

**BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH**

**IN THE MATTER OF THE REQUEST  
OF DOMINION ENERGY UTAH FOR  
APPROVAL OF A VOLUNTARY  
RESOURCE DECISION TO  
CONSTRUCT AN LNG FACILITY**

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**Docket No. 19-057-13  
Direct Testimony  
of Daniel J. Lawton  
For the Utah Office of Consumer  
Services**

**Exhibits OCS 2.0D & 2.1D**

**August 15, 2019**

**DIRECT TESTIMONY OF  
DANIEL J. LAWTON**

1       **SECTION I: INTRODUCTION/BACKGROUND/SUMMARY**

2       **Q.     PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3       A.     My name is Daniel J. Lawton. My business address is 12600 Hill Country  
4            Boulevard, Suite R-275, Austin, Texas 78738.

5       **Q.     PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**  
6            **WORK EXPERIENCE.**

7       A.     In terms of education I have a BA and MA in Economics and a JD in law. I began  
8            my career in utility regulation in 1981 working as a rate analyst with the  
9            Department of Public Service at the Public Utilities Commission of Minnesota. In  
10           1983 I began work as a utility consultant for the private consulting firm R.W. Beck  
11           & Associates. Consulting engagements included electric utility load and revenue  
12           forecasting, cost of capital analyses, financial analyses, revenue requirements/cost  
13           of service reviews, and rate design analyses in litigated rate proceedings before  
14           federal, state and local regulatory authorities, and in court proceedings. I have  
15           worked with numerous municipal utilities developing electric rate cost of service  
16           studies for reviewing and setting rates. In 1987 I started my own consulting firm  
17           Diversified Utility Consultants, Inc. and continued working in the utility business  
18           and providing expert testimony for clients in various state jurisdictions and the  
19           Federal Energy Regulatory Commission (“FERC”). I have a law practice based in  
20           Austin, Texas. My main areas of legal practice include administrative law  
21           representing municipalities in electric and gas rate proceedings and other litigation  
22           and contract matters. I have included a brief description of my relevant  
23           educational background and professional work experience in Exhibit OCS 2.1D.

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25 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN RATE**  
26 **PROCEEDINGS?**

27 A. Yes, I have testified as an expert witness on various utility rate matters before  
28 numerous regulatory authorities across the country, including a number of cases  
29 in Utah. A list of cases where I have previously filed testimony is included in  
30 Exhibit OCS 2.1D.

31 **Q. ON WHOSE BEHALF ARE YOU FILING TESTIMONY IN THIS**  
32 **PROCEEDING?**

33 A. I have been retained by the Utah Office of Consumer Services (“OCS”) to review  
34 the Dominion Energy Utah (“DEU” or “Company”) request for a Voluntary  
35 Resource Decision to Construct an LNG Facility in this docket.

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

38 A. The purpose of my testimony in this proceeding is to address Company witness  
39 Kelly B. Mendenhall’s testimony and analysis of the Request for Proposal  
40 (“RFP”) evaluations that led to the Company’s decision to self-build a liquefied  
41 natural gas (“LNG”) facility. Specifically, I address the inclusion of imputed debt  
42 in the evaluation of the RFP bids resulting in the decision that a Company-built  
43 LNG facility is the lowest cost option. This issue is discussed at pages 13 and 14  
44 of witness Mendenhall’s testimony and presented in DEU Highly Confidential  
45 Exhibit 1.07.

46 **Q. WHAT MATERIALS DID YOU REVIEW AND RELY ON FOR THIS**  
47 **TESTIMONY?**

48 A. I have reviewed prior orders of the Public Service Commission of Utah  
49 (“Commission”), the Company’s current direct testimony, Company responses to  
50 discovery requests, financial reports of the Company, along with other financial  
51 information, such as Standard & Poor’s (“S&P”) and Moody’s Investor Services  
52 (“Moody’s”) available in the public domain. When relying on various sources, I  
53 have referenced such sources in my testimony.

54 **Q. PLEASE SUMMARIZE YOUR FINDINGS AND CONCLUSIONS IN THIS**  
55 **CASE.**

56 A. My analysis of witness Mendenhall's presentation of the quantitative factors that  
57 led to the Company's determination that the "... **DEU-owned LNG Facility is**  
58 **the preferred option to meet Dominion Energy Utah's supply reliability needs**  
59 **...**" (emphasis added) finds that it is based on a flawed evaluation of debt  
60 imputation favoring the Company's self-build approach over other less costly RFP  
61 bid options.<sup>1</sup> I should note that the Company's decision to self-build the LNG  
62 Facility is based on both qualitative and quantitative factors presented by various  
63 Company witnesses. My testimony addresses only the quantitative factor of debt  
64 imputation and the impact on the Company's decision to self-build.

