BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

IN THE MATTER OF THE APPLICATION OF NEW MEXICO GAS COMPANY, INC. FOR APPROVAL OF REVISIONS TO ITS RATES, RULES, AND CHARGES PURSUANT TO ADVICE NOTICE NO. 87	)	**Case No. 21-00267-UT**
NEW MEXICO GAS COMPANY, INC.	)	
Applicant.	)	

DIRECT TESTIMONY AND EXHIBITS

OF

JIMMIE L. BLOTTER

December 13, 2021

DIRECT TESTIMONY OF
JIMMIE L. BLOTTER
NMPRC CASE NO. 21-00267-UT

Exhibits:

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Jimmie L. Blotter. I am the Vice President of Finance of New Mexico Gas Company Inc. ("NMGC" or "Company"). My business address is 7120 Wyoming Boulevard NE, Suite 20, Albuquerque, New Mexico 87109.

Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES AS VICE PRESIDENT OF FINANCE.

A. I am responsible for the financial operations of NMGC, including the accounting, financial reporting, tax compliance, budgeting, cost of service, financial planning and treasury functions. I sponsor the Base Period data from the Company's books and records that is used by NMGC Witness Erik C. Buchanan to develop the Company's revenue requirement in this filing. I also sponsor the various Schedules required to be submitted with this filing pursuant to 17.10.630 NMAC ("Rule 630").

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. My educational background and professional experience are summarized in NMGC Exhibit JLB-1.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION ("NMPRC" OR THE "COMMISSION")?

A. Yes, my experience testifying is included in NMGC Exhibit JLB-1.

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

A. The purpose of my testimony in this proceeding is to:

II. Discuss the financial reasons for this rate case;

III. Present and support the "Base Period" for this case July 1, 2020 through June 30, 2021 ("Base Period"), including the Company's affiliate transactions and advertising expenses;

IV. Present the Company's weighted average cost of capital for the Future Test Year for this case, January 1, 2023 through December 31, 2023 ("Future Test Year"), including discussing a debt issuance and equity contribution that will be made in 2023;

V. Support the recovery of certain rate case expenses the Company has incurred in relation to this rate case filing;

VI. Provide the details of and justification for the regulatory asset the Company is seeking in this filing; and

VII. Present a summary of the components of the Company's working capital calculations.

Q. PLEASE DESCRIBE YOUR ROLE IN HELPING PREPARE THE COMPANY'S RATE CASE.

A. As the Company's Vice President of Finance, I worked with NMGC Witness Buchanan in the development of the Company's cost of service in the Future Test Year. Additionally, I have ultimate responsibility for the Company's books and records, which I used to provide NMGC Witness Buchanan with the Base Period amounts. I also provided Mr. Buchanan with the Company's forecasted weighted average cost of capital, regulatory asset values, and working capital numbers, which he used in determining the Company's revenue request.

Q. ARE YOU SPONSORING ANY SCHEDULES REQUIRED BY RULE 630?

A. Yes, I am sponsoring several Rule 630 Schedules, as listed in NMGC Exhibit JLB-2. NMGC Exhibit JLB-2 identifies not only the Rule 630 Schedules that I am sponsoring, but is a comprehensive list of the Rule 630 Schedules filed in this case. Certain of these schedules are included as part of the fully functional cost of service model NMGC Witness Buchanan describes in detail in his testimony, and are therefore in executable electronic format. NMGC Exhibit JLB-2 notes the format, as well as the sponsor, of each Rule 630 Schedule.

Q. HAS NMGC PROVIDED OPERATING RESULTS AND FINANCIAL DATA THAT ARE PREPARED IN THE NORMAL COURSE OF BUSINESS FOR THE THREE YEARS PRECEDING THE BASE PERIOD, AS REQUIRED BY 17.1.3.13 NMAC?

A. Yes, NMGC files its FERC Form No. 2 report as part of the annual report NMGC files with the Commission in compliance with 17.3.610 NMAC. The data required by 17.1.3.13 NMAC is contained in these FERC Form No. 2 reports. I have attached as NMGC Exhibit JLB-3 a list of the filing dates of the financial data for 2017, 2018, 2019, and 2020.

Q. HAS NMGC COMPLIED WITH THE REQUIREMENTS OF 17.1.3.15 NMAC?

A. Yes, the data for Base Period, Adjusted Base Period, Linkage Periods, and Future Test Year are presented in conformity with the applicable Uniform System of Accounts ("USOA") prescribed by the Commission.

Q. HAS NMGC PROVIDED OPERATING EXPENSES DATA, AS REQUIRED BY 17.1.3.16(B) NMAC?

A. Yes, NMGC's application, testimonies, and exhibits in this case present Operations and Maintenance ("O&M") information in compliance with the requirements of 17.1.3.16(B) NMAC. NMGC only serves customers in New Mexico, therefore the total company amounts are also the jurisdictional amounts.

