Exhibit No.: _____
Issue: Carrying Costs
Witness: Craig Root
Exhibit Type: Surrebuttal
Sponsoring Party: Summit Natural Gas of Missouri, Inc.
Case No.: GR-2022-0122
Date: June 22, 2022

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. GR-2022-0122

SURREBUTTAL TESTIMONY

OF

CRAIG ROOT

ON BEHALF OF

SUMMIT NATURAL GAS OF MISSOURI, INC.

June 22, 2022

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, PRESENT TITLE AND BUSINESS ADDRESS.

A. My name is Craig Root. I am the Vice President and Corporate Treasurer for Summit Utilities, Inc., the ultimate parent company of Summit Natural Gas of Missouri, Inc. ("SNGMO" or the "Company"). My business address is 10825 E. Geddes Avenue, Suite 410, Centennial, CO 80112.

Q. ARE YOU THE SAME CRAIG ROOT WHO PREVIOUSLY FILED DIRECT TESTIMONY AND REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. Yes, I provided direct and rebuttal testimony on behalf of SNGMO in this case.

II. PURPOSE OF SURREBUTTAL TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY IN THIS PROCEEDING?

A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimonies of Missouri Public Service Commission ("Commission") Staff witnesses David M. Sommerer and Randall T. Jennings and Office of the Public Counsel ("OPC") witness David Murray as they relate to the Company's proposed carrying cost rate and financial impacts.

III. FINANCING

Q. MR. JENNINGS ARGUES THAT FINANCING THE WINTER STORM URI COSTS USING 100% DEBT WOULD BE CONSISTENT WITH SNGMO'S CAPITAL STRUCTURE APPROVED IN CASE NO. GR-2014-0086. (JENNINGS REBUTTAL, PG. 5). DO YOU AGREE?

A. No. As stated in my direct testimony, financing for SNGMO, as well as other operating entities, was obtained by Summit Holdings. Because of this, it is not appropriate to consider SNGMO's capital structure on a stand-alone basis without consideration for the debt that Summit Holdings has incurred on its behalf. I would view the proforma capital structure at Summit Holdings to be the most relevant view of SNGMO's current capital structure.

Assuming 100% of Winter Storm Costs incurred by Summit Holdings was financed with debt, the proforma capital structure would be 46% debt and 54% equity, which completely absorbs Summit Holdings' remaining debt capacity for normal business operations. To achieve the capital structure set by the Commission in Case No. GR-2014-0086 (43% Debt / 57% Equity), Summit Holdings would need to finance approximately half of the Winter Storm costs using equity. This financing plan was proposed by the Company and approved by the Commission in Case No. GF-2022-2016.

Q. DOES THE CAPITAL STRUCTURE HAVE AN IMPACT ON SNGMO'S CUSTOMERS?

A. Yes. As articulated in Mr. Jennings' testimony, relying solely on debt financing to finance Winter Storm costs could decrease SNGMO's credit ratings, which could be detrimental to customers due to a rise in the cost of debt.

Q. MR. SOMMERER REFERS TO THE COMPANY'S OWNERSHIP AS "NOT THE TRADITIONAL STRUCTURE" AND STATES THAT CERTAIN "TOOLS SUCH AS AFFILIATED 'MONEY POOLS' AND COMMERCIAL PAPER PROGRAMS

DO NOT APPEAR TO BE AVAILABLE TO SNGMO." (SOMMERER REBUTTAL, PG. 3). WHAT FINANCING TOOLS DOES SNGMO HAVE AVAILABLE?

A. I'm not sure what Mr. Sommerer considers to be a "traditional structure." If he is referring to being a publicly traded company as a "traditional" ownership structure, Mr. Sommerer is partially correct regarding SNGMO's access to certain financing tools. SNGMO and Summit Holdings do not have public credit ratings, a commercial paper program or money pooling arrangements. At this time, SNGMO's primary source of financing is either debt or equity contributions from Summit Holdings.

