Exhibit No.: _____
Issue: Carrying Costs
Witness: Craig Root
Exhibit Type: Direct
Sponsoring Party: Summit Natural Gas of Missouri, Inc.
Case No.: GR-2022-0122
Date: May 13, 2022

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. GR-2022-0122

DIRECT TESTIMONY

OF

CRAIG ROOT

ON BEHALF OF

SUMMIT NATURAL GAS OF MISSOURI, INC.

Jefferson City, Missouri

May 13, 2022

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INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Craig Root. My business address is 10825 E. Geddes Avenue, Suite 410, Centennial, CO 80012.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?

A. I am employed by Summit Utilities, Inc. ("Summit"), the ultimate parent company of Summit Natural Gas of Missouri, Inc. ("SNGMO" or "Company") as the Vice President and Corporate Treasurer.

Q. WHAT ARE YOUR DUTIES AS VICE PRESIDENT AND CORPORATE TREASURER AS IT PERTAINS TO SNGMO?

A. In this capacity, I am responsible for managing all capital structure and corporate finance activities, including the issuance of short-term and long-term debt, for Summit and all of its subsidiaries, including SNGMO. In addition, I am responsible for managing banking relationships and treasury operations.

Q. WHAT IS YOUR PROFESSIONAL AND EDUCATIONAL EXPERIENCE?

A. I graduated from the University of Iowa in 1997 with a Bachelor of Business Administration degree with concentrations in Finance, Management and Communication Studies. In 2003, I graduated from the University of Chicago Booth School of Business with a Master of Business Administration with High Honors, with concentrations in Finance, Accounting and Strategic Management. I am a Registered Certified Public Accountant in the State of Illinois and a Certified Treasury Professional.

My work experience includes over twenty-five years of Treasury and Finance experience in complex public, private and not-for-profit global and domestic organizations across several industries. I started my career in 1997 as a Pension Administrator for The Principal Financial Group in Des Moines, Iowa. In May 1998, I moved to Chicago, Illinois, where I worked as a financial consultant at Merrill Lynch, Pierce, Fenner and Smith in Oak Brook, Illinois. In January 1999, I started my career in corporate finance as a Treasury Analyst at Hollister Incorporated in Libertyville, IL. In April 2002, I joined Dade Behring Incorporated as a Senior Treasury Analyst. I was promoted to Senior Manager of Global Treasury Operations in 2003 and was promoted again in 2006 to Senior Manager, Corporate Financial Planning and Analysis. In February 2007, I moved to Minnesota and started a new role as Director, Corporate Finance and Banking for Ecolab, Inc. in St. Paul, Minnesota. In April 2009, I took a new role as Senior Director, Treasury, Credit and Real Estate at Nash Finch Company, and worked there until November 2013, when I took a new role as Vice President and Treasurer at Taylor-Wharton International, LLC. I left Taylor Wharton in October 2014 and started my own consulting company where I provided treasury and corporate finance consulting services for various companies until I took a new full-time role as Director, Treasury at Fairview Health Services in October 2015. I was promoted to System Director of Strategic Analysis in September 2019. I left Fairview Health Services in December 2020 and started a new company providing treasury and corporate finance consulting services for various companies. In March 2022, I was appointed to my current role as Vice President and Corporate Treasurer at Summit in Denver, Colorado.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY REGULATORY BODIES?

A. No.

PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. The purpose of my testimony is to provide support for SNGMO's request to recover carrying costs associated with its deferred recovery of gas costs at a different rate than that identified in Sheet No. 52 of SNGMO's tariff. Specifically, I will provide an overview of SNGMO's business, the current five-year recovery period, financing of gas costs, current carrying costs and proposed carrying costs. Company witness Walt McCarter provides an overview of SNGMO's gas supply planning process and the challenges faced by the Company during the extreme winter weather event.

