20180629150108
Filed Date: 06/29/2018
State Corporation Commission
of Kansas

BEFORE THE

KANSAS CORPORATION COMMISSION

KANSAS GAS SERVICE
A DIVISION OF ONE GAS, INC.

DIRECT TESTIMONY
OF
BRUCE H. FAIRCHILD

TABLE OF CONTENTS

LIST OF EXHIBITS

DIRECT TESTIMONY OF BRUCE H. FAIRCHILD

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Bruce H. Fairchild, 3907 Red River, Austin, Texas 78751.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?

A. I am a principal in Financial Concepts and Applications, Inc. ("FINCAP"), a firm engaged in financial, economic, and policy consulting to business and government.

A. Qualifications

Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND, PROFESSIONAL QUALIFICATIONS, AND PRIOR EXPERIENCE.

A. I hold a BBA degree from Southern Methodist University and MBA and PhD degrees from the University of Texas at Austin. I am also a Certified Public Accountant. My previous employment includes working in the Controller's Department at Sears, Roebuck and Company and serving as Assistant Director of Economic Research at the Public Utility Commission of Texas ("PUCT"). I have also been on the business school faculties at the University of Colorado at Boulder and the University of Texas at Austin, where I taught undergraduate and graduate courses in finance and accounting.

Q. BRIEFLY DESCRIBE YOUR EXPERIENCE IN UTILITY-RELATED MATTERS.

A. While at the PUCT, I assisted in managing a division comprised of approximately twenty-five professionals responsible for financial analysis, cost allocation and rate design, economic and financial research, and data processing systems. I

testified on behalf of the PUCT staff in numerous cases involving most major investor-owned and cooperative electric, telephone, and water/sewer utilities in the state regarding a variety of financial, accounting, and economic issues. Since forming FINCAP in 1979, I have participated in a wide range of analytical assignments involving utility-related matters on behalf of utilities, industrial consumers, municipalities, and regulatory commissions. I have also prepared and presented expert testimony before a number of regulatory authorities addressing revenue requirements, cost allocation, and rate design issues for gas, electric, telephone, and water/sewer utilities. I have been a frequent speaker at regulatory conferences and seminars and have published research concerning various regulatory issues. A resume that contains the details of my experience and qualifications is attached as Appendix A, with Appendix B listing my prior testimony before regulatory agencies since leaving the PUCT.

B. Overview

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to develop and recommend an overall rate of return for Kansas Gas Service ("KGS"), a Division of ONE Gas, Inc. ("ONE Gas").

Q. WHAT IS THE ROLE OF RATE OF RETURN IN SETTING A UTILITY'S RATES?

A. Rate of return serves to compensate investors for the use of their capital to finance the plant and equipment necessary to provide utility service to customers. Investors only commit money in anticipation of earning a return on their

investment commensurate with that from other investment alternatives having comparable risks. Consistent with both sound regulatory economics and the standards specified in the U.S. Supreme Court cases of *Bluefield Water Works & Improvement Co.* (1923)[1] and *Hope Natural Gas Co.* (1944)[2], rates should provide the utility a reasonable opportunity to earn a rate of return sufficient to: 1) fairly compensate capital presently invested in the utility, 2) enable the utility to offer a return adequate to attract new capital on reasonable terms, and 3) maintain the utility's financial integrity.

Q. IN GENERAL, HOW HAVE YOU DEVELOPED YOUR RECOMMENDED RATE OF RETURN FOR KGS?

A. My evaluation begins with a brief review of the operations and finances of KGS and general conditions in the natural gas industry and capital markets, including a discussion of the actions the Federal Reserve Board ("Fed") is taking in the aftermath of the financial crisis and Great Recession. With this background, I next develop a mix of investor-supplied capital (*i.e.*, debt and equity) to be used as weightings in calculating an overall rate of return. An average cost of debt applicable to the debt component of the capital structure is then calculated. Next, various analyses are conducted to determine a fair rate of return on common equity ("ROE"). These include applications of the discounted cash flow ("DCF") model, capital asset pricing model ("CAPM"), risk premium method, and comparable earnings method to develop a cost of equity range, from which my

[1] *Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 692-3, 43 S.Ct. 675, 679 (1923).

[2] *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 603, 64 S.Ct. 281, 288 (1944).

recommended ROE for KGS is selected. Finally, these components are combined to calculate my recommended overall rate of return for KGS.

C. Summary of Conclusions

Q. WHAT IS YOUR RATE OF RETURN RECOMMENDATION?

A. As developed in Schedule 7-A of Section 7 of the Minimum Filing Requirements ("MFR"), I recommend an overall rate of return for KGS of 7.7076%. This rate of return is based on capital structure ratios of 37.81% debt and 62.19% equity, a cost of debt of 3.9377%, and an ROE of 10.0%.

Q. WHAT ARE YOUR RECOMMENDED CAPITAL STRUCTURE RATIOS FOR KGS?

A. My recommended capital structure ratios of 37.81% debt and 62.19% equity are those of ONE Gas, Inc. ("ONE Gas"), of which KGS is a division, as of the end of the test year, December 31, 2017. These ratios are consistent with the capital structure ONE Gas has maintained since it was spun off from ONEOK Inc. ("ONEOK") into a stand-alone company on January 31, 2014. They reflect ONE Gas' need to establish a credit profile supporting an industry standard, single-A bond rating that enables it to attract new capital on reasonable terms and maintain its financial integrity. Besides being KGS's actual capital structure, ONE Gas' test year-end capital structure ratios are generally consistent with and fall within the range of those historically maintained by other local natural gas distribution companies ("LDCs").

Q. WHAT IS YOUR RECOMMENDED COST OF DEBT FOR KGS?

A. My recommended 3.9377% cost of debt is the average cost at December 31, 2017 of the $1.2 billion of long-term debt issued by ONE Gas in connection with its spin- off from ONEOK in 2014.

Q. WHAT IS YOUR RECOMMENDED ROE FOR KGS?

A. Based on applications of the DCF, CAPM, risk premium, and comparable earnings methods to a proxy group of publicly traded LDCs, I conclude that investors currently require a ROE from a publicly traded LDC in the range of 9.5% to 10.5%. While the higher capital costs that will result from the Fed ending its stimulative monetary policies following the Great Recession imply that the ROE for KGS should be selected from the upper end of the cost of equity range, this is partially offset by ONE Gas' capital structure ratios, which imply slightly lower financial risk relative to most of the LDCs in the proxy group. Taking both of these factors into consideration, I recommend an ROE for KGS equal to the midpoint of my 9.5% to 10.5% cost of equity range, or 10.0%.

II. FUNDAMENTAL ANALYSIS

Q. WHAT IS THE PURPOSE OF THIS SECTION OF YOUR TESTIMONY?

A. As a predicate to subsequent quantitative analyses, this section briefly reviews the operations and finances of KGS and ONE Gas. It also examines the natural gas distribution industry along with current conditions in the capital markets and the U.S. economy.

A. Kansas Gas Service

Q. BRIEFLY DESCRIBE KGS.

A. KGS is the operating division of ONE Gas that distributes natural gas to approximately two-thirds of the market in Kansas, including the cities of Kansas City, Overland Park, Topeka, and Wichita. At December 31, 2017, KGS had total assets of approximately $1.63 billion, with revenues for the previous twelve months being $526.4 million.

Q. BRIEFLY DESCRIBE ONE GAS.

A. ONE Gas is the largest natural gas distributor in Oklahoma and Kansas, and the third largest in Texas, serving a total of over 2.1 million customers. ONE Gas was created when ONEOK spun off its natural gas distribution operations into a separate entity on January 31, 2014. At December 31, 2017, ONE Gas had total assets of approximately $5.2 billion, with revenues during 2017 totaling more than $1.5 billion. ONE Gas' common stock is traded on the New York Stock Exchange and its debt is rated A by Standard & Poor's Financial Services LLC ("S&P") and A2 by Moody's Investors Service, Inc. ("Moody's").

B. Natural Gas Distribution Industry

Q. PLEASE DESCRIBE THE NATURAL GAS DISTRIBUTION INDUSTRY.

A. LDCs normally transport, deliver, and sell natural gas from receipt points on inter- and intrastate pipelines to households and businesses. They often have an exclusive right to operate in a specified geographic area, with their rates and operations being subject to the jurisdiction of state or local regulatory authorities. Historically, LDCs provided only "bundled" service, which included the

transportation, distribution, and natural gas itself, although some now allow customers to choose their own gas supplier, with the LDC providing the delivery and service of that gas. Structural changes, which have occurred on both the demand and supply sides, have eroded the traditional monopoly status of many gas utilities, with LDCs experiencing "bypass" as large commercial and industrial customers seek to acquire gas supplies at the lowest possible prices and, in the process, abandon traditional "full-service" utility suppliers.

Q. WHAT RISKS DO LDCS FACE THAT ARE OF CONCERN TO INVESTORS?

A. LDCs face a variety of market, operating, capital-related, and regulatory risks. The natural gas business is increasingly competitive and complex, with LDCs having to vie with electric companies, oil and propane suppliers, and, in some cases, energy marketers and trading companies. Moreover, the demand for natural gas is impacted by energy efficiency and technological advances adversely affecting growth over time, especially in the residential sector. The financial results of LDCs are also heavily dependent on general economic conditions, not only in terms of the overall activity of businesses, but also in the growth of households and use per customer.

With respect to operations, gas distribution inherently involves a variety of hazards and operating risks, including the need to replace aging and obsolete infrastructure, leaks, accidents, and third-party damages. Many LDCs are faced with substantial known and unknown environmental costs (*e.g.*, pipeline integrity testing) and post-retirement employee costs (*e.g.*, pensions and medical benefits).

Inflation and other increases could adversely impact LDCs' ability to control operating expenses and costs, and interruptions in gas supply, strikes, natural disasters, security breaches, and terrorist activities could disrupt or shut down operations. Finally, most LDCs are involved in ongoing legal or administrative proceedings before courts and governmental bodies related to a variety of matters (*e.g.*, general claims, taxes, environmental issues, billing, and credit and collection matters), which could result in detrimental outcomes.

Q. PLEASE ELABORATE ON THE CAPITAL AND REGULATORY RISKS FACED BY LDCS.

A. Regarding capital-related risks, virtually all LDCs are facing significant infrastructure improvements to meet customer service requirements and improve system reliability, as well as satisfy a number of government-mandated safety initiatives. The ability of LDCs to fund these and other capital expenditures is affected by a variety of factors, including regulatory decisions, maintenance of a sufficient bond rating, capital market conditions (*e.g.*, interest rates), and availability of credit facilities and access to capital markets. In addition, LDCs' ability to retain and attract capital is subject to changes in state and federal tax laws and accounting standards, which may adversely affect their cash flows and financial condition.

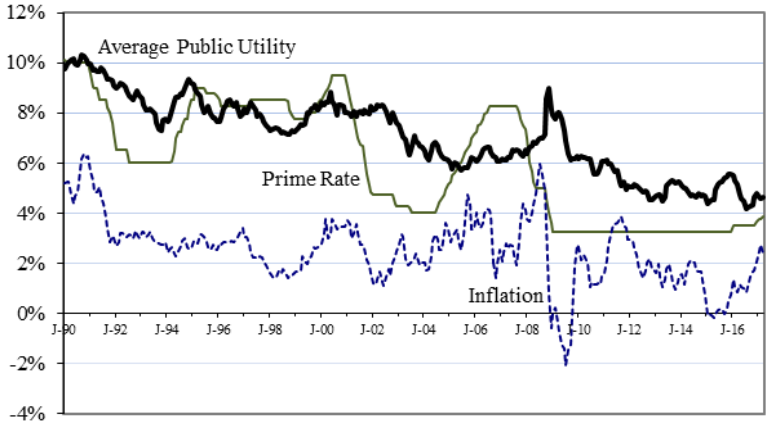
Finally, because most aspects of an LDC's operations (*e.g.*, rates; operating terms and conditions of service; types of services offered; construction of new facilities; the integrity, safety, and security of facilities and operations; acquisition, extension, or abandonment of services or facilities; reporting and

information posting requirements; maintenance of accounts and records; and relationships with affiliate companies) are subject to government oversight, investors are understandably concerned with rate, safety, and environmental regulation. Potential changes in laws, regulations, and policies, as well as the inherent uncertainty surrounding regulatory decisions, all represent significant risks to LDCs.

C. Capital Markets

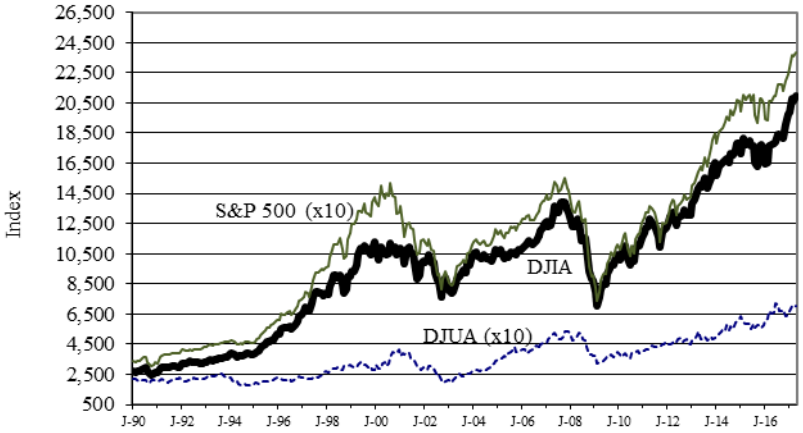
Q. WHAT HAS BEEN THE PATTERN OF INTEREST RATES OVER THE LAST TWO DECADES?

A. Average long-term public utility bond rates, the borrowing prime rate, and inflation as measured by the Consumer Price Index ("CPI") since 1990 are plotted in the graph below. After rising to approximately 10% in mid-1990, the average yield on long-term public utility bonds generally fell because of monetary and fiscal policies designed to keep the economy growing. This ended abruptly with the 2008 financial market meltdown and global recession. Investors became exceedingly risk averse, causing interest rates on corporate bonds to spike, while government policies pushed down short-term interest rates and depressed economic conditions and lower energy prices reduced inflation. Since that time, various actions by the Fed to stimulate the economy through easy-money policies resulted in short- and long-term interest rates reaching record low levels:



Q. HOW HAS THE MARKET FOR COMMON EQUITY CAPITAL PERFORMED OVER THIS SAME PERIOD?

A. Between 1990 and early 2000, stock prices pushed steadily higher as the longest bull market in United States history continued unabated. In mid-2000, mounting concerns over prospects for future growth, particularly for firms in the high technology and telecommunications sectors, pushed equity prices lower, in some cases precipitously. Common stock prices generally recovered and reached record highs, buoyed in large part by widespread acquisition activity, until the capital market crisis and global recession hit in 2008. Stock prices tumbled by some 40%, and although they have fully recovered, the market remains volatile, with share values routinely changing in full percentage points during a single day's trading. The graph below plots the performances of the Dow-Jones Industrial Average, the S&P 500, and the Dow Jones Utility Average since 1990 (the latter two indices were scaled for comparability):



Q. WHAT IS THE OUTLOOK FOR THE U.S. ECONOMY?

A. The U.S. economy has largely recovered from the Great Recession that was precipitated by the financial crisis that began in 2007. To make capital available and to lower short- and long-term interest rates, the Fed implemented extraordinary programs, which included reducing the federal funds rate from 5.25% to effectively zero and purchasing some $4.5 trillion in mortgage-backed and Treasury securities. In December 2015, the Fed began to return to more "normal" monetary policies by increasing the target federal funds rate (seven times thus far) and unwinding its massive portfolio of securities. These actions have caused, and are expected to continue causing both short- and long-term interest rates to rise, which implies a higher cost of all capital, including common equity. This expected increase in capital costs is evidenced by various forecasts (*e.g.*, *The Value Line Investment Survey* ("*Value Line*") and the *Blue Chip Financial Forecasts*) that project interest rates on 30-year Treasury bonds to increase from their current level of approximately 3.1% to between 4.2% and

4.3% in the 2022 timeframe. In the meantime, persistent stock and bond price volatility provide tangible evidence that the U.S. economy and capital markets continue to face considerable uncertainty.

