what the
3 company has proposed, which is a true-up based upon the
4 actual interest rate that it achieves through the new
5 debt issuances pursuant to the intercompany debt
6 agreement, but rather reflects the allocation of the
7 existing Tampa Electric debt on that company's books to
8 PGS.
9 So my recommendations are integrated in the
10 sense that, first of all, I recommend against the
11 increases in the cost from the new issuances of debt
12 and, instead, that there be an allocation of the debt
13 that was issued originally for PGS to PGS. Much lower
14 cost, 3.6 percent compared to 5.6 percent, and then that
15 would be integrated into the true-up mechanism.
16 **Q The purpose of a true-up mechanism is to**
17 **ensure that the proposed long-term debt interest rate is**
18 **reconciled with the actual long-term debt interest rate**
19 **incurred by the utility, isn't it?**
20 A That's the company's proposal. So the answer
21 to your specific question is yes. But, again, my
22 recommendation is a conditional recommendation to
23 incorporate an allocation of the existing debt, and then
24 the true-up would be only on the incremental new debt
25 that doesn't represent an allocation of the existing

1 debt.

2 **Q May I ask, as a part of qualifying your**
3 **support for the true-up mechanism, if I can ask you as**
4 **kind of a belt and suspenders question here, you state**
5 **that the Commission should ensure that the affects of**
6 **this recommendation, i.e., your recommendation, is not**
7 **off obviated through the proposed true-up mechanism. Do**
8 **you recall setting that out in your testimony?**

9 A Yes. That's the conditional recommendation to
10 adopt a true-up mechanism, whereby the prior
11 recommendation, which was to reject the increase in
12 costs, namely the interest expense as a result of the
13 2023 Transaction, to make sure that that wasn't simply
14 undone through the true-up mechanism.

15 **Q Well, here's actually my ultimate question on**
16 **that point, which is what do you mean precisely when you**
17 **date that the affects of the recommendation are not**
18 **obviated through the proposed true-up mechanism? If you**
19 **forgive me, I have read that, and I didn't understand**
20 **what it meant, and I was hoping you could elaborate --**

21 A Sure.

22 **Q -- on that in a way that's easier to**
23 **understand maybe.**

24 A Sure. The company's proposed true-up
25 mechanism takes what the cost of the debt that's

1 actually issued, 800 and some million dollars, and
2 compares that to the estimate that it has in the filing,
3 which is about $5.56 million -- or 5.6 percent.
4 However, that doesn't reflect an allocation of any of
5 the existing debt that's on Tampa Electric Company's
6 books that was issued over the last 20 plus years to
7 support the PGS, and to finance PGS's rate base.
8 So I don't want that recommendation to reject
9 the, you know, to basically neutralize the harm related
10 to the 2023 Transaction, I don't want that undone
11 through a true-up mechanism that's just actual cost on
12 the full $825 million compared to the company's interest
13 rate assumption on that same full 800 some million
14 dollars.
15 In other words, I want to make sure that PGS
16 customers get the benefit of the debt that was issued
17 for their benefit over the last 27 years, and not have
18 that undone through the true-up mechanism.
19 **Q Okay. In your testimony, I believe you**
20 **propose a long-term debt interest rate of four point, I**
21 **think it's 61 percent, is that correct?**
22 A I believe so. I have a table.
23 **Q I believe it's on page 62, which I am happy to**
24 **send your way if that's helpful.**
25 A No. I have a copy of it that's fine. That's

1 right 4.61 percent.

2 **Q I will try, for the sake of everyone else, to**

3 **send it their way. Well, look at that. Okay.**

4 **Now, just so I understand your testimony, and**

5 **this is really just sort of to flesh things out and**

6 **clarify it, if you will indulge me, in the event that**

7 **the utility's actual long-term debt interest rate, upon**

8 **issuance of the long-term debt, whenever that is, if**

9 **it's lower than 4.61 percent, it would seem to reason**

10 **that through the true-up mechanism, those interest rates**

11 **would be lowered, would they not, and then ultimately**

12 **result in a lower cost of capital?**

13 A Well, that's not necessarily true and I will

14 tell you why.