Q. HAS NMGC PROVIDED RATE BASE DATA, AS REQUIRED BY 17.1.3.16(C)(1) AND (2) NMAC?

A. Yes, NMGC's rate base is presented as required by 17.1.3.16(C)(1) and (2) NMAC in NMGC's Rule 630 Schedule A-4.

Q. HAS NMGC COMPLIED WITH THE REQUIREMENTS OF 17.1.3.16(D)(2), (3), (5), AND (6) NMAC?

A. Yes. We have complied with the following requirements, as shown in NMGC Exhibit JLB-4:

- 17.1.3.16(D)(2) – NMGC is providing projections for 2022 and 2023;
- 17.1.3.16(D)(3) – NMGC is providing information related to its short-term debt balances, external financing requirements, and projected capitalized ratios;
- 17.1.3.16(D)(5) – NMGC is providing information on its estimates of interest and preferred dividend coverages; and
- 17.1.3.16(D)(6) – NMGC is providing information related to the computations of ratios of earnings to fixed charges.

Q. HAS NMGC COMPLIED WITH THE REQUIREMENTS OF 17.1.3.17 NMAC?

A. Yes.

II. <u>FINANCIAL OVERVIEW OF RATE CASE FILING</u>

Q. FROM A FINANCIAL PERSPECTIVE, WHY IS NMGC FILING THIS RATE CASE?

A. As shown in NMGC Exhibit ECB-3, by 2023, NMGC is projecting a Future Test Year cost of service revenue requirement of $237.1 million, resulting in a revenue deficiency of $40.7 million under NMGC's current rates. The reasons for NMGC's revenue deficiency are the capital investments NMGC is making between January 2022 and the end of 2023 and recovery of increased operating expenses in 2023 as described below. Between 2022 and the end of 2023 NMGC will invest approximately $245 million in capital improvements. O&M expenses are expected to increase from $90.8 million in the Adjusted Base Period to $104.1 million in the Future Test Year, which contributes to NMGC's overall increase in annual operating expenses, which include O&M, from $141.9 million in the Adjusted Base Period to $169.7 million in the Future Test Year.

These increases in costs are not projected to be offset by growth on NMGC's system by the Future Test Year. NMGC is therefore seeking a 2023 cost of service revenue increase in this case of $40.7 million.

Q. PLEASE BRIEFLY DISCUSS THE INCREASE IN NMGC'S EXPENSES.

A. Overall, all of NMGC's expenses are going up – both O&M and non-O&M. O&M expenses include items such as labor and wages, employee benefits and expenses, materials and supplies, insurance, and outside services. There are four points I would like to make about O&M expense increases:

- First, the Company consistently works to control O&M expenses while maintaining the safety and reliability of its systems and the quality of its services to customers. Many elements of O&M are, to some extent, within our control, and we do control them to the best of our ability. We work to control costs by shopping smartly for services and materials, but O&M costs are and will continue to increase. We have a good history of maintaining our controllable O&M expenses.

- Second, similar to many businesses across the nation, NMGC is experiencing O&M cost increase pressures in areas such as health and dental benefits expenses, increased general liability insurance costs, and increased costs related to information technology. NMGC also is experiencing increased costs resulting from new Transportation Safety Administration ("TSA") pipeline security compliance costs and Integrity Management Plan expenses. Many of these costs are, to some extent, out of our control as general inflation has caused the price of many goods and services to increase.
- Third, the Company has undertaken initiatives that have and will result in in decreases to O&M such as a review of how it accounts for Administrative and General ("A&G") expenses to more accurately reflect NMGC's business operations. As a result, in the Base Period, the Company increased the amount of A&G expense loaded to capital by approximately $0.8 million which correspondingly reduced overall O&M expense.
- Fourth, due to continued requirements of our business, we are proposing adding 32 new positions to our employee base.

Non-O&M operating expenses include things like property taxes, possessory interest taxes, and depreciation. In total, operating expenses are increasing by $27.8 million between the Adjusted Base Period and the Future Test Year.

III. BASE PERIOD

Q. WHAT TWELVE-MONTH PERIOD DID NMGC USE TO DEVELOP THE BASE PERIOD TOTAL COST OF PROVIDING SERVICE TO THE COMPANY'S CUSTOMERS?

A. NMGC used the twelve-month period ended June 30, 2021 to develop its Base Period total cost of service. As discussed below, the Base Period amounts are the starting point for the development of data for setting revised base rates in this proceeding.

Q. HOW DID NMGC DETERMINE THE BASE PERIOD COSTS?

A. All of the unadjusted amounts in the Base Period are taken directly from the Company's books and records, in accordance with 17.10.630.7(F) NMAC. These amounts have been reviewed by the accounting firm of Ernst & Young, as demonstrated in Rule 630 Schedule R-7. The Base Period reflects actual balance sheet amounts as of June 30, 2021 and income statement amounts for the twelve-month period ending June 30, 2021. Please see Rule 630 Schedule A-1 for these costs.

Q. ARE THERE ANY SPECIFIC EXPENSES IN THE BASE PERIOD YOU WANT TO TALK ABOUT?

A. Yes. I would specifically like to address affiliate transactions ("Affiliate Transactions") costs related to shared services, and advertising expenses ("Advertising Expenses").

A. Affiliate Charges for Shared Services

Q. DOES THE BASE PERIOD INCLUDE CHARGES TO AND FROM AFFILIATES?

A. Yes, the Base Period contains charges that NMGC receives from its affiliates, and credits for the services NMGC provides to its affiliates.

