CAUSE NO. 45990

SOUTHERN INDIANA GAS AND ELECTRIC COMPANY
d/b/a CENTERPOINT ENERGY INDIANA SOUTH
(CEI SOUTH)

DIRECT TESTIMONY
OF
BRETT A. JERASA
ASSISTANT TREASURER

ON

CAPITAL STRUCTURE AND COST OF DEBT

PETITIONER'S EXHIBIT NO. 14

DIRECT TESTIMONY OF BRETT A. JERASA

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Brett A. Jerasa. My business address is 1111 Louisiana Street, Houston, Texas 77002.

Q. BY WHOM ARE YOU EMPLOYED?

A. I am employed by CenterPoint Energy Service Company, LLC ("Service Company"), a wholly owned subsidiary of CenterPoint Energy, Inc. The Service Company provides centralized support services to CenterPoint Energy Inc.'s operating units, one of which is Southern Indiana Gas and Electric Company d/b/a CenterPoint Energy Indiana South ("CEI South", "Petitioner", or the "Company").

Q. ON WHOSE BEHALF ARE YOU SUBMITTING THIS DIRECT TESTIMONY?

A. I am submitting testimony on behalf of CEI South.

Q. WHAT IS YOUR ROLE WITH THE SERVICE COMPANY?

A. I am Assistant Treasurer for CenterPoint Energy, Inc, the ultimate parent company of CEI South.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I have a Bachelor of Arts in Economics from the University of Virginia, a Master of Arts in History from Old Dominion University, and a Master of Business Administration from Indiana University's Kelley School of Business.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. I have held various positions of increasing responsibility since joining CenterPoint Energy, Inc. in 2012. From 2012 – 2015, I was a lead analyst in the Corporate Strategic Planning group, responsible for assisting various business units and functions with the creation of their strategic plans and capital project evaluations. In 2015, I joined the Treasury group, first as a Treasury Manager responsible for the administration and operations of CenterPoint Energy, Inc.'s various pension, savings, and benefit plans and capital markets activities. In 2020, I was promoted to Assistant Treasurer and have responsibilities for CenterPoint Energy, Inc.'s capital markets activities, debt compliance, treasury operations and investments.

Q. WHAT ARE YOUR PRESENT DUTIES AND RESPONSIBILITIES AS ASSISTANT TREASURER?

A. I am responsible for the short-term and long-term financing activities of CenterPoint Energy, Inc. and its subsidiaries, including CEI South. This includes responsibilities for cash management, bank relations, short-term borrowings, long-term capital financing, rating agency relations, and a variety of other finance-related activities. I am also responsible for arranging the corporate financings and bank credit facilities for CenterPoint Energy, Inc. and its subsidiaries.

Q. HAVE YOU EVER TESTIFIED BEFORE THE INDIANA UTILITY REGULATORY COMMISSION ("COMMISSION")?

A. Yes. I have testified before the Commission on behalf of CEI South and Indiana Gas Company, Inc. d/b/a CenterPoint Energy Indiana North ("CEI North") in their general gas base rate cases, Cause Nos. 45447 and 45468, respectively. I have also testified on behalf of CEI South (Cause Nos. 45458 and 45590) and CEI North (Cause Nos. 45457 and 45589) in their requests for approval of various finance programs. And, most recently, I have testified on behalf of CEI South in support of its request for authorization to issue Securitization Bonds in accordance with Ind. Code ch. 8-1-40.5, Cause No. 45722; and to enter into power purchase agreements related to Solar Projects in Cause Nos. 45501 and 45600.

II. <u>PURPOSE & SCOPE OF TESTIMONY</u>

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

A. I will support the components of CEI South's capital structure and weighted average cost of capital.

Q. ARE YOU SPONSORING ANY ATTACHMENTS OR SCHEDULES IN THIS PROCEEDING?

A. Yes. I am sponsoring the **D Schedules** in <u>Petitioner's Exhibit No. 20</u>, Capital Structure and Cost of Capital.

