

INDIANA GAS COMPANY, INC.
d/b/a VECTREN ENERGY DELIVERY OF INDIANA, INC.

A CENTERPOINT ENERGY COMPANY

(VECTREN NORTH)

FILED
December 18, 2020
INDIANA UTILITY
REGULATORY COMMISSION

IURC CAUSE NO. 45468

DIRECT TESTIMONY

OF

ROBERT B. MCRAE

VICE PRESIDENT AND TREASURER

ON

CAPITAL STRUCTURE AND COST OF DEBT

Glossary of Acronyms

CenterPoint	CenterPoint Energy, Inc.
Company	Indiana Gas Company, Inc. d/b/a Vectren Energy Delivery of Indiana, Inc.
FSA	Financial Services Agreement
IURC or Commission	Indiana Utility Regulatory Commission
Petitioner	Indiana Gas Company, Inc. d/b/a Vectren Energy Delivery of Indiana, Inc.
Service Company	CenterPoint Energy Service Company, LLC
Vectren	Vectren Corporation
Vectren North	Indiana Gas Company, Inc. d/b/a Vectren Energy Delivery of Indiana, Inc.
Vectren South	Southern Indiana Gas and Electric Company d/b/a Vectren Energy Delivery of Indiana, Inc.
Vectren Ohio	Vectren Energy Delivery of Ohio, Inc.
VUHI	Vectren Utility Holding, Inc.

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DIRECT TESTIMONY OF ROBERT B. MCRAE

1 **I. INTRODUCTION**

2

3 **Q. Please state your name and business address.**

4 A. My name is Robert Bruce McRae. My business address is 1111 Louisiana St,
5 Houston, TX 77002.

6

7 **Q. By whom are you employed?**

8 A. I am employed by CenterPoint Energy Service Company, LLC ("Service Company"),
9 a wholly-owned subsidiary of CenterPoint Energy, Inc. ("CenterPoint"). The Service
10 Company provides centralized support services to CenterPoint's operating units,
11 which includes Vectren Corporation ("Vectren"), a wholly-owned subsidiary of
12 CenterPoint.

13

14 **Q. On whose behalf are you testifying in this proceeding?**

15 A. I am testifying on behalf of Indiana Gas Company, Inc. d/b/a Vectren Energy Delivery
16 of Indiana, Inc. ("Petitioner", "Vectren North" or "the Company"), which is a subsidiary
17 of Vectren.

18

19 **Q. What is your role with respect to Petitioner Vectren North?**

20 A. I am Vice President and Treasurer for CenterPoint, the ultimate parent company of
21 Vectren North. I have the same role with two other utility subsidiaries of Vectren –
22 Southern Indiana Gas and Electric Company d/b/a Vectren Energy Delivery of Indiana,
23 Inc. ("Vectren South") and Vectren Energy Delivery of Ohio, Inc. ("Vectren Ohio").

1

2 **Q. Please describe your educational background.**3 A. I have a Bachelor of Science in Management from Brigham Young University and a
4 Master of Business Administration from Indiana University's Kelley School of
5 Business.

6

7 **Q. Please describe your professional experience.**8 A. I have been employed by CenterPoint since 2011 and have held various positions
9 within the company. From 2011 to 2012, I was a lead analyst in the Corporate Strategic
10 Planning group responsible for assisting various business units and functions with the
11 creation of their strategic plans. From 2012 to 2015 I was a manager in the Investor
12 Relations group where I was responsible for communicating financial, strategic, and
13 operational information to existing and prospective investors and research analysts.
14 Since 2015 I have worked in the Treasury group.

15

16 **Q. Provide some specific examples of activities you have undertaken during your
17 time in the Treasury department.**18 A. I have managed the debt service and compliance of more than \$15 billion of external
19 debt, led 16 external bond offerings aggregating \$5.7 billion, led multiple transactions
20 regarding CenterPoint and its subsidiaries' \$5.1 billion credit agreements, co-led a \$5
21 billion Bridge facility syndication, among other things.

22

23 **Q. What are your present duties and responsibilities as Vice President and
24 Treasurer?**

25 A. I am responsible for all Treasury functions of CenterPoint and its subsidiaries,

1 including Vectren, the parent company of Vectren North. Treasury includes all short-
2 term and long-term financing, short-term investing, cash management, pension and
3 savings plan administration, banking relationships, and rating agency relationships. In
4 addition, I am responsible for the credit risk function of CenterPoint and CenterPoint
5 Energy Houston Electric, LLC.

6

7 **Q. Have you ever testified before any state regulatory commission?**

8 A. Yes. I have testified before the Indiana Utility Regulatory Commission ("IURC" or "the
9 Commission") on behalf of Vectren South in its most recently filed general gas rate
10 case proceeding, Cause No. 45447. Additionally, I have testified on behalf of
11 CenterPoint Energy Houston Electric, LLC in dockets 48226 and 49421 and on behalf
12 of CenterPoint Energy Minnesota Gas in dockets G-008/GR-17-285 and G-008/GR-
13 19-524.