Q. IS NMGC SEEKING RECOVERY OF THE AFFILIATE CHARGES IT RECEIVES?

A. Yes, it is. NMGC has taken the Base Period expenses and depending on the nature of the charges has either escalated or separately forecasted those charges through the Future Test Year. The net amount of transactions with affiliates included in the cost of service model during the Base Period was $10.1 million, which includes $10.3 million in charges from affiliates offset by $0.2 million that NMGC charged to affiliates. During the Future Test Year, the total net amount NMGC is seeking to recover related to affiliate charges is $11.1 million. See 630 Schedule H-14.

Q. WHAT AFFILIATE CHARGES IS NMGC SEEKING IN THIS CASE?

A. NMGC is seeking to recover the affiliate charges in the following categories of services from affiliates:

- **Information Technology and Telecommunications ("IT&T") & Security Services –** Major services include: desktop computer support and performance management, employee service support (on-site and off-site), IT&T infrastructure maintenance and support, IT&T asset management, information and cyber security, telecommunications, and the support/maintenance of the SAP Enterprise Resources Program and other applications.

- **Finance & Related Services –** Major services include: accounts payable, insurance risk, treasury (including cash management), corporate tax, corporate accounting and research, internal audit, investor relations, budget and planning, and general assistance with financial matters.
- **Corporate & Related Services –** Major services include: support from the executives of TECO and Emera.
- **Human Resources & Related Services –** Major services include: corporate communications, emergency management, payroll, compensation, human resources policy administration, recruitment, training and development, and assessment and development.
- **Pension & Benefits –** Major services include: providing employees with benefits including a retirement savings plan, an employee incentive program, a retirement plan, medical, dental and vision insurance, life insurance, long-term care insurance, disability, and other employee benefits.
- **Legal & Related Services –** Major services include: risk management and claims support, compliance, assistance with federal affairs, general assistance with legal matters, and related administrative support and technology.

Q. DO THESE AFFILIATE CHARGES COMPLY WITH THE COMMISSION RULES ON AFFILIATE TRANSACTIONS?

A. Yes. The Commission's rules, specifically 17.6.450 NMAC, provide the requirements and guidelines utilities must observe when undertaking a transaction with a corporate affiliate. NMGC has complied with all of the requirements provided for in the Commission's rules.

Q. CAN TRANSACTIONS WITH AFFILIATES BENEFIT CUSTOMERS?

A. Yes. The central benefits of a shared services company are to allow related companies to employ economies of scale and to take advantage of a special expertise that may already exist at one company without having to undertake the expense of replicating that expertise at each of the companies under shared ownership. These benefits are passed along to customers in the form of lower costs.

Q. PLEASE EXPLAIN THE EVOLUTION OF AFFILIATE TRANSACTIONS AS THEY RELATE TO NMGC.

A. Beginning with TECO Energy, Inc.'s ("TECO") acquisition of NMGC in 2014, the Company has been part of a larger corporate umbrella that utilizes a shared services model for back-office functions. NMGC continues to operate under a shared services model today. The assignment of shared services costs for NMGC is governed by the Cost Allocation Manual ("CAM") that was agreed to among the parties and filed with the Commission pursuant to the Commission's Final Order in NMPRC Case No. 13-00231-UT. The CAM was updated to reflect the acquisition of TECO by Emera, on July 1, 2016, and was updated December 31, 2019 to reflect a change from TECO Services, Inc. ("TSI") to Tampa Electric Company ("Tampa Electric") as the centralized shared services company under the CAM.

Q. PLEASE DESCRIBE HOW NMGC HAS FORMALIZED THE SERVICES TO BE PERFORMED BY AND FOR AFFILIATE COMPANIES.

A. NMGC has entered into services agreements with Tampa Electric, Emera Brunswick Pipeline ("EBP"), and Emera. The Tampa Electric, and Emera services agreements detail the nature of the services and related charges to be provided to and from NMGC. The EBP service agreement details the services and charges to be provided by NMGC to EBP.

The current services agreements were also applicable during the Base Period. These agreements are on file with the NMPRC. NMGC has also filed annual Class I Transaction Reports that report the charges between NMGC and its affiliates.

Q. HOW ARE AFFILIATE CHARGES DETERMINED?

A. All charges are determined in accordance with the CAM. Under the CAM, costs are collected and charged using three methods in the following order: 1) direct costs charged to an affiliate ("Direct Charges"); 2) indirect costs for shared services are assessed to more than one affiliate using statistical cost drivers ("Assessed Charges"); 3) remaining indirect costs for Corporate Services are allocated ("Allocated Charges") to multiple affiliates using the Modified Massachusetts Method ("MMM"). No cost is allocated or charged twice to any affiliate.

Q. HOW ARE AFFILIATE CHARGES ASSESSED UNDER THE CAM?

A. The Assessed Charges relate to the costs of providing indirect services to affiliates. Applicable costs are gathered and charged to affiliates that receive a benefit from these services. During the Base Period NMGC's Assessed Charges from Tampa Electric were $4,869,561. Table 1 outlines the assessment methodology used to determine NMGC's Assessed Charges:

Table 1 – Assessment Methodology to Determine NMGC's Assessed Charges

Services Assessed to NMGC	Assessment Methodology
IT&T Services, Security Services, and Human Resources & Related Services	Assessed based on % of total headcount receiving the service
Procurement Admin, Inventory Management, Supplier Diversity, and Contracts Admin	Assessed based on % of total purchase order spend
Legal & Related Services (Claims)	Assessed based on % of average outstanding claims

Q. WHAT AFFILIATE CHARGES ARE ALLOCATED TO NMGC UNDER THE CAM?

A. The Allocated Charges are those charges that have not been direct charged or assessed as discussed above. The determined allocated costs are gathered and charged to affiliates that benefit from such services using the MMM. The MMM is a standard methodology utilized for this purpose and is based on a blended rate of each operating affiliate's total operating assets (excluding cash & acquisition adjustments, including goodwill), total operating revenues and net income. During the Base Period, the Allocated Charges to NMGC were $3,321,754.