65 As discussed below, in my opinion, the Company's self-build decision is not  
66 justified if the debt imputation is removed from the analysis of alternative RFP  
67 options available to address gas reliability issues.

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69 **SECTION II: OVERVIEW OF COMPANY'S REQUEST**

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71 **Q. PLEASE DESCRIBE THE COMPANY'S REQUEST IN THIS CASE.**

72 A. The Company has filed a request for Commission pre-approval to construct an on  
73 system Company-owned LNG facility.<sup>2</sup> The Company asserts the construction of  
74 an LNG Facility or some other equivalent alternative is necessary to address  
75 claimed system reliability concerns discussed in the direct testimony of DEU  
76 witness Faust.<sup>3</sup> In a prior similar proceeding, Docket No. 18-057-03, the Company  
77 had requested this Commission's pre-approval to construct an LNG Facility.<sup>4</sup> In  
78 that prior case the Commission declined to authorize the Company's request

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<sup>1</sup> See the Direct Testimony Kelly Mendenhall at page 6-7

<sup>2</sup> See the Direct Testimony Kelly Mendenhall at page 4

<sup>3</sup> See the Direct Testimony Kelly Mendenhall at page 2 & 3

<sup>4</sup> See the Direct Testimony Kelly Mendenhall at page 5

79 because the Commission did not have "... adequate assurance other more cost-  
80 effective options are not available."<sup>5</sup>

81 In response to the Commission's October 22, 2018 Order in Docket No. 18-057-  
82 03 the Company issued an RFP for supply reliability options that would be  
83 compared to the Company owned LNG option already under consideration.<sup>6</sup> The  
84 Company received a number of responses to the RFP and the only issue that I  
85 address is the Company's quantitative evaluation of certain RFP bids relative to  
86 the Company's LNG self-build option. As I stated earlier, the Company's RFP  
87 evaluation by including an imputed debt adder to the RFP bid claimed costs causes  
88 some RFP alternatives to be more costly than the Company's self-build option. In  
89 other words, if the imputed debt is not included in the RFP evaluation then some  
90 of the alternative RFP options are lower cost alternatives to the Company's self-  
91 build option. Thus, the imputed debt issue is determinative whether the self-build  
92 or an RFP option is the lowest cost alternative in this case. A review of DEU  
93 Highly Confidential Exhibit 1.06 shows that removal of "Imputed Debt Cost"  
94 from the economic evaluation makes some RFP alternatives significantly lower  
95 cost alternatives to the Company's self-build option. Thus, in terms of quantitative  
96 evaluation of the issues in this case the imputed debt issue should be of concern  
97 to the Commission.

98 **SECTION III: IMPUTED DEBT**

99 **Q. PLEASE DESCRIBE THE IMPUTED DEBT ISSUE?**

100 A. The issue or reason witness Mendenhall addresses imputed debt and includes  
101 imputed debt as an added cost for the RFP bid comparison to the LNG self-build  
102 proposal is explained at pages 13 and 14 of the direct testimony.

103 The Financial Accounting Standards Board ("FASB") issued Accounting  
104 Standards Codification ("ASC") 842, Leases, which requires lessees to recognize

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<sup>5</sup> See the Direct Testimony Kelly Mendenhall at page 5 Citing the Commission Order issued October 22, 2018; Docket No. 18-057-03, page 18.

<sup>6</sup> See the Direct Testimony Kelly Mendenhall at page 5-6

105 most leases on their balance sheets. In other words, the firm must capitalize all  
106 leases at the present value (PV) of lease payments. As witness Mendenhall  
107 explains ASC 842 "... requires public companies to recognize a right-of-use asset  
108 and a lease liability for all leases on its balance sheet to provide greater clarity to  
109 financial statement users."<sup>7</sup> This applies to a company's financial reporting under  
110 Generally Accepted Accounting Standards ("GAAP") requirements so that  
111 financial statements of a company are comparable for public use. It is not a Utah  
112 regulatory requirement. Moreover, ASC 842 does not create a new cost that must  
113 be imposed on lease proposals included in revenue requirements, as has been done  
114 in witness Mendenhall's analysis.

115 **Q. DO THE ASC 842 LEASE REPORTING REQUIREMENTS CREATE**  
116 **NEW OR DIFFERENT FINANCIAL METRIC IMPACTS FOR UTILITY**  
117 **COMPANIES?**

118 A. No they do not. For a number of years bond rating agencies such as S&P have  
119 employed methodologies to impute debt for leases and purchase power  
120 agreements. The reason rating agencies have imputed debt for evaluating  
121 financials and borrowing strength is that leases and lease type transactions create  
122 fixed, debt-like, financial obligations. These debt-like obligations are substitutes  
123 for debt capital investments and should be reflected in the financial metric  
124 calculations. In other words, because these lease type transactions and fixed  
125 obligations substitute for debt capital investments, rating agencies such as S&P  
126 and Moody's include in a utility's financial metrics imputed debt and interest as  
127 part of the utility's capital structure in evaluating creditworthiness.