IV. <u>CARRYING COSTS</u>

Q. MR. JENNINGS ASSERTS THAT THE COMPANY'S PROPOSED PRE-TAX RATE OF 9.47% IS NOT APPROPRIATE BECAUSE ECONOMIC CONDITIONS HAVE CHANGED SINCE IT WAS APPROVED BY THE COMMISSION EIGHT YEARS AGO. (JENNINGS REBUTTAL, PG. 7). HOW DO YOU RESPOND?

A. There are many factors that need to be considered in determining the Company's weighted average cost of capital ("WACC"), and Mr. Sommerer is correct that it may have changed. It could be higher or lower than 9.47%. Given the nature of the relief sought, using the current WACC is the most appropriate method of resolving this issue. If a future rate case were to determine that the Company's pre-tax rate should be changed, it is my assumption that any future recovery would be impacted at that time.

Q. MR. JENNINGS FURTHER STATES THAT AN APPROPRIATE WACC SHOULD BE DETERMINED THROUGH A FULL-LENGTH RATE CASE PROCEDURE. (JENNINGS REBUTTAL, PG. 7). DO YOU AGREE?

A. While a rate case procedure is a means of determining WACC, undergoing a new rate case is not practical, nor necessary, at this time. The WACC proposed by SNGMO is currently being used by the Company to set customer rates as this is what was determined by the Commission to be just and reasonable in the Company's most recent rate case. In order to make the Company whole, this is the rate that must be approved by the Commission for SNGMO's Winter Storm Uri carrying costs.

Q. MR. JENNINGS ARGUES THAT THERE IS NO EVIDENCE TO SUPPORT SNGMO'S WACC AS THE MOST APPROPRIATE CARRYING COST AND REFERENCES THE PGA TARIFF'S CARRYING COST RATE OF PRIME MINUS TWO PERCENT. (JENNINGS REBUTTAL, PG. 7). PLEASE EXPLAIN WHY USING WACC IS MORE APPROPRIATE IN THESE CIRCUMSTANCES.

A. The PGA tariff's carrying cost rate of prime minus two percent would normally be appropriate for recovering gas costs within a one-year timeframe (the common period for short term debt). Due to the extraordinary circumstances surrounding the recovery of Winter Storm costs over five years, it is more appropriate to use a long-term cost of capital to reflect true financing costs. In this circumstance, that would be WACC.

Q. MR. SOMMERER STATES THAT SNGMO'S FIVE-YEAR RECOVERY PERIOD FOR THESE COSTS DOES NOT SUPPORT A CARRYING COST REFLECTIVE

OF RATE BASE INVESTMENT. (SOMMERER REBUTTAL, PGS. 3-4). HOW DO YOU RESPOND?

A. Mr. Sommerer asserts in his rebuttal testimony that the reason why a five-year recovery does not support a rate base investment is because accelerating recovery would harm Summit's competitive position against propane. I find that to be an interesting argument, but it is irrelevant and completely ignores the financial realities at hand. The bottom line is that capital providers do not give away free money. They expect to be compensated for providing capital, and, if they are not compensated fairly, they will provide capital elsewhere. Using WACC to calculate carrying costs fairly compensates both debtholders and equity investors for providing the funds needed to carry these costs over five years on behalf of Summit's customers.

Q. IF SNGMO WERE REQUIRED TO UTILIZE THE PRIME MINUS TWO PERCENT RATE AS RECOMMENDED BY STAFF, WOULD THE COMPANY FULLY RECOVER ITS COSTS TO FINANCE THE EXTRAORDINARY WINTER STORM URI GAS COSTS?

A. No. The Winter Storm costs were funded with 100% equity, which has an after-tax cost of capital of 10.8%, or 14.19% on a pre-tax basis. With a current Prime Rate of 4.75% as of June 15, 2022, a rate of 2.75% would be grossly insufficient to cover the actual costs to finance the extraordinary Winter Storm Uri gas costs based on SNGMO's cost of equity to finance storm costs or its WACC of 9.47%.

