REDACTED

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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| IN THE MATTER OF THE REQUEST OF DOMINION ENERGY UTAH FOR APPROVAL OF A VOLUNTARY RESOURCE DECISION TO CONSTRUCT AN LNG FACILITY | Docket No. 19-057-13 |

**REBUTTAL TESTIMONY OF KELLY B. MENDENHALL**

**FOR DOMINION ENERGY UTAH**

September 12, 2019

**DEU HIGHLY CONFIDENTIAL Exhibit 1.0R**

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

A. My name is Kelly B. Mendenhall. My business address is 333 South State Street, Salt Lake City, Utah.

**Q. Did you file direct testimony in this docket?**

A. Yes.

**Q. What is the purpose of your rebuttal testimony in this Docket?**

A. I address certain issues raised in the direct testimony filed by Mr. Lawton, Mr. Wheelwright, Mr. Neale and Mr. Ware.

**Q. In his testimony, Mr. Lawton states that ASC 842 does not create new or different financial metric impacts for utility Companies. Do you agree with this assessment?**

A. Yes, I do, and I appreciate the clarification. While ASC 842 has created a new accounting requirement that the net present value of lease payments be booked as a liability, prior to the issuance of ASC 842, credit rating agencies were already treating these leases as liabilities. As Mr. Lawton acknowledges in his testimony: "The reason rating agencies have imputed debt for evaluating financials and borrowing strength is that leases and lease type transactions create fixed, debt-like, financial obligations. These debt-like obligations are substitutes for capital investments and should be reflected in the financial metric calculations." It is not the timing of ASC 842 but the treatment of these leases by the credit rating agencies that would cause an additional equity issuance to be made to maintain credit metrics.

**Q. Why would an additional equity issuance be necessary?**

A. Take, for example, [redacted]. Based on my analysis shown in the [redacted] in exhibit 1.07 of my testimony, the Net Present Value of the lease payments in 2022 when the proposed contract would go into service would be [redacted] This number is shown in cell [redacted] As Mr. Lawton describes in lines 118 to 127 of his testimony, this would be reflected in the credit agency financial metric calculations as debt.

**Q. If lease payments were reflected as debt by the credit agencies, how would those payments impact the credit metrics?**

A. Let's assume the current Commission-approved capital structure of 52% equity and 48% debt. The associated debt and equity dollar amounts for this debt/equity ratio are shown in the table below:

| | Amount | Percentage |
|---|---|---|
| Debt | $904,000,000 | 48% |
| Equity | $982,000,000 | 52% |
| Total | $1,886,000,000 | 100% |

If the [redacted] contract were executed, the lease payment net present value of [redacted] would have to be added to the cost of debt and the amount of debt for credit agency purposes would be [redacted].

**Q. How does this negatively impact the credit agency metrics?**

A. All of the rating agencies look at some form of cash flow divided by debt to measure the health of the utility. Standard and Poor's uses funds from operations (FFO) divided by debt, and Moody's uses Cash Flow from Operations Pre-working Capital (CFO Pre-WC) divided by debt. For simplicity I will refer to both metrics as FFO/Debt going forward. Using the 2018 funds from operations of $166 million per year as calculated by Moody's, FFO/debt would be 18% before the [redacted] contract is included. The 18% is calculated by taking $166 million in cash divided by $904 million in long term debt.

**Q. What happens to the FFO/Debt metric when the [redacted] lease payments are included?**

A. FFO/Debt drops to [redacted]

**Q. Are there any negative ramifications of having the FFO/Debt drop [redacted]**

A. Yes, most likely Dominion Energy Utah would receive a downgrade. As DEU issues its own debt, its cost of debt would be higher going forward, resulting in additional cost to customers.

**Q. What remedies would DEU have if it were placed in this situation?**

A. DEU could increase cash or reduce debt. A company can increase cash by not issuing dividends, but DEU is currently not issuing any dividends, so DEU could not resort to that as a remedy as that's a lever that's already been pulled. A company can also reduce debt by issuing more equity. In this example, the Company would most likely issue [redacted] in equity and use it to buy-back debt in order to maintain the existing capital structure. The capital structure including the NPV of lease payments would then look like this:

| | Amount | Percentage |
|---|---|---|
| Debt | [redacted] | 48% |
| Equity | [redacted] | 52% |
| Total | [redacted] | 100% |

**Q. What effect would this rebalancing have on the FFO/debt calculation?**

A. The FFO/Debt would increase from [redacted] Keeping this metric above [redacted] would most likely help avoid a potential downgrade.