Q. WERE THESE SCHEDULES PREPARED BY YOU OR UNDER YOUR SUPERVISION?

A. Yes, they were.

III. CAPITAL STRUCTURE

Q. WHAT TOPICS DO YOU DISCUSS IN THIS SECTION OF YOUR TESTIMONY?

A. In this part of my testimony, I explain the importance of maintaining a prudent capital structure for the Company, thereby allowing it to maintain access to capital on reasonable terms in all market conditions. Next, I describe the Company's forecasted capital structure for the test year, and I explain why that capital structure is reasonable.

Q. WHAT DOES THE PHRASE "CAPITAL STRUCTURE" MEAN IN THE CONTEXT OF UTILITY RATEMAKING?

A. "Capital structure" refers to the amount of debt and equity used to finance the assets and perform the operations necessary to provide service to customers. The primary sources of capital to finance long-term assets of the Company are long-term debt and common equity. Capital structure is typically expressed in terms of the ratio of a particular type of capital to total capital. Thus, for example, a utility with a total capitalization of $1 billion, long-term debt of $450 million, and common equity of $550 million would have a capital structure composed of 45% long-term debt and 55% common equity.

Q. ARE THERE OTHER CAPITAL STRUCTURE COMPONENTS OTHER THAN INVESTOR PROVIDED DEBT AND EQUITY USED TO DETERMINE CEI SOUTH'S REQUESTED CAPITAL STRUCTURE?

A. Yes. In addition to investor provided debt and equity, there are several additional components included in the regulatory capital structure calculation such as customer deposits, accumulated deferred income taxes, prepaid pension, and investment tax credits. Petitioner's Exhibit No. 20, **Schedule D-1** details all of the components used to calculate the Company's requested capital structure.

Q. WHY DOES A UTILITY FINANCE ITS ASSETS AND OPERATIONS WITH DIFFERENT TYPES OF CAPITAL?

A. A utility typically uses different types of capital because the various elements of capital have different risks, and, hence, different costs. Debt is less risky than equity because debt holders are senior to equity holders in terms of having a claim on the utility's assets, and for that reason, debt is generally cheaper than equity. Additionally, income tax deductibility of interest expense, in contrast with the non-deductibility of most types of cash dividends, further reduces the after-tax cost of debt capital. As a utility increases the proportion of debt in its capital structure, however, lenders increasingly demand higher returns to offset the risk of default. Utilities and other companies, therefore, try to strike a balance that will provide dependable access to capital in a cost-effective manner.

Q. WHAT INVESTOR PROVIDED CAPITAL STRUCTURE IS REFLECTED IN THE COMPANY'S FORECASTED CAPITAL STRUCTURE?

A. As detailed in workpapers to Petitioner's Exhibit No. 20, **D Schedules**, WPD D-1.1, the investor provided capital structure consists of 45.00% long-term debt and 55.00% common equity. This reflects a forecasted capital structure and will be updated to actual as of December 31, 2023 for Phase 1 rates; actual as of December 31, 2024 for Phase 2 rates; and actual as of December 31, 2025 for Phase 3 rates, as discussed in greater detail by Petitioner's Witness Chrissy M. Behme.

Q. DOES THE COMPANY DIRECTLY ISSUE EQUITY INTO THE EXTERNAL CAPITAL MARKETS?

A. No, the sources of the equity on the Company's balance sheet are: (1) equity contributions from Vectren Utility Holdings, LLC ("VUH"); and (2) retained earnings from operations. The Company may make periodic dividend payments to VUH to ensure the Company's equity ratio remains within a reasonable range, and VUH may make equity contributions to the Company for the same purpose. VUH, in turn, obtains equity financing ultimately from CenterPoint Energy, Inc.

Q. DOES THE COMPANY DIRECTLY ISSUE DEBT INTO THE EXTERNAL CAPITAL MARKETS?

A. Yes, CEI South issues taxable and tax-exempt debt in the public and private debt capital markets, in addition to intercompany debt issued to VUH. CEI South prefers to issue First Mortgage Bonds, which should be at a more competitive interest rate than intercompany debt due to its higher debt rating and secured nature. First Mortgage Bonds have first priority on any claims against the Company.