Q. STAFF RECOMMENDS THAT RECOVERY OF HIGHER CARRYING COSTS BE DEFERRED UNTIL PRUDENCY IS DECIDED BY THE COMMISSION

(JENNINGS REBUTTAL, PG. 8). WHY IS IT IMPORTANT THAT THIS ISSUE BE DETERMINED NOW?

A. As mentioned in my rebuttal testimony, the Commission directed Staff and SNGMO to resolve the carrying cost issue first. This will allow SNGMO's fall 2022 ACA filing to include the appropriate interest rate for under recovered gas costs. We see no reason to delay a decision on carrying costs pending a prudence review. Instead, the carrying charge rate determined in this proceeding should be applied to the Winter Storm Uri gas costs that are determined to be prudent. Further, any issues related to prudence can be trued-up later as PGA rates are, by nature, interim and subject to refund.

V. <u>OPC RECOMMENDATION</u>

Q. MR. MURRAY STATES THAT SNGMO SHOULD NOT BE ALLOWED A PROFIT FOR FUNDING THE WINTER STORM URI COSTS. (MURRAY REBUTTAL, PG. 2). DOES THE COMPANY'S PROPOSED RATE RESULT IN A PROFIT TO SNGMO?

A. The Company is not seeking to generate a profit for funding Winter Storm costs. SNGMO has two sources of capital, debt and equity. It is not prudent or reasonable to finance 100% of Winter Storm costs with debt, so it is necessary for SNGMO to utilize equity to fund the remaining difference. The Commission agreed in Case No. GR-2014-0086 that a mixture of 43% debt and 57% equity is a reasonable, long-term capital structure for the Company. Equity funding is more expensive than debt funding. By requesting carrying costs based on WACC, the Company is not seeking to make a profit, but, rather, to have the ability to compensate equity holders for their share of financing Winter Storm costs in the same way that interest is paid to debtholders.

Q. MR. MURRAY STATES THAT THE FACT THAT EQUITY WAS USED TO PROVIDE LIQUIDITY FOR FINANCING GAS COST PURCHASES, SHOULD NOT BE CONTROLLING AS TO FAIR AND REASONABLE CARRYING COSTS. (MURRAY REBUTTAL, PG. 3). DO YOU AGREE?

A. I partially agree and partially disagree with Mr. Murray. Summit used 100% equity to provide liquidity for financing gas cost purchases, whereas we are requesting carrying costs based on WACC, which assumes funding with both debt and equity. Mr. Murray asserts that there is "no risk of under recovery or over recovery of these costs" so an equity risk premium should not apply. The reason for the need to fund Winter Storm costs arises, not as a result of the risk of being repaid, but rather the unintended consequences that SNGMO and its customers would face due to higher levels of leverage that would result if these costs were financed using only debt. The deterioration of SNGMO's credit metrics from financing Winter Storm costs would result in a higher cost of both debt and equity as leverage increases. I agree with Mr. Murray that requiring customers to incur carrying costs at 13.57% based on 100% equity funding would be unfair, even though SNGMO actually funded the Winter Storm costs that way. Given the long-term nature of the recovery, it is justified to recover carrying costs using WACC similar to other long-term investments that the Company makes on behalf of customers so it can maintain a stable capital structure.

Q. MR. MURRAY CONTENDS THAT "[T]HE PGA/ACA PROCESS WILL ENSURE SNGMO RECOVERS ALL OF THE COSTS RELATED TO THE EXTRAORDINARY GAS COSTS . . . THE ACTUAL COST OF THE GAS ITSELF AND THE COST TO FINANCE THE PURCHASE OF THAT GAS." (MURRAY REBUTTAL, PG. 3). DO YOU AGREE THAT THE COMPANY WILL RECOVER ALL OF ITS EXTRAORDINARY GAS COSTS ABSENT A HIGHER RATE?