15 The 4.61 percent is a combination of the

16 allocation of the existing debt that was issued for PGS

17 in prior years, along with the incremental cost of the

18 remaining new debt. So in other words, it's still sum

19 to the 825 million, but there would be 500 to $600

20 million from the allocation of the existing debt.

21 So if the actual interest rate, or the

22 effective interest rate on the new debt was something

23 less than 5.54 percent, let's just say it was 4.3

24 percent --

25 **Q Sure.**

1 A -- that would, in fact, reduce the 4.61
2 percent, because that's a blended rate allocated debt
3 from -- that was issued originally for PGS along with
4 the new debt.
5 **Q So allow me to ask the inverse, if I may.**
6 **In the event that the utility were to -- well,**
7 **when they issue their long-term debt, let's say,**
8 **obviously setting aside the short-term debt, when they**
9 **issue their long-term debt, and if the actual long-term**
10 **debt interest rate is higher than 4.61 percent, would**
11 **the true-up mechanism not then raise interest rates, and**
12 **then ultimately increase the cost of capital?**
13 A Again, not necessarily, because the true-up
14 mechanism would only compare the interest rate on the
15 new debt issued specifically by PGS as a separate legal
16 entity compared to the estimate that they have in the
17 case, compared to the actual.
18 And so, you know, if the new debt was issued
19 at 4.61 percent, which is less than the 5.54 percent
20 assumption that the company had, then that would bring
21 down the weighted average of the old debt that was
22 allocated to PGS, plus the portion of the new debt.
23 So if it was actually issued at 4.61 percent,
24 then the blended rate would be, perhaps, 4.5 percent,
25 something like that.

1 It would only affect the blended rate from the
2 4.61 percent on the component of the new debt that was
3 included. So if it's more than 5.54 percent, it's going
4 to pull up the 4.61 percent. If it's less than 5.45
5 percent, it's going to pull that 4.61 percent down.
6 Hopefully that's a very succinct statement, so
7 hopefully that's a little clearer.
8 **Q Well, let me ask this: What is the -- what is**
9 **the incremental amount of debt that would be trued up**
10 **under your version -- your proposed version of the**
11 **long-term debt true-up mechanism?**
12 A Right. I think that -- I think that the
13 embedded debt is in the neighborhood of 700 million, and
14 then maybe it would be 240 million of new debt. This is
15 in my workpapers. It's in my electronic workpapers --
16 **Q Yes, sir.**
17 A -- so -- but I don't have those with me up
18 here, but that is --
19 **Q Subject to check to.**
20 A Yeah, I think it's maybe 700 million of
21 embedded debt, and maybe 240 million of new debt.
22 **Q Okay. If the overall cost of capital approved**
23 **by the Commission does not include the company's actual**
24 **embedded cost of debt, how will the utility be able to**
25 **earn its allowed rate of return?**

1 A Well, I think the premise here is that somehow
2 or another the utility is entitled to that cost of the
3 new debt, and that basically presupposes that the PGS
4 customers were not entitled to their prior allocation of
5 the existing, much lower cost debt.
6 And I think then it would be incumbent upon
7 Emera, and/or TECO, and/or Tampa Electric Company to
8 make PGS whole on that, because they are the ones who
9 set this process in motion, and entered into the
10 intercompany debt agreement, and forced PGS into
11 refinancing and paying, you know, financing all new
12 debt, $825 million of new debt, and then just giving up
13 the lower cost debt to which it was entitled.
14 That debt was issued for PGS in prior years,
15 all the way from 1997 through 2022. It was always
16 recognized in ratemaking, and now all of a sudden that
17 benefit disappears just because of this spinout
18 transaction. That's worth almost $10 million just that
19 issue alone. And it seems to me that -- and initially
20 that's a benefit to Tampa Electric Company, because it
21 keeps that low cost debt that previously was allocated
22 to PGS, and because it keeps it, then it's a benefit to
23 Emera. And so somebody upstream from PGS can make good
24 on that, and then that would be an appropriate way for
25 PGS to earn its authorized rate of return.

