STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF WESTFIELD GAS, LLC, D/B/A CITIZENS GAS OF WESTFIELD FOR (1) AUTHORITY TO INCREASE RATES AND CHARGES FOR GAS UTILITY SERVICE AND APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES; (2) APPROVAL OF CERTAIN REVISIONS TO ITS TERMS AND CONDITIONS APPLICABLE TO GAS UTILITY SERVICE; AND (3) APPROVAL PURSUANT TO INDIANA CODE SECTION 8-1-2.5-6 OF AN ALTERNATIVE REGULATORY PLAN UNDER WHICH IT WOULD CONTINUE ITS ENERGY EFFICIENCY PROGRAM PORTFOLIO AND ENERGY EFFICIENCY RIDER	)	**CAUSE NO.** 45761

VERIFIED DIRECT TESTIMONY
of
CRAIG JACKSON

On
Behalf of
Petitioner,
WESTFIELD GAS, LLC

Petitioner's Exhibit No. 2

INTRODUCTION AND BACKGROUND

Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A1. My name is Craig Jackson. My business address is 2020 North Meridian Street, Indianapolis, Indiana.

Q2. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A2. I am employed by the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis (the "Board of Directors" or "Board"), which does business as Citizens Energy Group ("Citizens"), as its Senior Vice President and Chief Financial Officer. Citizens also owns the stock of Citizens By-Products Coal Company d/b/a Citizens Resources, which itself owns a number of energy and utility related businesses. Citizens Westfield Utilities, LLC ("CWU"), which is a subsidiary of Citizens Resources, owns the sole membership interest in Westfield Gas, LLC d/b/a Citizens Gas of Westfield ("Westfield Gas" or "Petitioner"), which is the Petitioner in this proceeding.

Q3. PLEASE DESCRIBE THE DUTIES AND RESPONSIBILITIES OF YOUR PRESENT POSITION.

A3. As Chief Financial Officer, I have direct responsibility and oversight for the financial functions of Citizens and the utilities it manages and controls, including Westfield Gas.

Q4. HOW LONG HAVE YOU BEEN EMPLOYED BY CITIZENS ENERGY GROUP?

A4. I have been employed by Citizens since September 2021. I joined as Senior Vice President, Special Projects and held that position until April 1, 2022. On April 1, 2022, I was named Senior Vice President and Chief Financial Officer.

Q5. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A5. I received a Bachelor of Science degree in Business Administration from Bloomsburg University in 1996. I also earned a Master of Business Administration degree in Finance from Wright State University in 2001.

Q6. PLEASE DESCRIBE YOUR PRIOR BUSINESS EXPERIENCE?

A6. My prior business experience has spanned nearly 25 years, the majority of which have been in financial and financial leadership roles.

a. *United States Air Force* (May 1996 to January 2000) - Finance Technician

b. *Dayton Power & Light Company* (February 2000 to November 2002) - I served as a financial analyst responsible for budgeting, forecasting and corporate modeling.

c. *PPL Corporation* (December 2002 – May 2004) - I served as team leader, ISO Settlements, responsible for managing the settlement processes in the PJM, NYISO and NEISO regional transmission organization markets.

d. *Dayton Power & Light Company* (June 2004 – May 2013) - In June 2004, I returned to DP&L as Manager, Financial Planning and Analysis, reporting to the Chief Financial Officer. From June 2004 to May 2012, I was promoted through several positions of increasing responsibility within the Finance organization, the last of which was as Vice President and Treasurer. In this position, I led the financial planning, budgeting, debt and equity capital markets, cash management, risk management, and investor relations functions. In November 2011, AES Corporation's ("AES") acquisition of DP&L closed and in May 2012, I was promoted to Chief Financial Officer of DP&L.

e. *AES U.S. Services, LLC* (May 2013 – December 2018) - In May 2013, I was promoted to Chief Financial Officer of AES US Services, LLC where I had direct responsibility and oversight for the financial functions of Indianapolis Power & Light (today dba AES Indiana), Dayton Power and Light (today dba AES Ohio) and AES' U.S. portfolio of conventional and renewable generation. In December 2017, I was promoted to President and CEO of AES U.S. Utilities and served in that capacity until December 2018.

f. *MasTec Corporation* (April 2019 – September 2021) - I joined MasTec Corporation as Group CFO in April 2019, leading the finance functions for the Company's Transmission and Substation Group and served in that capacity until joining Citizens in September 2021.

Q7. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A7. Yes, I have provided written testimony on behalf of Indianapolis Power & Light in Cause No. 44339 (Eagle Valley Combined Cycle Gas Turbine and Harding Street Units 5 & 6 Refueling), and testimony in Cause Nos. 44576 and 45029 (IPL Basic Rates Cases). Additionally, I have provided testimony before the Public Utility Commission of Ohio in Dayton Power and Light's Electric Security Plan proceedings (Case No. 12-426EL-SSO et al and Case No. 16-0395-EL-SSO et al).

Q8. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A8. The purpose of my testimony is to discuss: (a) the fair value of Petitioner's utility property under Indiana law, (b) the Petitioner's capital structure, (c) the proposed fair rate of return for Petitioner's investment, and (d) the importance of Petitioner's financial integrity.

Q9. WHY IS WESTFIELD GAS REQUESTING A RATE INCREASE?