Q. PLEASE PROVIDE A SUMMARY OF THE AFFILIATE CHARGES FOR THE BASE PERIOD.

A. Table 2 summarizes the services and charges from affiliates during the Base Period:

Table 2 – Summary of Affiliate Charges for the Base Period

	Tampa Electric	Emera	Total
IT&T and Security Services	$5,152,711	-	$5,152,711
Finance and Related Services	$347,595	$1,762,717	$2,110,312
Corporate and Related Services	$2,488,922	-	$2,488,922
Human Resources and Related Services	$480,193	-	$480,193
Legal and Related Services	$69,489	-	$69,489
Total Direct Expenses	**$ 8,538,910**	**$1,762,717**	**$10,301,627**

Additionally, Table 3 shows the amount of direct charges, assessed charges, and allocated charges from affiliates for each category of service during the Base Period:

Table 3 – Direct, Assessed and Allocated Charges for the Base Period

	Direct	Assessed	Allocated	Total
IT&T and Security Services	-	$5,152,711	-	$5,152,711
Finance and Related Services	$2,110,312	-	-	$2,110,312
Corporate and Related Services	-	$140,720	$ 2,353,952	$2,488,922
Human Resources and Related Services	-	$480,193	-	$480,193
Legal and Related Services	-	$69,489	-	$69,489
Total Charges from Affiliates	**$2,110,312**	**$5,843,113**	**$2,348,202**	**$10,301,627**

Q. WILL NMGC HAVE AFFILIATE CHARGES IN THE FUTURE TEST YEAR?

A. Yes. Table 4 shows the amount of direct charges, assessed charges, and allocated charges anticipated from affiliates for each category of service during the Future Test Year.

Table 4 – Direct, Assessed and Allocated Charges for the Future Test Year

	Direct	Assessed	Allocated	Total
IT&T and Security Services	-	$6,490,821	-	$6,490,821
Finance and Related Services	$1,910,472	-	-	$1,910,472
Corporate and Related Services	-	$145,245	$2,488,032	$2,633,277
Human Resources and Related Services	-	$520,911	-	$520,911
Legal and Related Services	-	$95,408	-	$69,489
Total Charges from Affiliates	**$1,910,472**	**$7,572,385**	**$2,488,032**	**$11,650,889**

Q. HOW DID NMGC DETERMINE ITS AFFILIATE CHARGES FOR THE FUTURE TEST YEAR?

A. NMGC asked its shared services providers to provide it with cost projections for affiliate charges in the Future Test Year. TEC and Emera separately forecasted the affiliate charges to NMGC. NMGC reviewed and analyzed these forecasts and has determined these costs are reasonable and that NMGC cannot duplicate these services at a lower cost than what its shared services providers are charging.

Q. PLEASE PROVIDE DETAILS FOR THE AFFILIATE CHARGES IN THE FUTURE TEST YEAR.

A. Please see NMGC Exhibit JLB-5 for the details of the forecasted charges from TEC to NMGC, and NMGC Exhibit JLB-6 for the forecasted charges from Emera to NMGC.

Q. NMGC EXHIBITS JLB-5 AND JLB-6 TOTAL $9,100,105.54 FOR AFFILIATE CHARGES FOR THE FUTURE TEST YEAR WHEREAS TABLE 4 SHOWS AFFILIATE CHARGES OF $11,650,899. PLEASE EXPLAIN THE DIFFERENCE.

A. NMGC Exhibits JLB-5 and JLB-6 do not include the following:

1.	Asset usage fees which are included in NMGC Witness DeCourcey's testimony	$1,389,089
2.	Secondees (wherein NMGC reimburses Emera for compensation Emera provides to two NMGC Executives)	$468,036
3.	Direct labor charges	$259,049
4.	Safety materials and supplies	$238,330
5.	Pension and benefits charges	$192,985
6.	Employee Training	$3,387

Q. PLEASE DESCRIBE THE ITEMS IN THE STIPULATION IN NMPRC CASE NO. 15-00327-UT ("THE EMERA STIPULATION"), RELATED TO NMGC'S REVIEW AND CONTROL OF AFFILIATE CHARGES.

A. In paragraph 28 of the Emera Stipulation, NMGC committed to the following as related to the affiliate charges:

- 28.a. NMGC management will, consistent with good governance practices and based on an examination of its business needs, customer needs, and objectives, control and annually determine which if any services it will obtain from its affiliates.
- 28.b. Subject to its business needs and objectives, and consistent with good governance practices, in an effort to bring value to its customers through cost

savings, NMGC will show a preference for services to be performed in New Mexico by NMGC employees for NMGC.

- 28.c. NMGC shall make any and all charges, assessments or allocations from its affiliates transparent, and shall, to the greatest extent possible, use direct charges, as opposed to assessments or allocations, when identifying costs for recovery under the CAM.