1 You know, the -- I must say this, that PGS is
2 not entitled to earn a cost of debt that was not
3 properly incurred.
4 **Q If I may switch gears a little bit with you,**
5 **Mr. Kollen. I would like to ask you about the**
6 **Brightmark and New River renewable natural gas projects,**
7 **which are the point of some discussion in this rate**
8 **case. I would specifically like to ask you about some**
9 **accounting on those projects. Are you familiar with**
10 **those projects?**
11 A I am. I address them in my testimony, yes.
12 And the calculations of the ratemaking adjustments that
13 I propose are also reflected in my electronic schedules
14 and workpapers.
15 **Q Well, that's what I would like to ask you**
16 **about, if I may.**
17 **So sort of leading off to set the table, if**
18 **you will, you are familiar with the contracts that**
19 **govern those RNG projects?**
20 A Yes. They are essentially self-paying
21 contracts, but on a levelized basis, so that on a
22 levelized basis, if the costs are, let's just say, $600
23 a year, that on a net present value basis, they would
24 recover $600 of revenue from those RNG customers. And
25 the problem is, is that there is a disconnect in this

1 case, where it doesn't recognize that levelized form of
2 recovery from specific customers, but, rather, has less
3 revenue because it's in the early years of the contract,
4 but it has the highest level of costs, because costs, in
5 the traditional utility ratemaking model, are -- start
6 high and then decline, so you have a mismatch.
7 And what I proposed is that the Commission
8 match that up. In other words, make it revenue neutral
9 to all of the other customers, which was the intent of
10 the contracts, but it's just the nature of the proposed
11 ratemaking in this case, that there is this mismatch.
12 And I recommended that the company be allowed to defer
13 that difference, which I think is appropriate, and would
14 achieve the earnings objective necessary for the company
15 to -- and, in fact, they agreed to that in response to
16 OPC discovery.
17 And that was ability of a long answer.
18 **Q No. That's okay. That is okay.**
19 **Allow me to ask you a few follow-up questions**
20 **to kind of suss out what you said there.**
21 A Sure.
22 **Q And full candor, it's, from my understanding,**
23 **this is sort of in the weeds kind of stuff, and I just**
24 **want to make sure it's very basic.**
25 **You said you understand the contracts that**

1 **govern the RNG projects. It sounds very clear, yes,**
2 **that you also understand the utility's calculations sort**
3 **of present in the test year that they utilize in this**
4 **rate case?**
5 A Yes. In fact, the company gave us a
6 comparison in response to OPC discovery of the revenues
7 that were included, which, of course, would be something
8 that would reduce the rate increase, but then -- and
9 compared that to the costs, the so-called revenue
10 requirement in the rate case. And there was a mismatch.
11 The costs were much greater on those two contracts than
12 the revenues that were coming in, and that's simply
13 because of the nature of the contracts, you know.
14 In later years, under those contractors, the
15 costs will be less than the revenues coming in; but in
16 the early years, which we are in today, the revenues are
17 less than the costs. So it's going to flip around
18 further down the road, but -- and that's why this
19 particular set of circumstances is, I think, very
20 conducive to a deferral type of authorization for that
21 differential.
22 **Q Well -- so if I understand what you just said**
23 **there, the answer is, yes, you understand the**
24 **calculations in the test year put forward by the**
25 **utility?**

1 A Yes. That's correct. Yes.
2 **Q Okay. And if I also understand what you have**
3 **said, that over the term of the contracts for these RNG**
4 **projects, revenues offset costs, is that correct?**
5 A Yes, that's correct, on a net present value
6 basis. The problem is ratemaking is not realtime.
7 **Q Right. And so --**
8 A Those contracts are levelized to reflect on a
9 net present value basis the net present value of the
10 declining cost curve, because the investment is highest
11 in the initial years and then as it's depreciated, it
12 declines. But in this case, the revenue is less than
13 that cost in the early years, and in particular in the
14 test year, in this proceeding.
15 At some point, those revenues will be greater
16 as the cost curve declines. But there is not a tracking
17 of that right now, and so it's a harm to everybody else
18 that was never -- my understanding of those contracts,
19 it was never intended to spill over into a cost for the
20 nonparticipants, which it has.
21 So I have offered, I think, a constructive
22 solution, and the company agreed to it in discovery.
23 Although, they rejected it in rebuttal, they did agree
24 to it in discovery.
25 **Q So ultimately, over the term of these**