Q. ARE THERE ANY FORECASTED DEBT ISSUANCES INCLUDED IN CEI SOUTH'S INVESTOR PROVIDED CAPITAL STRUCTURE DURING THE TEST YEAR?

A. Yes. CEI South forecasts to issue $160 million of long-term debt in 2024 and $470 million of long-term debt in 2025, during the test year.

IV. FINANCIAL INTEGRITY AND CREDIT RATINGS

Q. WHAT ARE CEI SOUTH'S CURRENT CREDIT RATINGS?

A. CEI South's senior secured debt rating is A / stable from S&P Global Ratings ("S&P") and A1 / stable from Moody's Investors Service ("Moody's"). CEI South's issuer credit rating is BBB+ at S&P and A3 at Moody's.

Q. WHY IS IT IMPORTANT TO MAINTAIN CEI SOUTH'S CURRENT CREDIT RATINGS? WHAT ARE THE BENEFITS TO CUSTOMERS?

A. As discussed above, debt is normally less expensive capital than equity. One company's debt can be less expensive than another company depending on credit ratings. A higher credit rating, as assigned by rating agencies such as Moody's and S&P, signals their evaluation that the issuer is less likely to default on paying interest and repaying principal at maturity. CEI South's A and A1 rated debt will normally price at a more competitive coupon than a lower-rated entity. This more competitive coupon directly benefits CEI South customers via a lower weighted average cost of debt and a lower overall rate of return. Additionally, as a Midcontinent Independent System Operator ("MISO") market participant, CEI South is required to post collateral, which is determined by its credit rating. The credit evaluation considers the financial strength and creditworthiness and relies in part on rating agency evaluation. Those entities with an "unreasonable credit risk" based on MISO's credit evaluation may be required to provide additional financial security (for example, cash collateral).[1] Due to CEI South's strong credit ratings and financial strength, the Company has avoided the need to post

[1] Please see MISO FERC Electric Tariff, Attachment L Credit Policy, available at: https://www.misoenergy.org/legal/tariff/.

cash collateral; in fact, MISO recently increased CEI South's credit limit after a recent creditworthiness assessment. Avoiding the need to borrow and post cash collateral directly benefits CEI South's customers by reducing interest expense.

Q. WHAT ARE THE KEY CREDIT FEATURES CITED BY S&P AND MOODY'S?

A. S&P lists among CEI South's key strengths the fact that it is a fully regulated electric and natural gas utility with effective management of regulatory risk and a residential customer base that provides cash flow stability. Moody's similarly notes CEI South's credit supportive regulatory environment in Indiana with cost recovery mechanisms in place, significant legislative and regulatory support for carbon transition, and strong financial credit metrics including cash from operations before working capital to debt (as defined below) forecast in the 20-23% range. This metric refers to the ratio of cash flow before working capital needs to total debt, and is a frequently referenced measure of creditworthiness by the rating agencies. Maintaining a ratio within the agency's expectation will help CEI South to maintain its current ratings and avoid any downgrades to its ratings.

Q. WHAT ARE THE RISKS CITED BY S&P AND MOODY'S?

A. S&P notes CEI South's key risks as (1) its limited geographic footprint, (2) operating risks associated with coal generation, and (3) negative discretionary cash flow leading to external funding needs. Moody's lists the key credit challenges as (1) a large capital program with execution risk, (2) elevated carbon transition risk, and (3) "although independent of parent [CenterPoint Energy, Inc.], parent is more heavily levered."

Q. HOW DOES CENTERPOINT ENERGY, INC. SUPPORT CEI SOUTH'S CREDIT, GROWTH AND GENERATION TRANSITION?

A. In addition to shared services detailed by CEI South Witness Christopher G. Wood, CenterPoint Energy, Inc. provides equity capital to CEI South, allowing it to maintain a capital structure in line with its current ratings, financial covenants, and target credit ratios. With a sizable capital investment during the test year related to its generation transition, CEI South will require capital contributions from its ultimate parent – CenterPoint Energy, Inc. In 2022, CenterPoint Energy, Inc. contributed $102 million to CEI South in order to maintain its target capital structure; CenterPoint Energy, Inc. expects to do so again in future years.