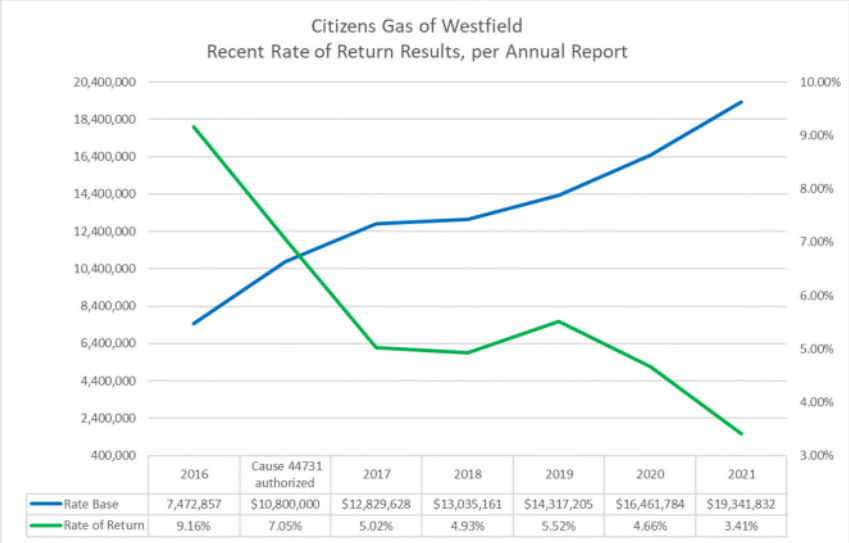
A9. Since 2010, the City of Westfield has experienced population growth of 68.38%[1] as compared to 4.97%[2] for the state of Indiana. This expansion has required Westfield Gas to invest in gas infrastructure to meet the City's and its residents' needs. The Commission approved the final Order in Westfield Gas' last rate case, Cause 44731, in 2017. This approval reflected, among other things, the City's growth through 2016 and authorized a $10.8 million fair value rate base and a 7.05% rate of return. Not surprisingly, the City's growth has continued and required further investment by Westfield Gas. The investment by Westfield Gas is clearly evidenced by the 79% growth in rate base between the approved 2017 rate case Order and December 31, 2021 rate base, as shown in the graph below.[3] Furthermore, as described by Petitioner witness Ghio, Westfield Gas has experienced increased operating costs along with this growth. Not surprisingly, as rate base has grown and costs have increased, the realized rate of return has declined sharply to 3.41% for calendar year 2021, materially impacting Westfield Gas' financial integrity. Thus,

[1] Represents population growth from April 2010 to July 2021 as reported by the U.S. Census Bureau. https://www.census.gov/quickfacts/fact/table/westfieldcityindiana/LFE305220

[2] Represents population growth from April 2010 to July 2021 as reported by the U.S. Census Bureau. https://www.census.gov/quickfacts/IN

[3] Rate Base growth of 79% = ($19,341,832 - $10,800,000) / $10,800,000. Note, the rate base shown on the graph for the calendar years 2016 through 2021 are reflective of the rate base reported in Westfield Gas' Annual Report that is filed with the Indiana Utility Regulatory Commission. The 2021 rate base of $19.3 million included in the Annual Report and the graph is inclusive of the Fair Value approved in approved in April 2017 plus net plant added through December 2021. This rate base amount is not, however, reflective of Fair Value rate base used for ratemaking purposes in this proceeding.

Westfield Gas is now requesting a rate increase to prospectively recover its investments and costs, and to have the opportunity to earn a reasonable rate of return.



	2016	Cause 44731 authorized	2017	2018	2019	2020	2021
Rate Base	7,472,857	$10,800,000	$12,829,628	$13,035,161	$14,317,205	$16,461,784	$19,341,832
Rate of Return	9.16%	7.05%	5.02%	4.93%	5.52%	4.66%	3.41%

FINANCIAL INTEGRITY

Q10. HOW DO YOU DEFINE FINANCIAL INTEGRITY?

A10. I define financial integrity as: (a) having sufficient cash flow to pay all normal operating expenses and capital expenditures that are necessary to ensure safe and reliable service; (b) meeting all contractual debt obligations on a timely basis, (c) maintaining strong investment grade credit ratings, and (d) having an opportunity to earn a reasonable rate of return.

Q11. WHY IS FINANCIAL INTEGRITY ESSENTIAL FOR WESTFIELD GAS AND ITS CUSTOMERS?

A11. A utility must have financial integrity to ensure it can (a) make the necessary operating and capital investments (as noted above) that are required in the normal course of business to

ensure safe and reliable service; (b) access debt capital markets, in all economic cycles, to refinance existing debt obligations on their contractually established maturity dates; (c) attract reasonably priced debt and equity capital, during all economic cycles, to finance growth in its regulated asset base; and (d) maintain reasonably priced capital to ensure reasonable rates to our customers.

CREDIT RATINGS

Q12. WHAT ARE CREDIT RATINGS?

A12. Credit ratings reflect a credit rating agency's independent judgement of a company's credit worthiness and its ability to meet its outstanding debt obligations. Credit committees at each agency determine the ratings of a company based on certain quantitative and qualitative measures. These measures are used to assess the financial and business risks of fixed-income issuers. Both S&P Global Ratings ("S&P") and Fitch Ratings ("Fitch") delineate investment grade as any rating equal to "BBB-" or above, while Moody's Investors Service ("Moody's") delineates investment grade as any ratings equal to "Baa3" or above. Non-investment grade ratings are "BB+" or below at S&P and Fitch, and "Ba1" or below at Moody's.

Q13. WHY ARE CREDIT RATINGS CONSIDERED AN IMPORTANT ELEMENT OF A UTILITY'S FINANCIAL INTEGRITY?