1 **contracts, revenues offset costs?**
2 A Yes, on a net present value basis, not on
3 nominal dollar basis --
4 **Q Net present value basis?**
5 A -- yeah, net present value.
6 **Q Now --**
7 A It's like the difference between paying off --
8 if you had a mortgage, for example, where you just paid
9 the interest and had straight line depreciation, that
10 would be a lot higher than the levelized payments that
11 you make to your mortgage company.
12 **Q Here's my next question, yes or no, and again,**
13 **this is for clarity sake, which I think a yes or not**
14 **would be appropriate, because think you have hit on**
15 **this. I just want to make sure that ultimately, while**
16 **revenues offset costs in the course of these contracts,**
17 **their revenues do not offset costs in the test year for**
18 **these contracts; is that right?**
19 A Yes, that's right. Yes.
20 **Q Now, ultimately, the costs exceed the revenues**
21 **in the test year, correct?**
22 A Yes. Well, the costs exceed the revenues in
23 the test year today, but five years, or seven years, or
24 10 years down the road, the costs will be less than the
25 revenues. But part of the problem is this whole issue

1 of once you set base rates based upon a cost level and a
2 revenue level, those stay in place for maybe two years,
3 three years, even four years --
4 **Q Well --**
5 A -- so you --
6 **Q -- ultimately, those rates are set with the**
7 **test year, are they not?**
8 A Yes. That's correct. And -- but in this
9 case, because it's something unique, and that it can be
10 tracked, I mean, it's not like base revenues charged to
11 millions of customers. These are -- there is one
12 participant in each of the contracts, and then some of
13 the costs are now being shifted to millions of other --
14 I mean, that's not millions of customers for PGS, but
15 hundreds of thousands of other customers.
16 **Q I am sure they would enjoy millions of**
17 **customers.**
18 **So if I understand your testimony correctly,**
19 **that in the test year itself, costs exceed revenues?**
20 A For those two contracts, correct.
21 **Q For those two contracts. Specifically, costs**
22 **exceed revenues for the Brightmark contract to the tune**
23 **of, I think, $1.389 million?**
24 A I think that's right. I have a table until my
25 testimony.

1 **Q Subject to check --**
2 A Yes.
3 **Q -- looking on the table in your testimony?**
4 A Right. Yes.
5 **Q Okay. And subject to check, looking at the**
6 **table in your testimony, costs exceed revenues for the**
7 **New River contract to the tune of $144,000?**
8 A Yeah, I think together, it's 1.6 million.
9 **Q Okay. And --**
10 A And I copied that table from a discovery
11 responds from the company.
12 **Q Sure.**
13 **Now, you have elaborated on this quite a bit,**
14 **except in simple terms, yes or no, the reason why**
15 **revenues offset costs over the term of the contracts for**
16 **these projects, however, revenues do not offset costs in**
17 **the course of the test year is because the utility has**
18 **put all the costs of the project into the test year and**
19 **only a portion of the revenues? That's obviously a**
20 **little more simplistic than the way you have expressed**
21 **it. I just want to see if I have got that correct.**
22 A Well, your question was correct up until the
23 phrase "portion of the revenues".
24 They have the revenues that are forecast under
25 both of those contracts in the test year, and they have

1 all of the costs forecasted under both of those
2 contracts in the test year. There is a mismatch in the
3 test year. And so what does is it shifts costs of the
4 nonparticipants of the 330,000 customers the company has
5 that weren't supposed to pay for this. And then it's
6 perpetuated that $1.6 million gets -- even though it's
7 above and beyond the revenues in the test year, they
8 will continue -- they meaning PGS -- will continue to
9 collect that for the next two to three years. So it
10 gets compounded for multiple years.
11 You can solve that problem constructively
12 through just essentially neutralizing the revenue
13 requirement in the rate case and allowing to the utility
14 to defer the difference, and then the deferral will
15 reverse in the latter years of those two contracts. So
16 the company is indifferent. Customers are not harmed,
17 and it's a win-win situation. And I think that's
18 probably why the company agreed -- well, I don't want to
19 talk to motor if I have, but the company did agree that
20 they would --
21 **Q In discovery?**
22 A In discovery.
23 **Q Except not right -- not right now?**
24 A Yeah.
25 **Q And so if I understand what you are saying,**

