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 1                          BEFORE THE
              FLORIDA PUBLIC SERVICE COMMISSION
 2
       In the Matter of:
 3                                DOCKET NO.  20230023-GU

 4     Petition for rate increase by Peoples
       Gas Systems, Inc.
 5     _____/
                                  DOCKET NO.  20220219-GU
 6
       Petition for approval of 2022 depreciation
 7     study by Peoples Gas Systems, Inc.
       _____/
 8                                DOCKET NO.  20220212-GU

 9     Petition for approval of depreciation rate
       and subaccount for renewable natural gas
10     facilities leased to others by Peoples
       Gas Systems, Inc.
11     _____/

12                   VOLUME 3 - PAGES 285 - 530

13     PROCEEDINGS:        HEARING

14     COMMISSIONERS
       PARTICIPATING:      CHAIRMAN ANDREW GILES FAY
15                         COMMISSIONER ART GRAHAM
                           COMMISSIONER GARY F. CLARK
16                         COMMISSIONER MIKE LA ROSA
                           COMMISSIONER GABRIELLA PASSIDOMO
17
       DATE:               Wednesday, September 13, 2023
18
       TIME:               Commenced:  9:00 a.m.
19                         Concluded:  6:35 p.m.

20     PLACE:              Betty Easley Conference Center
                           Room 148
21                         4075 Esplanade Way
                           Tallahassee, Florida
22
       REPORTED BY:        DEBRA R. KRICK
23                         Court Reporter

24     APPEARANCES:        (As heretofore noted.)

25                        PREMIER REPORTING
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1   I N D E X

2   WITNESS: PAGE

3   DYLAN D'ASCENDIS

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 1                    EXHIBITS CONTINUED

 2    NUMBER:                                 ID   ADMITTED

 3    178-179   As identified on the CEL                289

 4    180       Response to Interrogatory 109  457      526

 5    181       Response to Intergatory 112    457      526

 6    182       Order Establishing Authorized  457      526
               Range of Return on Common
 7             Equity For Water and
               Wastewater Utilities
 8
      183       Garrett 20230023-GU Testimony & 466      526
 9             Exhibits (Excerpt) Page 55,
               Figure 12: Equity Risk
10             Premium Results

11    184       Excerpt Pages 13-14 of Garrett  472      526
               20200051-GU Testimony
12
      20        As identified in the CEL                525
13
      30        As identified in the CEL                525
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1   P R O C E E D I N G S

2   (Transcript follows in sequence from Volume

3   2.)

4   CHAIRMAN FAY: All right. Commissioners, we

5   will start back for this afternoon.

6   We will stay on a similar schedule of

7   basically around two-hour blocks. We will make

8   sure we give our court reporter a break, and then

9   we will sort of play it by ear as to how far we go

10   tonight going forward.

11   We are going to start with witness D'Ascendis

12   this afternoon. Mr. Moyle, did we take care of

13   your issue? Do you still want to address that --

14   MR. MOYLE: No, I --

15   CHAIRMAN FAY: -- I just want to make sure I

16   give you the opportunity.

17   MR. MOYLE: I appreciate the opportunity to

18   have a couple of conversations, and I am clear, and

19   I have those two exhibits that I had marked and

20   would like to move those in, if we could.

21   CHAIRMAN FAY: Okay. So -- let's see, so 178

22   and 179, without objection show that --

23   MR. MEANS: No objection.

24   CHAIRMAN FAY: Without objection, okay, show

25   those moved into the record.

1   (Whereupon, Exhibit Nos. 178-179 were received

2   into evidence.)

3   CHAIRMAN FAY: All right. Does that take care

4   of it, Mr. Moyle?

5   MR. MOYLE: It does. Thank you for the

6   courtesy.

7   CHAIRMAN FAY: Sure.

8   All right. Next we will move into witness

9   testimony. I think we have witness D'Ascendis on

10   -- there he is, all right, available. We will make

11   sure we get you sworn in Mr. D'Ascendis.

12   Did we lose you?

13   MR. MEANS: I believe he said I do, but we

14   couldn't hear him.

15   CHAIRMAN FAY: Maybe a little bit louder. We

16   can't hear you. Hold on. Let's make sure we got

17   -- I don't know if it's on -- your mute is not on,

18   though, so let's see if it's on our end or your

19   ends real quick, just to make sure.

20   MR. MEANS: He has got his background blurred.

21   CHAIRMAN FAY: You want to give it another go,

22   Mr. D'Ascendis, see if we can hear you?

23   MR. MEANS: We can't hear him.

24   CHAIRMAN FAY: Not yet. Okay.

25   Let's check with Michael. I don't think it's

1   -- it's unlikely on our end with the speakers. Let

2   me see. We will check with Michael real quick. He

3   was signed in earlier.

4   (Discussion off the record.)

5   MR. MEANS: We probably should administer the

6   oath again just --

7   CHAIRMAN FAY: Yep. Sure. No problem.

8   MR. MEANS: Belt and suspenders.

9   CHAIRMAN FAY: Yep.

10 Whereupon,

11   DYLAN D'ASCENDIS

12 was called as a witness, having been first duly sworn to

13 speak the truth, the whole truth, and nothing but the

14 truth, was examined and testified as follows:

15   THE WITNESS: I do.

16   CHAIRMAN FAY: Okay. Mr. Means.

17   MR. MEANS: Thank you, Mr. Chairman.

18   EXAMINATION

19 BY MR. MEANS:

20   **Q   Mr. D'Ascendis, can you please state your full**

21 **name for the record?**

22   A   Yes. It's Dylan, D-Y-L-A-N, William,

23 W-I-L-L-I-A-M, D'Ascendis, D, apostrophe, capital

24 A-S-C-E-N-D-I-S.

25   **Q   And were you just sworn?**

1   A   I was.

2   **Q   Who is your current employer, and what is your**

3 **business address?**

4   A   I am a partner at ScottMadden, Inc., and my

5 business address is 3000 Atrium Way, Suite 200, Mount

6 Laurel, New Jersey, 08054.

7   **Q   And did you prepare and cause to be filed in**

8 **this docket on April 4th, 2023, prepared direct**

9 **testimony consisting of 78 pages?**

10   A   I did.

11   **Q   And did you prepare and cause to be filed in**

12 **this docket on July 20th, 2023, prepared rebuttal**

13 **testimony consisting of 55 pages?**

14   A   I did.

15   **Q   Do you have any additions or corrections to**

16 **your prepared direct or rebuttal testimony?**

17   A   I think there was a filed errata to my

18 rebuttal as a result of the deposition with a schedule,

19 or a document No. 9.

20   **Q   Other than that change, if I were to ask you**

21 **the questions contained in your prepared direct and**

22 **rebuttal today would your answers be the same?**

23   A   They would.

24   CHAIRMAN FAY: Okay. Maybe, Mr. D'Ascendis,

25   if we can have you just project a little bit more

1   just so our court reporter can pick up your audio.

2   THE WITNESS: Sure, I haven't had a problem

3   with it before, but I guess it's kind of -- can you

4   hear me now?

5   CHAIRMAN FAY: Yeah, we can hear you just

6   slightly muddled, so if you speak up a little bit,

7   it's just helpful to our court reporter to make

8   sure we can get everything on the record.

9   THE WITNESS: That works. I am sorry.

10   CHAIRMAN FAY: Okay. Appreciate that.

11   MR. MEANS: Peoples requests that the prepared

12   direct and rebuttal testimony of Mr. D'Ascendis be

13   inserted into the record as though read.

14   CHAIRMAN FAY: Okay. Show the direct and

15   rebuttal inserted.

16   (Whereupon, prefiled direct testimony of Dylan

17   D'Ascendis was inserted.)

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BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 20230023-GU

IN RE: PETITION FOR RATE INCREASE

BY PEOPLES GAS SYSTEM, INC.

PREPARED DIRECT TESTIMONY AND EXHIBIT

OF

DYLAN W. D'ASCENDIS

ON BEHALF OF

PEOPLES GAS SYSTEM, INC.

DOCKET NO. 20230023-GU
WITNESS: D'ASCENDIS

TABLE OF CONTENTS

PREPARED DIRECT TESTIMONY

OF

DYLAN W. D'ASCENDIS

ON BEHALF OF PEOPLES GAS SYSTEM, INC.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

PREPARED DIRECT TESTIMONY

OF

DYLAN W. D'ASCENDIS

ON BEHALF OF PEOPLES GAS SYSTEM, INC.

I.   **INTRODUCTION**

Q.   Please state your name, address, occupation and employer.

A.   My name is Dylan W. D'Ascendis. My business address is 3000
      Atrium Way, Suite 200, Mount Laurel, New Jersey 08054. I am
      employed by ScottMadden, Inc. as a Partner.

Q.   Please provide a brief outline of your educational background
      and relevant business experience.

A.   I am a graduate of the University of Pennsylvania, where I
      received a Bachelor of Arts degree in Economic History. I
      also received a Master of Business Administration with high
      honors and concentrations in Finance and International
      Business from Rutgers University.

      I have offered expert testimony on behalf of investor-owned
      utilities before more than 35 state regulatory commissions in
      the United States, the Federal Energy Regulatory Commission,

1   the Alberta Utility Commission, an American Arbitration

2   Association panel, and the Superior Court of Rhode Island on

3   issues including, but not limited to, common equity cost rate,

4   rate of return, valuation, capital structure, class cost of

5   service, and rate design.

6

7   I also provide services on behalf of the American Gas

8   Association ("AGA"). I calculate the AGA Gas Index, which

9   serves as the benchmark against which the performance of the

10   American Gas Index Fund ("AGIF") is measured on a monthly

11   basis. The AGA Gas Index and AGIF are a market capitalization

12   weighted index and mutual fund, respectively, comprised of

13   the common stocks of the publicly traded corporate members of

14   the AGA.

15

16   I am a member of the Society of Utility and Regulatory

17   Financial Analysts ("SURFA"). In 2011, I was awarded the

18   professional designation "Certified Rate of Return Analyst"

19   by SURFA, which is based on education, experience, and the

20   successful completion of a comprehensive written examination.

21

22   I am also a member of the National Association of Certified

23   Valuation Analysts ("NACVA") and was awarded the professional

24   designation "Certified Valuation Analyst" by the NACVA in

25   2015.

1   The details of my educational background and expert witness

2   appearances are provided in Document No. 13 to my direct

3   testimony.

4

5 Q. What is the purpose of your prepared direct testimony in this

6   proceeding?

7

8 A. The purpose of my direct testimony is to present evidence and

9   provide the Florida Public Service Commission ("Commission")

10   with a recommendation regarding Peoples Gas System, Inc.'s

11   ("Peoples" or the "company") return on common equity ("ROE")

12   for its natural gas operations, and to provide an assessment

13   of the capital structure to be used for ratemaking purposes,

14   as proposed in the direct testimony of Peoples witnesses

15   Rachel B. Parsons and Kenneth D. McOnie.

16

17 Q. Did you prepare any exhibits in support of your prepared

18   direct testimony?

19

20 A. Yes.   Exhibit No. DWD-1 was prepared by me or under my

21   direction and supervision. My analyses and conclusions are

22   supported by the data presented in Document Nos. 1 through

23   13.

24   Document No. 1   Summary of Common Equity Cost Rate

25   Document No. 2   Financial Profile of the Utility Proxy

1   Group

2   Document No. 3   Application of the Discounted Cash Flow

3   Model

4   Document No. 4   Application of the Risk Premium Model

5   Document No. 5   Application of the Capital Asset Pricing

6   Model

7   Document No. 6   Basis of Selection for the Non-Price

8   Regulated Companies Comparable in Total

9   Risk to the Utility Proxy Group

10   Document No. 7   Application of Cost of Common Equity Models

11   to the Non-Price Regulated Proxy Group

12   Document No. 8   Derivation of the Flotation Cost Adjustment

13   to the Cost of Common Equity

14   Document No. 9   Derivation of the Indicated Size Premium

15   for Peoples Relative to the Utility Proxy

16   Group

17   Document No. 10   Comparison of Projected Capital

18   Expenditures Relative to Net Plant

19   Document No. 11   Fama & French – Figure 2

20   Document No. 12   Referenced Endnotes for the Prepared Direct

21   Testimony of Dylan W. D'Ascendis

22   Document No. 13   Resume and Testimony Listing of Dylan W.

23   D'Ascendis

24

25   Q.   What is your recommended common equity cost rate?

1   **A.**   I recommend that the Commission authorize Peoples the

2   opportunity to earn an ROE of 11.00 percent on its

3   jurisdictional rate base, based on its proposed ratemaking

4   capital structure.   The company's requested ratemaking

5   capital structure consists of 40.48 percent long-term debt

6   and 54.68 percent common equity, to which my recommended ROE

7   of 11.00 percent would apply.   That common equity ratio is

8   consistent with the company's historical equity ratios, and

9   the equity ratios maintained by the Utility Proxy Group

10   (discussed below) and their operating subsidiary utility

11   companies.   The overall rate of return is summarized on page

12   1 of Document No. 1.

13

14 **Q.**   Please summarize your recommended ROE.

15

16 **A.**   My recommended ROE of 11.00 percent is summarized on page 2

17   of Document No. 1.   I have assessed the market-based common

18   equity cost rates of companies of relatively similar, but not

19   necessarily identical, risk to Peoples.   Using companies of

20   relatively comparable risk as proxies is consistent with the

21   principles of fair rate of return established by the U.S.

22   Supreme Court in two cases: (1) *Federal Power Comm'n v. Hope*

23   *Natural Gas Co.*, 320 U.S. 591 (1944) *("Hope")*; and (2)

24   *Bluefield Water Works Improvement Co. v. Public Serv. Comm'n*,

25   262 U.S. 679 (1923) *("Bluefield")*.   No proxy group can be

1   identical in risk to any single company. Consequently, there

2   must be an evaluation of relative risk between the company

3   and the proxy group to determine if it is appropriate to

4   adjust the proxy group's indicated rate of return.

5

6   My recommendation results from the application of several

7   cost of common equity models, specifically the Discounted

8   Cash Flow ("DCF") model, the Risk Premium Model ("RPM"), and

9   the Capital Asset Pricing Model ("CAPM"), to the market data

10 of a proxy group of six natural gas distribution utilities

11 ("Utility Proxy Group") whose selection criteria will be

12 discussed below. In addition, I applied the DCF model, RPM,

13 and CAPM to a Non-Price Regulated Proxy Group similar in total

14 risk to the Utility Proxy Group. In order to be conservative,

15 I did not consider the ROE model results applied to my Non-

16 Price Regulated Proxy Group in the determination of my

17 recommended range.   The results derived from each are

18 summarized on page 2 of Document No. 1.

19

20 The indicated range of common equity cost rates applicable to

21 the Utility Proxy Group is between 10.00 percent and 11.62

22 percent before any company-specific adjustments.

23

24 To reflect Peoples' specific business risks, I adjusted the

25 indicated common equity cost rate model results to reflect

1   the company's smaller relative size, as well as high level of

2   customer growth, overall performance, and capital investment

3   plans, as compared to the Utility Proxy Group. I also

4   adjusted the indicated range of common equity cost rate upward

5   to reflect flotation costs.[1] These adjustments resulted in a

6   company-specific indicated range of common equity cost rates

7   between 10.32 percent and 11.70 percent. Given the Utility

8   Proxy Group and company-specific ranges of common equity cost

9   rates, I recommend the Commission adopt an ROE of 11.00

10   percent for ratemaking purposes in this case.

11

12   **II.   GENERAL PRINCIPLES**

13   **Q.** What general principles have you considered in arriving at

14   your recommended common equity cost rate of 11.00 percent?

15

16   **A.** In unregulated industries, marketplace competition is the

17   principal determinant of the price of products or services.

18   For regulated public utilities, regulation must act as a

19   substitute for marketplace competition. Assuring that the

20   utility can fulfill its obligations to the public, while

21   providing safe and reliable service at all times, requires a

22   level of earnings sufficient to maintain the integrity of

23   presently invested capital. Sufficient earnings also permit

24   the attraction of needed new capital at a reasonable cost,

25   for which the utility must compete with other companies of

1 comparable risk, consistent with the fair rate of return

2 standards established by the U.S. Supreme Court in the

3 previously cited *Hope* and *Bluefield* cases.

4

5 The U.S. Supreme Court affirmed the fair rate of return

6 standards in *Hope* when it stated:

7   The rate-making process under the Act, *i.e.,* the

8   fixing of 'just and reasonable' rates, involves a

9   balancing of the investor and the consumer

10   interests.

11

12   Thus we stated in the *Natural Gas Pipeline Co.* Case

13   that 'regulation does not insure that the business

14   shall produce net revenues.' 315 U.S. at page 590,

15   62 S.Ct. at page 745. But such considerations

16   aside, the investor interest has a legitimate

17   concern with the financial integrity of the company

18   whose rates are being regulated. From the investor

19   or company point of view it is important that there

20   be enough revenue not only for operating expenses

21   but also for the capital costs of the business.

22   These include service on the debt and dividends on

23   the stock. *Cf. Chicago & Grand Trunk R. Co. v.*

24   *Wellman*, 143 U.S. 339, 345, 346 12 S.Ct. 400,402.

25   By that standard the return to the equity owner

1   should be commensurate with returns on investments

2   in other enterprises having corresponding risks.