III. CAPITAL STRUCTURE

Q. WHAT IS THE PURPOSE OF THIS SECTION OF YOUR TESTIMONY?

A. The purpose of this section is to recommend capital structure ratios for use in calculating an overall rate of return for KGS.

Q. WHAT IS THE ROLE OF CAPITAL STRUCTURE IN SETTING A UTILITY'S RATE OF RETURN?

A. A utility's capital structure reflects the mix of capital – debt, preferred stock (if any), and common equity – used to finance the utility's assets. The proportions of a utility's total capitalization attributable to each source of capital are typically used to weight the cost of debt, cost of preferred stock, and ROE in calculating an overall rate of return.

Q. HOW DOES THE USE OF DIFFERENT AMOUNTS OF DEBT AND EQUITY IN A FIRM'S CAPITAL STRUCTURE AFFECT THE RATES OF RETURN REQUIRED BY INVESTORS?

A. A higher debt ratio, or lower common equity ratio, generally translates into increased financial risk for all investors. A greater amount of debt means more investors have a senior claim on available cash flow, thereby reducing the certainty that each will receive his contractual payments. This, in turn, increases the risks to which lenders are exposed, and they require correspondingly higher rates of interest for bearing this increased risk. From common shareholders'

viewpoint, higher debt ratios mean that there are proportionately more investors ahead of them, thereby increasing the uncertainty as to the amount of cash flow, if any, that remains. Again, in accordance with the fundamental risk-return trade-off principle to be discussed in greater detail later, common shareholders require a correspondingly higher rate of return to compensate them for bearing the greater financial risk associated with a lower common equity ratio.

Q. WHAT SOURCES OF CAPITAL ARE USED TO FINANCE KGS'S INVESTMENT IN UTILITY PLANT?

A. As an operating division of ONE Gas, KGS has no independent financing, and it relies entirely on capital supplied by ONE Gas to finance its investment in assets.

Q. WHAT ARE THE SOURCES OF CAPITAL USED TO FINANCE ONE GAS?

A. ONE Gas' permanent financing at December 31, 2017 is shown on Schedule 7-A of Section 7 of the MFR. Also shown there are ONE Gas' test year-end capital structure ratios of 37.81% debt and 62.19% equity.

Q. WHAT CONSIDERATIONS WENT INTO HOW ONE GAS WAS FINANCED WHEN IT WAS SPUN OFF FROM ONEOK?

A. The Registration Form 10 filed with the Securities and Exchange Commission in connection with the spin-off of ONE Gas from ONEOK stated:

> Our capital structure was designed to obtain investment grade credit ratings that are higher than the current credit ratings of ONEOK and similar to those of our natural gas utility peers and to provide us with the financial flexibility to maintain our current level of operations and to continue to invest in our natural gas distribution system.

Toward this objective, ONE Gas was initially financed with approximately 40% debt and 60% equity. This capital structure was instrumental in ONE Gas being rated A- by S&P, which has since been increased to A, and A2 by Moody's. As shown on Schedule BHF-8, single-A is the average bond rating of the publicly traded LDCs included in *Value Line's* Natural Gas Utility industry that are predominantly involved in natural gas distribution and are not affected by an acquisition or divestiture. Also, ONE Gas' single-A ratings are an improvement over the triple-B bond ratings of ONEOK prior to the spin off. Of additional importance is that ONE Gas' capital structure and single-A bond ratings enabled it to issue its initial debt on very favorable terms, which is a direct benefit to customers.

Q. HAS ONE GAS MAINTAINED SIMILAR CAPITAL STRUCTURE RATIOS SINCE ITS INCEPTION?

A. Yes. Schedule BHF-1 displays the capital structure of ONE Gas at each year-end since it became a separate entity in 2014. As evidenced there, ONE Gas' capital structure ratios have generally remained in the approximately 40% debt and 60% equity vicinity over this period, although its equity ratio has increased slightly as earnings have been retained and the balance of the initially issued debt has remained essentially unchanged.

Q. HOW DO ONE GAS' CAPITAL STRUCTURE RATIOS COMPARE WITH THOSE OF OTHER LDCS?

A. Based on data published by the American Gas Association ("AGA"), the gas distribution industry maintained the following composite capital structure ratios between 2012 and 2016:

Capital Component	2016	2015	2014	2013	2012
Long-term Debt	40.1%	42.0%	42.3%	42.4%	42.6%
Preferred Stock	1.1%	0.6%	1.0%	0.1%	0.1%
Common Equity	58.8%	57.3%	56.7%	57.5%	57.3%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

The table above indicates that gas distribution companies have historically financed their investment in utility plant with around 42% long-term debt and 58% preferred and common equity, with the most recently reported capital structure ratios being approximately 40% debt and 60% preferred and common equity.

Alternatively, Schedule BHF-2 displays the capital structure ratios at each fiscal year-end between 2012 and 2017 for the seven LDCs other than ONE Gas in the proxy group identified earlier. While ONE Gas' test year-end capital structure ratios of approximately 38% debt and 62% equity are below and above, respectively, the averages for this group over the last five years, they fall within industry bounds. Moreover, it is noteworthy that the LDCs in the proxy group are longstanding companies that did not need to establish their creditworthiness to be able to attract new capital on reasonable terms and maintain their financial integrity as ONE Gas did when it was spun-off from ONEOK.

Q. HAS ANYTHING OCCURRED RECENTLY THAT SUPPORTS THE NEED FOR ONE GAS TO MAINTAIN DEBT AND EQUITY RATIOS AT THE LOWER AND UPPERS ENDS, RESPECTIVELY, OF INDUSTRY NORMS?

A. Yes. In January 2018, Moody's lowered its rating outlook for ONE Gas from "stable" to "negative" because of the adverse impact on its credit metrics resulting from the reduction of the corporate income tax rate from 35% to 21% provided for in the Tax Cuts and Jobs Act ("TCJA"). A "negative" outlook is intended to warn investors of the potential for a bond rating downgrade. Because ONE Gas' actual capital structure entails less financial risk, it serves as a buffer to a bond rating downgrade and corresponding reduction in creditworthiness. ONE Gas has advised the investment community that it intends to maintain its current capital structure ratios to preserve ONE Gas' financial integrity and ability to attract capital on reasonable terms, which is a benefit to customers.

Q. WHAT CAPITAL STRUCTURE RATIOS DO YOU RECOMMEND BE USED TO CALCULATE THE RATE OF RETURN FOR KGS?

A. I recommend that the rate of return for KGS be calculated using ONE Gas' December 31, 2017 capital structure ratios of 37.81% debt and 62.19% equity. These capital structure ratios were designed to secure a credit rating similar to other LDCs when ONE Gas was spun-off from ONEOK and may forestall a bond rating downgrade precipitated by the recent passage of the TCJA. Besides reflecting how KGS is actually financed, ONE Gas' capital structure ratios are generally consistent with and fall within the range of those maintained by other

LDCs. Additionally, in arriving at my recommended ROE for KGS, I have taken into account that ONE Gas' debt and equity ratios are at the lower and higher ends, respectively, of industry norms, which implies slightly lower financial risk relative to most of the LDCs in the proxy group.

IV. COST OF DEBT

Q. WHAT IS THE PURPOSE OF THIS SECTION OF YOUR TESTIMONY?

A. The purpose of this section is to recommend a cost of debt applicable to the debt component of the capital structure used to calculate an overall rate of return for KGS.

Q. PLEASE DESCRIBE THE DEBT ONE GAS ISSUED AT ITS INCEPTION.

A. As shown on Schedule 7-B of Section 7 of the MFR, in January 2014, ONE Gas completed the private placement of three series of senior notes, consisting of $300 million maturing in 2019 and carrying an interest rate of 2.07%, $300 million due in 2024 with an interest rate of 3.61%, and $600 million maturing in 2044 at an interest rate of 4.658%. The favorable interest rates on the debt issued by ONE Gas reflected capital market conditions at the time of issue, its capital structure ratios, and the single-A bond rating ONE Gas had received from S&P and Moody's. At December 31, 2017, ONE Gas had approximately $8.0 million in unamortized issuance costs that had been incurred in connection with the sale of the $1.2 billion of debt, and approximately $8.1 million in unamortized costs associated with previously retired debt.

Q. WHAT IS THE AVERAGE COST OF ONE GAS' DEBT?

A. Also developed on Schedule 7-B, the weighted average cost of ONE Gas' outstanding debt at December 31, 2017 is 3.9377%.

Q. HOW DOES ONE GAS' COST OF DEBT COMPARE WITH THAT OF OTHER LDCS?

A. The average costs of debt of the other seven LDCs in the proxy group identified earlier at their 2017 fiscal year-ends are shown in the following table:

Company	**Cost of Debt**
Atmos Energy	4.93%
Chesapeake Utilities	4.41%
New Jersey Resources	3.43%
Northwest Natural Gas	4.78%
South Jersey Industries	3.55%
Southwest Gas	4.21%
Spire	4.20%
Average	**4.22%**

ONE Gas' 3.9377% cost of debt is well below the 4.22% average of the proxy group and less than all but two of the other LDCs.

Q. WHAT COST OF DEBT DO YOU RECOMMEND BE USED TO CALCULATE THE RATE OF RETURN FOR KGS?

A. Consistent with using ONE Gas' actual capital structure ratios at December 31, 2017, I recommend that the rate of return for KGS be calculated using ONE Gas' 3.9377% cost of debt. This favorable cost of debt reflects ONE Gas' single-A bond rating, which is largely predicated on its actual capital structure ratios, and as demonstrated above is lower than that of most other LDCs.

V. RETURN ON EQUITY

Q. WHAT IS THE PURPOSE OF THIS SECTION OF YOUR TESTIMONY?

A. The purpose of this section is to develop a cost of equity range for a proxy group of LDCs having risks similar to KGS. It begins by introducing the cost of equity concept, explaining the risk-return tradeoff principle fundamental to capital markets, and discussing the importance of using multiple approaches to estimate the cost of equity. The DCF model is then developed and applied to a proxy group of publicly traded LDCs to estimate their current cost of equity. Next, the CAPM is described and alternative cost of equity estimates developed using this method. Cost of equity estimates are also developed using the risk premium method based on ROEs previously authorized for other LDCs, and a comparable earnings method is applied. The results of these analyses are then combined to arrive at a current cost of equity range for LDCs having risks similar to KGS.

A. Cost of Equity Concept

Q. HOW IS A RATE OF RETURN ON COMMON EQUITY CUSTOMARILY DETERMINED?

A. Unlike debt capital, there is no contractually guaranteed return on common equity capital, because shareholders are the residual owners of the utility. Nonetheless, common equity investors still require a return on their investment, with the "cost of equity" being the minimum rent that must be paid for the use of their money.

Q. WHAT FUNDAMENTAL ECONOMIC PRINCIPLE UNDERLIES THIS COST OF EQUITY CONCEPT?

A. The cost of equity concept is predicated on the notion that investors are risk averse and willingly accept additional risk only if they expect to be compensated for bearing that risk. In capital markets where relatively risk-free assets are available, such as U.S. Treasury securities, investors can be induced to hold more risky assets only if they are offered a premium, or additional return, above the rate of return on a risk-free asset. Since all assets compete with each other for investors' funds, riskier assets must yield a higher expected rate of return than less risky assets in order for investors to be willing to hold them.

Given this risk-return tradeoff, the minimum required rate of return (k) from an asset (i) can be generally expressed as:

$$k_i = R_f + RPi$$

where: R_f = Risk-free rate of return; and
RP_I = Risk premium required to hold more risky asset i.

Thus, the minimum required rate of return for a particular asset at any point in time is a function of: 1) the yield on risk-free assets, and 2) its relative risk, with investors demanding correspondingly larger risk premiums for assets bearing greater risk.

Q. IS THERE EVIDENCE THAT THE RISK-RETURN TRADEOFF PRINCIPLE ACTUALLY OPERATES IN THE CAPITAL MARKETS?

A. Yes. The risk-return tradeoff can be readily documented in certain segments of the capital markets where required rates of return can be directly inferred from market data and generally accepted measures of risk exist. For example, bond

yields are reflective of investors' expected rates of return, and bond ratings are indicative of the risk of fixed income securities. The observed yields on government securities and bonds of various rating categories demonstrate that the risk-return tradeoff does, in fact, exist in the capital markets.

To illustrate, average yields during May 2018 on 30-year U.S. Treasury bonds and public utility bonds of different ratings reported by Moody's are shown in the table below. As evidenced there, as risk increases (measured by progressively lower bond ratings), the required rate of return (measured by yields) rises accordingly. Also shown are the indicated risk premiums over long-term government securities for the additional risk associated with each bond rating category.

Bond and Rating	**May 2018 Yield**	**Risk Premium Over 30-Year Treasury**
U.S. Treasury		
30-Year	3.13%	--
Public Utility		
Aa	4.10%	0.97%
A	4.28%	1.15%
Baa	4.71%	1.58%

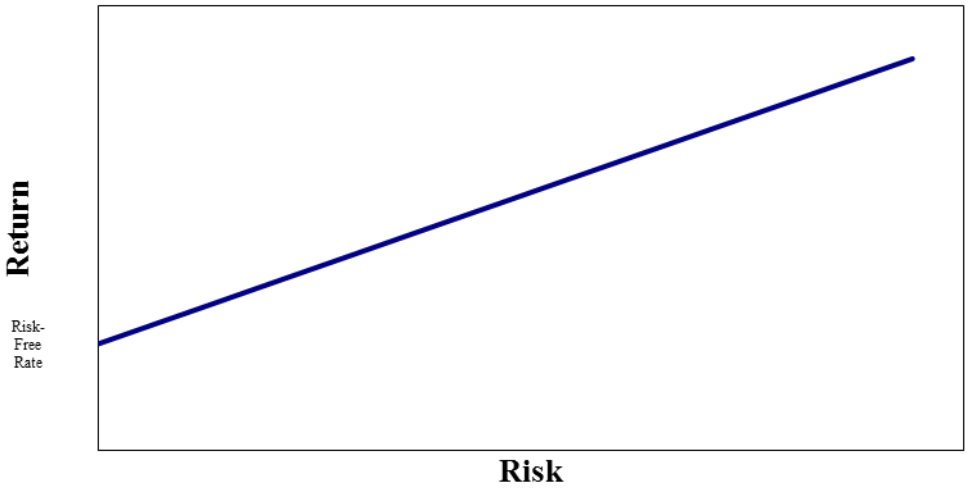
Q. DOES THE RISK-RETURN TRADEOFF OBSERVED WITH FIXED INCOME SECURITIES EXTEND TO COMMON STOCKS AND OTHER ASSETS?