1 **and I just want to make sure I have got my facts right,**
2 **and I have got some follow-up questions for you.**
3 A Sure.
4 **Q Ultimately, this revenue imbalance has caused**
5 **an increase revenue requirement in the test year,**
6 **correct?**
7 A Yes, 1.6 million.
8 **Q Now -- and ultimately -- it sounds like the**
9 **principles which you have used to address this increased**
10 **revenue requirement is a consequence of the revenue**
11 **imbalance is to hold ratepayers harmless and ostensibly**
12 **ensure the utility does not receive a, sort of unjust**
13 **gain or unnecessary or unearned gain, is that generally**
14 **correct?**
15 A Well, that's right. And, you know, the use of
16 deferral mechanism is a hold harmless result, and it
17 benefits the company because the company gets full
18 recovery ultimately of all of its costs. There is no
19 harm to nonparticipants, so it's a win-win really for
20 everybody. You know, I hate to use the term no-brainer,
21 but it really is.
22 **Q Well -- so in regard to that win-win, you**
23 **know, kind of thinking about the goals you have set out**
24 **of holding the customers harmless, and also ensuring the**
25 **utility does not receive an unearned gain --**

1 A But also ensuring that it doesn't lose either.

2 **Q Sure. Sure.**

3 A I am mean, I am sorry to interrupt you, but I

4 want to make sure that that's clear.

5 **Q Let me rephrase my question then to be more in**

6 **line with what you have expressed.**

7 **Ultimately, a win-win sort of proposition**

8 **could be met if the Brightmark and New River projects**

9 **had a net zero affect on ratepayers, isn't that right?**

10 A Right, and that's my recommendation. Yes.

11 **Q Now, excluding the Alliance program, because**

12 **we are not discussing Alliance, it's sort of an over**

13 **here and we are just talking about the Brightmark and**

14 **New River programs, ultimately, the adjustments you**

15 **propose in your witness testimony, they reduce the**

16 **revenue requirement, is that correct?**

17 A They do, but they will increase the revenue

18 requirement in future years. So in other words, the

19 accounting entry, I think you started out this line of

20 questioning saying you wanted to discuss the accounting

21 entries, but the accounting entry would be a negative

22 expense, if you will, of $1.6 million. So that would

23 bring the costs into alignment with the revenues, okay.

24 So it would be a $1.6 million deferral in the

25 test year. And there would similarly be deferrals in

1 the subsequent years. And then when the revenues are
2 greater than the cost, the deferrals would start to
3 reduce. And then by the end of each one of the
4 contracts, at the end of 15 years, the deferrals would
5 be zero.
6 So it would act and operate -- the deferral
7 process would act to balance the revenue and the
8 expenses, not only in this case, this test year for
9 2024, but in future cases as well.
10 **Q If I understand the adjustments you are**
11 **proposing in your witness testimony, they ultimately**
12 **reduce the project cost of these RNG projects, is that**
13 **correct?**
14 A No. The project cost is whatever it is. What
15 this does is it balances the revenues for ratemaking
16 with the costs for ratemaking, so that none of the costs
17 are shifted from the -- that the utility is made whole,
18 PGS is made whole, the participant is made whole, but
19 the cus -- the nonparticipating customers, there are
20 336,000 other customers, they don't have any part of
21 this.
22 It would be comparable, in a sense, to taking
23 all of these RNG projects below-the-line. But I would
24 argue that this is just simply revenue neutrality. It
25 doesn't harm the company, and it protects customers.

1 **Q So you don't have an issue with the costs**
2 **associated with these projects?**
3 A I do not. No.
4 **Q And ultimately, your goal is to ensure that**
5 **revenues offset costs for the sake of ratemaking?**
6 A Yes. This is purely a ratemaking issue from
7 my perspective.
8 **Q Now, you would agree that imputing revenues to**
9 **offset the level of costs in these projects would result**
10 **in a net zero affect on ratepayers, wouldn't it?**
11 A If I could rephrase your question. I would
12 say --
13 **Q Please.**
14 A -- that the credit, or the reduction should be
15 to the expense side. That's typically where deferrals
16 are made. And so the deferral would be to match the
17 levelized recovery, which will be the same each year for
18 the 15-year period. And so then you just have a
19 negative expense to match the costs, so the company has
20 no affect on its income statement and customers are not
21 harmed.
22 You wouldn't defer revenues, because you are
23 not doing anything with the revenues. You would defer
24 the costs for future recovery.
25 **Q So let me just clarify, if I may.**