A13. Westfield Gas operates in a capital-intensive industry and in a growing community. At times, the Petitioner may need to issue short and/or long-term debt to meet its capital expenditure requirements and to appropriately manage its capital structure. When

Westfield Gas issues debt, credit rating agencies rate it as to the safety of principal and interest based on the Petitioner's ability to pay. Credit ratings are important to investors because the higher the rating, the safer the debt. But credit ratings are also important to debt issuers, like Westfield Gas, because they affect the cost of doing business and the ability to access debt capital during all economic cycles. The higher the credit rating, the less interest a company pays on its debt and the lower the cost burden on ratepayers to service the debt. This is because investors are willing to accept lower interest for more safety of principal and interest. Furthermore, the higher the credit rating, the more demand there is for the debt and the easier it is for a company to sell it. With the Westfield community continuing to grow and the on-going need for Petitioner to support this growth, the ability to access the market and issue debt at the lowest rate possible helps secure Westfield Gas' financial integrity. More importantly, though, it positions Westfield Gas to continue fulfilling its mission to serve and create long-term benefit for the Westfield community.

Q14. PLEASE DISCUSS THE IMPACT OF A CREDIT RATINGS DOWNGRADE.

A14. A downgrade in the credit rating would lead to an increase in overall financing costs, result in a higher cost of capital, and could limit access to the capital markets under certain economic conditions. Customers would be adversely affected as higher capital costs (a) lead to higher rates for gas service and (b) strain resources that could otherwise be utilized to meet our customers' on-going need for reliable service.

Q15. IS COST CONTROL IMPORTANT TO WESTFIELD GAS AND ITS CREDIT RATING?

A15. Yes. Rating agencies evaluate Westfield Gas' ability to manage costs, as it directly impacts operating cash flow and credit metrics, as a key component of financial integrity and credit ratings.

Internally, cost control is important to Westfield Gas, but never at the expense of safety. Westfield Gas strives to be efficient in its asset management process, the procurement of goods and services, and the management of our employees and contractors. Our approach to cost management, as discussed by Petitioner witness Ghio, is customer focused and balances customer service, system reliability, and legal/regulatory compliance, while incorporating best practices for managing costs.

Q16. DOES WESTFIELD GAS CURRENTLY HAVE INVESTMENT GRADE CREDIT RATINGS?

A16. Westfield Gas currently does not have any ratings assigned to it. This is because the Petitioner's existing bank funded revolving line of credit does not require ratings from the rating agencies. Additionally, we recently issued new, private placement debt that was sourced by one local bank. The bank performed its own credit analysis and therefore, did not require a ratings initiation from any of the ratings agencies. Looking to the future, as the City of Westfield continues to grow and requires further infrastructure investment by Westfield Gas, we likely will need to access the public debt market as a source of capital funding. Such a capital raise will require a ratings initiation by the ratings agencies. Given the likely need to obtain credit ratings from one or more of the rating agencies in the future, Westfield Gas' efforts to maintain and improve its financial integrity, such as by initiating this proceeding, are of vital importance.

FAIR VALUE AND FAIR RETURN

Q17. WHAT IS THE LEGAL BASIS FOR CITIZENS TO VALUE ITS PROPERTY AT FAIR VALUE FOR PURPOSES OF THE REQUESTED RELIEF?

A17. IC 8-1-2-6 requires the Commission to "value all property of every public utility actually used and useful for the convenience of the public at its fair value." Thus, in accordance with IC 8-1-2-6, Westfield Gas' property must be valued, for ratemaking purposes, at its fair value.

Q18. HOW DO YOU DEFINE FAIR VALUE?

A18. I define fair value as the true current worth of property, perhaps best measured by what a third-party market participant would be willing to pay for the property. My understanding of fair value has been influenced through (a) my academic training, (b) my practical valuation experience related to business entities, property, and a combination thereof, and (c) specifically as it relates to ratemaking in Indiana, by Orders of the Commission and by decisions of the Indiana Courts.

Q19. WHAT ORDERS OF THE COMMISSION AND/OR DECISIONS OF THE INDIANA COURTS HAVE INFORMED YOUR DEFINITION OF FAIR VALUE?

A19. My definition of fair value is closely aligned to and has been informed by Orders of the Commission and by decisions of the Indiana Courts. Specifically, the Commission defined fair value in its Order in Cause No. 39314 (Indiana Michigan Power Company, November 12, 1993, at p. 46):

> As we have recently held, we believe that the fair value of a utility's property is most analogous to the true current worth of that property, perhaps what a willing buyer would pay a willing seller in an arms

> length transaction. This standard comports very well to the directives of the Court and our discussions above. Certainly then, the book net original cost of that property would make little difference to a willing buyer attempting to make a fair assessment of a reasonable purchase price. This is also consistent with the Courts' directives that we must consider the effects of inflation upon the value of a utility's property and its cost to be reproduced at current prices. As our potential, willing buyer examines the property he can scarcely argue that the effects of past inflation should be calculated and removed from the potential purchase price. Similarly, a willing buyer will reasonably consider the current cost of reproducing that property. Thus, the Commission is charged specifically by statute and by the Courts with considering all of the factors which can be quantified such as reproduction cost new, net original cost, and the effects of inflation in determining the true current worth or fair value of the utility's used and useful property.