3   That return, moreover, should be sufficient to

4   assure confidence in the financial integrity of the

5   enterprise, so as to maintain its credit and to

6   attract capital.[2]

7

8   In summary, the U.S. Supreme Court has found a return that is

9   adequate to attract capital at reasonable terms enables the

10 utility to provide service while maintaining its financial

11 integrity.   As discussed above, and in keeping with

12 established regulatory standards, that return should be

13 commensurate with the returns expected elsewhere for

14 investments of equivalent risk. The Commission's decision in

15 this proceeding, therefore, should provide the company with

16 the opportunity to earn a return that is: (1) adequate to

17 attract capital at reasonable cost and terms; (2) sufficient

18 to ensure its financial integrity; and (3) commensurate with

19 returns on investments in enterprises having corresponding

20 risks.

21

22 Lastly, the required return for a regulated public utility is

23 established on a stand-alone basis, *i.e.,* for the utility

24 operating company at issue in a rate case. Parent entities,

25 like other investors, have capital constraints and must look

1 at the attractiveness of the expected risk-adjusted return of

2 each investment alternative in their capital budgeting

3 process. That is, utility holding companies that own many

4 utility operating companies have choices as to where they

5 will invest their capital within the holding company family.

6 Therefore, the opportunity cost concept applies regardless of

7 the source of the funding, public funding or corporate

8 funding.

9

10 It therefore is important that the authorized ROE reflects

11 the risks and prospects of the utility's operations and

12 supports the utility's financial integrity from a stand-alone

13 perspective, as measured by its combined business and

14 financial risks. Consequently, the ROE authorized in this

15 proceeding should be sufficient to support the operational

16 (*i.e.,* business risk) and financing (*i.e.,* financial risk) of

17 the company's utility subsidiary on a stand-alone basis.

18

19 **Q.** Within that broad framework, how is the cost of capital

20 estimated in regulatory proceedings?

21

22 **A.** Regulated utilities primarily use common stock and long-term

23 debt to finance their permanent property, plant, and

24 equipment (*i.e.,* rate base). The fair rate of return for a

25 regulated utility is based on its weighted average cost of

1   capital, in which, as noted earlier, the costs of the

2   individual sources of capital are weighted by their

3   respective book values.

4

5   The cost of capital is the return investors require to make

6   an investment in a company. Investors will provide funds to

7   a firm only if the return that they *expect* is equal to, or

8   greater than, the return that they *require* to accept the risk

9   of providing funds to the firm.

10

11 The cost of capital (*i.e.,* the combination of the costs of

12 debt and equity) is based on the economic principle of

13 "opportunity costs." Investing in any asset (whether debt or

14 equity securities) represents a forgone opportunity to invest

15 in alternative assets. For any investment to be sensible,

16 its expected return must be at least equal to the return

17 expected on alternative, comparable risk investment

18 opportunities. Because investments with like risks should

19 offer similar returns, the opportunity cost of an investment

20 should equal the return available on an investment of

21 comparable risk.

22

23 Whereas the cost of debt is contractually defined and can be

24 directly observed as the interest rate or yield on debt

25 securities, the cost of common equity must be estimated based

1   on market data and various financial models. Because the

2   cost of common equity is premised on opportunity costs, the

3   models used to determine it are typically applied to a group

4   of "comparable" or "proxy" companies.

5

6   In the end, the estimated cost of capital should reflect the

7   return that investors require in light of the subject

8   company's business and financial risks, and the returns

9   available on comparable investments.

10

11 **Q.** Is the authorized return set in regulatory proceedings

12   guaranteed?

13

14 **A.** No, it is not. Consistent with the *Hope* and *Bluefield*

15   standards, the ratemaking process should provide the utility

16   a reasonable opportunity to recover its return of, and return

17   on, its reasonably incurred investments, but it does not

18   guarantee that return. While a utility may have control over

19   some factors that affect the ability to earn its authorized

20   return (*e.g.*, management performance, operating and

21   maintenance expenses, etc.), there are several factors beyond

22   a utility's control that affect its ability to earn its

23   authorized return. Those may include factors such as weather,

24   the economy, and the prevalence and magnitude of regulatory

25   lag.

1 **A.** **<u>Business Risk</u>**

2 **Q.** Please define business risk and explain why it is important

3 for determining a fair rate of return.

4

5 **A.** The investor-required return on common equity reflects

6 investors' assessment of the total investment risk of the

7 subject firm. Total investment risk is often discussed in

8 the context of business and financial risk.[3]

9

10 Business risk reflects the uncertainty associated with owning

11 a company's common stock without the company's use of debt

12 and/or preferred stock financing. One way of considering the

13 distinction between business and financial risk is to view

14 the former as the uncertainty of the expected earned return

15 on common equity, assuming the firm is financed with no debt.

16

17 Examples of business risks <u>generally</u> faced by utilities

18 include, but are not limited to, the regulatory environment,

19 mandatory environmental compliance requirements, customer mix

20 and concentration of customers, service territory economic

21 growth, market demand, risks and uncertainties of supply,

22 operations, capital intensity, size, the degree of operating

23 leverage, emerging technologies, the vagaries of weather, and

24 the like, all of which have a direct bearing on earnings.

25

1   Although analysts, including ratings agencies, may categorize

2   business risks individually, as a practical matter, such

3   risks are interrelated and not wholly distinct from one

4   another. When determining an appropriate return on common

5   equity, the relevant issue is where investors see the subject

6   company in relation to other similarly situated utility

7   companies (*e.g.,* those in the Utility Proxy Group). To the

8   extent investors view a company as being exposed to higher

9   risk, the required return will increase, and vice versa.

10

11   For regulated utilities, business risks are both long-term

12   and near-term in nature. Whereas near-term business risks

13   are reflected in year-to-year variability in earnings and

14   cash flow brought about by economic or regulatory factors,

15   long-term business risks reflect the prospect of an impaired

16   ability of investors to obtain both a fair rate of return on,

17   and return of, their capital. Moreover, because utilities

18   accept the obligation to provide safe, adequate, and reliable

19   service at all times (in exchange for a reasonable opportunity

20   to earn a fair return on their investment), they generally do

21   not have the option to delay, defer, or reject capital

22   investments.   Because those investments are capital-

23   intensive, utilities generally do not have the option to avoid

24   raising external funds during periods of capital market

25   distress, if necessary.

1   Because utilities invest in long-lived assets, long-term

2   business risks are of paramount concern to equity investors.

3   That is, the risk of not recovering the return on their

4   investment extends far into the future. The timing and nature

5   of events that may lead to losses, however, also are uncertain

6   and, consequently, those risks and their implications for the

7   required return on equity tend to be difficult to quantify.

8   Regulatory commissions (like investors who commit their

9   capital) must review a variety of quantitative and

10 qualitative data and apply their reasoned judgment to

11 determine how long-term risks weigh in their assessment of

12 the market-required return on common equity.

13

14 **B.**   **Financial Risk**

15 **Q.**   Please define financial risk and explain why it is important

16   for determining a fair rate of return.

17

18 **A.**   Financial risk is the additional risk created by the

19   introduction of debt and preferred stock into the capital

20   structure. The higher the proportion of debt and preferred

21   stock in the capital structure, the higher the financial risk

22   to common equity owners (*i.e.,* failure to receive dividends

23   due to default or other covenants). Therefore, consistent

24   with the basic financial principle of risk and return, common

25   equity investors require higher returns as compensation for

1   bearing higher financial risk.

2

3   Q.   Can bond and credit ratings be a proxy for a firm's combined

4   business and financial risks to equity owners (*i.e.*,

5   investment risk)?

6

7   A.   Yes, similar bond ratings/issuer credit ratings reflect, and

8   are representative of, similar combined business and

9   financial risks (*i.e.*, total risk) faced by bond investors.[4]

10   Although specific business or financial risks may differ

11   between companies, the same bond/credit rating indicates that

12   the combined risks are roughly similar from a debtholder

13   perspective.   The caveat is that these debtholder risk

14   measures do not translate directly to risks for common equity.

15

16 Q.   Do ratings agencies account for company size in their bond

17   ratings?

18

19 A.   No.   Neither Standard & Poor's Ratings Services ("S&P") nor

20   Moody's Investors Service ("Moody's") have minimum company

21   size requirements for any given rating level.   This means,

22   all else being equal, a relative size analysis must be

23   conducted for equity investments in companies with similar

24   bond ratings.

25

1 III. **PEOPLES AND THE UTILITY PROXY GROUP**

2 **Q.** Are you familiar with Peoples' operations?

3

4 **A.** Yes. As of the end of December, 2022, Peoples Gas System was

5 a division of Tampa Electric Company providing natural gas

6 distribution service to over 467,000 residential, commercial,

7 industrial and electric power generation customers in the

8 state of Florida.[5] As of January 1, 2023, the assets of

9 Peoples Gas System, a division of Tampa Electric Company were

10 transferred to Peoples Gas System, Inc., a wholly owned

11 subsidiary of TECO Gas Operations, Inc., which is not publicly

12 traded as it comprises an operating subsidiary of TECO Energy,

13 Inc., whose ultimate parent is Emera Incorporated ("Emera").[6]

14 Emera has electric generation, transmission and distribution

15 operations, natural gas transmission and distribution

16 operations, and non-regulated energy marketing operations in

17 the U.S., Canada, and Caribbean Islands.[7] Emera is publicly

18 traded on the Toronto Stock Exchange under ticker symbol EMA.

19

20 **Q.** Why is it necessary to develop a proxy group when estimating

21 the ROE for the company?

22

23 **A.** Because the company is not publicly traded and does not have

24 publicly traded equity securities, it is necessary to develop

25 groups of publicly traded, comparable companies to serve as

1   "proxies" for the company. In addition to the analytical

2   necessity of doing so, the use of proxy companies is

3   consistent with the *Hope* and *Bluefield* comparable risk

4   standards, as discussed above. I have selected two proxy

5   groups that, in my view, are fundamentally risk-comparable to

6   the company: a Utility Proxy Group, and a Non-Price Regulated

7   Proxy Group that is comparable in total risk to the Utility

8   Proxy Group.[8]

9

10   Even when proxy groups are carefully selected, it is common

11   for analytical results to vary from company to company.

12   Despite the care taken to ensure comparability, because no

13   two companies are identical, market expectations regarding

14   future risks and prospects will vary within the proxy group.

15   It therefore is common for analytical results to reflect a

16   seemingly wide range, even for a group of similarly situated

17   companies. At issue is how to estimate the ROE from within

18   that range. That determination will be best informed by

19   employing a variety of sound analyses that necessarily must

20   consider the sort of quantitative and qualitative information

21   discussed throughout my direct testimony. Additionally, a

22   relative risk analysis between the company and the Utility

23   Proxy Group must be made to determine whether or not explicit

24   company-specific adjustments need to be made to the Utility

25   Proxy Group's indicated results.

1 **Q.** Please explain how you selected the companies in the Utility

2   Proxy Group.

3

4 **A.** The companies selected for the Utility Proxy Group met the

5   following criteria:

6   • They were included in the Natural Gas Utility Group of

7   *Value Line's Standard Edition* (November 25, 2022) ("*Value*

8   *Line*");

9   • They have 60 percent or greater of fiscal year 2021 total

10   operating income derived from, and 60 percent or greater

11   of fiscal year 2021 total assets attributable to,

12   regulated gas distribution operations;

13   • At the time of preparation of this testimony, they had

14   not publicly announced that they were involved in any

15   major merger or acquisition activity (*i.e.*, one publicly-

16   traded utility merging with or acquiring another) or any

17   other major development;

18   • They have not cut or omitted their common dividends during

19   the five years ended 2021 or through the time of

20   preparation of this testimony;

21   • They have *Value Line* and Bloomberg Professional Services

22   ("Bloomberg") adjusted Beta coefficients ("beta");

23   • They have positive *Value Line* five-year dividends per

24   share ("DPS") growth rate projections; and

25   • They have *Value Line*, Zacks, or Yahoo! Finance consensus

1   five-year   earnings   per   share   ("EPS")   growth   rate

2   projections.

3

4   Q. Please identify the companies that met the above-stated

5   criteria.

6

7   A. The following six companies met these criteria: Atmos Energy

8   Corporation (Ticker: ATO); New Jersey Resources Corporation

9   (Ticker: NJR); NiSource Inc. (Ticker: NI); Northwest Natural

10   Gas Company (Ticker: NWN); ONE Gas, Inc. (Ticker: OGS); and

11   Spire Inc. (Ticker: SR).

12

13 Q. Please describe Document No. 2, page 1.

14

15 A. Page 1 of Document No. 2 contains comparative capitalization

16   and financial statistics for the Utility Proxy Group for the

17   five years from 2017 to 2021.

18

19   During the five-year period ending December 31, 2021, the

20   historically achieved average earnings rate on book common

21   equity for the group was 8.13 percent, the average common

22   equity ratio based on total permanent capital (excluding

23   short-term debt) was 50.13 percent, and the average dividend

24   payout ratio was 63.67 percent.

25

1	Total debt to earnings before interest, taxes, depreciation,
2	and amortization for the years 2017 to 2021 ranges between
3	4.96 and 7.65 times, with an average of 5.75 times. Funds
4	from operations to total debt range from 11.70 percent to
5	24.21 percent, with an average of 15.94 percent.

6

IV. CAPITAL STRUCTURE

8 **Q.** What is Peoples' requested capital structure?

9

10 **A.** Peoples' requested capital structure consists of 40.48
11 percent long-term debt and 54.68 percent common equity, as
12 shown in my Document No. 1 that is based on data included in
13 the company's MFR Schedule G-3, page 2.

14

15 **Q.** What are the typical sources of capital commonly considered
16 in establishing a utility's capital structure?

17

18 **A.** Common equity and long-term debt are commonly considered in
19 establishing a utility's capital structure, because they are
20 the typical sources of capital financing for a utility's rate
21 base.

22

23 **Q.** Please explain.

24

25 **A.** Long-lived assets are typically financed with long-lived

1   securities, so that the overall term structure of the

2   utility's long-term liabilities (both debt and equity)

3   closely match the life of the assets being financed. As

4   stated by Brigham and Houston:

5   In practice, firms don't finance each specific

6   asset with a type of capital that has a maturity

7   equal to the asset's life. However, academic

8   studies do show that most firms tend to finance

9   short-term assets from short-term sources and long-

10   term assets from long-term sources.[9]

11

12 Whereas short-term debt has a maturity of one year or less,

13 long-term debt may have maturities of 30 years or longer.

14 Although there are practical financing constraints, such as

15 the need to "stagger" long-term debt maturities, the general

16 objective is to extend the average life of long-term debt.

17 Still, long-term debt has a finite life, which is likely to

18 be less than the life of the assets included in rate base.

19 Common equity, on the other hand, is outstanding into

20 perpetuity. Thus, common equity more accurately matches the

21 life of the going concern of the utility, which is also

22 assumed to operate in perpetuity. Consequently, it is both

23 typical and important for utilities to have significant

24 proportions of common equity in their capital structures.

25

Q.   Why is it important that the company's requested capital
     structure, consisting of 40.48 percent long-term debt and
     54.68 percent common equity, be authorized in this
     proceeding?

A.   In order to continue to provide safe and reliable service to
     its customers, Peoples must meet the needs and serve the
     interests of its various stakeholders, including its
     customers, shareholders, and bondholders. The interests of
     these stakeholder groups are aligned with maintaining a
     healthy balance sheet, strong credit ratings, and a
     supportive regulatory environment, so that the company has
     access to capital on reasonable terms in order to make
     necessary investments.

     Safe and reliable service cannot be maintained at a reasonable
     cost if utilities do not have the financial flexibility and
     strength to access competitive financing markets on
     reasonable terms. The authorization of a capital structure
     that understates the company's actual common equity will
     weaken the financial condition of its operations and
     adversely impact the company's ability to address expenses
     and investments, to the detriment of customers and
     shareholders. Safe and reliable service for customers cannot
     be sustained over the long term if the interests of

1   shareholders and bondholders are minimized such that the

2   public interest is not optimized.

3

4 Q. How does the company's requested common equity ratio of 54.68

5   percent compare with the common equity ratios maintained by

6   the Utility Proxy Group?

7

8 A. The company's requested ratemaking common equity ratio of

9   54.68 percent is reasonable and consistent with the range of

10   common equity ratios maintained by the Utility Proxy Group.

11

12   As shown on page 2 of Document No. 2, common equity ratios

13   for the Utility Proxy Group range from 33.36 percent to 60.65

14   percent for fiscal year 2021.[10] I also considered *Value Line*

15   projected capital structures for the Utility Proxy Group for

16   2025-2027. That analysis showed a range of projected common

17   equity ratios between 39.50 percent and 60.00 percent for the

18   Utility Proxy Group (*see*, pages 2 through 7 of Document No.

19   3).

20

21   In addition to comparing the company's proposed common equity

22   ratio with common equity ratios currently and expected to be

23   maintained by the Utility Proxy Group, I also compared the

24   company's proposed common equity ratio with the equity ratios

25   maintained by the operating subsidiaries of the Utility Proxy

1   Group.   As shown on page 3 of Document No. 2, common equity

2   ratios of the operating utility subsidiaries of the companies

3   in the Utility Proxy Group range from 38.74 percent to 58.48

4   percent for fiscal year 2021.

5

6 **Q.**   Given the range of equity ratios present within the Utility

7   Proxy Group, is the equity ratio of 54.68 percent proposed by

8   Peoples appropriate for ratemaking purposes?

9

10 **A.**   Yes, it is.