14

15 **Q. What is the purpose of your testimony in this proceeding?**

16 A. My testimony will provide an overview of the components of Vectren North's capital
17 structure and its weighted average cost of capital.

18

19 **Q. Are you sponsoring any attachments in this proceeding?**

20 A. Yes. I am sponsoring the following attachments in this proceeding:

- 21 • The D Schedules of Petitioner's Exhibit No. 18, Capital Structure and Cost of
22 Capital

23

24 **Q. Were these schedules prepared by you or under your supervision?**

25 A. Yes, they were.

1

2

3 **II. CAPITAL STRUCTURE**

4

5 **Q. What topics do you discuss in this section of your testimony?**

6 A. In this part of my testimony I explain the importance of establishing a capital structure
7 that will help preserve the financial integrity of the Company, thereby allowing it to
8 maintain access to capital on reasonable terms in all market conditions. Next, I
9 describe the Company's projected capital structure for the test year and I explain why
10 that capital structure is reasonable.

11

12 **Q. What does the phrase "capital structure" mean in the context of utility
13 ratemaking?**

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

22

23 **Q. Are there other capital structure components other than investor provided debt
24 and equity used to determine Vectren North's requested capital structure?**

25 A. Yes. In addition to investor provided debt and equity, there are several additional

1 components included in the regulatory capital structure calculation such as customer
2 deposits, accumulated deferred income taxes, prepaid pension and investment tax
3 credits. Petitioner's Exhibit No. 18, Schedule D-1 details all of the components used
4 to calculate the Company's requested capital structure.

5

6 **Q. Why does a utility finance its assets and operations with different types of**
7 **capital?**

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

1 **Q. What is the forecasted capital structure for this case?**

2 A. Table RBM-1 below details the Company's forecasted capital structure.

3

Table RBM-1

Long-Term Debt	36.88%
Preferred Stock	0.00%
Common Equity	46.22%
Cost Free Capital	15.29%
Other Capital	1.61%
Total Capital	100.00%

4

5 **Q. What investor provided capital structure is reflected in the Company's**
6 **forecasted capital structure?**

7 A. As is detailed in workpapers to Petitioner's Exhibit No. 18, D Schedules, WPD-1.1, the
8 investor provided capital structure consists of 44.38% long-term debt and 55.62%
9 common equity. This reflects a projected capital structure and will be updated to actual
10 as of June 30, 2021 for Phase 1 rates, and actual as of December 31, 2021 for Phase
11 2 rates, as discussed by Petitioner's Witness Angie M. Bell.

12

13 **Q. Does the Company directly issue equity into the external capital markets?**

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

20

1 **Q. Does the Company issue debt into the external capital markets?**

2 A. In the past, the Company did issue debt in the public or private debt capital markets,
3 however today all of its debt capital is issued to VUHI.

4

5 **Q. Are there any forecasted debt issuances included in Vectren North's investor
6 provided capital structure during the test year?**

7 A. There are two notes planned for issuance in 2021 aggregating \$80 million. The \$80
8 million will be used to term out short-term borrowing and invest in capital expenditures.

9

10 **Q. You testified earlier that the Company's investor provided capital structure
11 includes 55.62% common equity. Why is that percentage reasonable and
12 appropriate?**

13 A. The projected common equity ratio of 55.62% as of the end of the test year is
14 reasonable for several reasons. First, it is consistent with equity ratios found to be
15 reasonable for other utilities within Indiana in recent Commission orders. Second, it is
16 reasonable as compared to the equity ratios of the Company's proxy group, as
17 presented by Petitioner's Witness Ann E. Bulkley. Finally, this is consistent with
18 current financing authority as approved in Cause No. 45171 for Vectren North.

19

20 **Q. You testified that a 55.62% equity ratio is consistent with equity ratios found by
21 the Commission to be reasonable for other utilities. What findings are you
22 referring to?**

23 A. The IURC issued an order in the Duke Energy rate case (Cause No. 45253) on June
24 29, 2020 which included an investor provided equity ratio of 53%. Additionally, the
25 IURC issued an order approving a settlement in the NIPSCO electric rate case (Cause

1 No. 45159) on December 4, 2019 which included an investor provided equity ratio of
2 57% and an order approving a settlement in the NIPSCO gas rate case (Cause No.
3 44988) on September 19, 2018 which included an investor provided equity ratio of
4 56.02% at the end of the test year in that case. Given that the equity ratio being
5 requested in this case is within the range of these recent orders, the request is
6 reasonable.