Q. PLEASE DESCRIBE HOW NMGC COMPLIES WITH PARAGRAPH 28.A OF THE EMERA STIPULATION.

A. On an annual basis as part of its budgeting process, the NMGC management team reviews the services to be provided to NMGC by all affiliates – not just Tampa Electric. The services and related charges are first reviewed and approved by the appropriate management team members and then by members of executive management. Then, throughout the year the charges are billed to NMGC by the affiliates and each invoice is reviewed before being approved and paid. Throughout the year we continue to look for ways to control costs and expenses from both affiliates and within NMGC.

Q. PLEASE DESCRIBE HOW NMGC COMPLIES WITH PARAGRAPH 28.B OF THE EMERA STIPULATION.

A. As a team, we consider what services can be provided in-house as opposed to from an affiliate. We provide services within New Mexico where feasible and cost effective. Some areas to highlight include:

- Regulatory;
- Gas supply and control;
- Call center;
- Billing and credit operations;
- Certain human resources functions;
- Certain financial functions;
- Legal functions; and
- Local IT support.

Q. PLEASE DESCRIBE HOW NMGC COMPLIES WITH PARAGRAPH 28.C OF THE EMERA STIPULATION.

A. As reflected in NMGC Exhibit ECB-5 and in my testimony, we are providing transparency and detail on all the affiliate charges to and from NMGC's affiliates. NMGC continues to emphasize the use of direct charges, but in many instances assessments or allocations under the CAM are the best way to spread costs amongst all of the affiliates receiving services.

Q. WHAT FACTORS DOES NMGC CONSIDER WHEN EVALUATING THE VALIDITY OF SERVICES PROVIDED BY AFFILIATES?

A. NMGC considers two primary factors when evaluating the appropriateness of services provided by affiliates: 1) the cost of the service, and 2) the quality of the service. While NMGC is always focused on the cost of services provided for our customers, in many instances it is difficult to make direct cost comparisons – especially when you also consider or account for qualitative differences in services. There are areas where affiliates provide a service that NMGC cannot economically replicate, such as cyber security and internal audit services wherein NMGC's affiliates in Florida and Nova Scotia provide world-class services to NMGC. In many areas, we believe NMGC provides a better-quality service than can be obtained from affiliates, such as call center and customer service. NMGC and its affiliates continue to evaluate the balance between shared and local services.

Q. PLEASE DESCRIBE THE SERVICES PROVIDED BY NMGC TO AFFILIATES.

A. NMGC provides IT desktop services to affiliates in Florida. The amounts allocated by NMGC to these affiliates for the Base Period were $218,506.

NMGC also provides services to EBP for certain management, budgeting and administrative services, engineering services, gas control services, gas management services, financial services, and accounting services. The amounts allocated by NMGC to EBP for the Base Period were $501,067. Neither NMGC's costs nor the associated affiliate charges are included in the cost of service Model because they are recorded in Other Income & Deductions and therefore are not included in the costs that are recovered from customers.

B. Advertising Expenses

Q. PLEASE DESCRIBE 17.3.350 NMAC.

A. Rule 17.3.350 NMAC governs the treatment of certain expenses in setting a utility's rates. The operating expenses covered by this rule include advertising expenses, contributions, donations, dues, subscriptions and membership fees, and lobbying expenses. Advertising expenses are defined under Rule 350 as all expenses made for the development, publication, and dissemination of information to a utility's customers, the public at large, or to stockholders.

Q. UNDER RULE 17.3.350 NMAC, CAN ALL ADVERTISING EXPENSES BE INCLUDED IN COST OF SERVICE RATES?

A. No. Under Rule 17.3.350.9(B) NMAC, in order to be includable in rates, advertising expenses must be reasonable and must meet one of the following requirements:

- Advises ratepayers of matters of public safety, health or emergency situations;
- Advocates conservation of energy and reduction of peak demand;
- Explains billing practices, services and rates to customers;
- Is required to be filed with governmental authorities or financial institutions;
- Provides information required to be available to customers under state or federal law; or
- Otherwise results in a measurable reduction in operating costs and more efficient service to customers.

In addition, advertising costs that are described as "Unallowable Expenditures" in Rule 17.3.350.9(C) NMAC are not properly includable in cost of service rates.

Q. DID NMGC ANALYZE ITS ADVERTISING EXPENSES TO DETERMINE WHETHER THEY ARE RECOVERABLE?

A. Yes, NMGC has reviewed its advertising expenses and NMGC is seeking recovery of $693,036 for allowable advertising expenses in the Future Test Year, the details of which can be found in Rule 630 Schedule H-5. In addition, Rule 630 Schedule H-5, Workpaper H-5-1 includes a summary of NMGC's analysis as to why such expenses are allowable under Rule 350.9(B).

IV. <u>WEIGHTED AVERAGE COST OF CAPITAL</u>

Q. WHAT WEIGHTED AVERAGE COST OF CAPITAL DID YOU USE FOR THE FUTURE TEST YEAR?

A. We used a weighted cost of capital rate ("WACC") of 6.89% for the Future Test Year. We arrived at this number by using a long-term cost of debt of 3.27%, a return on equity of 10.1%, and a capital structure of 53% equity and 47% long term debt. Please see Rule 630 Schedule G-3 for the calculation related to NMGC's long-term cost of debt, and the testimony of NMGC Witness Roger A. Morin, Ph.D. for the details of the proposed return on equity.