Q. HOW WILL CEI SOUTH'S GENERATION TRANSITION IMPACT ITS CREDIT RATINGS?

A. Both S&P and Moody's cite CEI South's coal generation as a credit and operational risk. Transitioning CEI South's generation portfolio from predominately coal to alternative sources (solar, wind, natural gas) will alleviate some of this risk. However, the large capital investment required will present execution risk and financing risk, requiring equity support from its parent CenterPoint Energy, Inc. and consistent access to the debt capital markets. Maintaining CEI South's current strong A/A1 ratings will mitigate these risks and support capital investment at competitive financing rates to benefit CEI South's customers.

Q. DOES THE RECENT INFLATION REDUCTION ACT ("IRA") HAVE AN IMPACT ON CEI SOUTH'S CREDIT RATINGS?

A. Yes. As noted in Company Witness Jennifer K. Story's testimony, the Inflation Reduction Act imposes a new 15% Corporate Alternative Minimum Tax ("CAMT") based upon adjusted financial statement income. Based on our review of the impacts, we expect that CEI South will be subject to the 15% tax, beginning in 2024 and including the test year of 2025. Accordingly, the cash outlay associated with CAMT presents a risk that will likely adversely impact CEI South's credit metrics including Funds from Operations ("FFO")/debt if we are unable to recover the impact of the tax through rates as illustrated in **Table BAJ-1** below:

Table BAJ-1 – Corporate Alternative Minimum Tax Impact To FFO

Southern Indiana Gas and Electric Company
d/b/a CenterPoint Energy South (CEI South)
ILLUSTRATIVE ONLY

	Cash Flow with Min Tax (A)		
Funds from Operations (FFO)	(without recovery)	(with recovery)	
Net Income adjusted for cash items = FFO	1,000	(B) 1,015	(A)
Minus: Min Tax Payment	(15)	(15)	(B)
Adjusted FFO	**985**	**1,000**	**(C) = (A) - (B)**
Adjusted Total Debt			
Total Debt	6,567	6,567	(D)
FFO/Debt	**15.0%**	**15.2%**	**(E) = (C) / (D)**

(A) All figures are illustrative only, not to be representative of actuals
(B) Assumes that Rate Base is adjusted for Min Tax, allowing for recovery through rates

In the event that credit ratings and metrics deteriorate, CEI South's ability to invest in necessary projects may be impeded as incremental debt issuances may be otherwise limited based on lower credit metrics.

Q. HAVE THE CREDIT AGENCIES COMMENTED ON THE IMPACT OF THE CORPORATE ALTERNATIVE MINIMUM TAX ON CREDIT?

A. Yes. S&P published a report[2] on August 30, 2022 on the Inflation Reduction Act tax impacts to credit, and stated, "[T]he corporate [C]AMT will impact the FFO of mostly investment-grade companies due to an increase in cash tax outflows related to higher taxes paid, and will also result in reduced accessible cash to offset debt." S&P does not expect the CAMT itself to affect ratings, but I believe this is an additional drag on credit metrics. Moody's published a similar report on August 10, 2022[3] and noted that "from a liquidity perspective, this tax will have the largest negative effects on large, growing companies that only recently met the income threshold. Their net operating losses have been used to offset taxable income, but that offset will be undone by the book minimum tax of 15%, which can be a substantial portion of operating cash flow."

V. COST OF DEBT

Q. WHAT IS THE WEIGHTED COST OF LONG-TERM DEBT PORTION OF CEI SOUTH'S CAPITAL STRUCTURE?

A. As shown in Petitioner's Exhibit No. 20, **Schedule D-1**, CEI South's forecasted weighted average cost of long-term debt as of the end of the test year is 5.12%. The details used to calculate this cost of long-term debt are shown in Petitioner's Exhibit No. 20, **Schedule D-2**. This cost reflects the carrying value of long-term debt, which reflects the unamortized issuance costs and is consistent with the Company's Financing Authority granted in Cause No. 45799.

