BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION
NASHVILLE, TENNESSEE

August 3, 2018

IN RE:	)	
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CHATTANOOGA GAS COMPANY PETITION FOR APPROVAL OF AN ADJUSTMENT IN RATES AND TARIFF; THE RECOVERY OF THE AUA MECHANISM REVENUE DEFICIENCY; AND THE IMPLEMENTATION OF ALTERNATIVE REGULATORY METHODS	))))))	**Docket No. 18-00017**
	)	

REBUTTAL TESTIMONY OF

GREGORY MACLEOD

ON BEHALF OF

CHATTANOOGA GAS COMPANY

Q. Will you please state your name and business address?

A. Gregory MacLeod, 10 Peachtree Place, Atlanta, GA 30309

Q. By whom and in what capacity are you employed?

A. I am Assistant Treasurer and Financial Planning & Analysis Manager for Southern Company Gas ("SCG"). Southern Company Gas is the parent holding company for multiple natural gas distribution companies, including Chattanooga Gas Company ("CGC" or "Company").

Q. Will you please summarize your educational and professional background?

A. I have my Bachelors of Science in Finance and Political Science from Florida State University. I have worked for Southern Company and Southern Company Gas for 10 years in multiple positions, primarily in the financial field.

Q. Have you previously testified in this matter?

A. No, I have not.

Q. What is the purpose of your testimony?

A. I have been asked by CGC to respond to the testimony of the Consumer Advocate witness Dr. Christopher Klein and his assertion that a double leverage situation exists for CGC that requires a substantial adjustment to CGC's capital structure.

Q. Do you have any exhibits to accompany your testimony.

A. Yes, I have four exhibits as follows:

- Exhibit GBM-1, Southern Company Capital Infusions.
- Exhibit GBM-2, Southern Company Investment in Southern Natural Gas Company.

- Exhibit GBM-3, Southern Company Stock Issuance for Southern Natural Gas Company Purchase.
- Exhibit GBM-4, Fitch Ratings Report Post-Southern Natural Gas Company Purchase.

Q. Turning to Dr. Klein's testimony, what is double leverage?

A. Double leverage is a term that comes from the world of banking, where regulators imposed standards for minimum capitalization on banks, so some holding companies adopted a policy of borrowing money to invest in subsidiary banks as equity. Other regulators, notably utility regulators have adopted the term to prevent holding companies from borrowing to invest as, and earn on, equity in utility subsidiaries.

Q. Has a double leverage adjustment been made in CGC's past rate cases?

A. No. In CGC's 1997 and 2004 rate cases, it appears that the Commission used the capital structure of AGL Resources for CGC, and the panel specifically did not apply the double leverage approach in the 2004 case. Docket No. 04-00034, Order, at 44 (October 20, 2004).

Q. What was Dr. Klein's rationale for applying a double leverage adjustment to CGC's capital structure in this case?

A. On page 8, lines 19-20 of his testimony, Dr. Klein notes that CGC "is solely dependent upon SCG or other SCG subsidiaries for all of its debt and equity financing." He then states at page 9, lines 2-3 that "SCG obtains its equity financing from its parent, TSC (the Southern Company)." From this he concludes at page 9, lines 4-5 that "it is inappropriate to view CGC independently of SCG and SCG independently from TSC."

Q. What was the specific adjustment Dr. Klein made to CGC's capital structure?

A. As Dr. Klein explains at page 9, lines 13-22, he took the Southern Company's parent-only capital structure and "imputed TSC's forecasted parent-only capital structure to the equity portion of Mr. Tucker's recommended capital structure for CGC/SCG."

Q. Do you agree with Dr. Klein's double leverage adjustment to CGC?

A. No, I do not.

Q. Why should there not be a double leverage adjustment to CGC's capital structure in this case?

A. I recognize that CGC's holding company parent, Southern Company, is capitalized with more debt than CGC's parent, Southern Company Gas and its financing entity Southern Company Gas Finance Corp. (Finance Corp.). However, it can be demonstrated by following the cash flows between parent and subsidiary since Southern Company acquired Southern Company Gas that no Southern Company debt has been issued to be invested as equity in either CGC or SCG. Thus, to arbitrarily apply Southern Company's capital structure as CGC's equity does not reflect how CGC is actually financed.