A. Documenting the risk-return tradeoff for assets other than fixed income securities is complicated by two factors. First, there is no standard measure of risk applicable to all assets. Second, for most assets (*e.g.*, common stock), required rates of return cannot be directly observed. Yet there is every reason to believe that investors exhibit risk aversion in deciding whether to hold common stocks

and other assets, just as when choosing among fixed income securities. Accordingly, it is generally accepted that the risk-return tradeoff evidenced with long-term debt extends to all assets.

The extension of the risk-return tradeoff from assets with observable required rates of return (*e.g.*, bonds) to other assets is represented by the concept of a "capital market line." In particular, competition between securities and among investors in the capital markets drives the prices of assets to equilibrium such that the expected rate of return from each is commensurate with its risk. Thus, the expected rate of return from any asset is a risk-free rate of return plus a corresponding risk premium. This concept of a capital market line is illustrated below. The vertical axis represents required rates of return and the horizontal axis indicates relative riskiness, with the intercept of the capital market line being the risk-free rate of return.

Capital Market Line



Q. IS THIS RISK-RETURN TRADEOFF LIMITED TO DIFFERENCES BETWEEN FIRMS?

A. No. The risk-return tradeoff principle applies not only to investments in different firms, but also to different securities issued by the same firm. As discussed earlier, the securities issued by a utility vary considerably in risk because they have different characteristics and priorities. Long-term debt secured by a mortgage on property is senior among all capital in its claim on a utility's net revenues and is, therefore, the least risky because mortgage bondholders have a direct claim on the utility's property. Following first mortgage bonds are other debt instruments also holding contractual claims on the utility's net revenues, such as debentures. The last investors in line are common shareholders. They only receive the net revenues, if any, that remain after all other claimants have been paid. As a result, the minimum rate of return that investors require from a utility's common stock, the most junior and riskiest of its securities, must be considerably higher than the yield offered by the utility's senior, long-term debt.

Q. WHAT DOES THE ABOVE DISCUSSION IMPLY WITH RESPECT TO ESTIMATING THE COST OF EQUITY FOR A UTILITY?

A. Although the cost of equity cannot be observed directly, it is a function of the returns available from other investment alternatives and the risks to which the equity capital is exposed. Because it is unobservable, the cost of equity for a particular utility must be estimated by analyzing information about capital market conditions generally, assessing the relative risks of the utility specifically, and employing various quantitative methods that focus on investors' required rates of

return. These various quantitative methods typically attempt to infer investors' required rates of return from stock prices, by extrapolating interest rates, or through an analysis of other financial data.

Q. DO YOU RELY ON A SINGLE METHOD TO ESTIMATE THE COST OF EQUITY?

A. No. Despite the theoretical appeal of or precedent for using a particular method to estimate the cost of equity, no single approach can be regarded as wholly reliable. Therefore, I use multiple methods to estimate the cost of equity. Indeed, it is essential that estimates of investors' minimum required rate of return produced by one method be compared with those produced by other methods, and that all cost of equity estimates be required to pass fundamental tests of reasonableness and economic logic.

B. Discounted Cash Flow Model

Q. HOW ARE DCF MODELS USED TO ESTIMATE THE COST OF EQUITY?

A. The use of DCF models to estimate the cost of equity is essentially an attempt to replicate the market valuation process that led to the price investors are willing to pay for a share of a company's common stock. It is predicated on the assumption that investors evaluate the risks and expected rates of return from all securities in the capital markets. Given these expected rates of return, the price of each share of stock is adjusted by the market so that investors are adequately compensated for the risks to which they are exposed. Therefore, we can look to the market to determine what investors believe a share of common stock is worth, and by

estimating the cash flows they expect to receive from the stock in the way of future dividends and stock price, their required rate of return can be mathematically imputed. In other words, the cash flows that investors expect from a stock are estimated, and given the stock's current market price, we can "back-into" the discount rate, or cost of equity, investors presumably used in arriving at that price.

Q. WHAT MARKET VALUATION PROCESS UNDERLIES DCF MODELS?

A. DCF models are derived from a theory of valuation that posits that the price of a share of common stock is equal to the present value of the expected cash flows (*i.e.*, future dividends and stock price) that will be received while holding the stock, discounted at investors' required rate of return, or the cost of equity. Notationally, the general form of the DCF model is as follows:

$$P_0 = \frac{D_1}{(1+K_e)^1} + \frac{D_2}{(1+K_e)^2} + \cdots + \frac{D_t}{(1+K_e)^t} + \frac{P_t}{(1+K_e)^t}$$

where: P_0 = Current price per share;
P_t = Future price per share in period t;
D_t = Expected dividend per share in period t;
K_e = Cost of equity.

Q. HAS THIS GENERAL FORM OF THE DCF MODEL CUSTOMARILY BEEN SIMPLIFIED FOR USE IN ESTIMATING THE COST OF EQUITY IN RATE CASES?

A. Yes. In an effort to reduce the number of required estimates and computational difficulties, the general form of the DCF model has been simplified to a "constant growth" form. In order to convert the general form of the DCF model to the

constant growth DCF model, a number of assumptions must be made. These include:

- A constant growth rate for both dividends and earnings;
- A stable dividend payout ratio;
- The discount rate exceeds the growth rate;
- A constant growth rate for book value and price;
- A constant earned rate of return on book value;
- No sales of stock at a price above or below book value;
- A constant price-earnings ratio;
- A constant discount rate (*i.e.*, no changes in risk or interest rate levels and a flat yield curve); and
- All of the above extend to infinity.

Given these assumptions, the general form of the DCF model can be reduced to the more manageable formula of:

$$P_0 = \frac{D_1}{K_e - g}$$

where: g = Investors' long-term growth expectations.

The cost of equity ("K_e") can be isolated by rearranging terms:

$$K_e = \frac{D_1}{P_0} + g$$

The constant growth form of the DCF model recognizes that the rate of return to stockholders consists of two parts: 1) dividend yield (D_1/P_0); and 2) growth (g). In other words, investors expect to receive a portion of their total return in the form of current dividends and the remainder through price appreciation.

While the constant growth form of the DCF model provides a more manageable formula to estimate the cost of equity, it is important to note that the assumptions required to convert the general form of the DCF model to the constant growth form are never strictly met in practice. In some instances, where

earnings are derived solely from stable activities, and earnings, dividends, and book value track fairly closely, the constant growth form of the DCF model may be a reasonable working approximation of stock valuation. However, in other cases, where the circumstances cause the required assumptions to be severely violated, the constant growth DCF model may produce widely divergent and meaningless results. This is especially the case if the firm's earnings or dividends are unstable, or if investors are expecting the stock price to be affected by factors other than earnings and dividends.

Q. HOW DID YOU ESTIMATE THE COST OF EQUITY USING THE DCF MODEL?

A. I applied the constant growth form of the DCF model to a proxy group of publicly traded LDCs having risks similar to KGS. Specifically, I began with the eleven companies included in *Value Line's* Natural Gas Utility industry and excluded those: 1) that are not predominantly engaged in natural gas distribution (*i.e.*, UGI Corp.;, 2) that are in the midst of a merger/acquisition (*i.e.*, WGL Holdings); and 3) whose historical and other financial data are distorted by a divestiture (NiSource Inc.). This resulted in the following proxy group of eight LDCs:

Atmos Energy
Chesapeake Utilities
New Jersey Resources
Northwest Natural Gas
ONE Gas
South Jersey Industries
Southwest Gas Holdings
Spire, Inc.

Q. HOW IS THE CONSTANT GROWTH FORM OF THE DCF MODEL USED TO ESTIMATE THE COST OF EQUITY?

A. The first step in implementing the constant growth DCF model is to determine the expected dividend yield (D_1/P_0) for the firm in question. This is usually calculated based on an estimate of dividends to be paid in the coming year divided by the current price of the stock.

Q. HOW DID YOU CALCULATE THE DIVIDEND YIELD COMPONENT OF THE CONSTANT GROWTH DCF MODEL FOR THE GAS UTILITY GROUP?

A. Because estimating the cost of equity using the DCF model is an attempt to replicate how investors arrived at an observed stock price, all of its components should be contemporaneous. Price, dividend, and growth data from different points in time, or averaged over long time-periods, violate the matching principle underlying the DCF model. Therefore, dividend yield was calculated by dividing an estimate of dividends to be paid by each of the LDCs in the group over the next twelve months, obtained from the index to *Value Line's* June 1, 2018 edition, by the average daily closing price of each firm's stock during the month of May 2018. The expected dividends, representative price, and resulting dividend yield for each of the eight gas utilities are displayed on Schedule BHF-3. As also shown there, the average dividend yield for the industry group is 2.79%.

Q. EXPLAIN HOW ESTIMATES OF INVESTORS' LONG-TERM GROWTH EXPECTATIONS ARE CUSTOMARILY DEVELOPED FOR USE IN THE CONSTANT GROWTH DCF MODEL.

A. In constant growth DCF theory, earnings, dividends, book value, and market price are all assumed to grow in lockstep, and the growth horizon of the DCF model is infinite. But implementation of the DCF model is more than just a theoretical exercise; it is an effort to replicate the mechanism investors used to arrive at observable stock prices. Therefore, the only "g" that matters in using the DCF model to estimate the cost of equity is that which investors expect and have embodied in current market prices.

Q. WHAT DRIVES INVESTORS' GROWTH EXPECTATIONS?

A. Trends in earnings, which ultimately support future dividends and share price, play a pivotal role in determining investors' long-term growth expectations. Security analysts' growth forecasts are generally regarded as the closest single measure of the expected long-term growth rate of the constant growth DCF model. While being primarily based on the outlook for a firm, they also reflect the utility's historical experience and other factors considered by investors in forming their long-term growth expectations. Moreover, various empirical studies have found that security analysts' projections are a superior source of DCF growth rates. The 5-year earnings growth projections by security analysts for each of the eight gas utilities reported by *Value Line*, Thomson Reuters' *Institutional Brokers Estimate System* ("*I/B/E/S*"), and *Zacks Investment Research* ("*Zacks*") are displayed on Schedule BHF-4, with the averages for the group being 8.4%, 5.0%,

and 6.4%, respectively. Also shown on Schedule BHF-4 are the 10-year and 5-year historical earnings growth rates reported by *Value Line* for each of the gas utilities, which average 5.8% and 4.9%, respectively.

Q. HOW ELSE ARE INVESTOR EXPECTATIONS OF FUTURE LONG-TERM GROWTH PROSPECTS FOR A FIRM OFTEN ESTIMATED FOR USE IN THE CONSTANT GROWTH DCF MODEL?

A. In DCF theory and practice, growth in book equity comes from the reinvestment of earnings within the business and the effects of external financing. Accordingly, conventional applications of the constant growth DCF model often examine the relationships between variables that determine the "sustainable" growth attributable to these two factors.

Q. HOW IS A FIRM'S SUSTAINABLE GROWTH ESTIMATED?

A. The sustainable growth rate is calculated by the formula:

$$g = br + sv$$

where "b" is the expected earnings retention ratio (one minus the dividend payout ratio), "r" is the expected rate of return earned on book equity, "s" is the percent of common equity expected to be issued annually as new common stock, and "v" is the equity accretion ratio. The "br" term represents the growth from reinvesting earnings within the firm while the "sv" term represents the growth from external financing. This external financing growth results because existing shareholders share in a portion of any excess received from selling new shares at a price above book value.

Q. WHAT GROWTH RATE DOES THE SUSTAINABLE GROWTH METHOD SUGGEST FOR THE GAS UTILITY GROUP?

A. The sustainable growth rate for each of the gas utilities in the industry group based on *Value Line's* projections for 2021-2023 is developed in Schedule BHF-5. As shown there, the sustainable growth method implies an average long-term growth rate for the gas utility group of 7.8%.

Q. WHAT ARE OTHER PROJECTED AND HISTORICAL GROWTH RATES FOR THE INDUSTRY GROUP?

A. Schedule BHF-6 displays *Value Line* projected growth rates and 10- and 5-year historical growth rates in book value per share, dividends per share, and stock price for each of the eight gas utilities in the industry group. The averages for the LDC group range from 4.7% (projected growth in share price) to 9.9% (5-year historical growth is share price). Besides the fact that some of these growth rates, when combined with the group's 2.79% dividend yield, imply implausible cost of equity estimates, the variation in these other growth rates results in them providing limited guidance as to the prospective growth that investors expect.

Q. WHAT IS YOUR CONCLUSION AS TO THE GROWTH THAT INVESTORS ARE EXPECTING FROM THE INDUSTRY GROUP?

A. After excluding clearly unreliable indicators of growth, the plausible growth rates shown on Schedules BHF-4, BHF-5, and BHF-6 indicate a range for the LDC group of between approximately 6.0% and 8.0%, which compares with *Zacks* projected earnings growth rate for its gas distribution industry of 7.4%. Taken

together, I conclude that investors expect long-term growth from the LDC group in the 6.25% to 7.25% range.

Q. WHAT CURRENT DCF COST OF EQUITY ESTIMATES DO THESE GROWTH RATE RANGES IMPLY FOR THE GAS UTILITY GROUP?

A. Summing the LDC group's average dividend yield of approximately 2.8% with a 6.25% to 7.25% growth rate range indicates a current DCF cost of equity for the industry group of between 9.1% and 10.1%.

C. Capital Asset Pricing Model

Q. HOW ELSE DID YOU ESTIMATE THE COST OF EQUITY?

A. The cost of equity to the gas utility group was also estimated using the CAPM, which is a theory of market equilibrium that serves as the basis for current financial education and management. Under the CAPM, investors are assumed fully diversified, so that the relevant risk of an individual asset (*e.g.*, common stock) is its volatility relative to the market as a whole, which is measured using a "beta" coefficient. Beta reflects the tendency of a stock's price to follow changes in the market, with stocks having a beta less than 1.00 being considered less risky and stocks with a beta greater than 1.00 being regarded as more risky. The CAPM is mathematically expressed as:

$$R_j = R_f + \beta_j (R_m - R_f)$$

where: R_j = required rate of return for stock j;
R_f = risk-free interest rate;
R_m = expected return on the market portfolio; and
β_j = beta, or systematic risk, for stock j.

While the CAPM is not without controversy, it is routinely referenced in the financial literature and regulatory proceedings, and firms' beta values are widely reported.

Q. HOW DID YOU APPLY THE CAPM?

A. I applied the CAPM using two methods to determine the risk premium for the market as a whole, or the (R_m - R_f) term in the CAPM formula. The first was based on historical rates of return and the second was based on forward-looking estimates of investors' required rates of return. In both instances, the companies included in the S&P 500 index were used as a proxy for the market portfolio and the 30-year U.S. Treasury bond served as the risk-free investment.

Q. PLEASE DESCRIBE THE FIRST METHOD BASED ON HISTORICAL RATES OF RETURN.

A. Under the historical rate of return approach, equity risk premiums are calculated by first measuring the rate of return (including dividends and capital gains and losses) actually realized on an investment in common stocks over historical time periods. The historical return on bonds is then subtracted from that earned on common stocks to measure equity risk premiums. Widely used in academia, the historical rate of return approach is based on the assumption that, given a sufficiently large number of observations over long historical periods, average market rates of return will converge to investors' required rates of return. From a more practical perspective, investors may base their expectations for the future on, or may have come to expect that they will earn, rates of return corresponding to those in the past.