1 **So ultimately, you would agree, at least as a**
2 **concept, that imputing revenues is a means of holding**
3 **ratepayers, or having a net zero impact on ratepayers?**
4 A I am not sure -- I don't really follow the
5 question. We are not doing anything with revenues. We
6 are -- you know, I realize that we are reducing the rate
7 increase of the revenue requirement, but we are doing it
8 through reducing the expense by deferring it. That's
9 how you do something like that.
10 You know, for example, if you had $100 storm
11 cost in the test year, and you only allowed 20, okay,
12 but you can defer the 80 and get it over a five-year
13 period, let's say, that's where the 20 comes from, then
14 you would defer 60. You wouldn't change your revenues.
15 You would defer the expense for recovery in a future
16 time period. And that's consistent with the
17 accounting -- the Generally Accepted Accounting
18 Principles for costs like this.
19 MR. SANDY: Mr. Chair, may I have a moment?
20 CHAIRMAN FAY: Sure.
21 MR. SANDY: Thank you, sir.
22 BY MR. SANDY:
23 **Q Mr. McOnie, moving on, I think there was some**
24 **discussion --**
25 A Whoops. Whoops. Whoops.

1 **Q I'm sorry. I'm sorry. I'm sorry. My brain**
2 **was elsewhere. My apologies. My apologies.**
3 **Mr. Kollen. Mr. Kollen.**
4 **Aside from the recommendations you make for**
5 **removing the company's requested additional employee**
6 **positions, would you have any specific adjustments**
7 **associated with the implementation of the WAM system**
8 **that you would make?**
9 A I did not, because I essentially made the
10 argument that the WAM investment, some $37 million of
11 capital investment for the purpose of proving
12 efficiencies in workflows, should have eliminated the
13 need for many of those additional positions. And so
14 because I recommended reducing the payroll and the
15 related expenses in the forecast test year, I left the
16 full WAM costs in without any additional adjustments.
17 MR. SANDY: No further questions, Mr. Chair.
18 CHAIRMAN FAY: Okay. Commissioners?
19 Okay.
20 MR. THOMPSON: Mr. Chair, if I could, I don't
21 believe FIPUG was offered and opportunity to cross
22 Mr. Kollen.
23 CHAIRMAN FAY: He was, but he stepped out a
24 little bit --
25 MR. THOMPSON: Okay.

1 CHAIRMAN FAY: -- so I think he waived that
2 opportunity. Thank you.
3 All right. Ms. Wessling, I would just add,
4 just be mindful on the redirect to stay within the
5 lines of what was asked during cross for purposes
6 of not going overly broad.
7 MS. WESSLING: Yes, Mr. Chair.
8 CHAIRMAN FAY: Thank you.
9 FURTHER EXAMINATION
10 BY MS. WESSLING:
11 **Q Mr. Kollen, Mr. Sandy asked about the fairness**
12 **of setting rates based off of old debt. Do you remember**
13 **that portion of the questions?**
14 A I do.
15 **Q Is it your view that the Commission should be**
16 **making what is effectively a prudence determination**
17 **about the circumstances leading to the spinoff, and the**
18 **loss of benefit to customers of the lower interest**
19 **rates?**
20 A Yeah. In essence, that's at the very core of
21 this issue. You don't have the authority, as I
22 understand it, to approve a spinout like PGS, but do you
23 have the authority, from a ratemaking perspective, to
24 set rates based upon the correct result.
25 For 25 years, since 1997, Tampa has issued