11

12 **V.**   **COMMON EQUITY COST RATE MODEL**

13 **Q.**   Is it important that cost of common equity models be market-

14   based?

15

16 **A.**   Yes.   While a public utility operates a regulated business

17   within the states in which it operates, it still must compete

18   for equity in capital markets along with all other companies

19   of comparable risk, which includes non-utilities.   The cost

20   of common equity is thus determined based on equity market

21   expectations for the returns of those companies.   If an

22   individual investor is choosing to invest their capital among

23   companies of comparable risk, they will choose a company

24   providing a higher return over a company providing a lower

25   return.

1 Q. Are your cost of common equity models market-based?

2

3 A. Yes. The DCF model uses market prices in developing the

4   model's dividend yield component. The RPM uses bond ratings

5   and expected bond yields that reflect the market's assessment

6   of bond/credit risk. In addition, betas (β), which reflect

7   the market/systematic risk component of equity risk premium,

8   are derived from regression analyses of market prices. The

9   Predictive Risk Premium Model ("PRPM") uses monthly market

10   returns in addition to expectations of the risk-free rate.

11   The CAPM is market-based for many of the same reasons that

12   the RPM is market-based (*i.e.*, the use of expected bond yields

13   and betas). Selection criteria for comparable risk, non-

14   price regulated companies are based on regression analyses of

15   market prices and reflect the market's assessment of total

16   risk.

17

18 Q. What analytical approaches did you use to determine the

19   company's ROE?

20

21 A. As discussed earlier, I have relied on the DCF model, the

22   RPM, and the CAPM, which I applied to the Utility Proxy Group

23   described above. I also applied these same models to a Non-

24   Price Regulated Proxy Group described later in this section.

25

1   I rely on these models because reasonable investors use a

2   variety of tools and do not rely exclusively on a single

3   source of information or single model. Moreover, the models

4   on which I rely focus on different aspects of return

5   requirements and provide different insights to investors'

6   views of risk and return.   The DCF model, for example,

7   estimates the investor-required return assuming a constant

8   expected dividend yield and growth rate in perpetuity, while

9   Risk Premium-based methods (*i.e.,* the RPM and CAPM

10 approaches) provide the ability to reflect investors' views

11 of risk, future market returns, and the relationship between

12 interest rates and the cost of common equity. Just as the

13 use of market data for the Utility Proxy Group adds the

14 reliability necessary to inform expert judgment in arriving

15 at a recommended common equity cost rate, the use of multiple

16 generally accepted common equity cost rate models also adds

17 reliability and accuracy when arriving at a recommended

18 common equity cost rate.

19

20 **Q.** Has the Commission approved the use of multiple methods in

21 determining the cost of equity during past rate cases of

22 Peoples?

23

24 **A.** Yes. In Docket No. 20080318-GU, the Commission stated that

25 there are several models which satisfy the terms for

1   determining a fair rate of return as laid out by *Hope* and

2   *Bluefield*:

3   While the logic of the legal and economic concepts

4   of a fair rate of return are fairly straight

5   forward, the actual implementation of these

6   concepts is more controversial. Unlike the cost

7   rate on debt that is fixed and known due to its

8   contractual terms, the cost of equity must be

9   estimated. **Financial models have been developed to**

10   **estimate the investor-required ROE for a company.**

11   Market-based approaches such as the Discounted Cash

12   Flow (DCF) model and the Capital Asset Pricing

13   Model (CAPM) are generally recognized as being

14   consistent with the market-based standards of a

15   fair return enunciated in Hope, 320 U.S. 591 and

16   Bluefield, 262 U.S. 679. [Emphasis added][11]

17

18 **A.**   **Discounted Cash Flow Model**

19 **Q.**   What is the theoretical basis of the DCF model?

20

21 **A.**   The theory underlying the DCF model is that the present value

22   of an expected future stream of net cash flows during the

23   investment holding period can be determined by discounting

24   those cash flows at the cost of capital, or the investors'

25   capitalization rate. DCF theory indicates that an investor

1 buys a stock for an expected total return rate, which is

2 derived from the cash flows received from dividends and market

3 price appreciation. Mathematically, the dividend yield on

4 market price plus a growth rate equals the capitalization

5 rate (*i.e.*, the total common equity return rate expected by

6 investors), as depicted in the formula below:

7 $K_e = (D_0 (1+g))/P + g$

8 Where:

9 K_e = the required return on common equity;

10 D_0 = the annualized dividend per share;

11 P = the current stock price; and

12 g = the growth rate.

13

14 **Q.** Which version of the DCF model did you use?

15

16 **A.** I relied on the single-stage constant growth DCF model in my

17 analyses.

18

19 **Q.** Please describe the dividend yield you used in applying the

20 constant growth DCF model.

21

22 **A.** The unadjusted dividend yields are based on the proxy

23 companies' dividends as of December 30, 2022, divided by the

24 average closing market price for the 60 trading days ended

25 December 30, 2022 (*see*, Column 1, page 1 of Document No. 3).

1   **Q.**   Please explain your adjustment to the dividend yield.

2

3   **A.**   Because dividends are paid periodically (*e.g.,* quarterly), as

4   opposed to continuously (daily), an adjustment must be made

5   to the dividend yield. This is often referred to as the

6   discrete, or the Gordon Periodic, version of the DCF model.

7

8   DCF theory calls for using the full growth rate, or D_1, in

9   calculating the model's dividend yield component. Since the

10   companies in the Utility Proxy Group increase their quarterly

11   dividends at various times during the year, a reasonable

12   assumption is to reflect one-half the annual dividend growth

13   rate in the dividend yield component, or $D_{1/2}$. Because the

14   dividend should be representative of the next 12-month

15   period, this adjustment is a conservative approach that does

16   not overstate the dividend yield. Therefore, the actual

17   average dividend yields in Column 1, page 1 of Document No.

18   3 have been adjusted upward to reflect one-half the average

19   projected growth rate shown in Column 5.

20

21   **Q.**   Please explain the basis for the growth rates you apply to

22   the Utility Proxy Group in your constant growth DCF model.

23

24   **A.**   Investors are likely to rely on widely available financial

25   information services, such as *Value Line*, Zacks, and Yahoo!

1   Finance. Investors realize that analysts have significant

2   insight into the dynamics of the industries and individual

3   companies they analyze, as well as companies' abilities to

4   effectively manage the effects of changing laws and

5   regulations, and ever-changing economic and market

6   conditions. For these reasons, I used analysts' five-year

7   forecasts of earnings per share growth in my DCF analysis.

8

9   Over the long run, there can be no growth in dividends per

10   share without growth in earnings per share. Security

11   analysts' earnings expectations have a more significant

12   influence on market prices than dividend expectations. Thus,

13   using projected earnings growth rates in a DCF analysis

14   provides a better match between investors' market price

15   appreciation expectations and the growth rate component of

16   the DCF.

17

18 **Q.**   Please summarize the constant growth DCF model results.

19

20 **A.**   As shown on page 1 of Document No. 3, the application of the

21   constant growth DCF model to the Utility Proxy Group results

22   in a range of indicated ROEs from 8.80 percent to 11.70

23   percent. The mean of those results is 10.12 percent, the

24   median result is 9.89 percent, and the average of the two is

25   10.00 percent.

1   In arriving at a conclusion for the constant growth DCF-
2   indicated common equity cost rate for the Utility Proxy Group,
3   I relied on an average of the mean and the median results of
4   the DCF, specifically 10.00 percent, applicable to the
5   Utility Proxy Group. This approach takes into consideration
6   all proxy company results while mitigating high and low side
7   outliers of those results.

8

9   **B.   The Risk Premium Model**

10   **Q.**   Please describe the theoretical basis of the Risk Premium
11   Model.

12

13   **A.**   The RPM is based on the fundamental financial principle of
14   risk and return; namely, that investors require greater
15   returns for bearing greater risk. The RPM recognizes that
16   common equity capital has greater investment risk than debt
17   capital, as common equity shareholders are behind debt
18   holders in any claim on a company's assets and earnings. As
19   a result, investors require higher returns from common stocks
20   than from bonds to compensate them for bearing the additional
21   risk.

22

23   While it is possible to directly observe bond returns and
24   yields, common equity returns required by investors cannot be
25   directly determined or observed. According to RPM theory,

1   one can estimate a common equity risk premium over bonds

2   (either historically or prospectively) and use that premium

3   to derive a cost rate of common equity. The cost of common

4   equity equals the expected cost rate for long-term debt

5   capital, plus a risk premium over that cost rate, to

6   compensate common shareholders for the added risk of being

7   unsecured and last-in-line for any claim on the corporation's

8   assets and earnings upon liquidation.

9

10   **Q.** Please explain how you derived your indicated cost of common

11   equity based on the RPM.

12

13   **A.** To derive my indicated cost of common equity under the RPM,

14   I used two risk premium methods. The first method was the

15   PRPM and the second method was a risk premium model using a

16   total market approach. The PRPM estimates the risk-return

17   relationship directly, while the total market approach

18   indirectly derives a risk premium by using known metrics as

19   a proxy for risk.

20

21   ***The Predictive Risk Premium Model***

22   **Q.** Please explain the PRPM.

23

24   **A.** The PRPM, published in the *Journal of Regulatory Economics*,[12]

25   was developed from the work of Robert F. Engle, who shared

1   the Nobel Prize in Economics in 2003 "for methods of analyzing

2   economic time series with time-varying volatility" or ARCH.[13]

3   Engle found that volatility changes over time and is related

4   from one period to the next, especially in financial markets.

5   Engle discovered that volatility of prices and returns

6   clusters over time and is, therefore, highly predictable and

7   can be used to predict future levels of risk and risk

8   premiums.

9

10   The PRPM estimates the risk-return relationship directly, as

11   the predicted equity risk premium is generated by predicting

12   volatility or risk. The PRPM is not based on an <u>estimate</u> of

13   investor behavior, but rather on an evaluation of the results

14   of that behavior (*i.e.,* the variance of historical equity

15   risk premiums).

16

17   A generalized form of the ARCH methodology ("GARCH") has been

18   well tested by academia since Engle's, *et al*. research was

19   originally published in 1982, 40 years ago. The PRPM is in

20   the public domain, having been published six times in

21   academically peer-reviewed journals: <u>Journal of Economics and</u>

22   <u>Business</u> (June 2011 and April 2015),[14] <u>The Journal of</u>

23   <u>Regulatory Economics</u> (December 2011),[15] <u>The Electricity</u>

24   <u>Journal</u> (May 2013 and March 2020),[16] and <u>Energy Policy</u> (April

25   2019).[17] Notably, none of these articles have been rebutted

1   in the academic literature.

2

3   The PRPM is also cited in the following textbooks on cost of

4   capital by authors unaffiliated with the authors of the

5   academic articles cited above:

6   • Shannon Pratt and Roger Grabowski, Cost of Capital:

7   Applications and Examples, (Fifth Edition), Wiley & Sons,

8   2015;

9   • Shannon Pratt and Roger Grabowski, The Lawyer's Guide to

10   Cost of Capital: Understanding Risk and Return for Valuing

11   Businesses and Other Investments, ABA Publishing, 2015;

12   and

13   • Roger A. Morin, Modern Regulatory Finance, PUR Books, 2021.

14

15 Q. Please explain the application of the PRPM.

16

17 A. The inputs to the model are the historical returns on the

18   common shares of each of the Utility Proxy Group's companies

19   minus the historical monthly yield on long-term U.S. Treasury

20   securities through December 2022. Using GARCH, I calculated

21   each of the Utility Proxy Group's companies' projected equity

22   risk premium using Eviews© statistical software. When the

23   GARCH model is applied to the historical return data, it

24   produces a predicted GARCH variance series (as illustrated on

25   Columns 1 and 2, page 2 of Document No. 4) and a GARCH

1   coefficient (as illustrated on Column 4, page 2 of Document

2   No. 4).   Multiplying the predicted monthly variance by the

3   GARCH coefficient and then annualizing it[18] produces the

4   predicted annual equity risk premium.   I then added the

5   forecasted 30-year U.S. Treasury bond yield of 3.91 percent

6   (*see*, Column 6, page 2 of Document No. 4) to each company's

7   PRPM-derived equity risk premium to arrive at an indicated

8   cost of common equity.   The 30-year U.S. Treasury bond yield

9   is a consensus forecast derived from *Blue Chip Financial*

10   *Forecasts* ("*Blue Chip*").[19]

11

12 **Q.** Please describe your selection of a risk-free rate of return.

13

14 **A.** As shown in Document Nos. 4 and 5, the risk-free rate of

15   return adopted for applications of the RPM and CAPM is 3.91

16   percent.   This risk-free rate is based on the average of the

17   *Blue Chip* consensus forecast of the expected yields on 30-

18   year U.S. Treasury bonds for the six quarters ending with the

19   first calendar quarter of 2024, and long-term projections for

20   the years 2024 to 2028 and 2029 to 2033.

21

22 **Q.** Why did you use the projected 30-year Treasury yield in your

23   analyses?

24

25 **A.** The yield on long-term U.S. Treasury bonds is almost risk-

1   free and its term is consistent with the long-term cost of

2   capital to public utilities measured by the yields on Moody's

3   A2-rated public utility bonds; the long-term investment

4   horizon inherent in utilities' common stocks; and the long-

5   term life of the jurisdictional rate base to which the allowed

6   fair rate of return (*i.e.,* cost of capital) will be applied.

7   In contrast, short-term U.S. Treasury yields are more

8   volatile and largely a function of Federal Reserve monetary

9   policy.

10

11   Q.   What are the results of the PRPM as applied to the Utility

12   Proxy Group?

13

14   A.   As shown on page 2 of Document No. 4, the mean PRPM-indicated

15   common equity cost rate for the Utility Proxy Group is 11.80

16   percent, the median is 12.23 percent, and the average of the

17   two is 12.02 percent. Consistent with my reliance on the

18   average of the median and mean results of the DCF model, I

19   relied on the average of the mean and median results of the

20   Utility Proxy Group's PRPM to calculate cost of common equity

21   rates of 12.02 percent for the Utility Proxy Group.

22

23   ***The Total Market Approach Risk Premium Model (RPM)***

24   Q.   Please explain the total market approach RPM.

25

1 A. The total market approach RPM adds a prospective public

2   utility bond yield to an average of: (1) an equity risk

3   premium that is derived from a beta-adjusted total market

4   equity risk premium, (2) an equity risk premium based on the

5   S&P Utilities Index, and (3) an equity risk premium based on

6   authorized ROEs for natural gas distribution utilities.

7

8 Q. Please explain the basis of the expected bond yield of 5.88

9   percent, applicable to the Utility Proxy Group.

10

11 A. The first step in the total market approach RPM analysis is

12   to determine the expected bond yield. Because both ratemaking

13   and the cost of capital, including the common equity cost

14   rate, are prospective in nature, a prospective yield on

15   similarly rated long-term debt is essential. I relied on a

16   consensus forecast of about 50 economists of the expected

17   yield on Aaa-rated corporate bonds for the six calendar

18   quarters ending with the first calendar quarter of 2024, and

19   *Blue Chip's* long-term projections for 2024 to 2028 and 2029

20   to 2033. As shown on line 1, page 3 of Document No. 4, the

21   average expected yield on Moody's Aaa-rated corporate bonds

22   is 5.05 percent. In order to adjust the expected Aaa-rated

23   corporate bond yield to an equivalent A2-rated public utility

24   bond yield, I made an upward adjustment of 0.83 percent, which

25   represents a recent spread between Aaa-rated corporate bonds

1   and A2-rated public utility bonds, as shown on line 2 and

2   explained in note 2, page 3 of Document No. 4. Adding that

3   recent 0.83 percent spread to the expected Aaa-rated

4   corporate bond yield of 5.05 percent results in an expected

5   A2-rated public utility bond yield of 5.88 percent, as shown

6   on page 3 of Document No. 4. This corresponds to the average

7   Moody's long-term issuer rating of the Utility Proxy Group of

8   A2.

9

10   **Q.**   Please explain how the beta-derived equity risk premium is

11   determined.

12

13   **A.**   The components of the beta-derived risk premium model are:

14   (1) an expected market equity risk premium over corporate

15   bonds, and (2) the beta. The derivation of the beta-derived

16   equity risk premium that I applied to the Utility Proxy Group

17   is shown on lines 1 through 9, on page 8 of Document No. 4.

18   The total beta-derived equity risk premium I applied is based

19   on an average of three historical market data-based equity

20   risk premiums, two *Value Line*-based equity risk premiums, and

21   a Bloomberg-based equity risk premium. Each of these is

22   described below.

23

24   **Q.**   How did you derive a market equity risk premium based on long-

25   term historical data?

1   **A.**   To derive an historical market equity risk premium, I used

2   the most recent holding period returns for the large company

3   common stocks from the Stocks, Bonds, Bills, and Inflation

4   (SBBI) Yearbook 2022 ("SBBI-2022")[20] less the average

5   historical yield on Moody's Aaa/Aa-rated corporate bonds for

6   the period 1928 to 2021. Using holding period returns over

7   a very long time is appropriate because it is consistent with

8   the long-term investment horizon presumed by investing in a

9   going concern, *i.e.*, a company expected to operate in

10   perpetuity.