Similarly, the Indiana Court of Appeals has explained:

> Although it is clear from the statute and from the case law that the Commission has discretion in determining the fair value of utility property, it is also clear that the Commission may not ignore the commonly known and recognized fact of inflation. In his concurring opinion in *Public Service Commission v. City of Indianapolis* Judge Emmert commented:
>
> > We judicially know there has been an inflation in values since 1939. A utility corporation and its stockholders take the gain from an increase in values of its property, and they stand the loss when values depreciate during a time of falling prices or a depression, just the same as any other corporation and its stockholders may benefit or lose when the value of the corporate property goes up or down. If the state condemns a shack in shanty town the owner is compensated according to its value when taken, and not according to what it cost him. The Federal Constitution and the Indiana Constitution both protect him, and they protect corporate enterprise with equal fairness by prohibiting confiscation of its property either directly or indirectly. Utilities are not bought and sold in any market place so that a market

> value can be thus established, and in an area like Indianapolis, with its growth or population and industry, reproduction cost new less depreciation cannot be disregarded in fixing a valuation for rate making purposes.

Indianapolis Water Company v. Public Service Commission of Indiana, 484 N.E. 2d 635, 640 (Ind. Ct. App. 1985) (quoting Public Service Commission v. City of Indianapolis, 131 N.E. 2d 308, 325 (Ind. 1956) (Emmert J. concurring)).

The Commission and the courts have recognized the importance of determining the true current worth when estimating the actual value of a utility's property by acknowledging that a utility takes the gain from an increase in property value and conversely takes the loss from a decrease in property value.

Q20. DOES FAIR VALUE DIFFER FROM ORIGINAL COST?

A20. Yes. Original cost represents the initial costs incurred to place an asset in service. It is this cost upon which the asset is then depreciated over its useful life. Fair value, as I defined earlier, is defined as the true worth of the asset at a given point in time. This is an important distinction and was noted by the Commission in its Order on remand in Cause No. 37612. In this Order, the Commission stated:

> The Court has given the Commission four basic directives in its reconsideration of the valuation of Petitioner's property. In summary, these directives are as follows:
>
> (A) That it is upon the statutory "fair value" of its used and useful property that a utility should be allowed to earn a return.
>
> (B) That "fair value" is not an either/or situation as to original cost or reproduction cost new, but fair value is a conclusion or final

> figure, drawn from all the various values or factors to be weighed in accordance with the statute by the Commission.
>
> (C) That in its determination of "fair value" the Commission may not ignore the commonly known and recognized fact of inflation.
>
> (D) **That while original cost is one of the factors which the Commission should consider in arriving at a fair value figure, it is not necessarily, in and of itself, an accurate reflection of the fair value of the company's property**.

Indianapolis Water Co., 1986 WL 1261649 (Ind. P.S.C. July 3, 1986) (emphasis added).

Q21. DOES FAIR VALUE INCLUDE THE EFFECTS OF INFLATION?

A21. Yes. As discussed by Petitioner's witness Miller, the estimated fair value includes the effect of historical, or already incurred, inflation.

Q22. HOW DOES FAIR VALUE RELATE TO FAIR RATE OF RETURN?

A22. In addition to determining the fair value of utility property or rate base upon which an opportunity to earn a return will be authorized, the Commission must also decide a fair rate of return to apply to the fair value rate base. The key is that the rate of return a utility is authorized must be sufficient to allow it an opportunity to earn a fair return on the fair value of its investment in utility plant. In the Indianapolis Water Co. v. Public Service Commission of Indiana case I referenced earlier, "the Indiana Court of Appeals confirmed that a utility is entitled to earn a fair rate of return on the fair value of its used and useful property." *See* Cause No. 39314 (Indiana Michigan Power Company), Final Order at Section 9(A)(i) (citing Indianapolis Water Co., 484 N.E.2d 635).

Additionally, in the Indiana Michigan rate case Order in Cause No. 39314 that I mentioned above, the Commission explained:

> it is increasingly clear that a ratemaking agency's rate of return formula must be methodically consistent with its rate base development. Otherwise, the result will be insupportably arbitrary and unlawful since the ratemaking agency has a duty to ensure that the method of selecting the appropriate rate of return is reasonably related to the method of calculating the rate base. When the two methods lack consistency the combination of rate base and rate of return methodology does not produce an acceptable end result.

(Order at p. 42).

Furthermore, in the same Indiana Michigan Order, the Commission stated, "the Commission must find the current fair value of Petitioner's used and useful property dedicated to service of the public in Indiana, and give actual effect to that fair value finding in determining allowed return." (Order at p. 46.)

Q23. IF FAIR VALUE OF PROPERTY EXCEEDS THE ORIGINAL COST, SHOULD THE FAIR RATE OF RETURN ON THE FAIR VALUE OF PROPERTY RESULT IN THE SAME DOLLAR RETURN THAT WOULD BE ALLOWED IF THE RATE BASE WAS VALUED AT ITS ORIGINAL COST?

A23. No. If the property value increases and exceeds original cost, Westfield Gas is entitled to benefit from the increase and, therefore, the dollar return should be greater. Conversely, if the property value decreases and is less than original cost, the dollar return should also be less. This truth was embraced by the Commission in the Indiana Michigan Order discussed above. In that Order, the Commission explicitly rejected an intervenor's proposal to essentially ignore fair value and the increase in the worth of the utility's rate base by "backing into" a return based on original cost. The Commission stated:

> This we cannot do. The Court's directives to this Commission on fair value ratemaking are more than hollow words. When utility

property "has increased in value since it was acquired, the Company is entitled the benefit of such increase." Columbus Gaslight Co. v. Public Service Commission (1923), 193 Ind. 399, 140 N.E. 538, 539 (quoting from Wilcox v. Consolidated Gas Co. 212 U.S. 19, 52 (1909). As the North Carolina Supreme Court stated in State ex. rel. Utilities Commission v. Duke Power Co. (1974), N.C., 206 S.E.2d 269, 279:

> The concept...of a fair rate of return on the fair value of the property used in rendering the service clearly contemplates the allowance of a greater dollar return that would be allowed if the rate base were the original cost, depreciated to the same properties, assuming, as is here true, that the value of the properties has been enhanced by inflation. Otherwise, the exceedingly costly and laborious determination of "fair value" as distinguished from original cost would be a meaningless exercise.