NMGC's cost of debt was 3.15% for the Base Period. NMGC then made an adjustment to incorporate the amount and rate of a debt issuance planned in February 2023, which resulted in an average cost of debt of 3.29%. Finally, NMGC calculated the 13-month average of its cost of debt, which resulted in an adjustment of -0.02% as required by 17.1.3 NMAC. Therefore 3.27% long-term cost of debt is used in the Future Test Year.

Q. NMGC ISSUED $220 MILLION OF LONG-TERM DEBT IN FEBRUARY 2021, PURSUANT TO THE COMMISSION'S FINAL ORDER IN CASE NO. 20-00180-UT, WAS THIS INCLUDED IN THE LONG-TERM DEBT CALCULATION?

A. Yes. In February 2021, the Company issued a total of $220 million of long-term debt in three tranches with a weighted average interest rate of 2.751%. See NMGC Exhibit ECB-3 630 Schedule G3.1 Base.

Q. NMGC ISSUED A $100 MILLION TERM LOAN IN ASSOCIATION WITH THE FEBRUARY 2021 WINTER WEATHER EVENT. IS THIS INCLUDED IN THE COMPANY'S LONG-TERM CAPITAL STRUCTURE?

A. No. The $100 million term loan that was issued to fund the extraordinary gas costs incurred associated with the February 2021 Winter Weather Event is not included in NMGC's capital structure. As such, this loan and its associated interest costs are being recovered through the Company's Purchased Gas Adjustment Clause, and are not applicable to NMGC's rate base in any way. Additionally, this is a short-term debt which will mature in less than 18 months, and as such the custom and practice in New Mexico is to not include these types of loans in a utility's regulatory capital structure.

Q. WHAT ARE THE ASSUMPTIONS IN 2022 AND 2023 RELATED TO EQUITY CONTRIBUTIONS FROM NMGC'S PARENT?

A. NMGC issued $220 million of debt in February 2021. Of this debt issuance, $200 million was refinancing of previously existing debt. The remaining $20 million of the total was new debt and therefore NMGC's parent provided an equity contribution to match that new debt issuance at the Company's authorized capital structure that was in place at the time of the debt issuance (48% debt and 52% equity). This resulted in an equity contribution related to this debt issuance of $21.7 million which was received in October 2021.

Additionally, NMGC expects to issue $50 million of new debt in February 2023. This new debt is also expected to be matched with an equity contribution from our parent company. It is expected that the parent company would match the debt issuance at NMGC's authorized regulatory capital structure. Therefore, in the Future Test Year, it is assumed that the debt would represent 47% and the equity contribution would be 53%. That results in an equity contribution of approximately $56.4 million, which is assumed to be received in February 2023.

Q. HOW WAS THE CAPITAL STRUCTURE DEVELOPED THAT WAS USED IN THE FUTURE TEST YEAR REVENUE REQUIREMENT?

A. The actual capital structure in the Base Period was impacted by accounting for several acquisitions and the inclusion of goodwill on the balance sheet of NMGC. Additionally, as discussed above, we received equity contributions from NMGC's parent during the linkage period.

As discussed above, the Company intends to issue $50 million of new debt in February 2023 and expects to also receive a capital contribution related to the debt issuance.
The Company decided not to use its actual capital structure and instead is proposing an imputed capital structure consisting of 47% long-term debt and 53% equity in the development of its Future Test Year revenue requirement. As discussed by NMGC Witness Morin, this is a reasonable capital structure when considering the proxy group he used to determine his recommended return on equity for NMGC.

Q. WHAT INTEREST RATE DID NMGC ASSUME FOR THE FEBRUARY 2023 $50 MILLION DEBT ISSUANCE?

A. Under advisement from one of its investment bankers, NMGC used a 30-year all-in rate of 4.3%. This represents a 30-year Treasury forward curve of 2.71% plus a spread of 159 basis points.

Q. DID YOU CONSIDER USING A DIFFERENT MATURITY FOR THE FORECASTED DEBT ISSUANCE?

A. Yes. We received quotes from the investment banker for a 10-year issuance as well. That quote represents a 10-year forward curve rate of 2.19% and a spread of 129 basis points for an all-in rate of 3.48%. Given the 30-year quote only being 82 basis points higher, we chose the longer-dated maturity in the model as this provides customers with a longer term of low interest rate financing.

Q. IN THE DEVELOPMENT OF ITS EQUITY AND DEBT AMOUNTS FOR THE WACC, DID NMGC UTILIZE AN AVERAGE AS REQUIRED BY 17.1.3.16(D)(4) NMAC?

A. Yes.

V. CERTAIN RATE CASE EXPENSES

Q. WHO IS PROVIDING DETAIL ON THE RATE CASE EXPENSES BEING REQUESTED IN THE RATE CASE?

A. NMGC Witness Lesley J. Nash is providing the detail for the rate case expenses that are being sought in the rate case. I provide additional details on the following: 1) the Lead-Lag Study that is used for Cash Working Capital, 2) the amounts paid to Concentric Energy Advisors, Inc. ("Concentric") related to the review of the cost of service model, and 3) the amounts paid to the auditors Ernst & Young, for the necessary review required by the Commission's Rule 630 schedules

Q. PLEASE DISCUSS THE SERVICES PROVIDED BY EXPERGY IN CONNECTION WITH THIS PROCEEDING.

A. Expergy was retained to develop the lead-lag study as required by the Commission's rules, and was utilized in the development of cash working capital, which is a necessary component to a rate case filing.