11

12   SBBI's long-term arithmetic mean monthly total return rate on

13   large company common stocks was 12.11 percent and the long-

14   term arithmetic mean monthly yield on Moody's Aaa/Aa-rated

15   corporate bonds was 5.98 percent, as explained in note 1,

16   page 9 of Document No. 4. As shown on line 1, page 8 of

17   Document No. 4, subtracting the mean monthly bond yield from

18   the total return on large company stocks results in a long-

19   term historical equity risk premium of 6.13 percent.

20

21   I used the arithmetic mean monthly total return rates for the

22   large company stocks and yields (income returns) for the

23   Moody's Aaa/Aa-rated corporate bonds, because they are

24   appropriate for the purpose of estimating the cost of capital

25   as noted in SBBI-2022.[21] Using the arithmetic mean return

1   rates and yields is appropriate because historical total

2   returns and equity risk premiums provide insight into the

3   variance and standard deviation of returns needed by

4   investors in estimating future risk when making a current

5   investment. If investors relied on the geometric mean of

6   historical equity risk premiums, they would have no insight

7   into the potential variance of future returns; the geometric

8   mean relates the change over many periods to a constant rate

9   of change, thereby obviating the year-to-year fluctuations,

10   or variance, which is critical to risk analysis.

11

12 **Q.** Please explain the derivation of the regression-based market

13   equity risk premium.

14

15 **A.** To derive the regression-based market equity risk premium of

16   7.26 percent shown on line 2, page 8 of Document No. 4, I

17   used the same monthly annualized total returns on large

18   company common stocks relative to the monthly annualized

19   yields on Moody's Aaa/Aa-rated corporate bonds as mentioned

20   above. I modeled the relationship between interest rates and

21   the market equity risk premium using the observed monthly

22   market equity risk premium as the dependent variable, and the

23   monthly yield on Moody's Aaa/Aa-rated corporate bonds as the

24   independent variable. I then used a linear Ordinary Least

25   Squares ("OLS") regression, in which the market equity risk

1   premium is expressed as a function of the Moody's Aaa/Aa-

2   rated corporate bond yield:

3        $RP = \alpha + \beta (R_{Aaa/Aa})$

4   Where:

5   RP = the market equity risk premium;

6   α = the regression intercept coefficient;

7   β = the regression slope coefficient; and

8            $R_{Aaa/Aa}$ = the Moody's Aaa/Aa-rated corporate bond

9   yield.

10

11   **Q.**   Please explain the derivation of the PRPM equity risk premium.

12

13   **A.**   I used the same PRPM approach described above to the PRPM

14   equity risk premium.   The inputs to the model are the

15   historical monthly returns on large company common stocks

16   minus the monthly yields on Moody's Aaa/Aa-rated corporate

17   bonds during the period from January 1928 through December

18   2022.[22]   Using the previously discussed GARCH method, the

19   projected equity risk premium is determined using Eviews©

20   statistical software.   The resulting PRPM predicted a market

21   equity risk premium of 9.76 percent (as shown on line 3, page

22   8 of Document No. 4).

23

24   **Q.**   Please explain the derivation of a projected equity risk

25   premium based on *Value Line* data for your RPM analysis.

1 **A.** As noted above, because both ratemaking and the cost of

2   capital are prospective, a prospective market equity risk

3   premium is needed. The derivation of the forecasted or

4   prospective market equity risk premium can be found in note

5   4, page 9 of Document No. 4. Consistent with my calculation

6   of the dividend yield component in my DCF analysis, this

7   prospective market equity risk premium is derived from an

8   average of the three- to five-year median market price

9   appreciation potential by *Value Line* for the 13 weeks ended

10   December 30, 2022, plus an average of the median estimated

11   dividend yield for the common stocks of the 1,700 firms

12   covered in *Value Line* (Standard Edition) (as explained in

13   detail in note 1, page 2 of Document No. 5).

14

15   The average median expected price appreciation is 71 percent,

16   which translates to a 14.35 percent annual appreciation, and

17   when added to the average of *Value Line's* median expected

18   dividend yields of 2.23 percent, equates to a forecasted

19   annual total return rate on the market of 16.58 percent. The

20   forecasted Moody's Aaa-rated corporate bond yield of 5.05

21   percent is deducted from the total market return of 16.58

22   percent, resulting in an equity risk premium of 11.53 percent,

23   as shown on line 4, page 8 of Document No. 4.

24

25 **Q.** Please explain the derivation of an equity risk premium based

1   on the S&P 500 companies.

2

3 **A.** Using data from *Value Line*, I calculated an expected total

4   return on the S&P 500 companies using expected dividend yields

5   and long-term growth estimates as a proxy for capital

6   appreciation. The expected total return for the S&P 500 is

7   15.67 percent. Subtracting the prospective yield on Moody's

8   Aaa-rated corporate bonds of 5.05 percent results in a 10.62

9   percent projected equity risk premium.

10

11 **Q.** Please explain the derivation of an equity risk premium based

12   on Bloomberg data.

13

14 **A.** Using data from Bloomberg, I calculated an expected total

15   return on the S&P 500 using expected dividend yields and long-

16   term growth estimates as a proxy for capital appreciation

17   identical to the method described above. The expected total

18   return for the S&P 500 is 11.06 percent. Subtracting the

19   prospective yield on Moody's Aaa-rated corporate bonds of

20   5.05 percent results in a 6.01 percent projected equity risk

21   premium.

22

23 **Q.** What is your conclusion of a beta-derived equity risk premium

24   for use in your RPM analysis?

25

1   **A.**   I gave equal weight to all six equity risk premiums based on

2   each source – historical, *Value Line*, and Bloomberg – in

3   arriving at an 8.55 percent equity risk premium, as shown on

4   page 8 of Document No. 4.

5

6   After calculating the average market equity risk premium of

7   8.55 percent, I adjusted it by beta to account for the risk

8   of the Utility Proxy Group. As discussed below, beta is a

9   meaningful measure of prospective relative risk to the market

10   as a whole, and is a logical way to allocate a company's, or

11   proxy group's, share of the market's total equity risk premium

12   relative to corporate bond yields. As shown on page 1 of

13   Document No. 5, the average of the mean and median beta for

14   the Utility Proxy Group is 0.76. Multiplying this beta by

15   the market equity risk premium of 8.55 percent results in a

16   beta-adjusted equity risk premium for the Utility Proxy Group

17   of 6.50 percent.

18

19 **Q.**   How did you derive the equity risk premium based on the S&P

20   Utility Index and Moody's A2-rated public utility bonds?

21

22 **A.**   I estimated three equity risk premiums based on S&P Utility

23   Index holding period returns, and two equity risk premiums

24   based on the expected returns of the S&P Utilities Index,

25   using *Value Line* and Bloomberg data, respectively. Turning

1   first to the S&P Utility Index holding period returns, I

2   derived a long-term monthly arithmetic mean equity risk

3   premium between the S&P Utility Index total returns of 10.74

4   percent and monthly Moody's A2-rated public utility bond

5   yields of 6.46 percent from 1928 to 2021, to arrive at an

6   equity risk premium of 4.28 percent (as shown on line 1, page

7   12 of Document No. 4). I then used the same historical data

8   to derive an equity risk premium of 4.80 percent based on a

9   regression of the monthly equity risk premiums. The final

10   S&P Utility Index holding period equity risk premium involved

11   applying the PRPM using the historical monthly equity risk

12   premiums from January 1928 to December 2022 to arrive at a

13   PRPM-derived equity risk premium of 5.56 percent for the S&P

14   Utility Index.

15

16   I then derived expected total returns on the S&P Utilities

17   Index of 9.50 percent and 9.20 percent using data from *Value*

18   *Line* and Bloomberg, respectively, and subtracted the

19   prospective Moody's A2-rated public utility bond yield of

20   5.88 percent (derived on line 3, page 3 of Document No. 4).

21   This resulted in equity risk premiums of 3.62 percent and

22   3.32 percent, respectively. As with the market equity risk

23   premiums, I averaged each risk premium based on each source

24   (*i.e.*, historical, *Value Line*, and Bloomberg) to arrive at my

25   utility-specific equity risk premium of 4.32 percent, as

1   shown on page 12 of Document No. 4.

2

3 Q.   How did you derive an equity risk premium of 4.71 percent

4   based on authorized ROEs for gas utilities?

5

6 A.   The equity risk premium of 4.71 percent shown on page 13 of

7   Document No. 4 is the result of a regression analysis based

8   on regulatory awarded ROEs related to the yields on Moody's

9   A2-rated public utility bonds, and contains the graphical

10   results of a regression analysis of 818 rate cases for

11   distribution natural gas utilities, which were fully

12   litigated during the period from January 1, 1980 through

13   December 30, 2022. It shows the implicit equity risk premium

14   relative to the yields on A2-rated public utility bonds

15   immediately prior to the issuance of each regulatory

16   decision. It is readily discernible that there is an inverse

17   relationship between the yield on A2-rated public utility

18   bonds and equity risk premiums. In other words, as interest

19   rates decline, the equity risk premium rises and vice versa,

20   a result consistent with financial literature on the

21   subject.[23] I used the regression results to estimate the

22   equity risk premium applicable to the projected yield on

23   Moody's A2-rated public utility bonds. Given the expected

24   A2-rated utility bond yield of 5.88 percent, it can be

25   calculated that the indicated equity risk premium applicable

1   to that bond yield is 4.71 percent.

2

3 **Q.** What is your conclusion of equity risk premium for use in

4   your total market approach RPM for the Utility Proxy Group?

5

6 **A.** The equity risk premium I applied to the Utility Proxy Group

7   is 5.18 percent, which is the average of the beta-adjusted

8   equity risk premium for the Utility Proxy Group, the S&P

9   Utilities Index, and the authorized return utility equity

10   risk premiums of 6.50 percent, 4.32 percent, and 4.71 percent,

11   respectively, as shown on page 7 of Document No. 4.

12

13 **Q.** What is the indicated RPM common equity cost rate based on

14   the total market approach?

15

16 **A.** As shown on line 5, page 3 of Document No. 4, I calculated a

17   common equity cost rate of 11.06 percent for the Utility Proxy

18   Group based on the total market approach RPM.

19

20 **Q.** What are the results of your application of the PRPM and the

21   total market approach RPM?

22

23 **A.** As shown on page 1 of Document No. 4, the indicated RPM-

24   derived common equity cost rate is 11.54 percent, which gives

25   equal weight to the results of the PRPM (12.02 percent) and

1   the adjusted-market approach (11.06 percent).

2

3 **C.**   **The Capital Asset Pricing Model**

4 **Q.**   Please explain the theoretical basis of the CAPM.

5

6 **A.**   CAPM theory defines risk as the co-variability of a security's

7   returns with the market's returns as measured by the beta

8   (β). A beta less than 1.0 indicates lower variability than

9   the market as a whole, while a beta greater than 1.0 indicates

10   greater variability than the market.

11

12   The CAPM assumes that all non-market or unsystematic risk can

13   be eliminated through diversification. The risk that cannot

14   be eliminated through diversification is called market, or

15   systematic, risk. In addition, the CAPM presumes that

16   investors only require compensation for systematic risk,

17   which is the result of macroeconomic and other events that

18   affect the returns on all assets. The model is applied by

19   adding a risk-free rate of return to a market risk premium,

20   which is adjusted proportionately to reflect the systematic

21   risk of the individual security relative to the total market

22   as measured by the beta. The traditional CAPM model is

23   expressed as:

24   R_s = R_f + β (R_m – R_f)

25   Where:

1   R_s = Return rate on the common stock;

2   R_f = Risk-free rate of return;

3   R_m = Return rate on the market as a whole; and

4   β = Adjusted beta (volatility of the security

5   relative to the market as a whole).

6

7   Numerous tests of the CAPM have measured the extent to which

8   security returns and beta are related as predicted by the

9   CAPM, confirming its validity. The empirical CAPM ("ECAPM")

10   reflects the reality that while the results of these tests

11   support the notion that the beta is related to security

12   returns, the empirical Security Market Line ("SML") described

13   by the CAPM formula is not as steeply sloped as the predicted

14   SML.[24]

15

16   The ECAPM reflects this empirical reality. Fama & French

17   clearly state regarding the figure in Document No. 11, below,

18   that "[t]he returns on the low beta portfolios are too high,

19   and the returns on the high beta portfolios are too low."[25]

20

21   In addition, Morin observes that while the results of these

22   tests support the notion that beta is related to security

23   returns, the empirical SML described by the CAPM formula is

24   not as steeply sloped as the predicted SML. Morin states:

25   With few exceptions, the empirical studies agree

1   that … low-beta securities earn returns somewhat

2   higher than the CAPM would predict, and high-beta

3   securities earn less than predicted.[26]

4   *   *   *

5   Therefore, the empirical evidence suggests that the

6   expected return on a security is related to its

7   risk by the following approximation:

8        $K = RF + x (RM - RF) + (1-x) \beta(RM - RF)$

9   where x is a fraction to be determined empirically.

10   The value of x that best explains the observed

11   relationship [is] Return = 0.0829 + 0.0520 β is

12   between 0.25 and 0.30. If x = 0.25, the equation

13   becomes:

14        $K = RF + 0.25(RM - RF) + 0.75 \beta(RM - RF)$[27]

15

16   Fama & French provide similar support for the ECAPM when they

17   state:

18   The early tests firmly reject the Sharpe-Lintner

19   version of the CAPM. There is a positive relation

20   between beta and average return, but it is too

21   'flat.'… The regressions consistently find that the

22   intercept is greater than the average risk-free

23   rate… and the coefficient on beta is less than the

24   average excess market return… This is true in the

25   early tests… as well as in more recent cross-

1   section regressions tests, like Fama and French

2   (1992).[28]

3

4   Finally, Fama & French further note:

5   Confirming earlier evidence, the relation between

6   beta and average return `for the ten portfolios is

7   much flatter than the Sharpe-Linter CAPM predicts.

8   The returns on low beta portfolios are too high,

9   and the returns on the high beta portfolios are too

10   low. For example, the predicted return on the

11   portfolio with the lowest beta is 8.3 percent per

12   year; the actual return as 11.1 percent. The

13   predicted return on the portfolio with the t beta

14   is 16.8 percent per year; the actual is 13.7

15   percent.[29]

16

17   Clearly, the justification from Morin and Fama & French, along

18   with their reviews of other academic research on the CAPM,

19   validate the use of the ECAPM. In view of theory and

20   practical research, I have applied both the traditional CAPM

21   and the ECAPM to the companies in the Utility Proxy Group and

22   averaged the results.

23

24 Q. What betas did you use in your CAPM analysis?

25

1 **A.** For the betas in my CAPM analysis, I considered two sources:

2 *Value Line* and Bloomberg. While both of these services adjust

3 their calculated (or "raw") beta to reflect their tendency to

4 regress to the market mean of 1.00, *Value Line* calculates

5 their beta over a five-year period, while Bloomberg

6 calculates theirs over a two-year period.

7

8 **Q.** Please describe your selection of a risk-free rate of return.

9

10 **A.** As discussed previously, the risk-free rate adopted for both

11 applications of the CAPM is 3.91 percent. This risk-free

12 rate is based on the average of the *Blue Chip* consensus

13 forecast of the expected yields on 30-year U.S. Treasury bonds

14 for the six quarters ending with the first calendar quarter

15 of 2024, and long-term projections for the years 2024 to 2028

16 and 2029 to 2033.

17

18 **Q.** Please explain the estimation of the expected risk premium

19 for the market used in your CAPM analysis.

20

21 **A.** The basis of the market risk premium is explained in detail

22 in note 1 on page 2 of Document No. 5. As discussed above,

23 the market risk premium is derived from an average of three

24 historical data-based market risk premiums, two *Value Line*

25 data-based market risk premiums, and one Bloomberg data-based

1 market risk premium.

2

3 The long-term income return on U.S. Government securities of

4 5.02 percent was deducted from the SBBI-2022 monthly

5 historical total market return of 12.37 percent, which

6 results in an historical market equity risk premium of 7.35

7 percent.[30] I applied a linear OLS regression to the monthly

8 annualized historical returns on the S&P 500 relative to

9 historical yields on long-term U.S. Government securities

10 from SBBI-2022. That regression analysis yielded a market

11 equity risk premium of 8.71 percent. The PRPM market equity

12 risk premium is 10.86 percent and is derived using the PRPM

13 relative to the yields on long-term U.S. Treasury securities

14 from January 1926 through December 2022, as shown on page 2

15 of Document No. 5.

16

17 The *Value Line*-derived forecasted total market equity risk

18 premium is derived by deducting the forecasted risk-free rate

19 of 3.91 percent, discussed above, from the *Value Line*

20 projected total annual market return of 16.58 percent,

21 resulting in a forecasted total market equity risk premium of

22 12.67 percent. The S&P 500 projected market equity risk

23 premium using *Value Line* data is derived by subtracting the

24 projected risk-free rate of 3.91 percent from the projected

25 total return of the S&P 500 of 15.67 percent. The resulting

1   market equity risk premium is 11.76 percent.

2

3   The S&P 500 projected market equity risk premium using

4   Bloomberg data is derived by subtracting the projected risk-

5   free rate of 3.91 percent from the projected total return of

6   the S&P 500 of 11.06 percent. The resulting market equity

7   risk premium is 7.15 percent. These six measures, when

8   averaged, result in an average total market equity risk

9   premium of 9.75 percent, as shown on page 2 of Document No.

10   5.

11

12 **Q.** What are the results of your application of the traditional

13   and empirical CAPM to the Utility Proxy Group?