Q. WHAT IS THE MARKET RISK PREMIUM BASED ON HISTORICAL RATES OF RETURN?

A. Perhaps the most exhaustive study of historical rates of return, and the one most frequently cited in regulatory proceedings, is that contained in *Market Results for Stocks, Bonds, Bills and Inflation*, variously published by Ibbotson Associates, Morningstar, and Duff & Phelps. Most recently, Duff & Phelps reports that the annual rate of return realized on the S&P 500 averaged 12.1% over the period 1926 through 2017 while the annual average income rate of return on 30-year Treasury bonds over this same period averaged 5.0%. Thus, the market risk premium based on historical average annual rates of return is 7.1%.

Q. PLEASE DESCRIBE THE SECOND METHOD BASED ON FORWARD-LOOKING REQUIRED RATES OF RETURN.

A. Consistent with the CAPM being an expectational (*i.e.*, forward-looking) model, the second method estimated the market risk premium using current indicators of investors' required rates of return. For the market portfolio, the cost of equity was estimated by applying the DCF model to the firms in the S&P 500 paying cash dividends, with each firm's dividend yield and growth rate being weighted by its proportionate share of total market value. The expected dividend yield for each firm was obtained from *Value Line*, with the expected growth rate being based on the earnings forecasts published for each firm by *Value Line*, *I/B/E/S*, and *Zacks*. As shown in footnote (b) on Schedule BHF-7, summing the 2.37% expected dividend yield for this market group, which is composed primarily of non-regulated firms, with the average *Value Line*, *I/B/E/S*, and *Zacks* projected growth

rate of 10.35% produces a required rate of return from the market portfolio (R_m) of 12.73%.

Q. WHAT IS THE MARKET RISK PREMIUM BASED ON FORWARD-LOOKING REQUIRED RATES OF RETURN?

A. From the 12.73% required rate of return on the market portfolio, a market risk premium is calculated by subtracting the average yield on 30-year Treasury bonds during May 2018 of 3.13%. This produces a forward-looking market risk premium of 9.60%.

Q. WHAT IS THE NEXT STEP IN APPLYING THE CAPM?

A. Having calculated market risk premiums of 7.10% and 9.60% using historical rates of return and forward-looking rates of return, respectively, the next step is to calculate specific risk premiums for the LDC industry group. This is done by multiplying the alternative market risk premium estimates by the LDC group's average beta of 0.74, calculated using firm betas obtained from *Value Line* and shown on Schedule BHF-8, which produces current industry risk premiums of 5.25% and 7.10%.

Q. WHAT ARE THE RESULTING THEORETICAL CAPM COST OF EQUITY ESTIMATES FOR THE LDC GROUP?

A. As developed in Schedule BHF-7, summing the industry risk premiums of 5.25% and 7.10% with a risk-free interest rate equal to the May 2018 30-year Treasury bond yield of 3.13% produces current theoretical CAPM cost of equity estimates for the LDC industry group of 8.38% and 10.23%.

Q. ARE THESE THEORETICAL CAPM COST OF EQUITY ESTIMATES ACCURATE MEASURES OF INVESTORS' REQUIRED RATE OF RETURN FROM THE GROUP OF LDCS?

A. No. These cost of equity estimates are based on CAPM theory. However, as explained by Morningstar in its *2015 Classic Yearbook* edition of *Stocks, Bonds, Bills and Inflation*:

> One of the most remarkable discoveries of modern finance is that of a relationship between company size and return. Historically on average, small companies have higher returns than those of large ones. … The relationship between company size and return cuts across the entire size spectrum; it is not restricted to the smallest stocks. (page 99, footnote omitted)

In other words, in addition to the systematic risk measured by beta, investors' required rate of return depends on a firm's relative size. To account for this, Duff & Phelps has developed size premiums that need to be added to the theoretical CAPM cost of equity estimates to account for the level of a firm's market capitalization in determining the CAPM cost of equity.

Q. WHAT ARE THE CURRENT CAPM COST OF EQUITY ESTIMATES FOR THE LDC GROUP ONCE SIZE EFFECTS ARE TAKEN INTO ACCOUNT?

A. As shown on Schedule BHF-9, the average market capitalization of the LDC group is $3.7 billion. Based on Duff & Phelps most recent schedule of size premiums, this means that the theoretical CAPM cost of equity estimates need to be increased by 1.36% to account for the LDC industry group's smaller size relative to the S&P 500. As shown on Schedule BHF-8, increasing the theoretical CAPM cost of equity estimates for the LDC group by this size premium results in

current CAPM cost of equity estimates based on historical rates of return and forward-looking rates of return of 9.74% and 11.59%, respectively.

D. Risk Premium Method

Q. HOW ELSE DID YOU ESTIMATE THE COST OF EQUITY?

A. I also estimated the cost of equity using a risk premium method based on ROEs previously authorized for LDCs by state regulatory commissions. The risk premium method to estimate investors' required rate of return is an extension of the risk-return tradeoff observed with bonds to common stocks. The cost of equity is estimated by determining the additional return investors require to forego the relative safety of a bond and bear the greater risks associated with common stock, and then adding this equity risk premium to the current yield on bonds.

Q. GENERALLY DESCRIBE THE APPLICATION OF THE RISK PREMIUM METHOD USING AUTHORIZED ROES.

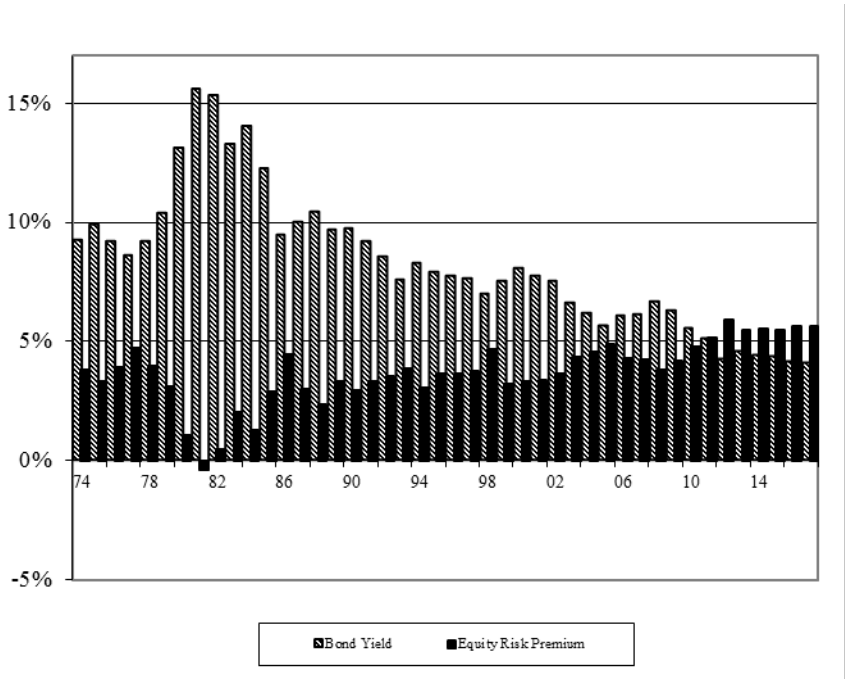
A. Application of the risk premium method based on authorized ROEs is predicated on the presumption that allowed returns reflect regulatory commissions' best estimates of the cost of equity, however determined, at the time they issued their final orders. A current risk premium is estimated based on the difference between past authorized ROEs and then-prevailing interest rates. This risk premium is then added to current interest rates to estimate the cost of equity.

Q. WHAT WAS THE PRINCIPAL SOURCE OF THE DATA USED TO APPLY THIS RISK PREMIUM METHOD?

A. Regulatory Research Associates, Inc. (RRA), which is now a group within S&P Global Market Intelligence, and its predecessors have compiled the ROEs authorized for major electric and gas utilities by regulatory commissions across the U.S. The average ROE authorized for natural gas utilities published by RRA in each quarter between 1980 and the first quarter of 2018 are displayed in Schedule BHF-9. As shown there, the ROEs granted LDCs over this approximately 38-year period have averaged 11.65%, while the average single-A utility bond yield has averaged 8.11%, resulting in an average risk premium of 3.54%.

Q. IS THIS 3.54% AVERAGE RISK PREMIUM THE RELEVANT BENCHMARK FOR ESTIMATING THE COST OF EQUITY?

A. No. It is necessary to account for the fact that authorized ROEs do not move in lockstep with interest rates. In particular, when interest rate levels are relatively high, ROEs tend to be lower (*i.e.*, equity risk premiums narrow), and when interest rates are relatively low, authorized ROEs are greater (*i.e.*, equity risk premiums increase). This inverse relationship can be observed in the data contained in Schedule BHF-9, which is shown graphically below. As evident there, the higher the level of interest rates (shaded bars), the lower the equity risk premiums (the solid bars calculated as the difference between authorized ROEs and bond yields), and vice versa:



The implication of this inverse relationship is that for a one percent increase or decrease in interest rates, the cost of equity may only rise or fall, say, one-half of a percent, respectively.

Q. HOW DID YOU ACCOUNT FOR THE RELATIONSHIP BETWEEN EQUITY RISK PREMIUMS AND INTEREST RATES IN ESTIMATING THE COST OF EQUITY FOR THE LDC GROUP USING PAST AUTHORIZED ROES?

A. To account for the fact that equity risk premiums are lower when interest rates are high and higher when interest rates are low, I developed two regression equations relating authorized past equity risk premiums to single-A bond yields. The first was a simple linear regression between equity risk premiums and interest rates and the second equation adjusted for first order autocorrelation using the Prais-Winsten algorithm. Shown in the bottom portion of Schedule BHF-9, substituting

the May 2018 yield of 4.28% on single-A public utility bonds into the regression equations indicates that the equity risk premium for an LDC at current interest rate levels is between approximately 5.33% and 5.49%.

Q. WHAT CURRENT COST OF EQUITY DOES THIS RISK PREMIUM IMPLY FOR THE GROUP OF LDCS?

A. Adding the 5.33% and 5.49% equity risk premiums developed on Schedule BHF-9 to the May 2018 yield on single-A utility bonds of 4.28% produces a current risk premium cost of equity range LDC's of between 9.61% and 9.77%.

E. Comparable Earnings Method

Q. WHAT IS THE LAST METHOD THAT YOU USED TO ESTIMATE THE COST OF EQUITY?

A. Often referred to as the comparable earnings method, this approach looks to the rates of return that other firms of comparable risk and that compete for investors' capital are expected to earn on their book equity. Reference to the expected return on book equity of other LDCs demonstrates the level of earnings that KGS needs in order to offer investors a competitive return, be able to attract capital on reasonable terms, and maintain its financial integrity.

Q. WHAT RETURNS ON BOOK EQUITY ARE OTHER LDCS EXPECTED TO EARN?

A. Schedule BHF-10 displays the return on book equity projected for each of the seven LDCs other than ONE Gas in the industry group for the 2018, 2019, and the 2021-2023 timeframes, calculated by dividing *Value Line's* projected earnings per share by average book value per share. As shown there, the average expected

book ROE for this group is 11.3% in 2018, 10.7% for 2019, and 11.1% for 2021-2023.

F. Recommended Rate of Return on Equity

Q. WHAT IS YOUR CONCLUSION AS TO THE CURRENT COST OF EQUITY RANGE FOR LDCS?

A. The DCF method indicates a cost of equity range for the LDC group of between 9.1% and 10.1%, while the CAPM indicates a cost of equity range of between approximately 9.7% and 11.6%. Meanwhile, the risk premium method based on the authorized ROEs for LDCs and current interest rates indicates a cost of equity of between 9.6% and 9.8%, and the comparable earnings method shows that other LDCs are expected to earn between 10.7% and 11.3% on their book equity. Taken together, I conclude that investors currently require a ROE from the LDC industry group in the 9.5% to 10.5% range.

Q. WHAT ROE DO YOU RECOMMEND FOR KGS?

A. As discussed earlier, the Fed has announced that it is ending its easy-money practices and will normalize its monetary policies by continuing to increase the target federal funds rate, as it did again most recently on June 13, 2018, and reduce its $4.5 trillion portfolio of mortgage-backed and U.S Treasury securities. Both of these actions will result in higher interest rates over the next few years, which will correspondingly increase the cost of equity. So that KGS is able to offer investors a competitive return, attract capital on reasonable terms, and maintain its financial integrity, the allowed ROE should reflect the higher capital market requirements that are expected to exist when KGS's rates will be in effect.

This outlook for higher capital costs implies that the ROE for KGS should be from the upper end of the cost of equity range. Tending to offset this, however, is the fact that ONE Gas' debt and equity ratios are at the lower and upper ends, respectively, of LDC industry norms, which implies somewhat less financial risk relative to the proxy group and a slightly lower cost of equity. Taking both of these factors into consideration, I recommend an ROE for KGS equal to the midpoint of my 9.5% to 10.5% cost of equity range, or 10.0%.

VI. OVERALL RATE OF RETURN

Q. WHAT OVERALL RATE OF RETURN DO YOU RECOMMEND BE APPLIED TO THE RATE BASE OF KGS?

A. I recommend that KGS be authorized an overall rate of return of 7.7076%. As developed in in Schedule 7-A of Section 7 of the MFR, his rate of return is based on capital structure ratios of 37.81% debt and 62.19% equity, a cost of debt of 3.9377%, and an ROE of 10.0%.

Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY IN THIS CASE?

A. Yes, it does.

VERIFICATION

STATE OF TEXAS)
)
COUNTY OF TRAVIS)

Bruce H. Fairchild, being duly sworn upon his oath, deposes and states that he is an Independent Consultant for Kansas Gas Service, a Division of ONE Gas, Inc.; that he has read and is familiar with the foregoing Testimony filed herewith; and that the statements made therein are true to the best of his knowledge, information and belief.

Bruce H. Fairchild

SUBSCRIBED AND SWORN to before me this 15th day of June, 2018.

Notary Public

Commission/ Appointment Expires:

NOTARY PUBLIC STATE OF TEXAS
ADRIEN McKENZIE
My Commission Expires
January 12, 2019

APPENDIX A

BRUCE H. FAIRCHILD

FINCAP, INC.
Financial Concepts and Applications
Economic and Financial Counsel

3907 Red River
Austin, Texas 78751
(512) 458–4644
FAX (512) 458–4768
fincap2@texas.net

Summary of Qualifications

M.B.A. and Ph.D. in finance, accounting, and economics; Certified Public Accountant. Extensive consulting experience involving regulated industries, valuation of closely-held businesses, and other economic analyses. Previously held managerial and technical positions in government, academia, and business, and taught at the undergraduate, graduate, and executive education levels. Broad experience in technical research, computer modeling, and expert witness testimony.