**Q. How did you estimate that this imputed debt would impact the revenue requirement calculation?**

A. I began by assuming that the NPV of the leases would necessitate a rebalancing of the capital structure and that it would be split between equity and debt using the Commission-approved capital structure of 52%. I then multiplied the $135 million attributed to equity by the current Commission-approved pretax return on equity of 13.08% (9.85% divided by 1 – 24.72% tax rate). I then subtracted the interest savings from reducing my debt costs. I used the Commission-approved cost of debt of 5.25%. The calculation is shown in the table below:

| | Inputs | Calculated Amounts |
|---|---|---|
| NPV of Lease Payments | [redacted] | |
| Debt Percentage | 52.07% | $135,029,435.4 |
| Pretax Return on Equity | 13.08% | [redacted] |
| Interest Savings | 5.25% | [redacted] |
| Pretax ROE less Interest Savings | | $10,578,860 |

I performed this calculation for every year of the contract and levelized those net present value calculations to calculate [redacted] imputed debt amount that I used in the cost comparisons.

**Q. Isn't DEU's current capital structure higher than the Commission-approved equity level of 52%?**

A. Yes, but the same principle would apply. To maintain the Company's credit metrics for any target capital structure, the Company would need to rebalance its equity levels to mitigate the impact of the lease payments on the FFO/debt calculation.

**Q. If the Commission ultimately determined that that the imputed debt calculation should be removed from the revenue requirement calculation, does that change the overall ranking and make the [redacted] project the preferred choice?**

A. No. There are additional quantitative and qualitative considerations that would still result in the [redacted] project not being the preferred choice.

**Q. Please discuss the additional considerations.**

A. In addition to the creditworthiness issues I discussed in my direct testimony, the details of the [redacted] proposal caused additional concerns. DEU Highly Confidential Exhibit 1.01R provides a list of follow-up questions that DEU asked [redacted] about its proposal. The answers indicate that the proposal was based upon the premise that [redacted].

**Q. Which answers specifically caused concern to the Company?**

A. In Question number two, the Company asked [redacted]

**Q. Why is this a concern?**

A. [redacted]

[redacted] Mr. Neale shared a similar concern in his testimony [redacted] On lines 628 – 632, Mr. Neale states that he's concerned that the Company-owned LNG facility could be used to make sales to non-firm customers and interstate pipelines rather than being preserved to maintain reliable service.

**Q. Mr. Wheelwright and Mr. Neale express concern that transportation customers will use the facility without paying for it and that they should be allocated a portion of the costs of the facility. Do you think any use of this facility should be charged to TS customers?**

A. This facility is not sized to increase the supply reliability for TS customers. While it is true that there may be some that theoretically could use it during cold weather periods, I maintain that the best way to manage unauthorized use of this facility from TS customers is through strict penalties. If parties don't feel that the current penalty and the Company's existing imbalance policies are adequate to change the behavior of these customers, then the solution is a higher penalty, or revision of the imbalance policies, not the allocation of costs of the facility to these customers. Allocating costs to these customers will give them the right to use the facility during times when the system is constrained, which would undermine the reliability DEU seeks to provide to its service customers through the LNG facility. DEU wants the opposite behavior from transportation customers on those days.

**Q. In Mr. Neale's summary he states that DEU should be held to maintain the construction costs of its facility consistent with its current estimates and that those costs be reviewed in the next rate case or single-issue cost review proceeding. Does the existing regulatory framework already address this concern?**

A. Yes. Utah Code 54-17-403(1)(b) outlines that any increases in preapproved project costs would have to be approved by the Commission in a separate proceeding. The Company will comply with this and other provisions of the Voluntary Resource Decision statutes.

**Q. Mr. Neale recommends that the benefits of using LNG for a satellite facility should be analyzed in a future proceeding when more accurate costs can be provided. Do you agree with this recommendation?**

A. In its Order in Docket No. 18-057-03, the Commission said, "DEU has presented information in testimony that the LNG Facility would provide the opportunity to extend service to remote, currently unserved, locations at a lower cost than building pipeline facilities; however, neither the costs of such service extensions, nor the cost of building alternative facilities to serve such areas, are part of the record. We conclude that the ability of the LNG Facility to serve remote, currently unserved locations could qualify as a relevant factor under our required analysis, but we find that the record in this proceeding is insufficient to consider that factor." Order, Docket No. 18-057-03, page 19. The Company provided additional information on the benefits of satellite facilities because the Commission indicated that such information may be relevant and helpful. The Company believes that these potential benefits are a relevant factor supporting approval of the proposed facility. That said, the Company agrees that it has not proposed the construction of any of those satellite facilities in this docket, and that should it seek pre-approval for any such facilities, it would need to do so in a separate docket and would need to provide additional information as required by the applicable statutes and regulations.

**Q. Mr. Neale recommends that the Company designate the proposed LNG facility as a materially strategic resource under the provisions of the Settlement Stipulation approved in Docket No. 16-057-01 to assure that it will not transfer ownership and/or control to an affiliate without prior review from the Commission. Are there already conditions in place that would prevent this transfer?**

A. Yes. Paragraph 27 of the Settlement Stipulation in Docket 16-057-01 states, "Dominion Questar Gas will not transfer material assets to or assume liabilities of Dominion or any other subsidiary of Dominion without the Commission's approval." This asset would be a material asset. If the Commission would like to reiterate this commitment in this docket, the Company has no objection.