(Cause No. 39314 Order at p. 44).

Q24. DOES FAIR RATE OF RETURN CONSIDER THE EFFECT OF INFLATION?

A24. As discussed by Petitioner's witness McKenzie, the recommended cost of equity includes the effect of future, or prospective, inflation. I have adjusted for inflation, as described below, when calculating the fair rate of return.

Q25. SINCE THE FAIR VALUE RATE BASE AND FAIR RATE OF RETURN BOTH INCLUDE THE EFFECTS OF INFLATION, IS WESTFIELD GAS DOUBLE COUNTING A PORTION OF ITS RECOMMENDED DOLLAR RETURN?

A25. No, for two reasons. First, per Petitioner's witness McKenzie's recommendation, I have adjusted the cost of equity by –2.3% for inflation to determine the fair rate of return. I use the adjusted cost of equity to calculate the fair rate of return. Second, as defined earlier, fair value is the true worth of property and represents what a third-party investor would be willing to pay for the property. Given rate regulation is a substitute for competition, an

investor would expect to earn an unadjusted rate of return on the investment. This suggests that the fair rate of return should not be adjusted for inflation, though we have included the inflation adjustment. We view this as a voluntary concession that results in a return the Petitioner is willing to accept as adequate under the circumstances in this case.

Q26. HAVE YOU CALCULATED WESTFIELD GAS' FAIR VALUE RATE BASE?

A26. Yes. Westfield Gas' total proposed fair value rate base is $22,073,595, as shown on Attachment CLJ-1, Line 17. The proposed rate base was calculated using the fair value of utility plant, provided by Petitioner's witness Miller, and adding the 13-month average of inventory[4].

- Fair Value of utility plant: $21,672,471
- 13-month average of inventory: $ 401,124
- Total fair value rate base: $22,073,595

Q27. HOW DOES THE FAIR VALUE RATE BASE COMPARE TO THE ORIGINAL COST RATE BASE?

A27. The fair value rate base is $8,196,110 higher than the original cost rate base of $13,877,485, as shown on Attachment CLJ-1, Line 23. For the purposes of my testimony, I refer to the amount by which the fair value rate base exceeds the original cost rate base as the fair value "increment."

Q28. WHAT IS WESTFIELD GAS' FAIR RATE OF RETURN AS OF DECEMBER 31, 2021?

[4] 13 mo. Average inventory is reflected on Attachment CLJ-1, Line 14.

A28. Westfield Gas' fair rate of return is 8.426%, as shown on Attachment CLJ-1, Line 24. This results in a proposed fair return of $1,859,896, which is reflected on Line 25 of the same Attachment.

Q29. HOW DID YOU DETERMINE THE FAIR RATE OF RETURN AND THE FAIR RETURN?

A29. As discussed above, if the fair value of property exceeds the original cost of property, Westfield Gas is entitled to benefit from the increase and the return should be greater. Based on this premise, I use a multi-step approach, that is methodically consistent with rate base development, to determine the fair rate of return and the fair return (Attachment CLJ-1, Lines 19 – 25).

Step 1: Original Cost Return = Original Cost Rate Base X Weighted Cost of Capital

Original Cost Rate Base:	$13,877,485
Times: Weighted Cost of Capital:	9.066%
Original Cost Return:	$1,258,187

The weighted cost of capital is inclusive of the 10.9% cost of equity recommended by Petitioner's witness McKenzie. The 10.9% cost of equity is appropriately **not** adjusted for inflation given original cost rate base excludes the effects of inflation.

Step 2: Fair Value Increment Return = Fair Value Increment X Adjusted Weighted Cost of Capital

Fair Value Rate Base:	$22,073,595
Less: Original Cost Rate Base:	$13,877,485

Fair Value "Increment":	$8,196,110
Times: Adj FV Weighted Cost of Capital:	7.341%
Fair Value Increment Return:	$601,709

The fair value "increment" is the difference between fair value rate base and original cost rate base. Since the "increment" value includes the effect of inflation, I have adjusted the cost of equity for the purpose of computing (a) the adjusted weighted cost of capital and (b) the return on the fair value "increment".

Step 3: Fair Value Return = Original Cost Return + Fair Value "Increment" Return

Since the fair value of property is greater than the original cost of property, Westfield is entitled to the return on original cost plus the return on the fair value "increment".

Original cost return:	$1,258,187
Plus: Fair Value "Increment" Return:	$601,709
Total Fair Value Return:	$1,859,896

Step 4: Fair Value Rate of Return = Fair Value Return / Fair Value Rate Base

The fair value rate of return is simply a mathematical calculation based on the computed fair value return and the fair value rate base

Total Fair Value Return:	$1,859,856
Divided by: Fair Value Rate Base:	$22,073,595
Fair Value Rate of Return:	8.426%

Q30. FOR THE PURPOSE OF DETERMINING THE FAIR RATE OF RETURN, YOU HAVE REDUCED THE COST OF EQUITY BY INFLATION. IS IT MORE APPROPRIATE TO ADJUST THE WEIGHED COST OF CAPITAL FOR INFLATION INSTEAD OF ONLY THE COST OF EQUITY?