14

15 **A.** As shown on page 1 of Document No. 5, the mean result of my

16   CAPM/ECAPM applied to the Utility Proxy Group is 11.54

17   percent, the median is 11.70 percent, and the average of the

18   two is 11.62 percent. Consistent with my reliance on the

19   average of mean and median DCF results discussed above, the

20   indicated common equity cost rate for each group using the

21   CAPM/ECAPM is 11.62 percent.

22

23 **D.** **Common Equity Cost Rates for a Proxy Group of Domestic,**

24   **Non-Price Regulated Companies Based on the DCF, RPM, and**

25   **CAPM**

1   Q.   Why do you also consider a proxy group of domestic, non-price

2   regulated companies?

3

4   A.   In the *Hope* and *Bluefield* cases, the U.S. Supreme Court did

5   not specify that comparable risk companies had to be

6   utilities. Since the purpose of rate regulation is to be a

7   substitute for marketplace competition, non-price regulated

8   firms operating in the competitive marketplace make an

9   excellent proxy if they are comparable in total risk to the

10   Utility Proxy Group being used to estimate the cost of common

11   equity. The selection of such domestic, non-price regulated

12   competitive firms theoretically and empirically results in a

13   proxy group which is comparable in total risk to the Utility

14   Proxy Group, since all of these companies compete for capital

15   in the exact same markets.

16

17   Q.   How did you select domestic, non-price regulated companies

18   that are comparable in total risk to the Utility Proxy Group?

19

20   A.   In order to select a proxy group of domestic, non-price

21   regulated companies similar in total risk to the Utility Proxy

22   Group, I relied on betas and related statistics derived from

23   *Value Line* regression analyses of weekly market prices over

24   the most recent 260 weeks (*i.e.*, five years). As shown on

25   Document No. 6, these selection criteria resulted in a proxy

1   group of 39 domestic, non-price regulated firms comparable in

2   total risk to the Utility Proxy Group. Total risk is the sum

3   of non-diversifiable market risk and diversifiable company-

4   specific risks. The criteria used in selecting the domestic,

5   non-price regulated firms were:

6   • They must be covered by *Value Line* (Standard Edition);

7   • They must be domestic, non-price regulated companies,

8   *i.e.,* not utilities;

9   • Their unadjusted betas must lie within plus or minus two

10   standard deviations of the average unadjusted beta of the

11   Utility Proxy Group; and

12   • The residual standard errors of the *Value Line*

13   regressions, which gave rise to the unadjusted betas, must

14   lie within plus or minus two standard deviations of the

15   average residual standard error of the Utility Proxy

16   Group.

17

18   Betas measure market, or systematic, risk, which is not

19   diversifiable. The residual standard errors of the

20   regressions measure each firm's company-specific,

21   diversifiable risk. Companies that have similar betas and

22   similar residual standard errors resulting from the same

23   regression analyses have similar total investment risk.

24

25 Q. Did you calculate the common equity cost rate using the DCF

1   model, the RPM, and the CAPM for the Non-Price Regulated Proxy

2   Group?

3

4 **A.** Yes. Because the DCF model, RPM, and CAPM have been applied

5   in an identical manner as described above, I will not repeat

6   the details of the rationale and application of each model.

7   One exception is in the application of the RPM, where I did

8   not use public utility-specific equity risk premiums because

9   these risk premiums are derived from utility-specific returns

10   and thus, are not applicable to non-price regulated

11   companies. Additionally, I did not apply the PRPM to the

12   individual non-price regulated companies due to a lack of

13   available data necessary to complete the analysis.

14

15   Page 2 of Document No. 7 derives the constant growth DCF model

16   common equity cost rate. As shown, the indicated common

17   equity cost rate, using the constant growth DCF for the Non-

18   Price Regulated Proxy Group comparable in total risk to the

19   Utility Proxy Group, is 11.57 percent.

20

21   Pages 3 through 5 of Document No. 7 contain the data and

22   calculations that support the 13.30 percent RPM common equity

23   cost rates. As shown on line 1, page 3 of Document No. 7,

24   the consensus prospective yield on Moody's Baa2-rated

25   corporate bonds for the six quarters ending in the first

1   quarter of 2024, and for the years 2024 to 2028 and 2029 to

2   2033, is 6.05 percent.[31] Since the Non-Price Regulated Proxy

3   Group has an average Moody's long-term issuer rating of Baa1,

4   a downward adjustment of 0.17 percent to the projected Baa2-

5   rated corporate bond yield is necessary to reflect a

6   difference in ratings which results in a projected Baa1-rated

7   corporate bond yield of 5.88 percent.

8

9   When beta-adjusted risk premiums of 7.42 percent (as derived

10   on page 5 of Document No. 7) relative to the Non-Price

11   Regulated Proxy Group is added to the adjusted prospective

12   Baa1 bond yield of 5.88 percent, the indicated RPM common

13   equity cost rate is 13.30 percent.

14

15   Page 6 of Document No. 7 contains the inputs and calculations

16   that support my indicated CAPM/ECAPM common equity cost rates

17   of 12.32 percent.

18

19 **Q.** What is the cost rate of common equity based on the Non-Price

20   Regulated Proxy Group comparable in total risk to the Utility

21   Proxy Group?

22

23 **A.** As shown on page 1 of Document No. 7, the results of the

24   common equity models applied to the Non-Price Regulated Proxy

25   Group – which group is comparable in total risk to the Utility

1   Proxy Group – are as follows: 11.57 percent (DCF), 13.30

2   percent (RPM), and 12.32 percent (CAPM).

3

4   The average of the mean and median of these models is 12.36

5   percent, which I used as the indicated common equity cost

6   rates for the Non-Price Regulated Proxy Group.   To be

7   conservative, I do not consider the results of this analysis

8   directly in my determination of the reasonable range of ROEs

9   attributable to the Utility Proxy Group.

10

11   **VI.**   **RANGE OF COMMON EQUITY COST RATES BEFORE ADJUSTMENTS**

12   **Q.**   What is the range of indicated common equity cost rates

13   produced by your ROE models?

14

15   **A.**   By applying multiple cost of common equity models to the

16   Utility Proxy Group and the Non-Price Regulated Proxy Group,

17   the indicated range of common equity cost rates attributable

18   to the Utility Proxy Group before any relative risk

19   adjustments is between 10.00 percent and 11.62 percent, as

20   shown on Document No. 1, page 2.   I used multiple cost of

21   common equity models as primary tools in arriving at my

22   recommended common equity cost rate, because no single model

23   is so inherently precise that it can be relied on to the

24   exclusion of other theoretically sound models.   Using

25   multiple models adds reliability to the estimated common

1   equity cost rate, with the prudence of using multiple cost of

2   common equity models supported in both the financial

3   literature and regulatory precedent.

4   As will be discussed below, Peoples has greater risk than the

5   Utility Proxy Group. Because of this, the indicated range of

6   model results based on the Utility Proxy Group must be

7   adjusted to reflect Peoples' greater relative risk.

8

9   **VII. ADJUSTMENTS TO THE COMMON EQUITY COST RATE**

10   **Q.**   What company-specific business risks did you consider for

11   your relative risk analysis?

12

13   **A.**   As detailed below, I have considered flotation costs. I also

14   considered Peoples' smaller relative size, as well as high

15   level of customer growth, overall performance, and capital

16   investment plans relative to the companies in the Utility

17   Proxy Group.

18

19   **A.**   **Flotation Costs**

20   **Q.**   What are flotation costs?

21

22   **A.**   Flotation costs are those costs associated with the sale of

23   new issuances of common stock. They include market pressure

24   and the mandatory unavoidable costs of issuance (*e.g.*,

25   underwriting fees and out-of-pocket costs for printing,

1   legal, registration, etc.). For every dollar raised through

2   debt or equity offerings, the company receives less than one

3   full dollar in financing.

4

5   **Q.** Has the Commission supported the use of flotation cost

6   adjustments in past rate proceedings?

7

8   **A.** Yes. In Peoples' 2008 rate proceedings, the Commission did

9   not make a specific adjustment for flotation costs but

10   recognized that "[t]his Commission has traditionally

11   recognized a reasonable adjustment for flotation costs in the

12   determination of the investor-required ROE."[32]

13

14   **Q.** Why is it important to recognize flotation costs in the

15   allowed common equity cost rate?

16

17   **A.** It is important because there is no other mechanism in the

18   ratemaking paradigm through which such costs can be

19   recognized and recovered. Because these costs are real,

20   necessary, and legitimate, recovery of these costs should be

21   permitted. As noted by Morin:

22   The costs of issuing these securities are just as

23   real as operating and maintenance expenses or costs

24   incurred to build utility plants, and fair

25   regulatory treatment must permit the recovery of

1   these costs….

2   The simple fact of the matter is that common equity

3   capital is not free….[Flotation costs] must be

4   recovered through a rate of return adjustment.[33]

5

6 Q. Should flotation costs be recognized whether or not there is

7   a stock issuance of additional shares during the test year?

8

9 A. Yes. As noted above, there is no mechanism to recapture such

10   costs in the ratemaking paradigm other than an adjustment to

11   the allowed common equity cost rate. Flotation costs are

12   charged to capital accounts and are not expensed on a

13   utility's income statement. As such, flotation costs are

14   analogous to capital investments, albeit negative, reflected

15   on the balance sheet. Recovery of capital investments relates

16   to the expected useful lives of the investment. Since common

17   equity has a very long and indefinite life (assumed to be

18   infinity in the standard regulatory DCF model), flotation

19   costs should be recovered through an adjustment to common

20   equity cost rate, even when there has not been an issuance

21   during the test year, or in the absence of an expected

22   imminent issuance of additional shares of common stock.

23

24   Historical flotation costs are a permanent loss of investment

25   to the utility and should be accounted for. When any company,

1   including a utility, issues common stock, flotation costs are

2   incurred for legal, accounting, printing fees and the like.

3   For each dollar of issuing market price, a small percentage

4   is expensed and is permanently unavailable for investment in

5   utility rate base.   Since these expenses are charged to

6   capital accounts and not expensed on the income statement,

7   the only way to restore the full value of that dollar of

8   issuing price with an assumed investor required return of

9   10.00 percent is for the net investment, $0.95, to earn more

10   than 10.00 percent to net back to the investor a fair return

11   on that dollar. In other words, if a company issues stock at

12   $1.00 with 5.00 percent in flotation costs, it will net $0.95

13   in investment. Assuming the investor in that stock requires

14   a 10.00 percent return on his or her invested $1.00 (*i.e.*, a

15   return of $0.10), the company needs to earn approximately

16   10.5 percent on its invested $0.95 to receive a $0.10 return.

17

18   Q. Do the common equity cost rate models you have used already

19   reflect investors' anticipation of flotation costs?

20

21   A. No. All of these models assume no transaction costs.   The

22   literature is quite clear that these costs are not reflected

23   in the market prices paid for common stocks. For example,

24   Brigham and Daves confirm this and provide the methodology

25   utilized to calculate the flotation adjustment.[34]   In

1   addition, Morin confirms the need for such an adjustment even

2   when no new equity issuance is imminent.[35] Consequently, it

3   is proper to include a flotation cost adjustment when using

4   cost of common equity models to estimate the common equity

5   cost rate.

6

7   **Q.**   How did you calculate the flotation cost allowance?

8

9   **A.**   I modified the DCF calculation to provide a dividend yield

10   that would reimburse investors for issuance costs in

11   accordance with the method cited in literature by Brigham and

12   Daves, as well as by Morin. The flotation cost adjustment

13   recognizes the actual costs of issuing equity that were

14   incurred by Emera in its equity issuances since 2016 when it

15   acquired Peoples. Based on the issuance costs shown on

16   Document No. 8, an adjustment of 0.12 percent is required to

17   reflect the flotation costs applicable to the Utility Proxy

18   Group.

19

20   **B.**   **Business Risk Adjustment**

21   **Q.**   Does Peoples' smaller size relative to the Utility Proxy Group

22   companies increase its business risk?

23

24   **A.**   Yes. Peoples' smaller size relative to the Utility Proxy

25   Group companies indicates greater relative business risk for

1   the company because, all else being equal, size has a material

2   bearing on risk.

3

4   Size affects business risk because smaller companies

5   generally are less able to cope with significant events that

6   affect sales, revenues, and earnings. For example, smaller

7   companies face more risk exposure to business cycles and

8   economic conditions, both nationally and locally.

9   Additionally, the loss of revenues from a few larger customers

10   would have a greater effect on a small company than on a

11   bigger company with a larger, more diverse, customer base.

12

13   As further evidence that smaller firms are riskier, investors

14   generally demand greater returns from smaller firms to

15   compensate for less marketability and liquidity of their

16   securities. Kroll's Cost of Capital Navigator: U.S. Cost of

17   Capital Module ("Kroll") discusses the nature of the small-

18   size phenomenon, providing an indication of the magnitude of

19   the size premium based on several measures of size. In

20   discussing "Size as a Predictor of Equity Returns," Kroll

21   states:

22   The size effect is based on the empirical

23   observation that companies of smaller size are

24   associated with greater risk and, therefore, have

25   greater cost of capital [sic]. The "size" of a

1 company is one of the most important risk elements

2 to consider when developing cost of equity capital

3 estimates for use in valuing a business simply

4 because size has been shown to be a *predictor* of

5 equity returns. In other words, there is a

6 significant (negative) relationship between size

7 and historical equity returns – as size *decreases*,

8 returns tend to *increase*, and vice versa. [Footnote

9 omitted] [Emphasis in original].[36]

10

11 Furthermore, in *The Capital Asset Pricing Model: Theory and*

12 *Evidence*, Fama & French note size is indeed a risk factor

13 which must be reflected when estimating the cost of common

14 equity. On page 38, they note:

15 . . . the higher average returns on small stocks

16 and high book-to-market stocks reflect unidentified

17 state variables that produce undiversifiable risks

18 (covariances) in returns not captured in the market

19 return and are priced separately from market

20 betas.[37]

21

22 Based on this evidence, Fama & French proposed their three-

23 factor model which includes a size variable in recognition of

24 the effect size has on the cost of common equity.

25

1   Also, it is a basic financial principle that the use of funds

2   invested, and not the source of funds, is what gives rise to

3   the risk of any investment.[38] Eugene Brigham, a well-known

4   authority, states:

5   A number of researchers have observed that

6   portfolios of small-firms (sic) have earned

7   consistently higher average returns than those of

8   large-firm stocks; this is called the "small-firm

9   effect." On the surface, it would seem to be

10   advantageous to the small firms to provide average

11   returns in a stock market that are higher than those

12   of larger firms. In reality, it is bad news for

13   the small firm; what the small-firm effect means is

14   that the capital market demands higher returns on

15   stocks of small firms than on otherwise similar

16   stocks of the large firms. [Emphasis added][39]

17

18   Consistent with the financial principle of risk and return

19   discussed above, increased relative risk due to small size

20   must be considered in the allowed rate of return on common

21   equity. Therefore, the Commission's authorization of a cost

22   rate of common equity in this proceeding must appropriately

23   reflect the unique risks of Peoples, including its smaller

24   relative size, which is justified and supported above by

25   evidence in the financial literature.

Q.   Is there a way to quantify a relative risk adjustment due to
     Peoples' smaller size relative to the Utility Proxy Group?

A.   Yes.   Peoples has greater relative risk than the average
     utility in the Utility Proxy Group because of its smaller
     size compared with the utilities in those groups, as measured
     by an estimated market capitalization of common equity for
     the company.

     As shown in page 1 of Document No. 9, Peoples' estimated
     market capitalization is approximately $2.180 billion,
     compared with the market capitalization of the average
     companies in the Utility Proxy Group of approximately $6.634
     billion as of December 30, 2022. The average companies in
     the Utility Proxy Group have a market capitalization of three
     times the size of Peoples' estimated market capitalization.
     As a proxy for the business risk adjustment, I used the SBBI-
     2022 size study. The determination is based on the size
     premiums for portfolios of New York Stock Exchange, American
     Stock Exchange, and NASDAQ listed companies ranked by deciles
     for the 1926 to 2021 period. The average size premium for
     the Utility Proxy Group with a market capitalization of
     approximately $6.634 billion falls in the 4th decile, while
     the company's estimated market capitalizations of $2.180
     billion places it in the 6th decile. The size premium spread

1   between the 4th decile and the 6th decile is 0.62 percent.

2

3 Q. Since Peoples is an indirectly owned operating subsidiary of

4   Emera, why is the size of the total company not more

5   appropriate to use when determining a business risk

6   adjustment?

7

8 A. The return derived in this proceeding will not apply to

9   Emera's operations as a whole, but only to Peoples. Emera is

10   the sum of its constituent parts, including those constituent

11   parts' ROEs. Potential investors in Emera are aware that it

12   is a combination of operations in each state, and that each

13   state's operations experience the operating risks specific to

14   their jurisdiction. The market's expectation of Emera's

15   return is commensurate with the realities of Emera's

16   composite operations in each of the states in which it

17   operates.

18

19 Q. Have you considered any other company-specific issues in

20   determining the company-specific business risk adjustment?

21

22 A. Yes, I have. In addition to the company's smaller relative

23   size, I have also considered the company's high level of

24   customer growth, overall performance, and capital expenditure

25   plans compared to the Utility Proxy Group companies in the

1   company-specific business risk adjustment.

2

3 **Q.**   Please describe the company's customer growth.