7

8 **Q. Your second reason for testifying that a 55.62% equity ratio is reasonable is that**
9 **it is reasonably comparable to the equity ratios of the Company's proxy group.**
10 **Has the Company provided an analysis comparing its proposed equity ratio to**
11 **the equity ratios of the proxy group companies?**

12 A. Petitioner's Witness Bulkley's direct testimony demonstrates that equity ratios of the
13 proxy group range from 50.03% to 66.58% with an average of 58.88%. As Petitioner's
14 Witness Bulkley states, this demonstrates that "Vectren North's projected equity ratio
15 of 55.62% is near the average equity ratio for the utility operating subsidiaries of the
16 proxy groups."

17

18 **Q. You testified earlier that the Company is requesting approval of a capital**
19 **structure containing 44.38% long-term debt. Is that debt ratio reasonable?**

20 A. Yes. That long-term debt ratio reflects projected long-term debt issuances during the
21 test year. See Petitioner's Exhibit No. 18, Schedule D-1. The determination of the cost
22 of debt associated with those projected issuances is discussed below.

23

24

1 **III. COST OF CAPITAL**

2

3 **Q. What topics do you discuss in this section of your testimony?**

4 A. I discuss the components of the Company's weighted average cost of capital.

5

6 **Q. What is the Company's requested weighted average cost of capital?**

7 A. The Company's requested weighted average cost of capital is 6.32%.

8

9 **Q. What is the weighted cost of the long-term debt portion of Vectren North's**
10 **capital structure?**

11 A. As shown in Petitioner's Exhibit No. 18, Schedule D-1, Vectren North's forecasted
12 weighted average cost of long-term debt as of the end of the test year is 4.36%. The
13 details used to calculate this cost of long-term debt are shown in Petitioner's Exhibit
14 No. 18, Schedule D-2. This cost rate reflects the carrying value of the long-term debt,
15 which reflects the unamortized issuance costs.

16

17 **Q. Previously you had mentioned that one source of debt capital was intercompany**
18 **notes between VUHI and the Company. How are the interest rates for those**
19 **notes determined?**

20 A. The interest on the intercompany notes between VUHI and the Company is governed
21 by the Financial Services Agreement ("FSA") each entity entered into as of December
22 31, 2011. Per the FSA, "interest shall be charged on the unpaid outstanding balance
23 ... at a rate per annum equal to the rate paid and to be paid by Lender with respect to
24 the borrowings it made in order to provide funds to Borrower hereunder." For example,
25 if VUHI borrows \$100 million at a rate of 4.0%, any intercompany notes put in place

1 between VUHI and the Company associated with that \$100 million borrowing would
2 carry the same 4.0% interest rate.

3

4 **Q. Earlier in your testimony you mentioned that there were expected debt**
5 **issuances planned for the test year. What is the interest rate assumed for those**
6 **issuances and what is the impact to the cost of long-term debt?**

7 A. The first issuance during the test year of \$50 million will have a coupon of 1.21%. The
8 second issuance during the test year of \$30 million assumes a coupon of 2.87%. Both
9 of these low coupons are included in the proposed cost of long-term debt and have
10 the effect of lowering the cost of debt to the projected 4.36%.

11

12 **Q. What was the cost of equity used to calculate the Company's proposed cost of**
13 **capital?**

14 A. The cost of equity used in the determination of the overall cost of capital was 10.15%.
15 Details regarding the cost of equity estimate can be found in Petitioner's Witness
16 Bulkley's direct testimony.

17

18 **Q. Are there other capital structure components for purposes of determining**
19 **Vectren North's cost of capital?**

20 A. Yes. As mentioned earlier, Petitioner's Exhibit No. 18, Schedule D-1 and the
21 supporting workpapers contain a listing of those components and their proposed
22 weighted average interest rates. That schedule includes customer deposits at a 1.50%
23 weighted average interest rate and investment tax credits at a rate of 7.58%.

24

1 **Q. Are there any cost-free components included in Vectren North's proposed cost**
2 **of capital?**

3 A. Yes. Accumulated deferred income taxes, customer advances for construction, other
4 post-employment benefits ("OPEB"), and prepaid pension were included at zero cost.
5 Accumulated deferred income taxes are addressed by Petitioner's Witness Brenda L.
6 Musser. Customer advances for construction are discussed by Petitioner's Witness
7 Bell.

8

9 **Q. What is the prepaid pension asset and why is it included in the capital structure?**

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

23

24 **Q. You also mentioned OPEB. What is that and why is it in the capital structure?**

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

9

10

11 **IV. CONCLUSION**

12

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

14 A. Yes, it does.

VERIFICATION

I, Robert B. McRae, affirm under the penalties of perjury that the forgoing representations of fact in my Direct Testimony are true to the best of my knowledge, information and belief.



Robert B. McRae

Dated: December 18, 2020