Employment

Principal, FINCAP, Inc. (Sep. 1979 to present)	Economic consulting firm specializing in regulated industries and valuation of closely-held businesses. Assignments have involved electric, gas, telecommunication, and water/sewer utilities, with clients including utilities, consumer groups, municipalities, regulatory agencies, and cogenerators. Areas of participation have included revenue requirements, rate of return, rate design, tariff analysis, avoided cost, forecasting, and negotiations. Other assignments have involved some seventy valuations as well as various economic (e.g., damage) analyses, typically in connection with litigation. Presented expert witness testimony before courts and regulatory agencies on over one hundred occasions.
Adjunct Assistant Professor, University of Texas at Austin (Sep. 1979 to May. 1981)	Taught undergraduate courses in finance: Fin. 370 – Integrative Finance and Fin. 357 – Managerial Finance.
Assistant Director, Economic Research Division, Public Utility Commission of Texas (Sep. 1976 to Aug. 1979)	Division consisted of approximately twenty-five financial analysts, economists, and systems analysts responsible for rate of return, rate design, special projects, and computer systems. Directed Staff participation in rate cases, presented testimony on approximately thirty-five occasions, and was involved in some forty other cases ultimately settled. Instrumental in the initial development of rate of return and financial policy for newly-created agency. Performed independent research and managed State and Federal funded projects. Assisted in preparing appeals to the Texas Supreme Court and testimony presented before the Interstate Commerce Commission and Department of Energy. Maintained communications with financial community, industry representatives, media, and consumer groups. Appointed by Commissioners as Acting Director.

Assistant Professor, College of Business Administration, University of Colorado at Boulder (Jan. 1977 to Dec. 1978)	Taught graduate and undergraduate courses in finance: Fin. 305 – Introductory Finance, Fin. 401 – Managerial Finance, Fin. 402 – Case Problems in Finance, and Fin. 602 – Graduate Corporate Finance.
Teaching Assistant, University of Texas at Austin (Jan. 1973 to Dec. 1976)	Taught undergraduate courses in finance and accounting: Acc. 311 – Financial Accounting, Acc. 312 – Managerial Accounting, and Fin. 357 – Managerial Finance. Elected to College of Business Administration Teaching Assistants' Committee.
Internal Auditor, Sears, Roebuck and Company, Dallas, Texas (Nov. 1970 to Aug 1972)	Performed audits on internal operations involving cash, accounts receivable, merchandise, accounting, and operational controls, purchasing, payroll, etc. Developed operating and administrative policy and instruction. Performed special assignments on inventory irregularities and Justice Department Civil Investigative Demands.
Accounts Payable Clerk, Transcontinental Gas Pipeline Corp., Houston, Texas (May. 1969 to Aug. 1969)	Processed documentation and authorized payments to suppliers and creditors.

Education

Ph.D., Finance, Accounting, and Economics, University of Texas at Austin (Sep. 1974 to May 1980)	Doctoral program included coursework in corporate finance, investment theory, accounting, and economics. Elected to honor society of Phi Kappa Phi. Received University outstanding doctoral dissertation award Dissertation: *Estimating the Cost of Equity to Texas Public Utility Companies*
M.B.A., Finance and Accounting, University of Texas at Austin, (Sep. 1972 to Aug. 1974)	Awarded Wright Patman Scholarship by World and Texas Credit Union Leagues. Professional Report: *Planning a Small Business Enterprise in Austin, Texas*
B.B.A., Accounting and Finance, Southern Methodist University, Dallas, Texas (Sep. 1967 to Dec. 1971)	Dean's List 1967-1971 and member of Phi Gamma Delta Fraternity.

Other Professional Activities

Certified Public Accountant, Texas Certificate No. 13,710 (October 1974); entire exam passed in May 1972. Member of the American Institute of Certified Public Accountants.

Participated as session chairman, moderator, and paper discussant at annual meetings of Financial Management Association, Southwestern Finance Association, American Finance Association, and other professional associations.

Visiting lecturer in Executive M.B.A program at the University of Stellenbosch Graduate Business School, Belleville, South Africa (1983 and 1984).

Associate Editor of *Austin Financial Digest*, 1974-1975. Wrote and edited a series of investment and economic articles published in a local investment advisory service.

Military

Texas Army National Guard, Feb. 1970 to Sep. 1976. Specialist 5th Class with duty assignments including recovery vehicle operator for armor unit and company clerk for finance unit.

Bibliography

Monographs

"On the Use of Security Analysts' Growth Projections in the DCF Model," with William E. Avera, *Earnings Regulation Under Inflation*, J. R. Foster and S. R. Holmberg, eds., Institute for Study of Regulation (1982).

"An Examination of the Concept of Using Relative Customer Class Risk to Set Target Rates of Return in Electric Cost-of-Service Studies", with William E. Avera, Electricity Consumers Resource Council (ELCON) (1981); portions reprinted in *Public Utilities Fortnightly* (Nov. 11, 1982).

"The Spring Thing (A) and (B)" and "Teaching Notes", with Mike E. Miles, a two-part case study in the evaluation, management, and control of risk; distributed by *Harvard's Intercollegiate Case Clearing House*; reprinted in *Strategy and Policy: Concepts and Cases*, A. A. Strickland and A. J. Thompson, Business Publications, Inc. (1978) and *Cases in Managing Financial Resources*, I. Matur and D. Loy, Reston Publishing Co., Inc. (1984).

"Energy Conservation in Existing Residences, Project Director for development of instruction manual and workshops promoting retrofitting of existing homes, *Governor's Office of Energy Resources* and *Department of Energy* (1977-1978).

"Linear Algebra," "Calculus," "Sets and Functions," and "Simulation Techniques," contributed to and edited four mathematics programmed learning texts for MBA students, *Texas Bureau of Business Research* (1975).

Articles and Notes

"How to Value Personal Service Practices," with Keith Wm. Fairchild, *The Practical Accountant* (August 1989).

"The Impact of Regulatory Climate on Utility Capital Costs: An Alternative Test," with Adrien M. McKenzie, *Public Utilities Fortnightly* (May 25, 1989).

"North Arctic Industries, Limited," with Keith Wm. Fairchild, *Case Research Journal* (Spring 1988).

"Regulatory Effects on Electric Utilities' Cost of Capital Reexamined," with Louis E. Buck, Jr., *Public Utilities Fortnightly* (September 2, 1982).

"Capital Needs for Electric Utility Companies in Texas: 1976-1985", *Texas Business Review* (January-February 1979), reprinted in "The Energy Picture: Problems and Prospects", J. E. Pluta, ed., *Bureau of Business Research* (1980).

"Some Thoughts on the Rate of Return to Public Utility Companies," with William E. Avera, *Proceedings of the NARUC Biennial Regulatory Information Conference* (1978).

"Regulatory Problems of EFTS," with Robert McLeod, *Issues in Bank Regulation* (Summer 1978) reprinted in *Illinois Banker* (January 1979).

"Regulation of EFTS as a Public Utility," with Robert McLeod, *Proceedings of the Conference on Bank Structure and Competition* (1978).

"Equity Management of REA Cooperatives," with Jerry Thomas, *Proceedings of the Southwestern Finance Association* (1978).

"Capital Costs Within a Firm," *Proceedings of the Southwestern Finance Association* (1977).

"The Cost of Capital to a Wholly-Owned Public Utility Subsidiary," *Proceedings of the Southwestern Finance Association* (1977).

Selected Papers and Presentations

"Perspectives on Texas Utility Regulation", TSCPA 2016 Energy Conference, Austin, Texas (May 16, 2016).

"Legislative Changes Affecting Texas Utilities," Texas Committee of Utility and Railroad Tax Representatives, Fall Meeting, Austin, Texas (September 1995).

"Rate of Return," "Origins of Information," Economics," and "Deferred Taxes and ITC's," New Mexico State University and National Association of Regulatory Utility Commissioners Public Utility Conferences on Regulation and the Rate-Making Process, Albuquerque, New Mexico (October 1983, 1984, 1985, 1986, 1987, 1988, 1990, 1991, 1992, 1994, and 1995, and September 1989); Pittsburgh, Pennsylvania (April 1993); and Baltimore, Maryland (May 1994 and 1995).

"Developing a Cost-of-Service Study," 1994 Texas Section American Water Works Association Annual Conference, Amarillo, Texas (March 1994).

"Financial Aspects of Cost of Capital and Common Cost Considerations," Kidder, Peabody & Co. Two-Day Rate Case Workshop for Regulated Utility Companies, New York, New York (June 1993).

"Cost-of-Service Studies and Rate Design," General Management of Electric Utilities (A Training Program for Electric Utility Managers from Developing Countries), Austin, Texas (October 1989 and November 1990 and 1991).

"Rate Base and Revenue Requirements," The University of Texas Regulatory Institute Fundamentals of Utility Regulation, Austin, Texas (June 1989 and 1990).

"Determining the Cost of Capital in Today's Diversified Companies," New Mexico State University Public Utilities Course Part II, Advanced Analysis of Pricing and Utility Revenues, San Francisco, California (June 1990).

"Estimating the Cost of Equity," Oklahoma Association of Tax Representatives, Tulsa, Oklahoma (May 1990).

"Impact of Regulations," Business and the Economy, Leadership Dallas, Dallas, Texas (November 1989).

"Accounting and Finance Workshop" and "Divisional Cost of Capital," New Mexico State University Current Issues Challenging the Regulatory Process, Albuquerque, New Mexico (April 1985 and 1986) and Santa Fe, New Mexico (March 1989).

"Divisional Cost of Equity by Risk Comparability and DCF Analyses," NARUC Advanced Regulatory Studies Program, Williamsburg, Virginia (February 1988) and USTA Rate of Return Task Force, Chicago, Illinois (June 1988).

"Revenue Requirements," Revenue, Pricing, and Regulation in Texas Water Utilities, Texas Water Utilities Conference, Austin, Texas (August 1987 and May 1988).

"Rate Filing – Basic Ratemaking," Texas Gas Association Accounting Workshop, Austin, Texas (March 1988).

"The Effects of Regulation on Fair Market Value: P.H. Robinson – A Case Study," Annual Meeting of the Texas Committee of Utility and Railroad Tax Representatives, Austin, Texas (September 1987).

"How to Value Closely-held Businesses," TSCPA 1987 Entrepreneurs Conference, San Antonio, Texas (May 1987).

"Revenue Requirements" and "Determining the Rate of Return", New Mexico State University Regulation and the Rate-Making Process, Southwestern Water Utilities Conference, Albuquerque, New Mexico (July 1986) and El Paso, Texas (November 1980).

"How to Evaluate Personal Service Practices," TSCPA CPE Exposition 1985, Houston and Dallas, Texas (December 1985).

"How to Start a Small Business – Accounting and Record Keeping," University of Texas Management Development Program, Austin, Texas (October 1984).

"Project Financing of Public Utility Facilities", TSCPA Conference on Public Utilities Accounting and Ratemaking, San Antonio, Texas (April 1984).

"Valuation of Closely-Held Businesses," Concho Valley Estate Planning Council, San Angelo, Texas (September 1982).

"Rating Regulatory Performance and Its Impact on the Cost of Capital," New Mexico State University Seminar on Regulation and the Cost of Capital, El Paso, Texas (May 1982).

"Effect of Inflation on Rate of Return," Cost of Capital Conference and Workshop, Pinehurst, North Carolina (April 1981).

"Original Cost Versus Current Cost Regulation: A Re-examination," Financial Management Association, New Orleans, Louisiana (October 1980).

"Capital Investment Analysis for Electric Utilities," The University of Texas at Dallas, Richardson, Texas (June 1980).

"The Determinants of Capital Costs to the Electric Utility Industry," with Cedric E. Grice, Southwestern Finance Association, San Antonio, Texas (March 1980).

"The Entrepreneur and Management: A Case Study," Small Business Administration Seminar, Austin, Texas (October 1979).

"Capital Budgeting by Public Utilities: A New Perspective," with W. Clifford Atherton, Jr., Financial Management Association, Boston, Massachusetts (October 1979).

"Issues in Regulated Industries – Electric Utilities," University of Texas at Dallas 4th Annual Public Utilities Conference, Dallas, Texas (July 1979).

"Investment Conditions and Strategies in Today's Markets," American Society of Women Accountants, Austin, Texas (January 1979).

"Attrition: A Practical Problem in Determining a Fair Return to Public Utility Companies," Financial Management Association, Minneapolis, Minnesota (October 1978).

"The Cost of Equity to Wholly-Owned Electric Utility Subsidiaries," with William L. Beedles, Financial Management Association, Minneapolis, Minnesota (October 1978).

"PUC Retrofitting Program," Texas Electric Cooperatives Spring Workshop, Austin, Texas (May 1978).

"The Economics of Regulated Industries," Consumer Economics Forum, Houston, Texas (November 1977).

"Public Utilities as Consumer Targets – Is the Pressure Justified?," University of Texas at Dallas 2nd Annual Public Utilities Conference, Dallas, Texas (July 1977).

APPENDIX B

BRUCE H. FAIRCHILD
SUMMARY OF TESTIMONY BEFORE REGULATORY AGENCIES

No.	Utility Case	Agency	Docket	Date	Nature of Testimony
1.	Arkansas Electric Cooperative	Arkansas PSC	U-3071	Aug-80	Wholesale Rate Design
2.	East Central Oklahoma Electric Cooperative	Oklahoma CC	26925	Sep-80	Retail Rate Design
3.	Kansas Gas & Electric Company	Kansas CC	115379-U	Nov-80	PURPA Rate Design Standards
4.	Kansas Gas & Electric Company	Kansas CC	128139-U	May-81	Attrition
5.	City of Austin Electric Department	City of Austin	--	Jun-81	PURPA Rate Design Standards
6.	Tarrant County Water Control and Improvement District No. 1	Texas Water Commission	--	Oct-81	Wholesale Rate Design
7.	Owentown Gas Company	Texas RRC	2720	Jan-82	Revenue Requirements and Retail Rate Design
8.	Kansas Gas & Electric Company	Kansas CC	134792-U	Aug-82	Attrition
9.	Mississippi Power Company	Mississippi PSC	U-4190	Sep-82	Working Capital
10.	Lone Star Gas Company	Texas RRC	3757; 3794	Feb-83	Rate of Return on Equity
11.	Kansas Gas & Electric Company	Kansas CC	134792-U	Feb-83	Rate of Return on Equity
12.	Southwestern Bell Telephone Company	Oklahoma CC	28002	Oct-83	Rate of Return on Equity
13.	Morgas Company	Texas RRC	4063	Nov-83	Revenue Requirements
14.	Seagull Energy	Texas RRC	4541	Jul-84	Rate of Return
15.	Southwestern Bell Telephone Company	FCC	84-800	Nov-84	Rate of Return on Equity
16.	Kansas Gas & Electric Company, Kansas City Power & Light Company, and Kansas Electric Power Cooperatives	Kansas CC	142098-U; 142099-U; 142100-U	May-85	Nuclear Plant Capital Costs and Allowance for Funds Used During Construction
17.	Lone Star Gas Company	Texas RRC	5207	Oct-85	Overhead Cost Allocation
18.	Westar Transmission Company	Texas RRC	5787	Nov-85 Jan-86 Jul-86	Rate of Return, Rate Design, and Gas Processing Plant Economics
19.	City of Houston	Texas Water Commission	RC-022; RC-023	Nov-86	Line Losses and Known and Measurable Changes
20.	ENSTAR Natural Company	Alaska PUC	TA 50-4; R-87-2; U-87-2	Nov-86 May-87 May-87	Cost Allocation, Rate Design, and Tax Rate Changes
21.	Brazos River Authority	Texas Water Commission	RC-020	Jan-87	Revenue Requirements and Rate Design
22.	East Texas Industrial Gas Company	Texas RRC	5878	Feb-87	Revenue Requirements and Rate Design
23.	Seagull Energy	Texas RRC	6629	Jun-87	Revenue Requirements