[2] S&P, "Taxes Under the Inflation Reduction Act May Increase the Amount Non-Financial Corporates Pay, With Limited Credit Impact." August 30, 2022.
[3] Moody's, "Inflation Reduction Act will build economic resilience, but its costs and benefits vary by sector." August 10, 2022.

Q. WHAT TYPES OF DEBT COMPOSE CEI SOUTH'S LONG-TERM DEBT?

A. CEI South's debt portfolio consists of First Mortgage Bonds and Tax-Exempt Bonds. The specific notes that compose CEI South's long-term debt are listed in Petitioner's Exhibit No. 20, **Schedule D-2**.

Q. DOES CEI SOUTH'S WEIGHTED COST OF LONG-TERM DEBT INCLUDE THE SECURITIZATION BONDS ISSUED IN JUNE 2023?

A. No, it does not. On June 29, 2023, a bankruptcy-remote special purpose entity issued $341,450,000 of securitization bonds to fund the retirement of A.B. Brown Units 1 and 2. CEI South services the securitization bonds, collecting and remitting securitization charges from customers to the trustee. The securitization charges are collected by CEI South on behalf of the special purpose entity. Since the securitization charges already collect the funds necessary to fund the payment of interest and principal, the securitization bonds are not reflected in CEI South's regulatory capital structure.

Q. IS THE REQUESTED WEIGHTED AVERAGE COST OF LONG-TERM DEBT IN CEI SOUTH'S CAPITAL STRUCTURE REASONABLE?

A. Yes. The cost of debt is based on market rates and is in compliance with all Financing Authority conditions.

Q. IS CEI SOUTH PURSUING ANY OPPORTUNITIES TO ACCESS LOWER-COST CAPITAL THAN CURRENTLY AVAILABLE?

A. Yes. CEI South is in discussions with the Department of Energy's ("DOE") Loan Programs Office ("LPO") for a loan through its Title 17 Clean Energy Financing Program. The LPO can finance projects that support energy infrastructure reinvestment to reduce greenhouse gas emissions and air pollution. We believe CEI South's solar and wind generation projects may qualify for a DOE loan at a more competitive coupon than available in the debt capital markets. The discussions are still preliminary as of submitting this testimony, and any financing would more than likely occur during or after calendar year 2025, so no DOE loan assumptions are included at this time in CEI South's requested cost of debt. If the loan is granted during this proceeding, but before the evidentiary record closes, we will provide an update to the Commission and parties. We view that this is aligned with GAO 2022-02 that "encourages jurisdictional utilities to explore possible grant and low-cost loan options that would reduce the cost of present and future projects needed to provide utility service." This also aligns with the affordability pillar in Ind. Code § 8-1-2-0.6. Since any DOE loan would be tied directly to specific projects, such a loan should only be reflected in the capital structure to the extent the specific project is included in rate base.

Q. IF CEI SOUTH DOES ENTER INTO A LOWER-COST LOAN WITH THE DOE, WILL ITS CUSTOMERS BENEFIT?

A. Yes. If a DOE loan is executed, CEI South will include this lower-cost loan in its cost of capital for future rate filings, including any Clean Energy Cost Adjustment ("CECA") filings.

VI. OTHER COMPONENTS OF COST OF CAPITAL

Q. WHAT IS THE COST OF EQUITY USED TO CALCULATE THE COMPANY'S PROPOSED COST OF CAPITAL?

A. The cost of equity used in the determination of the overall cost of capital was 10.40%. Details regarding the cost of equity estimate can be found in Petitioner's Witness Ann E. Bulkley's direct testimony.

Q. ARE THERE OTHER CAPITAL STRUCTURE COMPONENTS FOR PURPOSES OF DETERMINING CEI SOUTH'S COST OF CAPITAL?

A. Yes. As mentioned earlier, Petitioner's Exhibit No. 20, **Schedule D-1** and the supporting workpapers contain a listing of those components and their proposed weighted average interest rates. The schedule includes customer deposits at a 5.39% weighted average interest rate and investment tax credits at a rate of 8.02%.