128 As noted, this rating agency debt imputation for lease and lease-type  
129 transactions has been occurring for years and it does not change utility revenue  
130 requirements or rate considerations.

131 The ASC 842 requirements are not very different from what rating  
132 agencies have been doing for years. Witness Mendenhall's analysis would have  
133 one believe ASC 842 had created a new financial hurdle – it has not; in fact

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<sup>7</sup> See the Direct Testimony Kelly Mendenhall at page 13

134 utility companies have been dealing with the impact of leases, debt imputation,  
135 and financial metrics for years with bond rating agencies. It is also important to  
136 note that an April 1, 2019 S&P Global Report stated: “Our analytical  
137 adjustments are not generally affected by ongoing changes in accounting rules  
138 ...”<sup>8</sup>

139

140 **Q. DOES WITNESS MENDENHALL AGREE THAT EVEN IF THE**  
141 **IMPUTED DEBT WERE NECESSARY IT WOULD ONLY IMPACT**  
142 **CREDIT METRIC CALCULATIONS?**

143 A. Yes he does. In response to discovery request OCS 2.14 the Company states:

144 If the imputed debt were necessary **it would not have an impact on the**  
145 **capital structure calculations for regulatory or GAAP purposes but it**  
146 **would have an impact on the credit metrics** and would require the  
147 issuance of additional equity and a reduction of debt to keep the debt equity  
148 levels balanced after the calculation of the imputed debt. This would have  
149 an impact on cash flows in the form of lower interest costs and higher  
150 revenue requirements due to the increased equity levels. [emphasis added]

151 As stated by Mr. Mendenhall imputed debt **if necessary** does not impact  
152 regulatory calculations. As I discussed earlier, imputed debt impacts credit metrics  
153 in a similar manner that bond-rating agencies impute debt to reflect leases for  
154 financial metric evaluations.

155 Mr. Mendenhall’s response to this discovery request again contains the claim that  
156 additional equity would need to be issued. Yet Mr. Mendenhall provides no  
157 additional support to back up this claim. In fact, whether additional equity would  
158 be necessary will be dependent on a number of factors. Even when selecting the  
159 lower cost RFP bid option, and without adding equity for the imputed debt, the  
160 Company’s capital structure will still have over 50% equity. Bottom line --, the  
161 new accounting rules do not create cost adders for the RFP bids in this case.

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<sup>8</sup> S&P Global Ratings’ Credit Research, Guidance Criteria Corporates General: Corporate Methodology Ratios and Adjustments (April 1, 2019) at 1

163 **Q. DOES THE COMPANY'S CAPITAL STRUCTURE REQUIRE EQUITY**  
164 **INFUSIONS?**

165 No. The Company has a substantial equity level relative to its peers. It is important  
166 to point out that the Company's proposed equity level in the Company's current  
167 rate case, Docket No. 19-057-02, is 55%.<sup>9</sup> An equity level of 55% is the upper  
168 limit based on the merger settlement agreement in Docket No. 16-057-01.  
169 Moreover, the Company projects that the equity ratio will increase to 60% in 2020,  
170 during the current general rate case test period.<sup>10</sup> Thus, even if debt is imputed and  
171 no other changes are made to bolster financial metrics, the Company's equity ratio  
172 would decline, but still exceed 50%.

173 **Q. IN YOUR OPINION SHOULD THE COMMISSION INCREASE RFP BID**  
174 **COSTS FOR NON-COMPANY PROPOSALS TO REFLECT IMPUTED**  
175 **DEBT RESULTING FROM CHANGES IN LEASE REPORTING UNDER**  
176 **ASC 842?**

177 A. The short answer is no. In Docket No. 18-057-03 (the Company's prior request  
178 for pre-approval to construct an LNG facility) the Commission denied the DEU  
179 request because the Commission needed assurance that lower cost alternative  
180 options to a Company self-build LNG facility were not available. As a result, the  
181 Company solicited alternatives through an RFP. But now after receiving lower  
182 cost alternatives, the Company creates a cost that does not exist, "imputed debt",  
183 which results in causing the Company's self build proposal to be the lowest cost  
184 alternative. If the Commission correctly removes the imputed debt cost adder  
185 from the Company's RFP bid quantitative analysis, then the Company's self build  
186 proposal will not be the lowest cost alternative.

187 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

188 A. Yes.

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<sup>9</sup> Direct Testimony Jordan K. Stephenson in DEU Rate Case Docket No. 19-057-02 at page 20, line 560.

<sup>10</sup> Direct Testimony Jordan K. Stephenson in DEU Rate Case Docket No. 19-057-02 at page 20, line 557.