A30. No, it is not appropriate to adjust the weighted cost of capital for inflation. The cost of debt is reflective of actual costs and therefore, does not include the effects of inflation. As Petitioner's witness McKenzie points out, adjusting the weighted cost of capital for inflation ignores this economic reality and would, in fact, amount to a "double-dip." Since the cost of debt does not include inflation, any adjustment to it would financially position Westfield Gas to under-recover its debt service costs. This would have reverberating impacts on Westfield Gas' financial position, including (a) potential downward ratings impacts from the credit rating agencies, (b) an inability to meet debt obligations, and (c) severe limitations on accessing the debt markets, among others. From a practicality standpoint, Westfield Gas' current cost of debt is 3.59%. An inflation adjustment of –2.3% (comparable to the cost of equity adjustment), would imply cost of debt of 1.29%, which is woefully below our actual debt costs. Therefore, only the cost of equity (and not the cost of debt) should be adjusted for inflation.

Q31. PLEASE DESCRIBE THE INVESTOR SUPPLIED CAPITAL COMPONENTS THAT YOU HAVE REFLECTED IN THE CALCULATION OF WESTFIELD GAS' RATE OF RETURN.

A31. Westfield Gas seeks to maintain its financial integrity and a high investment grade profile so that we can deliver safe and reliable service at a reasonable cost to our customers.

Maintaining an appropriate capital structure and a high investment grade profile are important to ensure (a) we can access the credit markets at attractive rates during all economic cycles and (b) we can meet our financial obligations.

Attachment CLJ-1 includes Westfield Gas' investor-supplied capitalization as of December 31, 2021, updated for the new debt issuance noted earlier. This includes components of long-term debt, customer deposits, and common equity. The investor-supplied capital structure consists of 24.8% long-term debt, 75% common equity, and 0.2% customer deposits.

Q32. DOES WESTFIELD GAS' CAPITAL STRUCTURE HAVE AN APPROPRIATE EQUITY COMPONENT TO ENABLE THE COMPANY TO ACHIEVE FINANCIAL INTEGRITY?

A32. Yes. Although Westfield Gas' growth has been commensurate with the City of Westfield's growth, Westfield Gas is still a small entity that is growing into its capital structure. It is not financially responsible for a company of its size to be leveraged at levels comparable to larger investor-owned utilities ("IOU"). However, as Westfield Gas grows, its leverage position will continue to transition to that of a traditional IOU. In fact, we have started to see the transition. Since 2016, Westfield Gas' equity ratio has reduced from 100% to ~75% (as of December 31, 2021). This managed approach to capital structure takes into consideration (a) the (in)ability to access the debt markets given company size and debt service coverage capacity, (b) potential adverse consequences from an untimely overleveraged position, and (c) higher costs passed on to ratepayers.

Q33. WHAT CAN WESTFIELD GAS DO TO IMPROVE ITS ABILITY TO RAISE DEBT CAPITAL TO SERVE ITS GROWING CUSTOMER BASE?

A33. The first step is to receive the rate increase requested in this case. Westfield Gas has not increased its base rates since 2017; consequently, its present rates have become inadequate to the point that it cannot prudently raise debt beyond the amount I mentioned earlier in my testimony. Furthermore, the new debt issuance, executed in July 2022 at a 4.05% rate and 7-year term, was a private placement with a large institution, rather than trying to secure long-term bank financing. This transaction enabled Westfield Gas to avoid the need to amortize debt principal ratably over the life of the debt, (Note, amortization of debt principal would have been required with a bank financing). This will improve Westfield Gas' cash flow and hopefully enable it to develop a record of comfortably servicing its debt. By beginning to develop such a track record, I expect Westfield Gas eventually will be able to increase the pool of potential investors that would be interested in extending long-term debt. If a sufficiently large pool of potential debt investors can ultimately be cultivated, it might be possible for Westfield Gas to eventually raise debt that did not require the principal to be amortized; instead, a large percentage of the principal would be entirely due at final maturity of the debt. The ultimate goal would be to create confidence that Westfield Gas would always be able to issue new debt to replace the maturing old debt. Such an outcome would substantially minimize its annual debt service requirement, increase its cash flow, positively impact its credit rating, and ultimately benefit our customers.

Q34. WHAT IS THE BASIS FOR THE COMMON EQUITY RATE OF 10.9% AS SHOWN ON ATTACHMENT CLJ-1?

A34. The common equity rate of 10.9% has been developed and recommended by Petitioner's witness McKenzie. For purposes of calculating the fair value "increment" cost of capital only, Petitioner's witness McKenzie recommends adjusting the common equity rate of 10.9% by 2.3% to account for inflation. This results in a cost of equity of 8.6% for the fair value "increment".

Q35. HOW WAS THE COST RATE FOR CUSTOMER DEPOSITS AS SHOWN ON ATTACHMENT CLJ-1 DEVELOPED?

A35. The cost rate for Customer Deposits is 0.5%, which as of April 1, 2022, is the rate for one-year U.S. Treasury Constant Maturity securities rounded to the nearest one-half (1/2) of one percent (1%), as published by the Commission.

Q36. PLEASE DISCUSS THE LONG-TERM DEBT AND COST INCLUDED IN THE CAPITAL STRUCTURE.