Q. PLEASE DISCUSS THE SERVICES PROVIDED BY CONCENTRIC IN CONNECTION WITH THIS PROCEEDING.

A. NMGC used Concentric to perform a detailed review of the Future Test Year Model to ensure it complies with the requirements of the Future Test Year rules and requirements, remains fully functional, and that it is clerically accurate. Concentric also assisted NMGC in providing certain administrative support necessary for the filing of this case.

Q. PLEASE DISCUSS THE SERVICES PROVIDED BY ERNST & YOUNG.

A. NMGC retained Ernst & Young to perform the required review of financial information included in Rule 630. Ernst & Young was selected to perform this function as they are the external auditors of the Company and therefore are the most familiar and able to perform this review work of base period financial information.

VI. <u>REGULATORY ASSETS AND LIABILITIES</u>

Q. WHAT REGULATORY ASSETS AND LIABILITIES ARE INCLUDED IN THE FUTURE TEST YEAR REVENUE REQUIREMENT?

A. NMGC Exhibit ECB-4 WP Other RB COS Inputs and Rule 630 Schedule H-12 provide a summary of all regulatory assets and liabilities in the Future Test Year.

NMGC projected the balances of regulatory assets and liabilities based on the existing amortization schedules for these assets and liabilities. Specifically, for the 2019 rate case expenses, NMGC is proposing to extend recovery of the remainder of these amounts at the beginning of the Future Test Year over a two-year period, to coincide with the proposed recovery period of the 2021 Rate Case expenses in this case. The two-year period would begin on January 1, 2023, which is the beginning of the Future Test Year.

Additionally, NMGC has included the information related to the Integrity Management Regulatory Asset agreed to in NMGC's last rate case.

Q. PLEASE IDENTIFY THE REGULATORY ASSETS AND LIABILITIES FOR WHICH NMGC IS REQUESTING COMMISSION APPROVAL IN THIS PROCEEDING.

A. NMGC is requesting approval to establish a new regulatory asset to begin recovering incremental rate case expenses incurred in this proceeding ("2021 Rate Case Expenses"), as well as a regulatory asset to complete the recovery of the remaining balance of the 2019 Rate Case expenses. NMGC is also seeking formal Commission approval to establish a regulatory liability to refund certain accumulated deferred income tax ("ADIT") amounts to NMGC's customers. NMGC Witness Davicel Avellan discusses the treatment of ADIT in greater detail in his testimony, and the details can be found in Rule 630 Schedule H-12.

NMGC's proposal is the same proposal it made in its last rate case, which was resulted in a black box settlement allowing NMGC to account for ADIT in this manner for the purpose of its books and records.

NMGC has reflected the balances associated with the 2021 Rate Case Expenses in Other Rate Base, pending approval of these regulatory assets in this filing. See NMGC Exhibit ECB-4 WP Other RB COS Inputs.

Q. WHAT AMOUNT IS NMGC SEEKING TO RECOVER IN RATE CASE EXPENSES FOR THE CURRENT CASE?

A. NMGC is seeking recovery of $1,632,000 in rate case expenses, as is detailed in NMGC Exhibit ECB-4 WP 630 Schedule I-1-Rate Case Exp. Rate case expenses include the out-of-pocket costs incurred by the Company for providing notice to customers, making photocopies of the filing, postage, and costs for outside consultants, accounting firms, and attorneys in preparing and litigating the case. NMGC's engagement of outside services for this case is a cost-effective means to meet the requirements of a complex rate case filing. NMGC hires outside service firms to prepare and support its filing versus hiring full-time staff to provide these same services, as these services are cyclical in nature. NMGC is requesting to establish a regulatory asset to recover these costs over a two-year period.

Q. WHAT IS THE BASIS FOR NMGC USING A TWO-YEAR AMORTIZATION PERIOD FOR THESE RATE CASE EXPENSES?

A. NMGC is proposing a two-year amortization period to recover these costs. NMGC believes that a two-year amortization period balances the timely recovery of these costs by NMGC and the impacts to our customers.

Q. HAS NMGC RECORDED A COVID-19 REGULATORY ASSET?

A. No. As of the filing of this rate case, NMGC has not recorded a COVID-19 regulatory asset. NMGC continues to track the incremental expenses and associated savings resulting from the COVID-19 pandemic NMGC continues to work with its customers to recover the outstanding accounts receivable that resulted from the moratorium on customer disconnections. Should NMGC not be successful in recovering the majority of the outstanding accounts receivable, then NMGC may still record and request recovery of a regulatory asset related to COVID-19 in a future rate proceeding.

VII. <u>WORKING CAPITAL</u>

Q. WHAT IS WORKING CAPITAL AND WHAT ARE THE COMPONENTS OF WORKING CAPITAL IN RATE BASE?

A. Working capital for rate making purposes is a measure of funding of daily operating expenditures and other non-plant investments that are necessary to sustain ongoing operations of the utility. In other words it is a measure of ongoing funding requirements on average for day-to-day operations. Working Capital in rate base consists of natural gas inventories, materials and supplies, prepayments, and cash working capital.