Q. WHAT IS THE REASON FOR THIS REQUEST?

A. As addressed in more detail by Mr. McCarter, during the month of February 2021, an extreme winter weather event, Winter Storm Uri, resulted in a historic cost of gas for SNGMO's September 1, 2020, to August 31, 2021, season. The increase in natural gas prices realized during Winter Storm Uri were significantly outside the range of a typical cost and unlike anything the Company has ever experienced.

As the Commission previously agreed in the order issued in this case on November 17, 2021, a five-year recovery period was determined to be necessary to mitigate the impact of the extraordinary costs on customers. However, because

SNGMO had to initially finance these gas costs through equity and expects to finance the cost of gas through a combination of equity and debt, the interest rate otherwise provided by the PGA Clause will not adequately address SNGMO's actual costs associated with carrying these extraordinary gas costs.

SNGMO

Q. PLEASE DESCRIBE SNGMO'S BUSINESS AS IT RELATES TO THE COMMISSION.

A. SNGMO conducts business as a "gas corporation" and a "public utility" as those terms are defined at §386.020, RSMo. SNGMO provides natural gas service in the Missouri counties of Benton, Caldwell, Camden, Daviess, Douglas, Greene, Harrison, Howell, Laclede, Miller, Morgan, Pettis, Stone, Taney, Texas, Webster, and Wright, subject to the jurisdiction of the Commission.

Q. WHAT IS SNGMO'S ORGANIZATIONAL STRUCTURE?

A. SNGMO is a wholly owned subsidiary of Summit LDC Holdings, LLC ("Summit Holdings" or "Midco"), which is a wholly owned subsidiary of Summit.

Q. HOW IS FINANCING OBTAINED FOR SNGMO?

A. With the permission of the Commission (File No. GO-2019-0216), financing for SNGMO (as well as other Summit operating companies) is obtained by Summit Holdings. The indebtedness obtained by Summit Holdings is secured by its pledge of capital stock of its subsidiaries.

Q. WHY IS THIS STRUCTURE USED?

A. The capital markets are supportive of holding company financing structures in the utility industry and, thus, using this structure allows the Company to benefit from lower borrowing costs than SNGMO could obtain on its own.

CURRENT CARRYING COSTS

Q. PLEASE DESCRIBE SNGMO'S PURCHASED GAS ADJUSTMENT CLAUSE.

A. SNGMO's tariff includes its Purchased Gas Adjustment (PGA) Clause (Sheets Nos. 50-58). The purpose of the PGA Clause is to provide a mechanism for the recovery of the cost of gas and includes both: (1) The Regular Gas Adjustment factor; and (2) The Actual Cost Adjustment (ACA) factors. (*See* Sheet No. 50).

Q. DOES THIS PROVISION INCLUDE A DEFAULT RECOVERY/REFUND PERIOD AND INTEREST RATE FOR OVER AND UNDER RECOVERIES OF GAS COSTS?

A. Yes. Among other things, the PGA Clause requires that the ACA factors be set by addressing the cumulative balance of over-recoveries or under-recoveries during a twelve-month period. (See Sheet No. 54). The PGA clause further requires that interest is credited to the customers or Company, as appropriate, at a simple rate equal to the prime bank lending rate (as published in The Wall Street Journal on the first business day of the following month), minus two (2) percentage points.

Q. DOES THE TARIFF PROVIDE FOR EXCEPTIONS TO THE DEFAULT PROVISIONS?

A. Yes. Sheet No. 55, among other things, provides as follows:

> In the event of an Act of God or weather circumstance that has an extraordinary impact on the natural gas market, the Company, Staff, or OPC may apply, supported by an affidavit, to the Commission to seek to extend the ACA recovery period beyond 12 months, not to

> exceed 5 years. If the Commission allows the extended ACA recovery period not to exceed 5 years, the Company may also apply for the recovery of carrying costs associated with such deferred recovery at a different rate, from the effective date of this tariff Sheet No. 55 on a going forward basis, from that identified in Sheet No. 52.