A36. Westfield Gas did not have long-term bonds outstanding at December 31, 2021. Westfield Gas, did, however, have $5 million of debt borrowed, from its bank term loan and bank line of credit, at December 31, 2021. As discussed earlier, in July 2022, Westfield Gas issued $4 million of new long-term debt through a private placement offering. This debt was priced at 4.05% and the proceeds were used to pay off our $1 million bank term loan and pay down $3 million drawn from our line of credit. Upon the paydown, $1 million remains drawn on the line of credit. The average borrowing cost, shown on Attachment

CLJ-2, Line 14, for the new private placement and the outstanding draw on the line of credit is 3.59%.

Q37. BANK LINES OF CREDIT AND TERM LOANS ARE USUALLY CONSIDERED SHORT-TERM. EXPLAIN WHY WESTFIELD GAS HAS INCLUDED THE $1 MILLION DRAWN ON THE LINE OF CREDIT IN ITS CAPITAL STRUCTURE.

A37. $1 million has been drawn from Westfield Gas' line of credit. This line of credit does not mature until March 30, 2025. Given the maturity is greater than twelve months, the amount drawn is recognized as long-term debt for accounting purposes.

Q38. WHAT IS THE INTEREST RATE ON WESTFIELD GAS' LINE OF CREDIT?

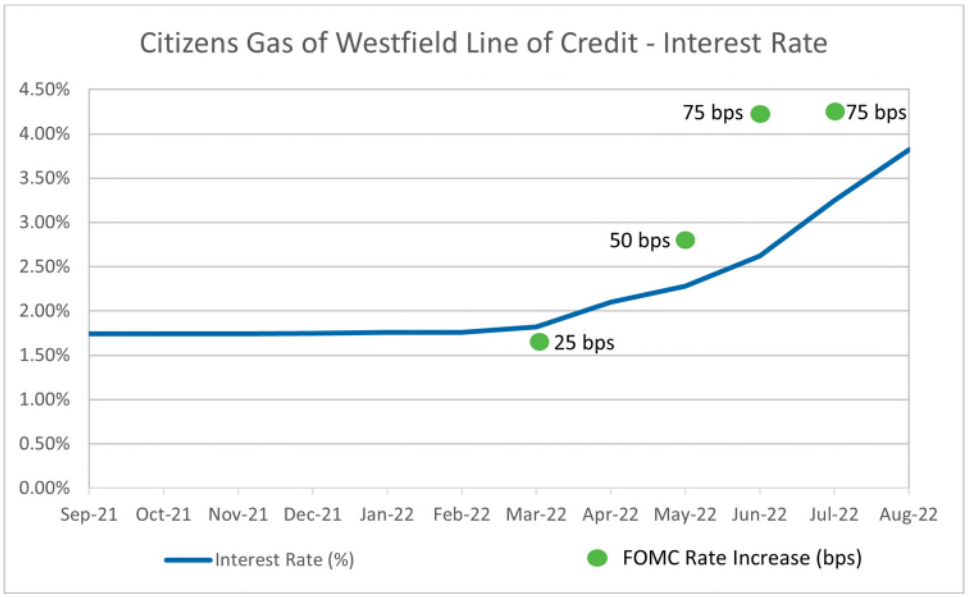
A38. Westfield Gas drew $1 million on its term loan in August 2021. This amount remained drawn at the end of the test year, December 31, 2021. As shown on Attachment CLJ-2, Line 10, the term loan's average annual interest rate from August 2021 to December 2021 was 1.74%. This rate is included in the total cost of debt calculation reflected on Lines 12 - 14 of the same attachment.

Q39. IS THE INTEREST RATE ON THE LINE OF CREDIT FIXED OR VARIABLE?

A39. The interest rate on the line of credit is variable. Prior to August 2022, the variable rate was applied to the drawn balance and was priced at London Interbank Offered Rate ("LIBOR") + 1.65%. The line of credit was renewed in August 2022 and the variable rate is now priced at Bloomberg Short-Term Bank Yield Index ("BSBY") + 1.65%.

Q40. HAS THE INTEREST RATE ON THE WESTFIELD GAS LINE OF CREDIT CHANGED SINCE THE END OF THE TEST YEAR?

A40. Yes. Since March 2022, the U.S. Federal Reserve ("Fed"), via its Federal Open Market Committee ("FOMC"), has increased the federal funds rate, in aggregate, by 2.25%. Consequently, Westfield Gas is experiencing the effects of this rising interest rate environment on its line of credit. As shown in the graph below, the increased cost of borrowing on the line of credit has coincided with the Fed's announced rate increases in March, May, June and July 2022.



Q41. WILL THE LINE OF CREDIT INTEREST RATE BE UPDATED DURING THIS RATE CASE PROCEEDING?

A41. Yes, I plan to update the line of credit interest rate used in this proceeding, pending further interest rate increases that are the result of actions from the Fed.

CONCLUSION

Q42. PLEASE SUMMARIZE THE PRINCIPAL POINTS IN YOUR TESTIMONY.

A42. Westfield Gas' base rates and charges were established over five years ago. Since that time, Petitioner has made significant investments in the utility plant necessary to serve the growth the City of Westfield has experienced, nearly doubling rate base. At the same time, operating costs have increased. Westfield Gas needs to improve its financial integrity in order to be able to access the public debt market as a source of capital funding and meet the growth expected to continue in the Westfield community. Adjusting rates to allow the Petitioner an opportunity to earn a fair return on the fair value of its rate base is an important step to that end. We have taken a measured approach by proposing a reasonable fair value rate base and a fair rate of return. Based on the foregoing and the testimony of the other witnesses testifying in support of Westfield Gas' Petition, I respectfully request the Commission grant Petitioner the relief it has requested.