Bruce H. Fairchild
Summary of Testimony Before Regulatory Agencies

(Continued)

No.	Utility Case	Agency	Docket	Date	Nature of Testimony
24.	ENSTAR Natural Company	Alaska PUC	U-87-42	Jul-87 Sep-87 Sep-87	Cost Allocation, Rate Design, and Contracts
25.	High Plains Natural Gas Company	Texas RRC	6779	Sep-87	Rate of Return
26.	Hughes Texas Petroleum	Texas RRC	2-91,855	Jan-88	Interim Rates
27.	Cavallo Pipeline Company	Texas RRC	7086	Sep-88	Revenue Requirements
28.	Union Gas System, Inc.	Kansas CC	165591-U	Mar-89 Aug-89	Rate of Return
29.	ENSTAR Natural Gas Company	Alaska PUC	U-88-70	Mar-89	Cost Allocation and Bypass
30.	Morgas Co.	Texas RRC	7538	Aug-89	Rate of Return and Cost Allocation
31.	Corpus Christi Transmission Company	Texas RRC	7346	Sep-89	Revenue Requirements
32.	Amoco Gas Co.	Texas RRC	7550	Oct-89	Rate of Return and Cost Allocation
33.	Iowa Southern Utilities	Iowa Utilities Board	RPU-89-7	Nov-89 Mar-90	Rate of Return on Equity
34.	Southwestern Bell Telephone Company	FCC	89-624	Feb-90 Apr-90	Rate of Return on Equity
35.	Lower Colorado River Authority	Texas PUC	9427	Mar-90 Aug-90 Aug-90	Revenue Requirements
36.	Rio Grande Valley Gas Company	Texas RRC	7604	May-90	Consolidated FIT and Depreciation
37.	Southern Union Gas Company	El Paso PURB	--	Oct-90	Disallowed Expenses and FIT
38.	Iowa Southern Utilities	Iowa Utilities Board	RPU-90-8	Nov-90 Feb-91	Rate of Return on Equity
39.	East Texas Gas Systems	Texas RRC	7863	Dec-90	Revenue Requirements
40.	San Jacinto Gas Transmission	Texas RRC	7865	Dec-90	Revenue Requirements
41.	Southern Union Gas Company	Austin; Texas RRC	-- 7878	Feb-91 Feb-91	Rate of Return and Acquisition Adjustment
42.	Southern Union Gas Company	Port Arthur; Texas RRC	-- 8033	Mar-91 Aug-91 Oct-91	Rate of Return and Acquisition Adjustment
43.	Cavallo Pipeline Company	Texas RRC	8016	Jun-91	Revenue Requirements
44.	New Orleans Public Service Inc.	New Orleans City Council	CD-91-1	Jun-91 Mar-92	Rate of Return on Equity
45.	Houston Pipe Line Company	Texas RRC	8017	Jul-91	Rate of Return

Bruce H. Fairchild
Summary of Testimony Before Regulatory Agencies

(Continued)

No.	Utility Case	Agency	Docket	Date	Nature of Testimony
46.	Southern Union Gas Company	El Paso PURB	--	Aug-91 Sep-91	Acquisition Adjustment
47.	Southwestern Gas Pipeline, Inc.	Texas RRC	8040	Jan-92 Feb-92	Rate Design and Settlement
48.	City of Fort Worth	Texas Water Commission	8748-A 9261-A	Mar-92 Aug-92 Dec-92 Oct-94 Nov-94	Interim Rates, Revenue Requirements, and Public Interest
49.	Southern Union Gas Company	Oklahoma Corp. Com.	--	Jun-92	Rate of Return
50.	Minnegasco	Minnesota PUC	G-008/GR-92-400	Jul-92 Dec-92	Rate of Return
51.	Guadalupe-Blanco River Authority	Texas PUC	11266	Sep-92	Cost Allocation and Bond Funds
52.	Dorchester Intra-State Gas System	Texas RRC	8111	Oct-92 Nov-92	Rate Impact of System Upgrade
53.	Corpus Christi Transmission Company GP and GPII	Texas RRC	8300 8301	Oct-92 Oct-92	Revenue Requirements
54.	East Texas Industrial Gas Company	Texas RRC	8326	Mar-93	Revenue Requirements
55.	Arkansas Louisiana Gas Company	Arkansas PSC	93-081-U	Apr-93 Oct-93	Rate of Return on Equity
56.	Texas Utilities Electric Company	Texas PUC	11735	Jun-93 Jul-93	Impact of Nuclear Plant Construction Delay
57.	Minnegasco	Minnesota PUC	G-008/GR-93-1090	Nov-93 Apr-94	Rate of Return
58.	Gulf States Utilities Company	Municipalities	--	May-94 Oct-94 Nov-94	Rate of Return on Equity
59.	Louisiana Power & Light Company	Louisiana PSC	U-20925	Aug-94 Feb-95	Rate of Return on Equity
60.	San Jacinto Gas Transmission	Texas RRC	8429	Sep-94	Revenue Requirements
61.	Cavallo Pipeline Company	Texas RRC	8465	Sep-94	Revenue Requirements
62.	Eastrans Limited Partnership	Texas RRC	8385	Oct-94	Revenue Requirements
63.	Gulf States Utilities Company	Louisiana PSC	U-19904	Oct-94	Rate of Return on Equity
64.	Entergy Services, Inc.	FERC	ER95-112-000	Mar-95 Nov-95	Rate of Return on Equity
65.	East Texas Gas Systems	Texas RRC	8435	Apr-95	Revenue Requirements
66.	System Energy Resources, Inc.	FERC	ER95-1042-000	May-95 Dec-95 Jan-96	Rate of Return on Equity

Bruce H. Fairchild
Summary of Testimony Before Regulatory Agencies

(Continued)

No.	Utility Case	Agency	Docket	Date	Nature of Testimony
67.	Minnegasco	Minnesota PUC	G-008/GR-95-700	Aug-95 Dec-95	Rate of Return
68.	Entex	Louisiana PSC	U-21586	Aug-95	Rate of Return
69.	City of Fort Worth	Texas NRCC	SOAH 582-95-1084	Nov-95	Public Interest of Contract
70.	Seagull Energy Corporation	Texas RRC	8589	Nov-95	Revenue Requirements
71.	Corpus Christi Transmission Company LP	Texas RRC	8449	Feb-96	Revenue Requirements
72.	Missouri Gas Energy	Missouri PSC	GR-96-285	Apr-96 Sep-96 Oct-96	Rate of Return
73.	Entex	Mississippi PSC	96-UA-202	May-96	Rate of Return
74.	Entergy Gulf States, Inc.	Louisiana PSC	U-22084	May-96	Rate of Return on Equity (Gas)
75.	Entergy Gulf States, Inc.	Louisiana PSC	U-22092	May-96 Oct-96	Rate of Return on Equity
76.	American Gas Storage, L.P.	Texas RRC	8591	Sep-96	Revenue Requirements
77.	Entergy Louisiana, Inc.	Louisiana PSC	U-20925	Sep-96 Oct-96	Rate of Return on Equity
78.	Lone Star Pipeline and Gas Company	Texas RRC	8664	Oct-96 Jan-97	Rate of Return
79.	Entergy Arkansas, Inc.	Arkansas PSC	96-360-U	Oct-96 Sep-97	Rate of Return on Equity
80.	East Texas Gas Systems	Texas RRC	8658	Nov-96	Revenue Requirements
81.	Entergy Gulf States, Inc.	Texas PUC	16705	Nov-96 Jul-97	Rate of Return on Equity
82.	Eastrans Limited Partnership	Texas RRC	8657	Nov-96	Revenue Requirements
83.	Enserch Processing, Inc.	Texas RRC	8763	Nov-96	Interim Rates
84.	Entergy New Orleans, Inc.	City of New Orleans	UD-97-1	Feb-97 Mar-97 May-98	Rate of Return on Equity
85.	ENSTAR Natural Gas Company	Alaska PUC	U-96-108	Mar-97 Apr-97	Service Area Certificate
86.	San Jacinto Gas Transmission	Texas RRC	8741	Sep-97	Revenue Requirements
87.	Missouri Gas Energy	Missouri PSC	GR-98-140	Nov-97 Apr-98 May-98	Rate of Return
88.	Corpus Christi Transmission Company LP	Texas RRC	8762	Dec-97	Revenue Requirements
89.	Texas-New Mexico Power Company	Texas PUC	17751	Feb-98	Excess Cost Over Market
90.	Southern Union Gas Company	Texas RRC	8878	May-98	Rate of Return

Bruce H. Fairchild
Summary of Testimony Before Regulatory Agencies

(Continued)

No.	Utility Case	Agency	Docket	Date	Nature of Testimony
91.	Entergy Louisiana, Inc.	Louisiana PSC	U-20925	May-98 Jul-98	Financial Integrity
92.	Entergy Gulf States, Inc.	Louisiana PSC	U-22092	May-98 Jul-98	Financial Integrity
93.	ACGC Gathering Company, LLC	Texas RRC	8896	Sep-98	Cost-based Rates
94.	American Gas Storage, L.P.	Texas RRC	8855	Oct-98	Revenue Requirements
95.	Duke Energy Intrastate Network	Texas RRC	8940	Jun-99	Rate of Return
96.	Aquila Energy Corporation	Texas RRC	8970	Aug-99	Revenue Requirements
97.	San Jacinto Gas Transmission	Texas RRC	8974	Sep-99	Revenue Requirements
98.	Southern Union Gas Company	El Paso PURB	--	Oct-99	Rate of Return
99.	TXU Lone Star Pipeline	Texas RRC	8976	Oct-99 Feb-00	Rate of Return
100.	Sharyland Utilities, L.P.	Texas PUC	21591	Nov-99	Rate of Return
101.	TXU Lone Star Gas Distribution	Texas RRC	9145	Apr-00 Aug-00	Rate of Return
102.	Rotherwood Eastex Gas Storage	Texas RRC	9136	May-00	Revenue Requirements
103.	Eastex Gas Storage & Exchange, Inc.	Texas RRC	9137	May-00	Revenue Requirements
104.	Eastex Gas Storage & Exchange, Inc.	Texas RRC	9138	Jul-00	Revenue Requirements
105.	East Texas Gas Systems	Texas RRC	9139	Jul-00	Revenue Requirements
106.	Eastrans Limited Partnership	Texas RRC	9140	Aug-00	Revenue Requirements
107.	Reliant Energy – Entex	City of Tyler	--	Oct-00	Rate of Return
108.	City of Fort Worth	Texas NRCC	SOAH 582-00-1092	Dec-00	CCN – Rates and Financial Ability
109.	Entergy Services, Inc.	FERC	RTO1-75	Dec-00	Rate of Return on Equity
110	ENSTAR Natural Gas Company	Alaska PUC	U-00-88	Jun-01 Aug-01 Nov-01 Sep-02 Dec-02	Revenue Requirements, Cost Allocation, and Rate Design
111.	TXU Gas Distribution	Texas RRC	9225	Jul-01	Rate of Return
112.	Centana Intrastate Pipeline LLC	Texas RRC	9243	Aug-01	Rate of Return
113.	Maxwell Water Supply Corp.	Texas NRCC	SOAH-582-01-0802	Oct-01 Mar-02 Apr-02	Reasonableness of Rates
114.	Reliant Energy Arkla	Arkansas PSC	01-243-U	Dec-01 Jun-01	Rate of Return
115.	Entergy Services, Inc.	FERC	ER01-2214-000	Mar-02	Rate of Return on Equity

Bruce H. Fairchild
Summary of Testimony Before Regulatory Agencies

(Continued)

No.	Utility Case	Agency	Docket	Date	Nature of Testimony
116.	TXU Lone Star Pipeline	Texas RRC	9292	Apr-02	Rate of Return
117.	Southern Union Gas Company	El Paso PURB	--	Apr-02	Rate of Return
118.	San Jacinto Gas Transmission Co.	Texas RRC	9301	May-02	Rate of Return
119.	Duke Energy Intrastate Network	Texas RRC	9302	May-02	Rate of Return
120.	Reliant Energy Arkla	Oklahoma CC	200200166	May-02	Rate of Return
121.	TXU Gas Distribution	Texas RRC	9313	Jul-02 Sep-02	Rate of Return
122.	Entergy Mississippi, Inc.	Mississippi PSC	2002-UN-256	Aug-02	Rate of Return on Equity
123.	Aquila Storage & Transportation LP	Texas RRC	9323	Sep-02	Revenue Requirements
124.	Panther Pipeline Ltd.	Texas RRC	9291	Oct-02	Revenue Requirements
125.	SEMCO Energy	Michigan PSC	U-13575	Nov-02	Revenue Requirements
126.	CenterPoint Energy Entex	Louisiana PSC	U-26720	Jan-03	Rate of Return
127.	Crosstex CCNG Transmission Ltd.	Texas RRC	9363	May-03	Revenue Requirements
128.	TXU Gas Company	Texas RRC	9400	May-03 Jan-04	Rate of Return
129.	Eastrans Limited Partnership	Texas RRC	9386	May-03	Rate of Return
130.	CenterPoint Energy Entex	City of Houston		Jun-03	Rate of Return
131.	East Texas Gas Systems, L.P.	Texas RRC	9385	Jun-03	Rate of Return
132.	ENSTAR Natural Gas Company	Alaska RCA	U-03-084	Aug-03 Nov-03	Line Extension Surcharge
133.	CenterPoint Energy Arkla	Louisiana PSC		Nov-03	Rate of Return
134.	ENSTAR Natural Gas Company	Alaska RCA	U-03-091	Feb-04	Cost Separation and Taxes
135.	Sid Richardson Pipeline, Ltd.	Texas RRC	9532	Jun-04 Nov-04	Revenue Requirements
136.	ETC Katy Pipeline, Ltd.	Texas RRC	9524	Sep-04	Revenue Requirements
137.	CenterPoint Energy Entex	Mississippi PSC	03-UN-0831	Sep-04	Rate Formula
138.	Centana Intrastate Pipeline LLC	Texas RRC	9527	Sep-04	Rate of Return
139.	SEMCO Energy	Michigan PSC	U-14338	Dec-04	Revenue Requirements
140.	Atmos Energy – Energas	Texas RRC	9539	Feb-05	Regulatory Policy
141.	Crosstex North Texas Pipeline, L.P.	Texas RRC	9613	Sep-05	Revenue Requirements
142.	SiEnergy, L.P.	Texas RRC	9604	Dec-05	Rate of Return, Income Taxes, and Cost Allocation
143.	ENSTAR Natural Gas Company	Alaska RCA	TA-140-4	Feb-06	Connection Fees
144.	SEMCO Energy	Michigan PSC	U-14984	May-06 Dec-06	Revenue Requirements

Bruce H. Fairchild
Summary of Testimony Before Regulatory Agencies

(Continued)