A. In normal circumstances, where recoveries are obtained in less than twelve months, I agree with Mr. Murray, since time value of money is the only issue at hand. Since this is a five-year recovery, it is more appropriate to use a combination of debt and equity to fund these costs. Using WACC ensures that the Company has the ability to appropriately compensate these providers of capital. SNGMO's current WACC, as determined in GR-2014-0086, is 9.47% on a pre-tax basis. With a current Prime Rate of 4.75% as of June 15, 2022, a rate of 2.75% would be grossly insufficient to cover the costs to finance the extraordinary Winter Storm Uri gas costs over a five-year period. While I agree that the Company will recover all of the cost of gas itself, I do not agree that the Company will recover all of its extraordinary costs or costs to finance the Winter Storm costs through the PGA/ACA process proposed by Mr. Murray.

Q. MR. MURRAY ASSERTS THAT USING THE PRIME RATE MINUS TWO PERCENT FORMULA FOR CARRYING COSTS HAS NOT RESULTED IN AN ACTUAL COST OF SHORT-TERM DEBT FOR ANY OTHER NATURAL GAS DISTRIBUTION SERVICE COMPANIES IN MISSOURI. (MURRAY REBUTTAL, P. 4). DO YOU AGREE?

A. As stated in my rebuttal testimony, I am not familiar with the financial circumstances of other Missouri LDCs and cannot speculate as to the financing needs of those companies. However, as fully supported in my direct and rebuttal testimonies, the facts and circumstances that apply to SNGMO warrant recovery of the proposed carrying charge, and the fact that other LDCs did not request such a charge does not address the facts of SNGMO's case.

Q. MR. MURRAY RECOMMENDS THAT SNGMO'S CARRYING COST RATE BE BASED ON THE VARIABLE RATE CHARGED ON MIDCO'S (SUMMIT HOLDING'S) REVOLVING CREDIT FACILITY. (MURRAY REBUTTAL, PGS. 5-6). DO YOU AGREE WITH THIS RECOMMENDATION?

A. No, I do not agree. This recommendation does not consider the deterioration in credit metrics that would result from higher levels of financial leverage.

Q. WOULD SNGMO RECOVER ALL OF ITS CARRYING COSTS USING OPC'S RECOMMENDATION?

A. No, it would not. As stated in my previous testimony, the size and long-term nature of the recovery necessitates the need for SNGMO to use its entire balance sheet to finance Winter Storm costs over a five-year period, including both debt and equity. Using the interest rate on the existing credit facility would be insufficient to cover SNGMO's carrying costs when its WACC is 9.47%.

Q. MR. MURRAY ARGUES THAT USING THE COMPANY'S PROPOSED RATE WOULD NOT ACCURATELY CAPTURE THE CHANGES TO CAPITAL COSTS ASSOCIATED WITH CARRYING THE EXTRAORDINARY PURCHASED GAS COSTS (MURRAY REBUTTAL, PG. 6). HOW DO YOU RESPOND?

A. I disagree with Mr. Murray. As stated in my previous testimony, SNGMO is currently in the process of refinancing approximately half of this equity injection with debt, as part of Case No. GF-2022-2016, which was recently approved by the Commission. In that testimony, I explained why SNGMO cannot rely solely on debt financing because it would result in a material deterioration of Summit Holdings' implied credit rating and an increase in its WACC due to higher debt costs through rates and higher equity costs as shareholders increased their required rate of return due to increased risk. Accordingly, relying on a debt carrying cost is not reasonable and unfairly limits the Company's ability to recover its costs and compensate providers of capital.

VI. CONCLUSION

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes.

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Summit Natural Gas	)	
Of Missouri, Inc.'s Changes to the	)	GR-2022-0122
Company's Purchase Gas Adjustment	)	
"PGA" Clause	)	

AFFIDAVIT

STATE OF MINNESOTA	)
	) **ss**
COUNTY SCOTT	)

1. My name is Craig Root. I am employed by Summit Utilities, Inc. as Vice President and Corporate Treasurer.

2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony on behalf of Summit Natural Gas of Missouri, Inc., which has been prepared in written form for introduction into evidence in the above-referenced docket.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.

Under penalty of perjury, I declare that the foregoing is true and correct to the best of my knowledge and belief.

DocuSigned by:
Craig Root
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Craig Root