Q. PLEASE DESCRIBE THE DEVELOPMENT OF THE FUTURE TEST YEAR BALANCES FOR NATURAL GAS INVENTORIES.

A. NMGC developed a forecast of natural gas inventories by utilizing forecasted natural gas prices and historical injection and withdrawal rates to develop expected monthly balances of natural gas in storage through December 2023. See Rule 630 Schedule E-4 for these details.

Q. PLEASE DESCRIBE HOW THE FUTURE TEST YEAR BALANCES WERE DEVELOPED FOR MATERIALS AND SUPPLIES.

A. NMGC utilized the thirteen-month average balances for materials and supplies included in the Adjusted Base Period as the balances in the Future Test Year revenue requirements. NMGC does not anticipate any significant changes in these balances. The Adjusted Base Period is a reasonable representation of balances expected during the Future Test Year. See NMGC Exhibit ECB-4 WP Working Capital COS Inputs and 630 Schedule E-2.1.

Q. PLEASE DESCRIBE HOW THE FUTURE TEST YEAR BALANCES WERE DEVELOPED FOR PREPAYMENTS.

A. NMGC utilized the 13-month average balances for prepayments included in the Adjusted Base Period as the balances in the Future Test Year revenue requirements. NMGC removed prepayments related to its revolving credit facility from this balance. NMGC does not anticipate any significant changes in the thirteen-month average balances. The Adjusted Base Period is a reasonable representation of balances expected during the Future

Test Year. See NMGC Exhibit ECB-4 WP Working Capital COS Inputs and 630 Schedule E-2.2.

Q. DID NMGC INCLUDE CASH WORKING CAPITAL IN RATE BASE FOR THE FUTURE TEST YEAR?

A. Yes. NMGC included a cash working capital ("CWC") amount in the Future Test Year revenue requirements. The CWC allowance is based on the lead-lag study performed by Expergy, as discussed later in my testimony. The calculation of the CWC amount is included in Rule 630 Schedule E-1. See NMGC Exhibit ECB-4 WP Working Capital COS Inputs.

Q. HOW DID YOU DETERMINE THE LEVEL OF AVERAGE DAILY BANK BALANCES TO INCLUDE IN CWC?

A. I considered the results of two approaches to quantify the minimum reasonable level of bank balances to include in CWC:

The first approach examined the actual daily bank balances for each day in the 12-month CWC test period ending May 31, 2021. The daily balances ranged from $816,048.46 to $233,890,769.35 and showed an average daily balance of $7,955,551.27. To estimate a minimum level of daily bank balances necessary for ongoing operations, I analyzed the thirty lowest daily bank balances which resulted in an average balance for those thirty days of $1,109,348.07.

The second approach examined the average daily miscellaneous operation and maintenance ("O&M") expenses for the future test year ending 12/31/2023. The expenses in this category of revenue requirements generally present the most unpredictable payment clearing dates and are therefore a primary driver of the need for minimum cash balances to allow for an adequate cushion for check clearing. This category excludes the revenue requirements with more predictable clearing times such as payroll, taxes, and purchased gas costs. Using this estimated $46 million in miscellaneous O&M costs for the future test year results in an average daily expense of approximately $126,000. Ten days of this category of expense results in a balance of $1,260,000.

Q. HOW DID YOU USE THESE TWO APPROACHES TO MAKE YOUR RECOMMENDATION?

A. The first approach yielded $1,109,348.07, and the second approach yielded $1,260,000. The two approaches resulted in similar numbers. Considering both amounts and rounding the results yields my recommendation of $1,250,000 of average daily bank balances to include in CWC.

Q. PLEASE EXPLAIN WHAT "LEAD-LAG" MEANS IN THE CONTEXT OF UTILITY REGULATION AND ACCOUNTING.

A. A lead-lag study is a method used to measure the amount of CWC required to finance a utility's day-to-day operations. I use the terms "Revenue Lag" and "Expense Lead" as follows: (i) Revenue Lag is the number of days between when bills for service go out to the Company's customers and when payments are received from customers; and (ii) Expense Lead is the number of days between when the Company uses goods or services and when it pays for those goods or services. The composite Revenue Lag days were developed from the billing and payment patterns exhibited by the Company's customers. Similarly, the Expense Lead days for each of the various categories of expense were developed by measuring the period of time from when the costs were incurred until related payments were made. The net difference between the computed Revenue Lag days and the computed Expense Lead days was multiplied by the average daily revenue requirement. The resulting amount is the net CWC requirement.

Q. DOES THE REVENUE LAG TAKE INTO CONSIDERATION THE COST OF GAS DELIVERED TO CUSTOMERS BUT UNBILLED OR OTHERWISE DEFERRED IN THE COMPANY'S BALANCE SHEET UNDER THE RATE RIDER 4 MECHANISM?

A. No. Any gas delivered but for which customers have not yet been billed is not taken into consideration.

Q. IS THERE A RULE 630 SCHEDULE THAT SUMMARIZES THE LEAD-LAG STUDY AND THE MEASUREMENT OF INVESTOR-PROVIDED FUNDS FOR THE CWC?

A. Yes. Rule 630 Schedule E-1 CWC contains a summary of the Lead-Lag Study results and calculates the CWC requirement.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.