Q. What do the cash flows between Southern Company and Southern Company Gas show?

A. As shown on my Exhibit GBM-1, since Southern Company acquired Southern Company Gas, Southern Company has made two capital infusions: one on

September 1, 2016, for $1.05 billion, and a second on June 17, 2017, for $50 million. The September 2016 infusion can be traced directly to the Southern Company Gas investment in 50 percent of the Southern Natural Gas Company, which is reflected on my Exhibit GBM-2. As Exhibit GBM-3 shows, no debt was issued by the parent prior to that investment and in fact Southern Company issued 32.5M shares prior to closure of this acquisition and that the acquisition of Southern Natural Gas Company is included as the "use of proceeds." Exhibit GBM-4 also further highlights reports from the credit rating agencies which speak to the financing of that acquisition. This evidence clearly shows the September 2016 infusion should be excluded from any double leverage calculation, which leaves the $50 million capital infusion in 2017 as the only equity from Southern Company invested in the Southern Company Gas base business.

During the same period of time, from the acquisition of Southern Company Gas through June 30, 2018, Southern Company Gas returned nearly $803 million to its parent, Southern Company, which is essentially a substitute for the dividends that AGL Resources formerly would have paid out to its stockholders. Thus, it is critical to understand that Southern Company is not a net provider of capital to Southern Company Gas outside of its one acquisition of an asset not related to any of its operating gas utility businesses.

Q. Did the acquisition of Southern Company Gas by Southern Company change the financing structure of CGC?

A. No. The acquisition price was paid out to shareholders of the previous parent entity, AGL Resources. All of the premium that were paid in the acquisition are being excluded from CGC's rate base and total capitalization. The financing structure that existed prior to the acquisition remains in place at the operating company.

Q. Southern Company has announced divestiture of certain assets. How do those divestitures impact CGC and its capital structure?

A. CGC is not directly affected by the asset divestitures. However, the proceeds that Southern Company receives will be used to pay down existing debt at Southern Company Gas and reduce the overall leverage of Southern Company. This is being done to improve the financial integrity and capital markets access of all of the Southern Company subsidiaries, including Southern Company Gas. CGC and its customers will benefit from the divestitures due to lower financial risk and improved capital access once the divestitures have all closed but this will not have any impact on CGC.

Q. Do you have any other observations concerning Dr. Klein's double leverage position?

A. Yes. While Dr. Klein has applied the double leverage adjustment to the capital structure as would be done according to banking regulations, what is missed is that in rate of return regulation any assumption made regarding possible double leverage must be considered as a rebuttable presumption. The situation cannot be assumed to exist just because of a disparity between the capitalization of a parent company and the capitalization of the operating utility. This testimony illustrates why that presumption must, on its face, be rebuttable. Not all corporate structures are created equal and it must be allowed that a utility operating company be able to demonstrate its own capitalization. As a large holding company of natural gas utility, electric utility, and other assets, Southern Company's capital structure represents a very different corporate profile than CGC or even Southern Company Gas, which is engaged in different aspects of the natural gas business.

Any rebuttal of the presumption needs to demonstrate that equity on Southern Company Gas's balance sheet was not actually financed with debt issued by Southern Company. I have shown how, since the acquisition by Southern Company, it is impossible to conclude that CGC as well as Southern Company Gas equity is financed by parent company issued debt. Thus, the only appropriate capital structure for CGC is that presented by Dr. Vander Weide and Mr. Tucker.

Q. Is there any academic or theoretical support for the position that double leverage should not be presumed to exist in rate of return regulation?

A. Yes, studies have shown (Pettway and Jordan, 1983; Beranek and Miles, 1988) that the "independent company" approach to determine the proper rate of return is shown to be universally correct, and that "double leverage" methodologies relying on the capitalization of diversified holding companies with parent issued debt are not compatible with the established goals and precedents of rate of return regulation as established by the Supreme Court in the *Hope* and *Bluefield* decisions referenced by Dr. Vander Weide and Dr. Klein.

Q. Please summarize your rebuttal testimony to Dr. Klein.

A. Southern Company Gas has not received any equity infusions from its parent, Southern Company, that could have been financed with debt. Southern Company Gas is a net returner of capital to Southern Company. Both of these facts rebut any presumption of double leverage existing at CGC as advocated by Dr. Klein.

Further, studies have shown that the independent company analysis method is the only theoretical basis for achieving the goals and abiding by the precedents of rate of return regulation as established in the *Hope* and *Bluefield* decisions. There is no sound basis for making any adjustment for double leverage to the capital structure provided by CGC in this case. It would benefit both CGC and its customers for this commission to establish a weighted average cost of capital (WACC) and capitalization structure that would continue to make CGC an attractive investment proposition for its parent and the capital markets so that we may continue to improve access, safety, and reliability in our gas service to the city of Chattanooga and the residents and businesses of our service territory.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.