No.	Utility Case	Agency	Docket	Date	Nature of Testimony
145.	Atmos Energy – Mid-Tex	Texas RRC	9676	May-06 Oct-06	Revenue Requirements
146.	EasTrans Limited Partnership	Texas RRC	9659	Jun-06	Rate of Return
147.	Kinder Morgan Texas Pipeline, L.P.	Texas RRC	9688	Jul-06	Rate of Return
148.	Crosstex CCNG Transmission Ltd.	Texas RRC	9660	Aug-06	Revenue Requirements
149.	Enbridge Pipelines (North Texas), LP	Texas RRC	9691	Oct-06	Rate of Return
150.	Panther Interstate Pipeline Energy	FERC	CP03-338-00	Mar-07	Revenue Requirements
151.	El Paso Electric Company	Texas PUC	34494	Jul-07	CCN
152.	El Paso Electric Company	NM PRC	07-00301-UT	Jul-07	CCN
153.	Atmos Energy	Kansas CC	08-ATMG-280-RTS	Sep-07 Feb-08	Rate of Return on Equity
154.	Centana Intrastate Pipeline LLC	Texas RRC	9759	Sep-07	Rate of Return
155.	Texas Gas Service Company	Texas RRC	9770	Nov-07	Rate of Return
156.	ENSTAR Natural Gas Company	Alaska RCA	U-08-25	Jun-08	Rate Class Switching
157.	ConocoPhillips Transportation Alaska	Alaska RCA	TL-131-301	Oct-08	Rate of Return
158.	ExxonMobil Pipeline Co.	Alaska RCA	TL-140-304	Nov-08	Rate of Return
159.	Crosstex North Texas Pipeline, L.P.	Texas RRC	9843	Dec-08	Revenue Requirements
160.	Koch Alaska Pipeline Company	Alaska RCA	TL 128-308	Dec-08	Rate of Return
161.	Unocal Pipeline Company	Alaska RCA	TL 118-312	Dec-08	Rate of Return
162.	ETC Katy Pipeline, Ltd.	Texas RRC	9841	Dec-08	Revenue Requirements
163.	Oklahoma Natural Gas	Oklahoma CC	200800348	Jan-09	Rate of Return on Equity
164.	Entergy Mississippi, Inc.	Mississippi PSC	EC-123-0082	Mar 09	Rate of Return on Equity
165.	ENSTAR Natural Gas Company	Alaska RCA	U-09-69 U-09-70	Jun-09 Jul-09 Oct-09	Revenue Requirements, Cost Allocation, and Rate Design
166.	EasTrans, LLC	Texas RRC	9857	Jun-09	Rate of Return
167.	Oklahoma Natural Gas	Oklahoma CC	200900110	Jun-09	Rate of Return
168.	Crosstex CCNG Transmission Ltd.	Texas RRC	9858	Jun-09	Revenue Requirements
169.	ConocoPhillips Transportation Alaska	Alaska RCA	TL-137-301	Jul-09	Rate of Return
170.	ENSTAR Natural Gas Company	Alaska RCA	U-08-142	Jul-09	Gas Cost Adjustment
171.	Kinder Morgan Texas Pipeline, LLC	Texas RRC	9889	Jul-09	Rate of Return
172.	Koch Alaska Pipeline Company	Alaska RCA	TL 133-308	Aug-09	Rate of Return
173.	ExxonMobil Pipeline Co.	Alaska RCA	TL-147-304	Nov-09	Rate of Return
174.	Texas Gas Service Company	El Paso PURB	--	Dec-09	Rate of Return
175.	Unocal Pipeline Company	Alaska RCA	TL126-312	Dec-09	Rate of Return

Bruce H. Fairchild
Summary of Testimony Before Regulatory Agencies

(Continued)

176.	Kuparuk Transportation Company	Alaska RCA	P-08-05	Apr-10	Rate of Return
177.	Trans-Alaska Pipeline System	FERC	ISO9-348-000	Apr 10 Octo 10	Rate of Return
178.	Texas Gas Service	Texas RRC	9988	May 10 Aug 10	Rate of Return
179.	SEMCO Energy Gas Company	Michigan PSC	U-16169	Jun 10 Dec 10	Revenue Requirements
180.	ConocoPhillips Transportation Alaska	Alaska RCA	TL-137-301	Jul 10	Rate of Return
181.	Koch Alaska Pipeline Company, LLC	Alaska RCA	TL-138-308	Aug 10	Rate of Return
182.	CPS Energy	Texas PUC	36633	Sep 10 Apr 11	Rate of Return for MOU
183.	ExxonMobil Pipeline Co.	Alaska RCA	TL-151-304	Dec 10	Rate of Return
184.	Unocal Pipeline Company	Alaska RCA	TL132-312	Feb 11	Rate of Return
185.	New Mexico Gas Company	NM PRC	11-00042-UT	Mar 11	Rate of Return
186.	ConocoPhillips Transportation Alaska	Alaska RCA	TL-143-301	May 11	Rate of Return
187.	Enbridge Pipelines (Southern Lights)	FERC	IS11-146-000	Jun 11 Nov 11	Rate of Return
188.	Koch Alaska Pipeline Company, LLC	Alaska RCA	TL-138-___	Jul 11	Rate of Return
189.	Unocal Pipeline Company	Alaska RCA	TL126-___	Dec 11	Rate of Return
190.	Kansas Gas Service	Kansas CC	12-KGSC- 835-RTS	May 12 Oct 12	Rate of Return
191.	ExxonMobil Pipeline Co.	Alaska RCA	TL-157-304	Jun 12	Rate of Return
192.	ConocoPhillips Transportation Alaska	Alaska RCA	TL-149-301	Jul 12	Rate of Return
193.	Seaway Crude Pipeline Company	FERC	IS12-226-000	Aug 12 Feb 13	Rate of Return
194.	Cross Texas Transmission, LLC	Texas PUC	40604	Aug 12 Oct 12 Nov 12	Revenue Requirements
195.	Wind Energy Transmission Texas	Texas PUC	40606	Aug 12 Nov 12	Revenue Requirements
196.	Lone Star Transmission LLC	Texas PUC	40798	Nov 12	Revenue Requirements
197.	West Texas Gas Company	Texas RRC	10235	Jan 13	Rate of Return
198.	Cross Texas Transmission, LLC	Texas PUC	41190	Feb 13	Revenue Requirements
199.	ExxonMobil Pipeline Co.	Alaska RCA	TL-162-304	Apr 13	Rate of Return
200.	EasTrans,LLC	Texas RRC	10276	Jul 13	Rate of Return
201.	ConocoPhillips Transportation Alaska	Alaska RCA	TL-152-301	Jul 13	Rate of Return
202.	BP Pipelines (Alaska) Inc.	Alaska RCA	TL-143-311	Sep 13	Rate of Return
203.	Wind Energy Transmission Texas	Texas PUC	41923	Oct 13	Revenue Requirements
204.	Oliktok Pipeline Company	Alaska RCA	P-13-013	Nov 13	Rate of Return

Bruce H. Fairchild
Summary of Testimony Before Regulatory Agencies

(Continued)

205.	Aqua Texas Southeast Region-Gray	Texas CEQ	2013-2007-UCR	Apr 14	Revenue Requirements
206.	Entergy Mississippi	Mississippi PSC	EC-123-0082	Jun 14	Rate of Return on Equity
207.	Westlake Ethylene Pipeline	Texas RRC	10358	Jul 14 Aug 15	Rates
208.	ExxonMobil Pipeline Co.	Alaska RCA	TL-164-304	Jul 14	Rate of Return
209.	ConocoPhillips Transportation Alaska	Alaska RCA	TL-154-301	Aug 14	Rate of Return
210.	Enstar Natural Gas Company	Alaska RCA	TA-262-4	Sep 14 Jun 15	Revenue Requirements, Cost Allocation, and Rate Design
211.	Oliktok Pipeline Company	Alaska RCA	TL-44-334	Mar 15	Rate of Return
212.	Entergy Arkansas, Inc.	Arkansas PSC	15-0150U	Apr 15 Oct 15 Dec 15	Rate of Return on Equity
213.	Wind Energy Transmission Texas	Texas PUC	44746	Jun 15	Revenue Requirements
214.	Texas City	Texas RRC	10408	Jun 15 Nov 15	Pipeline Annual Assessment
215.	Oklahoma Natural Gas	Oklahoma CC	201500213	Jul 15 Nov 15	Rate of Return
216.	PTE Pipeline LLC	Alaska RCA	P-12-015	Sep 15	Rate of Return
217.	Northeast Transmission Development, LLC	FERC	ER16-453	Dec 15	Formula Rates
218.	Oncor Electric Delivery	Texas PUC	45188	Dec 15	Public Interest of Acquisition
219.	Corix Utilities (Texas)	Texas PUC	45418	Dec 15 Oct 16	Rate of Return
220.	Texas Gas Service	Texas RRC	10488	Dec 15	Rate of Return
221.	Texas Gas Service	Texas RRC	10506	Mar 16 Jun 16	Rate of Return
222.	Kansas Gas Service	Kansas CC	16-KGSG-491-RTS	May 16 Sep 16	Rate of Return on Equity
223.	Enstar Natural Gas Company	Alaska RCA	TA-285-4	Jun 16 Apr 17	Revenue Requirements, Cost Allocation, and Rate Design
224.	Texas Gas Service	Texas RRC	10526	Jun 16	Rate of Return
225.	West Texas LPG Pipeline	Texas RRC	10455	Aug 16 Jan 17	Rates and Rate of Return
226.	Liberty Utilities	Texas PUC	46356	Sep 16 Feb 17 Jun 17	Revenue Requirements and Rate of Return
227.	DesertLink LLC	FERC	ER17-___	Oct 16	Formula Rates
228.	Houston Pipe Line Co.	Texas RRC	10559	Nov 16	Revenue Requirements
225.	Texas Gas Service	Texas RRC	10656	Jun 17	Rate of Return

Bruce H. Fairchild
Summary of Testimony Before Regulatory Agencies

(Continued)

226.	Trans-Pecos Pipeline	Texas RRC	10646	Sep 17 Feb 18	Revenue Requirements
227.	Comanche Trail Pipeline	Texas RRC	10647	Sep 17 Feb 18	Revenue Requirements
228.	Alpine High Pipeline	Texas RRC	10665	Oct 17 Feb 18	Revenue Requirements
229.	SiEnergy, L.P.	Texas RRC	10679	Jan 18	Rate of Return
230.	Targa Midland Gas Pipeline LLC	Texas RRC	10690	Jan 18	Revenue Requirements
231.	ET Fuel, LP	Texas RRC	10706	Apr 18	Revenue Requirements

ONE GAS, INC. CAPITAL STRUCTURE

	December 31, 2017		December 31, 2016		December 31, 2015		December 31, 2014	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
	(000's)		(000's)		(000's)		(000's)	
Long-term Debt:								
Current Maturities	-		7		7		6	
Long-term Debt	1,193,257		1,192,446		1,201,305		1,201,311	
Total Long-term Debt	1,193,257	37.8%	1,192,453	38.7%	1,201,312	39.5%	1,201,317	40.1%
Shareholders' Equity:	1,960,209	62.2%	1,888,280	61.3%	1,841,555	60.5%	1,794,037	59.9%
Total	**3,153,466**	**100.00%**	**3,080,733**	**100.00%**	**3,042,867**	**100.00%**	**2,995,354**	**100.00%**

Sources: ONE Gas, Inc. Forms 10-K.

LDC PROXY GROUP CAPITAL STRUCTURE RATIOS (a)

	Fiscal Year-end 2017		Fiscal Year-end 2016		Fiscal Year-end 2015		Fiscal Year-end 2014		Fiscal Year-end 2013	
Company	**L.T. Debt**	**Com. Equity**	**L.T. Debt**	**Com. Equity**	**L.T. Debt**	**Com. Equity**	**L.T. Debt**	**Com. Equity**	**L.T. Debt**	**Com. Equity**
Atmos Energy	44.0%	56.0%	38.7%	61.3%	43.5%	56.5%	44.3%	55.7%	48.8%	51.2%
Chesapeake Utilities	28.9%	71.1%	23.5%	76.5%	29.4%	70.6%	34.5%	65.5%	29.7%	70.3%
New Jersey Resources	44.6%	55.4%	47.7%	52.3%	43.2%	56.8%	38.2%	61.8%	36.6%	63.4%
Northwest Natural Gas	47.9%	52.1%	44.4%	55.6%	42.5%	57.5%	44.8%	55.2%	47.6%	52.4%
South Jersey Industries	48.5%	51.5%	38.5%	61.5%	49.2%	50.8%	48.0%	52.0%	45.1%	54.9%
Southwest Gas	49.8%	50.2%	48.2%	51.8%	49.3%	50.7%	52.4%	47.6%	49.4%	50.6%
Spire	50.0%	50.0%	50.9%	49.1%	53.0%	47.0%	55.1%	44.9%	46.6%	53.4%
LDC GROUP AVERAGE	**44.8%**	**55.2%**	**41.7%**	**58.3%**	**44.3%**	**55.7%**	**45.3%**	**54.7%**	**43.4%**	**56.6%**
Minimum	28.9%	50.0%	23.5%	49.1%	29.4%	47.0%	34.5%	44.9%	29.7%	50.6%
Maximum	50.0%	71.1%	50.9%	76.5%	53.0%	70.6%	55.1%	65.5%	49.4%	70.3%

(a) *The Value Line Investment Survey* (June 1, 2018).

DCF MODEL -- DIVIDEND YIELD

Company	Expected Dividend (a)	Price (b)	Dividend Yield (c)
Atmos Energy	$ 2.05	$ 87.38	2.35%
Chesapeake Utilities	$ 1.51	$ 76.76	1.97%
New Jersey Resources	$ 1.09	$ 43.14	2.53%
Northwest Natural Gas	$ 1.89	$ 60.16	3.14%
ONE Gas	$ 1.92	$ 72.52	2.65%
South Jersey Industries	$ 1.16	$ 32.16	3.61%
Southwest Gas	$ 2.10	$ 72.79	2.89%
Spire	$ 2.25	$ 70.81	3.18%
LDC GROUP AVERAGE			**2.79%**

(a) *The Value Line Investment Survey* (June 1, 2018).
(b) *Yahoo!* Finance (Average of daily May 2018 closing prices).
(c) Expected Dividend / Price.

DCF MODEL -- EARNINGS GROWTH RATES

	Projected Growth			Historical Growth	
Company	**Value Line (a)**	**I/B/E/S (b)**	**Zacks (c)**	**10-Year (a)**	**5-Year (a)**
Atmos Energy	7.5%	6.7%	7.0%	6.0%	9.0%
Chesapeake Utilities	8.5%	6.0%	6.0%	8.5%	7.5%
New Jersey Resources	9.5%	6.0%	6.0%	7.0%	5.5%
Northwest Natural Gas	NMF	4.5%	4.3%	NMF	NMF
ONE Gas	7.0%	5.5%	5.7%	N/A	N/A
South Jersey Industries	9.5%	3.1%	12.4%	2.5%	-1.5%
Southwest Gas	9.0%	4.0%	N/R	6.5%	5.0%
Spire	7.5%	4.1%	3.7%	4.0%	4.0%
LDC GROUP AVERAGE	**8.4%**	**5.0%**	**6.4%**	**5.8%**	**4.9%**

(a) *The Value Line Investment Survey* (June 1, 2018).
(b) *Yahoo!* Finance (Retrieved June 4, 2018).
(c) Zacks *Detailed Estimates* (Retrieved June 4, 2018).

NMF -- No meaningful figure. N/A -- Not applicable. N/R -- Not reported.