**Q. Mr. Wheelwright's main criticism seems to be the cost of the facility. He has proposed a variety of cost comparisons for the Commission to consider. Do you have an opinion of which metric is the most relevant?**

A. Because this facility will be included in the Company's rate base and will serve customers for decades, it is difficult to break the cost of the facility into a cost/Dth metric that is meaningful because most of the costs are fixed and unrelated to volumes. The $18.44 per year that Mr. Wheelwright cites to on line 343 is the all-in cost for each GS customer per year. In its order in Docket No. 18-057-03, the Commission said, "While the addition of the LNG Facility and its attendant rate base increase would have an upward effect on rates, this result alone is insufficient reason to withhold approval in this docket. As stated earlier, the issue before us is to determine whether the cost of mitigating the stated risk is reasonable and in the public interest." Order, Docket 18-057-03 at page 17. The Company believes that this cost is just, reasonable and in the public interest because of the added reliability that the proposed LNG facility would provide for the system.

**Q. Mr. Wheelwright notes that part of the [redacted] is made up of [redacted] in O&M costs. Is that correct?**

A. That is what is included in the estimate. I will clarify however that the $5.2 million assumes that the LNG facility will be completely filled and emptied each year. There is [redacted] included in the total O&M cost related to the energy costs to liquefy and vaporize the natural gas. This represents the highest cost scenario. In most years, the facility would not vaporize and liquefy the full capacity of the facility and the costs would be significantly lower. For example, if the facility is filled and only vaporized 30%, as the Company has discussed, the average variable costs in the first five years would be [redacted].

**Q. What impact would this reduction in O&M have on the annual bill impact?**

A. It would reduce the annual cost to [redacted] million per year and the annual bill impact to [redacted] per year.

**Q. Mr. Ware complains that the Company failed to adequately include its stakeholders in its planning process for an LNG facility by not providing sufficient analysis with adequate and required detail. Do you agree with this assessment?**

A. No. The resource is scheduled to go into service in 2022. As Mr. Ware states, DEU first discussed the LNG facility to meet supply reliability concerns in its 2017 Integrated Resource Plan (IRP), five years before the facility would be placed into service. It discussed the facility in its 2018 and 2019 IRPs. In addition, last year in Docket 18-057-03 the Company filed hundreds of pages of testimony and exhibits that provided detail related to the proposed facility. Mr. Ware made these same arguments in that docket, and the Commission's Order in that docket contained the guidance the Company should have issued a request for proposal so that all of the existing alternatives may be reviewed. The Company followed this guidance and issued an RFP and presented the results in this docket. The Company also updated much of the data provided in Docket No. 18-057-03 and provided additional information pertaining to the proposed facility in this docket.

Mr. Ware's contention that the system analysis was lacking is simply unsupported. The Company has provided substantial, and certainly ample, evidence of both, and the Commission's Order in Docket No. 18-057-03 does not indicate otherwise.

**Q. Is there anything else you'd like to clarify in your testimony?**

A. Yes. Mr. Wheelwright suggests that the identified schedule for completion of the LNG facility does not meet the stated in-service requirement as outlined in the RFP. Mr. Gill explains in his testimony that the tank could be filled beginning in September even though the in-service date of the entire facility is November 2019. I have updated DPU 3.14 to adjust for the revised schedule. This information is attached as DEU Exhibit 1.02R.

**Q. Can you summarize your recommendations?**

A. Yes. I recommend that the imputed debt adjustment continue to be included in the revenue requirement comparisons. Even if the Commission were to disagree and remove the imputed debt adjustment, I recommend that the Commission find the Company-owned LNG facility to be the most cost-effective option based on all quantitative and qualitative factors. I also recommend that no cost of the LNG facility be allocated to transportation customers.

**Q. Does this conclude your testimony?**

A. Yes.

State of Utah )
) ss.
County of Salt Lake )

I, Kelly B. Mendenhall, being first duly sworn on oath, state that the answers in the foregoing written testimony are true and correct to the best of my knowledge, information and belief. Except as stated in the testimony, the exhibits attached to the testimony were prepared by me or under my direction and supervision, and they are true and correct to the best of my knowledge, information and belief. Any exhibits not prepared by me or under my direction and supervision are true and correct copies of the documents they purport to be.

Kelly B. Mendenhall

SUBSCRIBED AND SWORN TO this 12th day of September, 2019.

Notary Public

GINGER JOHNSON
Notary Public State of Utah
My Commission Expires on:
August 4, 2023
Comm. Number: 707241