Q. HAS SNGMO MADE SUCH AN APPLICATION?

A. Yes. On November 5, 2021, SNGMO filed an *Application to Extend the ACA Recovery Period and for Carrying Costs and Motion for Expedited Treatment and, in the Alternative, Motion for Leave*. Subsequently, the Commission issued its *Order Rejecting Tariff, Approving Extended Recovery Period, Delegating Authority, and Directing Filing of Procedural Schedule* on November 17, 2021, wherein the Commission approved the request for an extended ACA recovery period (five years) due to Winter Storm Uri and directed the Staff of the Commission and SNGMO to jointly submit a proposed procedural schedule to resolve the carrying cost issues. This testimony is filed pursuant to the schedule adopted by the Commission on December 8, 2021.

FIVE-YEAR RECOVERY

Q. YOU MENTIONED PREVIOUSLY THAT THE COMMISSION APPROVED A FIVE-YEAR RECOVERY PERIOD FOR THESE GAS COSTS. WHY WAS THAT IMPORTANT?

A. If SNGMO were to utilize the standard twelve-month period for recovering the approximate $30.7 million of winter storm gas supply costs from Missouri customers through a single cost of gas adjustment, it would have been necessary to increase gas supply charges to customers significantly (40%-141%), depending on rate area and customer class.

Through no fault of any parties involved, the Winter Storm Uri caused SNGMO's sales customers to face a substantial increase in their gas supply bills. Extending recovery over a period of years, even with the inclusion of appropriate carrying costs, mitigates rate shock and hardships on customers without unduly burdening SNGMO.

FINANCING OF GAS COSTS

Q. HOW DOES SNGMO FINANCE GAS COSTS IN A NORMAL SITUATION?

A. Under normal circumstances, SNGMO funds its gas supply costs through cash generated from operations. This practice is appropriate given that forecasted gas supply costs are generally recovered during the current gas year. Any differences between the forecasted and actual gas costs incurred are refunded to or recovered from customers in the subsequent gas year. The funding matches the recovery period.

Q. WHAT IS UNIQUE ABOUT THIS SITUATION?

A. During February 2021, the magnitude of the gas supply costs incurred by SNGMO rendered the standard means of funding grossly insufficient.

Q. WHY?

A. The magnitude of the February 2021 gas supply costs ruled out funding those costs solely through debt. Summit Holdings is required to maintain debt covenants with lenders that restrict its ability to assume additional debt. Relying only on debt financing would cause Summit Holdings' credit worthiness to deteriorate with additional leverage. This would result in the credit markets viewing Summit Holdings as a riskier borrower, and lenders would likely require higher interest rates on debt as financing risk increases with higher leverage. Increasing leverage also has the effect of making the Company a riskier investment for equity holders, who in turn would require a higher return on their equity investment. These unintended consequences would result in a substantially higher overall cost of capital that would negatively impact the rates that Customers pay for service.

Q. WHAT DID SNGMO DO?

A. As an initial solution to prevent an immediate liquidity crisis, SNGMO obtained an equity infusion to cover the extraordinary gas supply costs that were incurred on behalf of customers. SNGMO's parent company, Summit Holdings, also obtained debt financing for a portion of these gas supply costs and other capital needs for SNGMO and Summit Holding's other operating companies. Summit Holdings is the holding company where debt financing is held for SNGMO, Arkansas Oklahoma Gas Corporation and Colorado Natural Gas, all of which were impacted in varying degrees by the 2021 Winter Storm.

Q. WHAT ROLE HAS THE EQUITY OBTAINED BY SNGMO PLAYED THUS FAR IN REGARD TO THE WINTER STORM URI GAS COSTS?

A. Currently, the costs resulting from Winter Storm Uri have been financed with equity, and the Company is currently earning only a minimal return on this equity.

Q. IN THE LONG TERM, HOW WILL THESE COSTS BE FINANCED?

A. The Company intends to replace approximately half of this equity injection with debt, consistent with the capital structure found to be reasonable by the Commission in Case No. GR-2014-0086. Ultimately, Summit Holdings will likely pursue and obtain debt financing for a portion of these gas supply costs and other capital needs of SNGMO and Summit Holdings' other operating companies. This initiative is currently underway and was recently approved by the Commission in Case No. GF-2022-0216.