DCF MODEL -- SUSTAINABLE GROWTH RATES

	2021-2023 Projected (a)						Earnings Retention Growth			External Financing Growth					
Company	Earnings per Share	Dividends per Share	Book Value per Share	Price per Share	Shares Outstanding (a) 2017	Shares Outstanding (a) Proj. 21-23	Retention Ratio	Return on Equity	"b x r"	2021-2023 Market-to-Book Ratio	Growth Rate in Shares	"s"	"v"	"s x v"	Sustainable Growth
Atmos Energy	$ 5.15	$ 2.50	$ 46.55	$ 110 00	106.10	130.00	51.5%	11.1%	5.7%	2.36	4.1%	9.8%	57.7%	5.7%	11.3%
Chesapeake Utilities	$ 4 50	$ 2.00	$ 45.50	$ 100 00	16.34	20.00	55.6%	9 9%	5.5%	2.20	4.1%	9.1%	54.5%	4.9%	10.4%
New Jersey Resources	$ 2 95	$ 1.24	$ 22.70	$ 50 00	86.32	86.50	58.0%	13 0%	7.5%	2.20	0 0%	0.1%	54.6%	0.1%	7.6%
Northwest Natural Gas	$ 3 50	$ 2.20	$ 29.40	$ 60 00	28.74	32.00	37.1%	11 9%	4.4%	2.04	2 2%	4.4%	51.0%	2.3%	6.7%
ONE Gas	$ 4 00	$ 2.50	$ 43.40	$ 100 00	52.31	55.00	37.5%	9 2%	3.5%	2.30	1 0%	2.3%	56.6%	1.3%	4.8%
South Jersey Industries	$ 2 30	$ 1.35	$ 20.55	$ 35 00	79.55	95.00	41.3%	11 2%	4.6%	1.70	3 6%	6.2%	41.3%	2.5%	7.2%
Southwest Gas	$ 5 50	$ 2.60	$ 52.85	$ 87 50	48.09	53.00	52.7%	10.4%	5.5%	1.66	2 0%	3.3%	39.6%	1.3%	6.8%
Spire	$ 5 00	$ 2.50	$ 48.10	$ 90 00	48.26	55.00	50.0%	10.4%	5.2%	1.87	2 6%	5.0%	46.6%	2.3%	7.5%
LDC GROUP AVERAGE									**5.2%**					**2.5%**	**7.8%**

(a) *The Value Line Investment Survey* (June 1, 2018).

DCF MODEL -- OTHER PROJECTED AND HISTORICAL GROWTH RATES

	Net Book Value (a)			Dividends per Share (a)			Price per Share		
	Pro-	Historical		Pro-	Historical		Pro-	Historical (b)	
Company	**jected**	**10-Year**	**5-Year**	**jected**	**10-Year**	**5-Year**	**jected (a)**	**10-Year**	**5-Year**
Atmos Energy	5.5%	5.0%	6.0%	7.0%	3.0%	4.5%	5.9%	12.1%	14.8%
Chesapeake Utilities	9.0%	9.5%	10.0%	9.0%	4.5%	5.5%	6.8%	15.0%	16.5%
New Jersey Resources	9.0%	7.0%	8.0%	4.0%	7.5%	6.5%	3.8%	10.0%	13.4%
Northwest Natural Gas	1.0%	2.5%	1.0%	2.5%	3.0%	1.5%	-0.1%	0.1%	6.3%
ONE Gas	3.0%	N/A	N/A	10.0%	N/A	N/A	8.4%	N/A	N/A
South Jersey Industries	5.0%	7.5%	8.0%	4.0%	8.5%	7.0%	2.1%	5.4%	1.5%
Southwest Gas	7.0%	5.5%	5.5%	6.5%	8.0%	11.0%	4.7%	-0.1%	7.9%
Spire	7.5%	7.5%	9.0%	4.0%	3.5%	4.0%	6.2%	5.9%	8.9%
LDC GROUP AVERAGE	**5.9%**	**6.4%**	**6.8%**	**5.9%**	**5.4%**	**5.7%**	**4.7%**	**6.9%**	**9.9%**

(a) *The Value Line Investment Survey* (June 1, 2018).

N/A -- Not applicable.

CAPITAL ASSET PRICING MODEL

	Historical Rates of Return (a)	Forward-Looking Rates of Return (b)
Market Required Rate of Return	12.10%	12.73%
Long-term Government Bond Return	5.00%	3.13%
Market Risk Premium (d)	7.10%	9.60%
LDC Group Beta (e)	0.74	0.74
LDC Group Risk Premium (f)	5.25%	7.10%
Risk-free Rate of Interest (c)	3.13%	3.13%
Theoretical CAPM Cost of Equity Estimate (g)	8.38%	10.23%
Size Premium (a)	1.36%	1.36%
CAPM Cost of Equity Estimates (h)	**9.74%**	**11.59%**

(a) Duff & Phelps: *2018 Cost of Capital; Annual U.S. Guidance and Examples (Market Results through 2017)* .

(b) Calculated by applying DCF model applied to S&P 500 firms paying dividends:

Expected Dividend Yield		2.37%
Projected Earnings Growth Rate:		
Value Line	9.84%	
I/B/E/S	11.23%	
Zacks	9.99%	
Average		10.35%
Market Required Rate of Return		12.73%

(c) May 2018 yield on 30-yr U.S. Treasury bonds (FederalReserve.gov). 3.13%

(d) Market Required Rate of Return minus Long-term Government Bond Return.

(e) Schedule BHF-6.

(f) Market risk premium times beta.

(g) Sum of Risk Premium and Risk-free Rate of Interest.

(h) Sum of Unadjusted CAPM Cost of Equity Estimate and Size Premium.

BOND RATINGS, BETA, AND MARKET CAPITALIZATION

Company	Bond Rating Moody's (a)	Bond Rating S&P (b)	Beta (c)	Market Capitalization (millions) (c)
Atmos Energy	A2	A	0.70	$ 9,600
Chesapeake Utilities	N/R	N/R	0.70	$ 1,300
New Jersey Resources	Aa2	A	0.80	$ 3,800
Northwest Natural Gas	A3	A+	0.70	$ 1,700
ONE Gas	A2	A	0.70	$ 3,800
South Jersey Industries	A2	BBB+	0.85	$ 2,800
Southwest Gas	Baa1	BBB+	0.80	$ 3,400
Spire	Baa2	A-	0.70	$ 3,400
LDC GROUP AVERAGE	**A2**	**A-**	**0.74**	**$ 3,725**

(a) Moody's.com (Retrieved May 6, 2018).
(b) StandardandPoors.com (Retreived May 6, 2018)
(c) *The Value Line Investment Survey* (June 1, 2018).

RISK PREMIUM METHOD

Year	Qtr.		Allowed ROE (a)	Single-A Utility Bond Yield (b)	Risk Premium
1980	1		13.45%	13.49%	-0.04%
	2		14.38%	12.87%	1.51%
	3		13.87%	12.88%	0.99%
	4		14.35%	14.11%	0.24%
1981	1		14.69%	14.77%	-0.08%
	2		14.61%	15.82%	-1.21%
	3		14.86%	16.65%	-1.79%
	4		15.70%	16.57%	-0.87%
1982	1		15.55%	16.72%	-1.17%
	2		15.62%	16.26%	-0.64%
	3		15.72%	15.88%	-0.16%
	4		15.62%	14.56%	1.06%
1983	1		15.41%	14.15%	1.26%
	2		14.84%	13.58%	1.26%
	3		15.24%	13.52%	1.72%
	4		15.41%	13.38%	2.03%
1984	1		15.39%	13.56%	1.83%
	2		15.07%	14.72%	0.35%
	3		15.37%	14.47%	0.90%
	4		15.33%	13.38%	1.95%
1985	1		15.03%	13.31%	1.72%
	2		15.44%	12.95%	2.49%
	3		14.64%	12.11%	2.53%
	4		14.44%	11.49%	2.95%
1986	1		14.05%	10.18%	3.87%
	2		13.28%	9.41%	3.87%
	3		13.09%	9.39%	3.70%
	4		13.62%	9.31%	4.31%
1987	1		12.61%	8.96%	3.65%
	2		13.13%	9.77%	3.36%
	3		12.56%	10.61%	1.95%
	4		12.73%	11.05%	1.68%
1988	1		12.94%	10.32%	2.62%
	2		12.48%	10.71%	1.77%
1988	3		12.79%	10.94%	1.85%
	4		12.98%	9.98%	3.00%
1989	1		12.99%	10.13%	2.86%
	2		13.25%	9.94%	3.31%
	3		12.56%	9.53%	3.03%
	4		12.94%	9.50%	3.44%
1990	1		12.60%	9.72%	2.88%
	2		12.81%	9.91%	2.90%
	3		12.34%	9.93%	2.41%
	4		12.77%	9.89%	2.88%
1991	1		12.69%	9.58%	3.11%
	2		12.53%	9.50%	3.03%
	3		12.43%	9.33%	3.10%
	4		12.38%	9.02%	3.36%
1992	1		12.42%	8.91%	3.51%
	2		11.98%	8.86%	3.12%
	3		11.87%	8.47%	3.40%
	4		11.94%	8.53%	3.41%
1993	1		11.75%	8.07%	3.68%
	2		11.71%	7.81%	3.90%
	3		11.39%	7.28%	4.11%
	4		11.15%	7.22%	3.93%
1994	1		11.12%	7.55%	3.57%
	2		10.81%	8.29%	2.52%
	3		10.95%	8.51%	2.44%
	4	(c)	11.64%	8.87%	2.77%
1995	2		11.00%	7.93%	3.07%
	3		11.07%	7.72%	3.35%
	4		11.56%	7.37%	4.19%
1996	1		11.45%	7.44%	4.01%
	2		10.88%	7.98%	2.90%
	3		11.25%	7.96%	3.29%
	4		11.32%	7.62%	3.70%
1997	1		11.31%	7.76%	3.55%
	2		11.70%	7.88%	3.82%
	3		12.00%	7.49%	4.51%
	4	(c)	11.01%	7.25%	3.76%
1998	2		11.37%	7.12%	4.25%
	3		11.41%	6.99%	4.42%
	4		11.69%	6.97%	4.72%
1999	1		10.82%	7.11%	3.71%
	2	(c)	10.82%	7.48%	3.34%
	4		10.33%	8.05%	2.28%
2000	1		10.71%	8.29%	2.42%
	2		11.08%	8.45%	2.63%
	3		11.33%	8.25%	3.08%
	4		12.50%	8.03%	4.47%
2001	1		11.16%	7.74%	3.42%
	2	(c)	10.75%	7.93%	2.82%
	4		10.65%	7.68%	2.97%
2002	1		10.67%	7.65%	3.02%
	2		11.64%	7.50%	4.14%
	3		11.50%	7.19%	4.31%
	4		10.78%	7.15%	3.63%
2003	1		11.38%	6.93%	4.45%
	2		11.36%	6.40%	4.96%
	3		10.61%	6.64%	3.97%
	4		10.84%	6.35%	4.49%
2004	1		11.10%	6.09%	5.01%
	2		10.25%	6.48%	3.77%
	3		10.37%	6.13%	4.24%
	4		10.66%	5.94%	4.72%
2005	1		10.65%	5.74%	4.91%
	2		10.52%	5.52%	5.00%
	3		10.47%	5.51%	4.96%
	4		10.40%	5.82%	4.58%
2006	1		10.63%	5.85%	4.78%
	2		10.50%	6.37%	4.13%
	3		10.45%	6.19%	4.26%
	4		10.14%	5.86%	4.28%
2007	1		10.44%	5.90%	4.54%
	2		10.12%	6.09%	4.03%
	3		10.03%	6.22%	3.81%
	4		10.27%	6.08%	4.19%
2008	1		10.38%	6.15%	4.23%
	2		10.17%	6.32%	3.85%
	3		10.49%	6.42%	4.07%
	4		10.34%	7.23%	3.11%
2009	1		10.24%	6.37%	3.87%
	2		10.11%	6.39%	3.72%
	3		9.88%	5.74%	4.14%
	4		10.27%	5.66%	4.61%
2010	1		10.24%	5.83%	4.41%
	2		9.99%	5.61%	4.38%
	3		9.93%	5.09%	4.84%
	4		10.09%	5.34%	4.75%
2011	1		10.10%	5.60%	4.50%
	2		9.85%	5.38%	4.47%
	3		9.65%	4.81%	4.84%
	4		9.88%	4.37%	5.51%
2012	1		9.63%	4.39%	5.24%
	2		9.83%	4.23%	5.60%
	3		9.75%	3.98%	5.77%
	4		10.07%	3.92%	6.15%
2013	1		9.57%	4.18%	5.39%
	2		9.47%	4.23%	5.24%
	3		9.60%	4.74%	4.86%
	4		9.83%	4.76%	5.07%
2014	1		9.54%	4.56%	4.98%
	2		9.84%	4.32%	5.52%
	3		9.45%	4.20%	5.25%
	4		10.28%	4.03%	6.25%
2015	1		9.47%	3.66%	5.81%
	2		9.43%	4.10%	5.33%
	3		9.75%	4.35%	5.40%
	4		9.68%	4.35%	5.33%
2016	1		9.48%	4.18%	5.30%
	2		9.42%	3.90%	5.52%
	3		9.47%	3.61%	5.86%
	4		9.60%	4.04%	5.56%
2017	1		9.60%	4.18%	5.42%
	2		9.47%	4.06%	5.41%
	3		10.14%	3.91%	6.23%
	4		9.68%	3.84%	5.84%
2018	1		9.68%	4.03%	5.65%
Average			**11.65%**	**8.11%**	**3.54%**

Unadusted:

Risk Premium = Intercept + (Slope X Interest Rate) (d)

RP	=	0.07330	+	-0.46757	X	4.17%
RP	=	0.07330	+	-0.01950		
RP	**=**	**5.38%**				
ROE	=	4.17%	+	5.38%		
ROE	**=**	**9.55%**				

Adjusted (Using Iterative Prais-Winsten algorithm):

Risk Premium = Intercept + (Slope X Interest Rate) (d)

RP	=	0.07680	+	-0.51189	X	4.17%
RP	=	0.07680	+	-0.02135		
RP	**=**	**5.55%**				
ROE	=	4.17%	+	5.55%		
ROE	**=**	**9.72%**				

(a) Regulatory Research Associates, Inc., Major Rate Case Decisions, (April 17, 2018, January 24, 2002, January 18, 1995, and January 16, 1990).
(b) Mergent Public Utility Manual (2003); Mergent Bond Record (September 2005); Moody's Credit Perspectives (Various Editions).
(c) No decisions reported for following quarter.
(d) Moody's Investors Service for May 2018.

COMPARABLE EARNINGS METHOD

Company	Projected Earned Return on Book Equity (a) 2018	2019	2021-23
Atmos Energy	10.3%	10.0%	11.1%
Chesapeake Utilities	10.2%	9.9%	9.9%
New Jersey Resources	17.5%	16.4%	13.0%
Northwest Natural Gas	8.6%	9.1%	11.9%
South Jersey Industries	11.5%	9.7%	11.2%
Southwest Gas	10.3%	10.5%	10.4%
Spire	10.6%	9.4%	10.4%
LDC GROUP AVERAGE	**11.3%**	**10.7%**	**11.1%**

(a) *The Value Line Investment Survey* (June 1, 2018).