4

5 **A.**   As discussed in the direct testimony of Peoples witness Eric

6   Fox, the company has experienced strong customer growth over

7   the last five years, with average residential customer growth

8   of 4.3 percent and average commercial customer growth of 1.9

9   percent. As discussed by witness Fox, Peoples will continue

10   to experience relatively strong growth over the next five

11   years driven by projected household and economic growth. The

12   increased customer growth in the company's service territory

13   necessitates increased and accelerated capital investment.

14

15 **Q.**   Please discuss the company's high level of overall

16   performance.

17

18 **A.**   Based upon the metrics of J.D. Power, which are the industry

19   standard for reliability and service, Peoples is a

20   consistently high performing gas utility. Peoples received

21   the first, second, or third highest J.D. Power Customer

22   Satisfaction Index Score amongst their entire industry for

23   both their Residential and Business Gas Customer groups every

24   year for the past 10 years.[40] The J.D. Power Gas Customer

25   Satisfaction Score is a comprehensive analysis of how gas

1 utilities are performing from a customer standpoint. For 10

2 consecutive years, Residential Customers have given the

3 company the top J.D. Power Customer Satisfaction score

4 amongst mid-size natural gas utilities in the south region.[41]

5 The company's industry leading satisfaction scores are based

6 upon excellence in areas such as Safety & Reliability, Price,

7 Billing & Payment, Communication, Customer Care and Corporate

8 Citizenship.[42]

9

10 Q. Please briefly summarize the company's capital investment

11   plans.

12

13 A. Peoples currently plans to invest over $1.0 billion of capital

14   from January 1, 2022 to December 31, 2024,[43] which represents

15   approximately 60.00 percent of its 2021 year-end net utility

16   plant.[44] That amount includes investments in its distribution

17   facilities, which are necessary to support growth and to

18   maintain safe, sufficient, and reliable service.   As

19   discussed by witnesses McOnie and Parsons, the company will

20   require continued access to the capital markets, at

21   reasonable terms, to finance its capital spending plan. As

22   Peoples moves forward with its capital spending plan, timely

23   recovery of its capital costs is critical to mitigate the

24   delay of capital recovery and execute its capital spending

25   program.

1 **Q.** Do substantial capital expenditures directly relate to a

2 utility being allowed the opportunity to earn a return

3 adequate to attract capital at reasonable terms?

4

5 **A.** Yes, they do. The allowed ROE should enable the subject

6 utility to finance capital expenditures and working capital

7 requirements at reasonable rates, and to maintain its

8 financial integrity in a variety of economic and capital

9 market conditions. As discussed throughout my direct

10 testimony, a return adequate to attract capital at reasonable

11 terms enables the utility to provide safe, reliable service

12 while maintaining its financial soundness. To the extent a

13 utility is provided the opportunity to earn its market-based

14 cost of capital, neither customers nor shareholders should be

15 disadvantaged. These requirements are of particular

16 importance to a utility when it is engaged in a substantial

17 capital expenditure program.

18

19 The ratemaking process is predicated on the principle that,

20 for investors and companies to commit the capital needed to

21 provide safe and reliable utility services, the utility must

22 have the opportunity to recover the return of, and the market-

23 required return on, invested capital. Regulatory commissions

24 recognize that since utility operations are capital

25 intensive, regulatory decisions should enable the utility to

1   attract capital at reasonable terms; doing so balances the

2   long-term interests of the utility and its ratepayers.

3

4   Further, the financial community carefully monitors the

5   current and expected financial conditions of utility

6   companies, as well as the regulatory environment in which

7   those companies operate. In that respect, the regulatory

8   environment is one of the most important factors considered

9   in both debt and equity investors' assessments of risk. That

10   is especially important during periods in which the utility

11   expects to make significant capital investments and,

12   therefore, may require access to capital markets.

13

14   **Q.** Do credit rating agencies recognize risks associated with

15   increased capital expenditures?

16

17   **A.** Yes, they do. From a credit perspective, the additional

18   pressure on cash flows associated with high levels of capital

19   expenditures exerts corresponding pressure on credit metrics

20   and, therefore, credit ratings. S&P has noted several long-

21   term challenges for utilities' financial health including

22   heavy construction programs to address demand growth,

23   declining capacity margins, aging infrastructure, and

24   regulatory responsiveness to mounting requests for rate

25   increases.[45] More recently, S&P noted:

1   We assume that capital spending will remain a focus

2   of most utility managements and strain credit

3   metrics. It provides growth when sales are

4   diminished by ongoing demanded efficiency from

5   regulators and other trends, and it is welcomed by

6   policymakers that appreciate the economic stimulus

7   and the benefits of safer, more reliable service.

8   The speed with which the regulatory process turns

9   the new spending into higher rates to begin to pay

10   for it is an important factor in our assumptions

11   and the forecast. Any extended lag between spending

12   and recovery can exacerbate the negative effect on

13   credit metrics and therefore ratings.[46]

14

15 The rating agency views noted above also are consistent with

16 certain observations discussed in my direct testimony: (1)

17 the benefits of maintaining a strong financial profile are

18 significant when capital access is required and become

19 particularly acute during periods of market instability; and

20 (2) the Commission's decision in this proceeding will have a

21 direct bearing on the company's credit profile and its ability

22 to access the capital needed to fund its investments.

23

24 Q. How do the company's expected capital expenditures compare to

25 the Utility Proxy Group?

1 A. To reasonably make that comparison, I calculated the ratio of

2   expected capital expenditures to net plant for each company

3   in the Utility Proxy Group. I performed that calculation using

4   Peoples' total projected capital expenditures from January 1,

5   2022 to December 31, 2024 relative to its net plant for the

6   year ended December 31, 2021. As shown in Document No. 10,

7   Peoples   has   the   highest   ratio   of   projected   capital

8   expenditures to net plant relative to the Utility Proxy Group,

9   approximately 21.00 percent higher than the Utility Proxy

10   Group median.

11

12 Q. What are your conclusions regarding the effect of Peoples'

13   capital investment plans on its risk profile and cost of

14   capital?

15

16 A. It is clear that Peoples' capital investment plans relative

17   to net plant is larger than the median of the Utility Proxy

18   Group companies. It also is clear that equity investors and

19   credit   rating   agencies   recognize   the   additional   risks

20   associated with substantial capital expenditures.

21

22 Q. What is your conclusion regarding an adjustment for the

23   company's specific business risks?

24

25 A. Based on my analysis, a business risk adjustment of 0.20

1   percent is appropriate for Peoples to account for the

2   company's smaller size, as well as strong customer growth,

3   high level of performance, and capital investment plans,

4   relative to the Utility Proxy Group. Even though my analysis

5   of the company's smaller size relative to the Utility Proxy

6   Group indicates an upward size adjustment of 0.62 percent, I

7   conservatively applied an overall business risk adjustment of

8   0.20 percent to the results as shown on page 2 of Document

9   No. 1.

10

11   **Q.** Please summarize your adjustments to the indicated ranges of

12   ROEs applicable to the Utility Proxy Group.

13

14   **A.** The summary of my adjustments for the company-specific

15   business risks and flotation costs to the indicated ranges of

16   ROEs applicable to the Utility Proxy Group are summarized in

17   page 2 of Document No. 1. As shown, the range of ROEs

18   applicable to the company is between 10.32 percent and 11.70

19   percent.

20

21   **VIII.   CONCLUSION**

22   **Q.** What is your recommended ROE for Peoples?

23

24   **A.** Given the indicated ROE range applicable to the company of

25   10.32 percent to 11.70 percent, I conclude that an appropriate

1   ROE for the company is 11.00 percent.

2

3 **Q.**   In your opinion, is your proposed ROE of 11.00 percent fair

4   and reasonable to Peoples and its customers?

5

6 **A.**   Yes, it is.

7

8 **Q.**   In your opinion, is Peoples' proposed capital structure

9   consisting of 40.48 percent long-term debt and 54.68 percent

10   common equity fair and reasonable?

11

12 **A.**   Yes, it is.

13

14 **Q.**   Does this conclude your prepared direct testimony?

15

16 **A.**   Yes.

17

18

19

20

21

22

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24

25

 1   (Whereupon, prefiled rebuttal testimony of

 2   Dylan D'Ascendis was inserted.)

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BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 20230023-GU

PETITION FOR RATE INCREASE

BY PEOPLES GAS SYSTEM, INC.

REBUTTAL TESTIMONY AND EXHIBIT

OF

DYLAN W. D'ASCENDIS

ON BEHALF OF

PEOPLES GAS SYSTEM, INC.

1   BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

2   REBUTTAL TESTIMONY

3   OF

4   DYLAN W. D'ASCENDIS

5   ON BEHALF OF PEOPLES GAS SYSTEM, INC.

6

7 **I. INTRODUCTION**

8 **Q.** Please state your name, address, occupation, and employer.

9

10 **A.** My name is Dylan W. D'Ascendis. My business address is 3000

11   Atrium Way, Suite 200, Mount Laurel, New Jersey 08054. I am

12   employed by ScottMadden, Inc. as a Partner.

13

14 **Q.** Are you the same Dylan W. D'Ascendis who filed direct

15   testimony in this proceeding?

16

17 **A.** Yes, I am.

18

19 **II. PURPOSE, SUMMARY AND OVERVIEW**

20 **Q.** What is the purpose of your rebuttal testimony?

21

22 **A.** The purpose of my rebuttal testimony is two-fold. First, due

23   to the passage of time since the analysis in my direct

24   testimony, I have updated my return on equity ("ROE") analyses

25   to reflect more recent market data. Second, I respond to the

1 direct testimony of witness David J. Garrett, on behalf of

2 the Florida Office of Public Counsel ("OPC"), concerning

3 Peoples Gas System, Inc.'s ("Peoples" or the "Company") ROE

4 on its Florida rate base.

5

6 **Q.** Have you prepared an exhibit supporting your rebuttal

7 testimony?

8

9 **A.** Yes. I have prepared Exhibit No. DWD-2, comprising Document

10 Nos. 1 through 17, which have been prepared by me or under my

11 direction.

12 Document No. 1   Updated Cost of Common Equity Results

13 Document No. 2   Financial Profile of the Utility Proxy

14   Group

15 Document No. 3   Application of the Discounted Cash Flow

16   Model

17 Document No. 4   Application of the Risk Premium Model

18 Document No. 5   Application of the Capital Asset Pricing

19   Model

20 Document No. 6   Basis of Selection for the Non-Price

21   Regulated Companies Comparable in Total

22   Risk to the Utility Proxy Group

23 Document No. 7   Application of Cost of Common Equity

24   Models to the Non-Price Regulated Proxy

25   Group

1	Document No. 8	Derivation of the Flotation Cost
2		Adjustment to the Cost of Common Equity
3	Document No. 9	Derivation of the Indicated Size Premium
4		for Peoples Relative to the Utility Proxy
5		Group
6	Document No. 10	Comparison of Projected Capital
7		Expenditures Relative to Net Plant
8	Document No. 11	Relationship Between Investor Required
9		Returns on the Market and Authorized ROEs
10		for Electric and Natural Gas Utilities,
11		1990 – 2022
12	Document No. 12	Gross Domestic Product ("GDP") by
13		Industry, 1947 - 2022
14	Document No. 13	Evaluation of Implied Risk Premium
15		Approach
16	Document No. 14	Company Size and Volatility of Returns
17	Document No. 15	Flotation Cost Illustration
18	Document No. 16	Frequency Distribution of Observed
19		Market Risk Premiums ("MRP"), 1926 - 2022
20	Document No. 17	Referenced Endnotes for the Rebuttal
21		Testimony of Dylan W. D'Ascendis

22

23 **Q.** How is the remainder of your rebuttal testimony organized?

24

25 **A.** The remainder of my rebuttal testimony is organized as

1   follows:

2   • Section III – Provides my updated analyses;

3   • Section IV – Contains my response to OPC witness Garrett;

4   and

5   • Section V – Summarizes my recommendations and conclusions.

6

7 **Q.** Please summarize the key issues addressed in your rebuttal

8   testimony.

9

10 **A.** First, I discuss my updated analyses for the Company using

11   market data as of June 16, 2023, which continue to support my

12   initial ROE recommendation.

13

14   Next, I respond to witness Garrett's direct testimony

15   concerning the appropriate ROE for Peoples. As discussed in

16   Section IV, witness Garrett's shortcomings in his analyses

17   include:

18   1. How far disconnected his recommended ROE is from his own

19   analytical results and observable and relevant data;

20   2. His misinterpretation of the relationship between

21   various returns referenced in an ROE analysis;

22   3. His misapplication of the Discounted Cash Flow ("DCF")

23   model;

24   4. His misapplication of the Capital Asset Pricing Model

25   ("CAPM"); and

1   5.   His failure to consider flotation costs and other

2   Company-specific risk factors in his ROE recommendation.

3

4   Finally, my rebuttal testimony also addresses witness

5   Garrett's unfounded critiques of my direct testimony.

6

7   **Q.** Please summarize your recommendations and conclusions.

8

9   **A.** My updated analytical results indicate the reasonable range

10   of ROEs applicable to Peoples is between 9.89 percent and

11   12.03 percent. From my updated analyses, I maintain my

12   initial recommendation that the Florida Public Service

13   Commission (the "Commission") authorize Peoples the

14   opportunity to earn an ROE of 11.00 percent on its

15   jurisdictional rate base, based on its proposed ratemaking

16   capital structure. In view of current markets and the results

17   of my ROE models, the 9.00 percent ROE proffered by witness

18   Garrett is woefully inadequate.

19

20 **III. <u>UPDATED ANALYSES</u>**

21 **Q.** Have you updated your analyses to reflect current market

22   conditions?

23

24 **A.** Yes, I have. As noted above, given the passage of time since

25   my direct testimony analyses (data as of December 30, 2022),

1   I have updated my analyses using data as of June 16, 2023.

2

3   **Q.** Have you applied any of your ROE models differently in your

4   updated analyses?

5

6   **A.** No, I have not.

7

8   **Q.** What are the results of your updated analyses?

9

10 **A.** Using market data available as of June 16, 2023, my updated

11   analytical results are summarized in Document No. 1 of Exhibit

12   No. DWD-2. As presented on page 2 of Document No. 1, the

13   updated indicated range of common equity cost rates for the

14   Company is between 9.89 percent and 12.03 percent. Since my

15   original recommended ROE of 11.00 percent is within my updated

16   recommended reasonable range of ROEs applicable to Peoples,

17   I maintain my ROE recommendation of 11.00 percent for the

18   Company for ratemaking purposes.

19

20 **Q.** Did you consider the indicated ROE from your Non-Price

21   Regulated Proxy Group in the determination of your

22   recommended ROE in this proceeding?

23

24 **A.** No, I did not. As stated on page 6 of my direct testimony,

25   "I did not consider the ROE model results applied to my Non-

1   Price Regulated Proxy Group in the determination of my

2   recommended range." Because I did not rely on the results of

3   the Non-Price Regulated Proxy Group in my recommendation, and

4   in an effort to limit the scope of this rebuttal testimony,

5   I will not respond to any critiques of my Non-Price Regulated

6   Proxy Group even though I maintain the applicability of the

7   results of the model to the cost of common equity for

8   utilities.

9

10 **IV.   RESPONSE TO WITNESS. GARRETT**

11 **Q.** Please provide a brief summary of witness Garrett's analyses

12 and recommendations regarding Peoples' ROE.

13

14 **A.** Witness Garrett believes an ROE of 9.00 percent is reasonable

15 if the Commission approves his recommended imputed debt ratio

16 of 51.00 percent for Peoples; otherwise, he suggests the

17 Company's cost of equity is only 8.10 percent if the

18 Commission approves Peoples' proposed debt ratio of

19 approximately 45.00 percent.[1] Witness Garrett estimates the

20 ROE using the sustainable growth DCF model (7.50 percent) and

21 the CAPM (8.50 percent).[2]

22

23 **Q.** In what key areas are witness Garrett's analyses and

24 recommendations incorrect or unsupported?

25

1   **A.**   There are several areas in which witness Garrett's analyses

2   and conclusions are incorrect or unsupported, including: (1)

3   his recommended ROEs which are detached from his analytical

4   results; (2) his incorrect observation that authorized ROEs

5   have exceeded the investor-required return on the market for

6   30 years; (3) his misapplication of the DCF model; (4) his

7   misapplication of the CAPM; and (5) his failure to consider

8   flotation costs and other Company-specific risk factors in

9   his recommended ROE. Those points are discussed in turn,

10   below.

11

12   **A.**   **Recommended Return on Equity**

13   **Q.**   Are witness Garrett's analytical results and recommendation

14   reasonable measures of Peoples' ROE?