Q43. DOES THAT CONCLUDE YOUR PREFILED DIRECT TESTIMONY?

A43. Yes.

VERIFICATION

The undersigned affirms under the penalties for perjury that the foregoing testimony is true to the best of his knowledge, information and belief.

Craig Jackson

Citizens Gas of Westfield **Attachment CLJ-1**
Rate Base, Cost of Capital and Return

Line No.

Average Inventory:

		164150 - Gas Stored Underground - Panhandle Contracted[1]	164155 - Gas Stored Underground - CEG Contracted[2]	Month End Balance	
1	Dec-20	239,294		$ 239,294	
2	Jan-21	143,248		143,248	
3	Feb-21	64,280		64,280	
4	Mar-21				no storage contracts in place
5	Apr-21				no storage contracts in place
6	May-21				no storage contracts in place
7	Jun-21				no storage contracts in place
8	Jul-21				no storage contracts in place
9	Aug-21				no storage contracts in place
10	Sep-21				no storage contracts in place
11	Oct-21				no storage contracts in place
12	Nov-21				no storage contracts in place
13	Dec-21		1,157,672	1,157,672	
14	Dec. 2020 - Dec. 2021 Average			$ 401,124	

			Amount
15	Fair Value Rate Base	Testimony of Scott Miller	$ 21,672,471
16	13 Mo. Avg. Inventory	Line 14	401,124
17	Total		$ 22,073,595

			Amount
18	Original Cost Rate Base	Testimony of Camela Johnson	$ 13,877,485

			Amount	Percent of Total	Cost of Capital	Weighted Cost of Capital	Inflation Adjustment	FV Cost of Capital	Adjusted FV Weighted Cost of Capital
19	Common Equity	Attachment SEK-1, page 1, Line 17	$ 15,109,326	75.00%	10.90% [3]	8.175%	-2.3000% [3]	8.6000%	6.450%
20	Short and Long-Term Debt	Attachment SEK-1, page 1, Line 18 + Line 2	5,000,000	24.82%	3.59% [4]	0.891%		3.5880%	0.891%
21	Customer Deposits	Attachment SEK-1, page 1, Line 24	36,500	0.18%	0.50% [5]	0.001%		0.5000%	0.001%
22	Total Capitalization		$ 20,145,826	100.00%		9.066%			7.341%

			Original Cost	Fair Value Increment	Total Fair Value
23	Total Rate Base	Line 20 (Original Cost); Line 17 (Fair Value)	$ 13,877,485	$ 8,196,110	$ 22,073,595
24	Weighted Cost of Capital	Line 22	9.066%	7.341%	8.426%
25	**Return**	Line 23 * Line 24	$ 1,258,187	$ 601,709	**$ 1,859,896**

[1] Storage Contract with Panhandle ended in March 2021
[2] Storage Contract with CEG began in December 2021
[3] Testimony of Adrien McKenzie
[4] Attachment CLJ-2, Line 14
[5] IURC GAO 2021-04

Citizens Gas of Westfield **Attachment CLJ-2**
Cost of Debt

Line No.	Month	(a) Term Loan Drawn	(b) Interest Rate %[1]	(c = a x b) Annualized Interest
1	Apr-21			
2	May-21			
3	Jun-21			
4	Jul-21			
5	Aug-21	$1,000,000	1.74	$17,400
6	Sep-21	$1,000,000	1.74	$17,400
7	Oct-21	$1,000,000	1.74	$17,400
8	Nov-21	$1,000,000	1.74	$17,400
9	Dec-21	$1,000,000	1.75	$17,500
10	Average Annual Interest Rate [d = sum(c) / sum(a)]			1.74%

Line No.	New Debt Issue	(e) Debt Outstanding	(f) Interest Rate %(2)	(g = e x f) Annualized Interest	Month Issued	Term
11	Gas Utility Revenue Bond, Series 2022	$4,000,000	4.05	$162,000	Jul-22	7 years

Line No.	Debt	Debt Outstanding	Interest Rate %	Annualized Interest	
12	Gas Utility Revenue Bond, Series 2022	$4,000,000	4.05	$162,000	Line 11
13	Term Loan	$1,000,000	1.74	$17,400	Lines 5 - 10
14	Total Debt	$5,000,000	3.59	$179,400	

(1) Interest on outstanding principal under the Term Loan Agreement is charged at a rate per annum equal to the LIBOR Rate, as determined for each applicable Interest Period, plus 1.65%. The Term Loan became effective in August 2021 and the $1,000,000 balance remained outstanding at the end of the Test Year. After Westfield Gas completed its $4 million private placement, as noted in footnote 2 below, Westfield Gas had $1 million of short-term debt outstanding and expects this balance to remain outstanding for the foreseeable future. Therefore, it is considered long-term debt for ratemaking purposes.

(2) At the end of the Test Year (December 31, 2021), Westfield Gas had $4 million drawn on its revolving line of credit and $1 million on its term loan. In July 2022, Westfield Gas completed a 7-year, $4 million private placement debt issuance at a 4.05% fixed rate. The proceeds from the private placement were used to pay off the $1 million term loan and pay down $3 million drawn from the line of credit. For purposes of determining Westfield Gas' average cost of debt, (a) the $4 million private placement was used in lieu of the historical line of credit and (b) the interest cost from the historical term loan, at $1 million drawn, was used.