1 debt, not only for its own investment purposes, but also
2 for PGS. That debt has been reflected in PGS rates for
3 some 25 or longer years, maybe 26 years.
4 And so with this case, for the first time, all
5 of that debt is being yanked out, it's being left over
6 here with Tampa Electric Company, and you are being told
7 that you have to set rates so that all new debt issued
8 for PGS, at a much, much higher interest rate, 3.5
9 percent, 3.6 percent, you know, for the debt that
10 previously was -- belonged to PGS but now has been kept
11 by Tampa Electric Company, should be replaced with 5.6
12 percent debt all across the board. You have to make a
13 decision whether or not that's appropriate for
14 ratemaking purposes.
15 That debt belonged to PGS, and then because of
16 the spinout, it was left back at Tampa Electric Company.
17 You can correct that injustice, that imbalance, whatever
18 you wants to call it, by saying that that debt station
19 with PGS, at least the cost of it.
20 And then the question that staff had with
21 respect to, well, that's something less than what the
22 company will actually occur. Well, that's right. And
23 then they need to look to Tampa to make them whole on
24 it, or need to look to TECO to make them whole on that,
25 or look to Emera to make them whole on that.

1 But it's patently inequitable to take lower
2 cost debt that belonged to PGS, that was issued to meet
3 its financing requirements for 25 or 26 years, and then
4 just abandon that, and then charge the higher interest
5 expense to PGS customers.
6 **Q And, Mr. Kollen, Mr. Sandy also asked you**
7 **about having a net zero effect. Do you recall that**
8 **portion of the questioning?**
9 A Yes.
10 **Q And just to clarify, did you mean net zero in**
11 **the test year, or over the life of the project?**
12 A Well, actually both, because if -- right now,
13 with the two contracts, the -- not the Alliance one, but
14 the other two contracts that remain at issue here, the
15 costs -- Alliance was a little bit different. The
16 revenues were greater than the cost. But the other two
17 contracts, the costs are greater than the revenues, and
18 so my recommendation is to allow the company to defer
19 the excess cost over the revenues in the test year, and
20 then that will neutralize the affect of those two RNG
21 contracts in the test year; but because of the deferral
22 methodology, it will neutralize the differences over the
23 remaining life of those contracts, the full 15 years.
24 **Q And just to further clarify, since Alliance is**
25 **no longer really -- it's part of a stipulation, your**

1 **testimony is really just referring to Brightmark and New**
2 **River, correct?**
3 A That's right. Just those two contracts.
4 Those are the two that have the costs that are greater
5 than the revenues. And the other one, the Alliance
6 contract, was addressed in the stipulation.
7 **Q Thank you.**
8 MS. WESSLING: Nothing further.
9 CHAIRMAN FAY: Okay. Great. Let's get some
10 exhibits in, Ms. Wessling.
11 MS. WESSLING: Yes. We would, at this time,
12 ask that exhibits, I believe they are 35 through 62
13 of the comprehensive exhibit list be entered into
14 the record.
15 CHAIRMAN FAY: Okay. Without objection, show
16 those entered into the record.
17 (Whereupon, Exhibit Nos. 35-62 were received
18 into evidence.)
19 MS. WESSLING: And then unless there is any
20 others.
21 CHAIRMAN FAY: No.
22 MS. WESSLING: We would ask for Mr. Kollen to
23 be excused.
24 CHAIRMAN FAY: Okay. Mr. Kollen McOnie, you
25 are excused.

1 THE WITNESS: I think he may object to that.
2 CHAIRMAN FAY: Probably.
3 THE WITNESS: Thank you.
4 CHAIRMAN FAY: Thank you to your travel here.
5 Thank you.
6 (Witness excused.)
7 (Transcript continues in sequence in Volume
8 8.)
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

1 CERTIFICATE OF REPORTER

2 STATE OF FLORIDA)
COUNTY OF LEON)
3

4

5 I, DEBRA KRICK, Court Reporter, do hereby

6 certify that the foregoing proceeding was heard at the

7 time and place herein stated.

8 IT IS FURTHER CERTIFIED that I

9 stenographically reported the said proceedings; that the

10 same has been transcribed under my direct supervision;

11 and that this transcript constitutes a true

12 transcription of my notes of said proceedings.

13 I FURTHER CERTIFY that I am not a relative,

14 employee, attorney or counsel of any of the parties, nor

15 am I a relative or employee of any of the parties'

16 attorney or counsel connected with the action, nor am I

17 financially interested in the action.

18 DATED this 18th day of September, 2023.

19

20

21

22

DEBRA R. KRICK
23 NOTARY PUBLIC
COMMISSION #HH31926
24 EXPIRES AUGUST 13, 2024

25