Q. IS IT PRACTICAL TO FINANCE 100% OF THE GAS COSTS WITH DEBT?

A. No.

Q. WHY NOT?

A. For the reasons mentioned previously, relying solely on debt financing would not be in the best interests of Summit Holdings or Customers. Using only debt financing would be inconsistent with the capital structure that was reviewed and found reasonable by the Commission in Case No. GR-2014-0086. 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 increase their required rate of return as risk increases.

For example, if Summit Holdings had financed 100% of the Winter Storm Uri costs using only debt, the deterioration in its credit metrics would indicate a reduction in credit rating by 2-4 levels. On a proforma basis as of year-end 2021, Funds from Operations (FFO) to Debt would have dropped from 13.50% to 9.40%., and Debt to Capitalization would have increased from 38% to 54%. According to the Moody's rating methodology, these company specific credit metrics account for 40% of the overall credit rating and this magnitude of deterioration in credit metrics would indicate a reduction in rating from roughly A to Baa- or even Ba+, which would be considered below investment grade. The other 60% of the credit rating is based on qualitative factors, such as the consistency and predictability of regulation (12.5%) and the ability to recover costs and earn returns (25%), which impact all utilities under a common regulatory authority. SNGMO and its holding company simply do not have a practical economic option of fully financing the Winter Storm Uri costs through debt and therefore, relying on a debt carrying cost is not reasonable and unfairly limits the Company's ability to earn a fair return and recover costs.

ACA CARRYING COSTS

Q. WHAT IS THE APPROPRIATE CARRYING COST TO USE FOR PURPOSES OF THE UNDER-RECOVERED GAS COSTS IN SNGMO'S ACA?

A. As the long-term financing of the February 2021 extraordinary gas supply costs is planned to be provided through a combination of debt and equity, SNGMO believes that it is appropriate to provide carrying costs at a rate greater than that currently reflected in the tariff.

Q. WHAT CARRYING COST RATE DO YOU THINK IS APPROPRIATE TO APPLY TO UNDER-RECOVERED GAS COSTS?

A. A weighted average cost of capital ("WACC") is the most appropriate carrying cost to apply to a mixture of debt and equity such as that used by SNGMO in this situation. If the Company is unable to apply the weighted average cost of capital in this extraordinary situation, SNGMO would be prohibited from earning a reasonable return. While SNGMO does not earn on the cost of gas, in this situation, SNGMO is being asked to finance these costs on its balance sheet for an extended period for the benefit of customers, much like rate base. This approach makes sense in that it provides much needed relief to Customers, but it should not come at the expense of the Company's shareholders, who should be allowed to earn a fair return on its investment in this matter.

Q. WHAT CARRYING COST DO YOU REQUEST THE COMMISSION ORDER?

A. As a result of the financing for the extraordinary gas supply cost, SNGMO is seeking to recover carrying costs for the cost associated with Winter Storm Uri at SNGMO's last Commission approved pre-tax rate of return, 9.47%, as ordered in Case No. GR-2014-0086.

This approach will allow Summit Holdings to maintain its credit worthiness and capital structure. Given that financing of the gas costs will be through a mixture of equity and debt, the pre-tax rate of return as adjusted from time-to-time provides an accurate measure of the actual financing cost over the proposed term.

Q. WOULD THIS RESULT IN JUST AND REASONABLE RATES FOR SNGMO'S CUSTOMERS?

A. Yes. As stated above, WACC is the most appropriate carrying cost rate to apply to finance these costs because most accurately reflects the Company's cost to fairly compensate both debtholders and equity holders. Investors are an important source of ongoing capital and expect that they will be able to earn a fair rate of return on their investments, and . allowing the Company to recover a reasonable rate of return provides stability for Customers and the Company. Using WACC is also consistent with the rate setting based on the capital employed to continue operations and there is no reasonable rationale for treating these extraordinary costs any differently than other costs incurred by the Company to provide service to customers.

Q. DOES THIS CONCLUDE YOUR 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	)
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 Direct 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