15

16   **A.**   No, they are not. Witness Garrett's recommended ROE of 9.00

17   percent is fundamentally disconnected from his own analyses

18   and conclusions. Throughout his testimony, witness Garrett

19   believes his analytical results indicate that the ROE range

20   for Peoples is between 7.50 and 8.50 percent,[3] which is

21   incorrect. His analytical model results of 8.50 percent and

22   lower are far removed from observable and relevant data,[4]

23   including the 2022 aggregated average authorized ROE of 9.53

24   percent for gas utilities provided in his testimony.[5] While

25   I appreciate the need for judgment in developing ROE

E5-113

1	recommendations, I believe there should be some empirical
2	basis for them. Since witness Garrett's 9.00 percent
3	recommendation is removed from his analytical model results,
4	we cannot assess the basis of his ultimate recommendation,
5	empirical or otherwise.
6	
7	**Q.** Has witness Garrett also disregarded the results of his
8	analytical models in determining his recommended ROE in other
9	proceedings?
10	
11	**A.** Yes, he has done so in several proceedings. For example, in
12	Docket No. 20200051-GU before the Commission, witness Garrett
13	noted that his analysis indicates the "true" ROE for the
14	Company to be 6.90 percent, yet he recommended a 9.50 percent
15	ROE.[6] Given that witness Garrett's analyses point to a lower
16	return than what he ultimately recommended, it is unclear the
17	extent to which witness Garrett relies on the analysis he
18	presents as they clearly have no correlation with his
19	recommendation.
20	
21	**Q.** Do you agree with witness Garrett's recommendation to the
22	Commission regarding the use of "gradualism" in determining
23	the appropriate ROE for the Company?
24	
25	**A.** No, I do not. I believe witness Garrett argues that the

1   Commission should apply the ratemaking concept of

2   "gradualism" to move Peoples' ROE higher than his purported

3   ROE based on his analytical results because he recognizes

4   that his ROE, if implemented, would be confiscatory and

5   illegal and he needs a different policy argument to avoid

6   that result.[7] The role of ROE witnesses is to testify

7   regarding the return required by equity investors, i.e., the

8   ROE at a given point in time, and therefore, the application

9   of "gradualism" is inappropriate.

10

11 Q. Please summarize witness Garrett's views on the relationship

12   between the cost of equity, the investor-required ROE, and

13   the awarded ROE for regulated utilities.

14

15 A. Witness Garrett initially correctly points out that the

16   required return from the investor's perspective is synonymous

17   with the cost of capital from the utility's perspective, but

18   then states that he believes the above specified returns are

19   different, yet related concepts.[8] Witness Garrett's views

20   regarding the relationship between allowed and investor-

21   required ROEs for utilities change throughout the course of

22   his testimony.

23

24   For example, on page 15 of his testimony, witness Garrett

25   discusses the equivalency of the cost of equity and the

1   awarded ROE, stating:

2   The *Hope* Court makes it clear that the allowed

3   return should be based on the actual cost of

4   capital. Under the rate base rate of return model,

5   a utility should be allowed to recover all its

6   reasonable expenses, its capital investments

7   through depreciation, and a return on its capital

8   investments sufficient to satisfy the required

9   return of its investors. The "required return" from

10   the investors' perspective is synonymous with the

11   "cost of capital" from the utility's perspective.

12   Scholars agree that the allowed rate of return

13   should be based on the actual cost of capital:

14   Since by definition the cost of capital of a

15   regulated firm represents precisely the

16   expected return that investors could

17   anticipate from other investments while

18   bearing no more or less risk, and since

19   investors will not provide capital unless the

20   investment is expected to yield its

21   opportunity cost of capital, the

22   correspondence of the definition of the cost

23   of capital with the court's definition of

24   legally required earnings appears clear.[9,10]

25

1   Then, on page 16 of his testimony, witness Garrett contradicts

2   his above testimony by stating that awarded ROEs and cost of

3   equity (i.e., investor-required returns) are very different

4   concepts because of the regulatory process that may be

5   influenced by factors other than objective market drivers.[11]

6

7   Witness Garrett continues to change his position regarding

8   the equivalency, or non-equivalency, of the allowed and

9   required ROE, sometimes in consecutive sentences.   For

10   example, on page 16 of his testimony, witness Garrett states

11   that "The two concepts [allowed and required ROEs] are related

12   in that the legal and technical standards encompassing this

13   issue require that the awarded return reflect the true cost

14   of capital. On the other hand, the two concepts are different

15   in that the legal standard do not mandate that awarded returns

16   exactly match the cost of capital."[12]

17

18 Q. What is your reaction to witness Garrett's views on the

19   relationship between allowed and required ROEs for utility

20   companies?

21

22 A. Witness Garrett is unnecessarily complicating a simple

23   relationship. For regulated utilities, the ROE equals the

24   investor-required ROE which equals the allowed ROE, as

25   reflected in the *Hope* and *Bluefield* Supreme Court decisions

1   cited in both my direct testimony[13] and witness Garrett's

2   testimony.[14]   This relationship holds because utility

3   regulation by regulatory commissions acts as a substitute for

4   competition.

5

6 **Q.**   Is the concept of utility regulation as a substitute for

7   market competition widely accepted as a fact and reflected as

8   such in academic literature?

9

10 **A.**   Yes, it is. The *Cost of Capital Manual*, which is the training

11   manual for the Society of Utility and Financial Analysts, of

12   which witness Garrett and I are members, states:

13   In a sense, the "visible hand of public regulation

14   was (created) to replace the invisible hand of Adam

15   Smith in order to protect consumers against

16   exorbitant charges, restriction of output,

17   deterioration of service, and unfair

18   discrimination."[footnote omitted]

19   ***

20   As indicated above, regulation of public utilities

21   reflects a belief that the competitive mechanism

22   alone cannot be relied upon to protect the public

23   interest. Essentially, it is theorized that a

24   truly competitive market involving utilities cannot

25   survive and, thereby, will fail to promote the

1 general economic welfare. But this does not mean

2 that regulation should alter the norm of

3 competitive behavior for utilities. On the

4 contrary, the primary objective of regulation is to

5 produce market results (*i.e.,* price and quantity

6 supplied) in the utility sectors of the economy

7 closely approximating those conditions which would

8 be obtained if utility rates and services were

9 determined competitively.[15]

10

11 Additionally, in *Principles of Public Utility Rates*, Dr.

12 Bonbright states:

13 Lest the reader of this chapter gain the impression

14 that it is intended to deny the relevance of any

15 tests of reasonable rates derived from the theory

16 or the behavior of competitive prices, let me state

17 my conviction that no such conclusion would be

18 warranted. On the contrary, a study of price

19 behavior both under assumed conditions of pure

20 competition and under actual conditions of mixed

21 competition is essential to the development of

22 sound principles of utility rate control. Not only

23 that: any good program of public utility rate

24 making must go a certain distance in accepting

25 competitive-price principles as guides to monopoly

1   pricing. For rate regulation must necessarily try

2   to accomplish the major objectives that unregulated

3   competition is designed to accomplish; and the

4   similarity of purpose calls for a considerable

5   degree of similarity of price behavior.

6   Regulation, then, as I conceive it, is indeed a

7   substitute for competition; and it is even a partly

8   imitative substitute. But so is a Diesel

9   locomotive a partly imitative substitute for a

10   steam locomotive, and so is a telephone message a

11   partly imitative substitute for a telegraph

12   message. What I am trying to emphasize by these

13   crude analogies is that the very nature of a

14   monopolistic public utility is such as to preclude

15   an attempt to make the emulation of competition

16   very close. The fact, for example, that theories

17   of pure competition leave no room for rate

18   discrimination, while suggesting a reason for

19   viewing the practice with skepticism, does not

20   prove that discrimination should be outlawed. And

21   a similar statement would apply alike to the use of

22   an original-cost or a fair value rate base, neither

23   of which is defensible under the theory or practice

24   of competitive pricing.[16]

25

1   Finally, Dr. Phillips states in *The Regulation of Public*

2   *Utilities*:

3   Public utilities are no longer, if they ever were,

4   isolated from the rest of the economy. It is

5   possible that the expanding utility sector has been

6   taking too large a share of the nation's resources,

7   especially of investment.[footnote omitted] At a

8   minimum, regulation must be viewed in the context

9   of the entire economy – and evaluated in a similar

10   context. Public utilities have always operated

11   within the framework of a competitive system. They

12   must obtain capital, labor and materials in

13   competition with unregulated industries. Adequate

14   profits are not guaranteed to them. Regulation

15   then, should provide incentives to adopt new

16   methods, improve quality, increase efficiency, cut

17   costs, develop new markets and expand output in

18   line with customer demand. In short, regulation is

19   a substitute for competition and should attempt to

20   put the utility sector under the same restraints

21   competition places on the industrial sector.[17]

22

23   In view of the legal standard cited by me and witness Garrett,

24   and treatises on regulation likening regulation of utilities

25   and the competitive market, it is plain to see that allowed

1   returns and investor-required returns are also equal.

2

3 Q. Do you have any concerns with witness Garrett's 8.10 percent

4   ROE estimate if the Company's proposed capital structure is

5   approved?

6

7 A. Yes, I do. Witness Garrett derives his 8.10 percent ROE

8   estimate using the Hamada model, which can be used to adjust

9   the cost of equity based on changes in the debt ratio,

10   assuming Peoples' proposed debt ratio of approximately 45.00

11   percent.[18] To estimate the change in the cost of equity based

12   on the change in the debt ratio, witness Garrett had to assume

13   a debt ratio to estimate the unlevered Beta coefficient

14   ("beta"). Witness Garrett's assumption that 51.00 percent is

15   an appropriate debt ratio for the proxy group is unfounded.

16

17 Q. Why do you disagree with witness Garrett's assumed 51.00

18   percent debt ratio?

19

20 A. While I agree that it is reasonable to review the capital

21   structures of the proxy companies, the range of common equity

22   ratios depicts the range of typical or proper equity ratios

23   maintained by comparable risk companies. As shown in witness

24   Garrett's Exhibit DJG-15, the Company's proposed debt ratio

25   is within the range of the proxy companies. Because Peoples'

1   requested capital structure is consistent with the proxy

2   companies, witness Garrett's Hamada adjustment, and his

3   adjustment to the ROE to reflect Peoples' proposed capital

4   structure, is unnecessary and should be ignored.

5

6 **B.** **Witness Garrett's Incorrect Observations that Allowed ROEs**

7   **for Utilities Exceed the Investor-Required Return on the**

8   **Market**

9 **Q.** Please summarize witness Garrett's claim that allowed returns

10   for utility companies exceed the required return on the

11   market.

12

13 **A.** Witness Garrett estimates the investor-required return on the

14   market by adding the annual average 10-year Treasury bond

15   yield to a MRP calculated by the New York University School

16   of Business for the period 1990-2022.[19] He then compares that

17   return to the average annual authorized returns for electric

18   utilities over that same period[20] to support his argument that

19   "awarded ROEs have been consistently above the market cost of

20   equity for many years."[21] Witness Garrett further argues that

21   the excess returns awarded to utilities result in a transfer

22   of wealth from customers to shareholders.[22]

23

24   Witness Garrett also refers to an article published in Public

25   Utilities Fortnightly,[23] suggesting that utility stocks have

1   outperformed the broader market and will continue to do so in

2   the future.

3

4 Q. What is your response to witness Garrett's observations and

5   the conclusions he draws from them?

6

7 A. Witness Garrett's observations and resulting conclusions are

8   misguided. As a preliminary matter, witness Garrett's

9   conclusion that allowed returns for utility companies exceed

10   the required return on the market is merely his opinion and

11   is driven by the inputs he has chosen to estimate the required

12   return on the market. As discussed below, applying more

13   reasonable models and inputs demonstrate allowed ROEs average

14   about 71 percent of the required return on the market,

15   consistent with utility betas over the period from 1990-

16   2022.]

17

18   The Public Utilities Fortnightly article referenced by

19   witness Garrett was published in August 2016 and relied on

20   data from August 31, 2004 to June 28, 2016. Shortly after

21   that date, the 30-year Treasury yield fell to its prior

22   cyclical low of 2.11 percent on July 8, 2016. Between July

23   and December 2016, the utility sector, as represented by

24   witness Garrett's proxy group, lost 9.17 percent of its value

25   as the broader market (measured by the S&P 500) increased by

1   5.11 percent. That is, despite the article's conviction that

2   utilities would continue to outperform the market, shortly

3   after its publication utility stocks meaningfully

4   underperformed the broad market. From August 2016 through

5   June 16, 2023, the utility sector (measured by the XLU and

6   the Dow Jones Utility Average) significantly underperformed

7   the S&P 500.[24] The premise and conclusion of the article

8   witness Garrett relies on, therefore, were essentially

9   immediately disproven.

10   Finally, regarding witness Garrett's required return on the

11   market, I disagree with his calculation of the implied MRP

12   because reasonable changes in his assumptions have

13   considerable effects on the calculation (as will be discussed

14   in detail in my critique of witness Garrett's CAPM analysis).

15

16 **Q.** Have you calculated the investor-required return on the

17   market for the period from 1990-2022?

18

19 **A.** Yes, I have. Using the Predictive Risk Premium Method

20   ("PRPM"),[25] I calculated the investor-required MRP for every

21   month in the period from 1990-2022. I then averaged the

22   monthly MRPs for each year and added the average 30-year

23   Treasury bond yield to those averages to arrive at investor-

24   required returns on the market for each year.

25

1 **Q.** How did you derive the investor-required return on the market

2   using the PRPM?

3

4 **A.** As explained in my direct testimony, the inputs to the PRPM

5   are the historical returns on large capitalization stocks

6   minus the historical monthly yield on long-term U.S. Treasury

7   securities for the period from January 1990 through December

8   2022.[26] Using a generalized form of ARCH,[27] known as GARCH,

9   each projected MRP was determined using Eviews© statistical

10   software. When the GARCH model is applied to the historical

11   returns data, it produces a predicted GARCH variance series

12   and a GARCH coefficient. I then averaged the monthly

13   investor-required return for each year to determine an annual

14   investor-required return, and then added the annual average

15   long-term government bond yield for each year[28] to arrive at

16   annual investor-required returns on the market for the period

17   from 1990-2022.

18

19   Next, I compared the investor-required return on the market

20   to the average allowed ROEs for natural gas and electric

21   utilities for each year. As shown on page 2 of Document No.

22   11, the investor-required return on the market is

23   consistently, and significantly, higher than the allowed

24   returns for natural gas distribution utility companies.

25   These results make intuitive sense, as the ratio of allowed

1   ROE versus required market return averages about 0.71, which

2   is consistent with utility betas over the period.] Given the

3   above, witness Garrett's claim that allowed ROEs for

4   utilities exceed investor-required market returns is simply

5   incorrect. In addition, witness Garrett's claim that the

6   excess returns awarded to utilities result in a transfer of

7   wealth from customers to shareholders[29] is also misplaced.

8   Document No. 11 shows that utilities have not been awarded

9   excess returns.

10

11   **C.   <u>Misapplication of the DCF Model</u>**

12   **Q.**   Please briefly describe witness Garrett's constant growth DCF

13   analyses and results.

14

15   **A.**   Witness Garrett applied "sustainable" growth rates to the

16   constant growth DCF Model, which produced an ROE estimate of

17   7.50 percent.[30] For the dividend yield component, witness

18   Garrett relied on annualized dividend payments and 30-day

19   average stock prices as of May 25, 2023.[31] To estimate

20   expected growth, witness Garrett looked to two measures: (1)

21   nominal Gross Domestic Product ("GDP") and (2) real GDP.[32] Of

22   those two measures, he chose the highest estimate, 3.90

23   percent.[33]

24

25   **Q.**   What are your general concerns with the growth rates on which

1   witness Garrett's DCF analyses rely?

2

3   A.   First, witness Garrett assumed a single, perpetual growth

4   rate of 3.90 percent for all his proxy companies.[34]   By

5   reference to the Congressional Budget Office's expected

6   inflation rate of 1.70 percent, witness Garrett's method

7   assumed his proxy companies all will grow at real rates of

8   approximately 2.20 percent, in perpetuity.[35]   It is unlikely

9   an investor would be willing to assume the risks of equity

10   ownership in exchange for expected growth only modestly

11   greater than expected inflation. The risk simply is not worth

12   the expected return.[36]

13   For the same reason stated above, witness Garrett's remaining

14   growth rate estimate (presented in Exhibit DJG-6) is also not

15   an appropriate measure of growth for his DCF analysis.

16

17   Finally, as a practical matter, because they are generic in

18   nature, his estimates fail to account for the risks and

19   prospects faced by the proxy companies.

20

21   Q.   What other concerns do you have with the 3.90 percent growth

22   rate assumed for all companies in witness Garrett's DCF

23   analysis?

24

25   A.   Witness Garrett's 3.90 percent growth rate is not based on

1   any measure of company-specific growth, or growth in the

2   utility industry in general. Rather, his proxy group serves

3   the sole purpose of calculating the dividend yield. Under

4   the DCF model's strict assumptions, however, expected growth

5   and dividend yields are inextricably related. Witness

6   Garrett's assumption that one growth rate applies to all

7   companies, even though dividend yields vary across those

8   companies, has no basis in theory or practice.

9

10   **Q.** Witness Garrett also offers his thoughts regarding the need

11   for qualitative analyses in developing expected growth

12   rates.[37] What is your response to witness Garrett's

13   observations?

14

15   **A.** Witness Garrett suggests that although equity analysts may

16   consider quantitative factors, such as historical growth in

17   revenues or earnings, they also should consider "qualitative"

18   factors, such as how a given company may meet some level of

19   "sustainable" growth.[38] He further observes unregulated

20   companies have options not available to utilities, and

21   suggests it would be more appropriate to consider factors

22   such as load growth in measuring growth rate expectations for

23   utilities.[39]

24

25   There is no question analysts consider qualitative factors.

1   To that point, I reviewed transcripts of various utility

2   earnings conference calls demonstrating that analysts focus

3   on issues relating to operating expenses, required capital

4   investments, rate relief, and other factors that affect the

5   earned returns on common equity and, therefore, the

6   sustainable growth estimate.[40] These inquiries reflect the

7   type of considerations analysts typically consider for

8   utility companies.