Q. ARE THERE ANY COST-FREE COMPONENTS INCLUDED IN CEI SOUTH'S PROPOSED COST OF CAPITAL?

A. Yes. Accumulated deferred income taxes, customer advances for construction, postretirement benefits other than pensions ("OPEB"), and prepaid pension were included at zero cost. Accumulated deferred income taxes are sponsored by Petitioner's Witness Story. The projected customer advances for construction in the capital structure are sponsored by Petitioner's Witness Behme.

Q. WHAT IS THE PREPAID PENSION ASSET AND WHY IS IT INCLUDED IN THE CAPITAL STRUCTURE?

A. The prepaid pension asset is the difference between cumulative contributions to the pension fund and the cumulative accruals of pension expense. In other words, these are amounts that have been paid into the pension fund in excess of cumulative pension expense. Once amounts are contributed to the fund, the Company no longer has access to these amounts – they must remain in the trust. The prepaid pension asset provides a benefit to customers in that it serves to reduce pension expense that would otherwise be accrued and recovered in rates. I understand that in Indiana there have been two recognized methods for including the value of the prepaid pension asset in ratemaking: some utilities have included the prepaid pension asset in rate base, and other utilities have included the prepaid pension asset in the capital structure as an offset to zero cost capital. Both methods have been accepted by this Commission. We have elected to include the prepaid pension asset in the capital structure.

Q. YOU ALSO MENTIONED OPEB. WHAT IS THAT AND WHY IS IT IN CAPITAL STRUCTURE?

A. This results from the adoption over thirty years ago of Financial Accounting Standards No. 106 (currently referred to as Accounting Standards Codification 715), which requires that postretirement benefits other than pension be reflected on an accrual basis. The difference between the accrued expense under generally accepted accounting principles and the amount that is paid out on a pay-as-you-go basis is reflected either as a rate base offset or as a component of zero cost capital. The Company has historically reflected it as zero cost capital. This treatment is the mirror image of the treatment of the prepaid pension asset, and so the OPEB zero cost capital is an offset to the prepaid pension asset in the capital structure.

Q. ARE YOU PROPOSING ANY ADDITIONAL ADJUSTMENTS TO CAPITAL STRUCTURE?

A. Yes. Per Cause No. 45086, the Troy Solar project is recovered via levelized rate and, therefore, not included in base rates. As such, CEI South is removing the project's net book value excluding ADIT and ITC from capital structure, using pro-forma adjustments to investor provided capital assuming 45.00% long-term debt and 55.00% common equity. This pro-forma adjustment plus its exclusion from rate base will prevent double recovery of the assets, only being reflected in the levelized rate and not in base rates. The details of this adjustment are detailed in Petitioner's Exhibit No. 20, **Schedule D, Workpaper WPD-2a**. As explained by Witness Behme, this workpaper shows similar treatment for Crosstrack Solar based upon the Commission's Order in Cause No. 45754. While the schedules may reflect adjustments for Crosstrack Solar as a levelized rate, the Crosstrack Solar Project adjustments are needed because it will not be placed in service prior to the end of the test year. In addition, per Cause No. 45722, the ADIT associated with the retired A.B. Brown Units 1 and 2 is segregated from all other ADIT and not included in the calculation of Petitioner's capital structure and not otherwise used in calculating CEI South's authorized return in this and future rate cases.

VII. CONCLUSION

Q. DOES THIS CONCLUDE YOUR PREPARED DIRECT TESTIMONY?

A. Yes, it does.

CAUSE NO. 45990

VERIFICATION

I affirm under penalties for perjury that the foregoing representations are true to the best of my knowledge, information, and belief.

SOUTHERN INDIANA GAS AND ELECTRIC COMPANY D/B/A CENTERPOINT ENERGY INDIANA SOUTH

Brett A. Jerasa
Director and Assistant Treasurer

11/28/2023
Date