9

10   In the case of just one of his proxy companies, therefore,

11   the level of fundamental research performed by analysts on

12   issues directly related to long-term growth reflects a

13   variety of factors, both quantitative and qualitative. They

14   certainly go beyond "mere increases to rate base or

15   earnings."[41] The analysts' research also far exceeded witness

16   Garrett's limited perspective that load growth forecasts,

17   together with other "qualitative factors", support his 3.90

18   percent expected growth rate.

19

20 Q. It is witness Garrett's opinion that growth in a DCF model is

21   limited by the long-term growth in GDP.[42] Why is long-term

22   growth in GDP not an upper limit for terminal growth as

23   witness Garrett contends?

24

25 A. First, GDP is not a market measure – rather it is a measure

1   of the value of the total output of goods and services,

2   excluding inflation, in an economy. While I understand that

3   earnings per share ("EPS") growth is also not a market

4   measure, it is well established in the financial literature

5   that projected growth in EPS is the superior measure of

6   dividend growth in a DCF model.[43] Furthermore, GDP is simply

7   the sum of all private industry and government output in the

8   United States, and its growth rate is simply an average of

9   the value of those industries. To illustrate, Document No.

10   12 presents the compound annual growth rate of the industries

11   that comprise GDP from 1947 to 2022. Of the 15 industries

12   represented, seven industries (including utilities) grew

13   faster than the overall GDP, and eight industries grew slower

14   than the overall GDP.[44] Given that utilities have grown faster

15   than the overall GDP over the 1947-2022 time period, I

16   disagree with witness Garrett's suggestion that "it is

17   reasonable to conclude that the long-term growth of a domestic

18   firm cannot outpace the growth rate of the aggregate economy

19   in which it operates."[45]

20

21 **Q.** Did you conduct another analysis that calculates the amount

22   of time it would take an industry to overtake the entire

23   economy?

24

25 **A.** Yes. I examined the value added by industry from 1947 to

1   2022 in Document No. 12 and used the compound annual growth

2   rates for the highest growth rate industry (i.e., Educational

3   Services, Healthcare, and Social Assistance at 8.53 percent

4   per year) to see when that industry would comprise the entire

5   economy. In the year 2327, or 380 years from the 1947

6   starting point, the industry would comprise over 50 percent

7   of GDP, and in the year 8982, or 7,035 years after the 1947

8   starting point, the industry would comprise 100 percent of

9   GDP.[46] Not only have individual companies or industries

10   consistently grown at rates beyond GDP growth, but they have

11   done so without overtaking the entire economy. While witness

12   Garrett's argument may be technically correct, it is

13   unrealistic at best.

14

15 Q. Please respond to witness Garrett's comment regarding

16   "steady-state" growth rates.

17

18 A. On page 36 of his direct testimony, witness Garrett states,

19   "it is not necessary to use multi-stage DCF Models to analyze

20   the cost of equity of regulated utility companies. This is

21   because regulated utilities are already in their

22   'sustainable,' low growth stage." While I agree with witness

23   Garrett's statement regarding regulated utilities being in

24   the "mature" stage in the company/industry life cycle, I

25   disagree with his conclusion regarding the long-term growth

1   rates of regulated utilities.

2

3   As witness Garrett describes, the multi-stage DCF and its

4   growth rates reflect the company/industry life cycle, which

5   is typically described in three stages: (1) the growth stage,

6   which is characterized by rapidly expanding sales, profits,

7   and earnings. In the growth stage, dividend payout ratios

8   are low in order to grow the firm; (2) the transition stage,

9   which is characterized by slower growth in sales, profits,

10   and earnings. In the transition stage, dividend payout ratios

11   increase, as their need for exponential growth diminishes;

12   and (3) the maturity (steady-state) stage, which is

13   characterized by limited, slightly attractive investment

14   opportunities, and steady earnings growth, dividend payout

15   ratios, and returns on equity.

16

17   Since the utility industry is in the mature phase of the

18   company life cycle, it is the company-specific projected EPS

19   growth rate that is the appropriate measure of growth in a

20   constant growth DCF model, not the projected GDP growth rate

21   as witness Garrett asserts.

22

23   Q. Are there examples in basic finance texts that support your

24   position?

25

1   **A.**   Yes.   For example, in <u>Investments</u>, life cycles and multi-

2   stage growth models are discussed:

3   As useful as the constant-growth DDM (dividend

4   discount model) formula is, you need to remember

5   that it is based on a simplifying assumption,

6   namely, that the dividend growth rate will be

7   constant forever.   In fact, firms typically pass

8   through life cycles with very different dividend

9   profiles in different phases.   In early years,

10   there are ample opportunities for profitable

11   reinvestment in the company.   Payout ratios are

12   low, and growth is correspondingly rapid.   In later

13   years, the firm matures, production capacity is

14   sufficient to meet market demand, competitors enter

15   the market, and attractive opportunities for

16   reinvestment may become harder to find.   In this

17   mature phase, the firm may choose to increase the

18   dividend payout ratio, rather than retain earnings.

19   The dividend level increases, but thereafter it

20   grows at a slower pace because the company has fewer

21   growth opportunities.

22

23   Table 18.2 illustrates this pattern.   It gives

24   Value Line's forecasts of return on assets,

25   dividend payout ratio, and 3-year growth in

earnings per share for a sample of the firms in the computer software industry versus those of east coast electric utilities…

By in large, the software firms have attractive investment opportunities. The median return on assets of these firms is forecast to be 19.5%, and the firms have responded with high plowback ratios. Most of these firms pay no dividends at all. The high return on assets and high plowback result in rapid growth. The median growth rate of earnings per share in this group is projected at 17.6%.

In contrast, the electric utilities are *more representative of mature firms*. Their median return on assets is lower, 6.5%; dividend payout is higher, 68%; and median growth is lower, 4.6%.

                                    ***

To value companies with temporarily high growth, analysts use a multistage version of the dividend discount model. Dividends in the early high-growth period are forecast and their combined present value is calculated. Then, once the firm is projected to settle down to *a steady-growth phase, the constant-growth DDM is applied to value the*

1   *remaining stream of dividends*.[47] (Clarification and

2   emphasis added)

3

4   The economics of the public utility business indicate that

5   the industry is in the steady-state, or constant-growth stage

6   of a multi-stage DCF, which would mean that the three- to

7   five-year projected growth rates for each company would be

8   the "steady-state" or terminal growth rate appropriate for

9   the DCF model for utility companies, not the GDP growth rate,

10   which is not a company-specific growth rate, nor is it an

11   upward bound for growth, as discussed previously.

12

13 **Q.** Witness Garrett expressed a concern about using analysts'

14   projected EPS growth rates because he asserts that analysts

15   consider rate base growth in their projected growth rates and

16   that utilities' natural financial incentive is to increase

17   rate base regardless of customer needs.[48] Please respond.

18

19 **A.** The overall premise of witness Garrett's concern is without

20   merit and should be dismissed. First, regulated utilities

21   are only allowed to earn returns on and of assets that are

22   considered used and useful in serving the needs of its

23   customers. As the U.S. Supreme Court decision in *Duquesne*

24   *Light Co. v. Barasch* states:

25   To the *extent* utilities' investments turn out to be

1   bad ones (such as plants that are cancelled and so

2   never used and useful to the public), the utilities

3   suffer because the investments have no fair value

4   and so justify no return.[49]

5

6   Additionally, capital projects undertaken by utility

7   companies are often subject to prudency reviews from

8   regulatory commissions, which would allow commissions to

9   review and deny any capital project not deemed in the public

10   interest. These two facts would eliminate any type of

11   investment by the utility that is not needed to expressly

12   provide safe, reliable service to their customers. Because

13   of this, equity analysts appropriately consider growth in

14   rate base in determining their recommended growth rates for

15   utilities.

16

17   Finally, witness Garrett should recognize two things: (1)

18   utility assets degrade over time and eventually need to be

19   replaced; and (2) the assets replacing the degraded assets

20   are usually significantly more expensive than the degraded

21   assets. Because of this, rate base will grow consistently *ad

22   infinitum*, which supports both the utility industry's mature

23   position on the company/industry lifecycle regarding steady

24   and predictable growth, and the use of company-specific

25   projected analysts' EPS growth rates for use in the constant

1   growth DCF model.

2

3 **Q.** Witness Garrett claims undue reliance on projected EPS growth

4   rates in the DCF model will lead to upward spiraling ROEs for

5   utility companies due to a feedback loop.[50] Please respond.

6

7 **A.** As witness Garrett shows in his Figure 7 concerning annual

8   authorized returns, an upward spiraling ROE simply does not

9   exist. The independence of authorized ROEs and market data

10   is consistent with conclusions reached by Bonbright, who

11   states:

12   In the first place, commissions cannot forecast,

13   except within wide limits, the effect their rate

14   orders will have on the market prices of the stocks

15   of the companies they regulate. In the second

16   place, *whatever the initial market prices may be,*

17   *they are sure to change not only with the changing*

18   *prospects for earnings, but with the changing*

19   *outlook of an inherently volatile stock market*. In

20   short, market prices are beyond the control, though

21   not beyond the influence of rate regulation.

22   Moreover, even if a commission did possess the

23   power of control, any attempt to exercise it ...

24   would result in harmful, uneconomic shifts in

25   public utility rate levels (emphasis added).[51]

1 **D.** __Misapplication of the Capital Asset Pricing Model__

2 **Q.** Please summarize witness Garrett's CAPM analysis and results.

3

4 **A.** Witness Garrett's CAPM estimate relied on a risk-free rate of

5 3.81 percent,[52] an MRP of 5.60 percent,[53] and betas as reported

6 by *Value Line Investment Services ("Value Line")*.[54] Those

7 assumptions combined to produce an average CAPM estimate of

8 8.50 percent.[55]

9

10 **Q.** Do you agree with witness Garrett's CAPM analysis?

11

12 **A.** No, I do not. I disagree with witness Garrett's sole reliance

13 on historical Treasury yields to estimate the risk-free rate

14 and the various methods he used to estimate the MRP. Just as

15 important as our methodological differences, however, is our

16 difference regarding the reasonableness and reliability of an

17 analysis that produces ROE estimates of 8.50 percent.

18

19 **Q.** How did witness Garrett derive his MRP estimate?

20

21 **A.** Witness Garrett estimated his MRP by reviewing: (1) a survey

22 of expected returns from IESE Business School (5.70 percent);

23 (2) an expected return reported by Kroll (6.00 percent); (3)

24 implied MRP from Damodaran (5.10 percent); and (4) an "Implied

25 Equity Risk Premium" calculation (5.50 percent).[56] Based on

1   those results, witness Garrett concluded that 5.60 percent,

2   the average of his range, is appropriate.

3

4 Q. Do any of the surveys cited by witness Garrett provide support

5   for your approach to estimating the current MRP?

6

7 A. Yes. As discussed in my direct testimony,[57] I calculated *ex-*

8   *ante* MRPs in a similar manner to a study by Pablo Fernandez,

9   *et al* (cited by witness Garrett), using the market

10   capitalization-weighted constant growth DCF calculation on

11   the individual companies in the S&P 500 Index.[58]

12

13 Q. Is there academic literature that supports the conclusion

14   that MRPs using surveys are not widely used by practitioners?

15

16 A. Yes. Damodaran, who was cited by witness Garrett throughout

17   his testimony, states the following about the applicability

18   of survey MRPs:

19   While survey premiums have become more accessible,

20   very few practitioners seem to be inclined to use

21   the numbers from these surveys in computations and

22   there are several reasons for this reluctance:

23   1.   Survey risk premiums are responsive to recent

24   stock prices movements, with survey numbers

25   generally increasing after bullish periods and

1   decreasing after market decline. Thus, the

2   peaks in the SIA survey premium of individual

3   investors occurred in the bull market of 1999,

4   and the more moderate premiums of 2003 and

5   2004 occurred after the market collapse in

6   2000 and 2001.

7 2. Survey premiums are sensitive not only to whom

8   the question is directed at but how the

9   question is asked. For instance, individual

10   investors seem to have higher (and more

11   volatile) expected returns on equity than

12   institutional investors and the survey numbers

13   vary depending upon the framing of the

14   question.[footnote omitted]

15 3. In keeping with other surveys that show

16   differences across sub-groups, the premium

17   seems to vary depending on who gets surveyed.

18   Kaustia, Lehtoranta and Puttonen (2011)

19   surveyed 1,465 Finnish investment advisors and

20   note that not only are male advisors more

21   likely to provide an estimate but that their

22   estimated premiums are roughly 2% lower than

23   those obtained from female advisors, after

24   controlling for experience, education and

25   other factors.[footnote omitted]

4.   Studies that have looked at the efficacy of survey premiums indicate that if they have any predictive power, it is in the wrong direction. Fisher and Statman (2000) document the negative relationship between investor sentiment (individual and institutional) and stock returns.[footnote omitted] In other words, investors becoming more optimistic (and demanding a larger premium) is more likely to be a precursor to poor (rather than good) market returns.

As technology aids the process, the number and sophistication of surveys of both individual and institutional investors will also increase. However, it is also likely that these survey premiums will be more reflective of the recent past rather than good forecasts of the future.[59]

Q. What is your position on the 6.00 percent MRP quoted by Kroll?

A. A forecast is only as good as its inputs, and if the assumptions within those forecasts are by its nature unpredictable (e.g., productivity growth forecasts), they are of little value. In addition, the determination of the MRP as calculated by Kroll is not transparent, especially in view

1   of the historical data presented in <u>2023 SBBI® Yearbook,</u>

2   <u>Stocks, Bonds, Bills, and Inflation</u> ("SBBI-2023"), or the

3   composition of its supply side method, which are already well

4   known by investors. Because of the transparency of the

5   historical data and how to gather and use the components of

6   the supply side model, both the historical MRP (using the

7   long-term arithmetic mean return on large company stocks less

8   the long-term arithmetic income returns on long-term

9   Government bonds) and the supply side model are superior

10 measures of the MRP, when comparing to Kroll's simplistic and

11 opaque MRP forecast.

12

13 **Q.** Please now describe the method by which witness Garrett

14 calculated his fourth estimate, the implied MRP.

15

16 **A.** As witness Garrett points out, his method developed the

17 Internal Rate of Return that sets equal the current value of

18 the market index to the projected value of cash flows

19 associated with owning the market index.[60] Witness Garrett

20 observes that Damodaran "promotes the implied ERP method."[61]

21 Although there are some differences, witness Garrett's

22 approach is similar to the model Damodaran provides on his

23 website.[62]

24

25 Witness Garrett's method, which is a two-stage form of the

1 DCF model, calculated the present value of cash flows over

2 the five-year initial period, together with the terminal

3 price (based on the Gordon Model[63]), to be received in the

4 last (i.e., fifth) year. The model's principal inputs include

5 the following assumptions:

6 • Over the coming five years, the S&P 500 Index (the "Index")

7   will appreciate at a rate equal to the compound growth rate

8   in "Operating Earnings" from 2012 through 2022;

9 • Cash flows associated with owning the Index will be equal

10   to the historical average earnings, dividends, and buyback

11   yields, applied to the projected Index value each year;

12   and

13 • Beginning in the terminal year, the Index will appreciate,

14   in perpetuity, at a rate equal to the 30-day average yield

15   on 30-year Treasury securities, as of May 25, 2023.[64]

16

17 As discussed below, reasonable changes to those assumptions

18 have a considerable effect on witness Garrett's calculated

19 expected market return.

20

21 **Q.** Do you have any observations regarding witness Garrett's

22   assumed first-stage growth rate?

23

24 **A.** Yes. Witness Garrett's 6.64 percent growth rate relates to

25   growth in operating earnings, and does not reflect capital

1 appreciation, growth in dividends, or buy-backs.[65]   In

2 addition, if witness Garrett's position is that historical

3 growth rates are meant to reflect expected future growth,

4 they should reflect year-to-year variation (i.e.,

5 uncertainty). That is best accomplished using the arithmetic

6 mean.   I therefore calculated the average growth (i.e.,

7 arithmetic mean) for the four metrics included in witness

8 Garrett's exhibit as shown on Document No. 13. The average

9 growth rate, 9.79 percent, produced an estimated market

10 return of about 10.02 percent,[66] which is still well below

11 historical experience.

12

13 **Q.** Why did the market return increase by only 76 basis points

14 (from 9.26 percent to 10.02 percent) when the first-stage

15 growth rate increased by 315 basis points (from 6.64 percent

16 to 9.79 percent)?

17

18 **A.** Because witness Garrett's model assumed the first stage lasts

19 for five years (and the terminal stage is perpetual), the

20 results are sensitive to changes in the assumed terminal

21 growth rate. To put that effect in perspective, the terminal

22 value (which is directly related to the terminal growth rate)

23 represents approximately 76.90 percent of the "Intrinsic

24 Value" in witness Garrett's analysis.[67]

25

1 **Q.** How did witness Garrett develop his assumed terminal growth

2 rate?

3

4 **A.** The terminal growth rate represents investors' expectations

5 of the rate at which the broad stock market will grow, in

6 perpetuity, beginning in the terminal year. Witness Garrett

7 assumed terminal growth is best measured by the average yield

8 on 30-year Treasury securities over the 30 days ended May 25,

9 2023. That is, witness Garrett assumed the average 30-year

10 Treasury yield between April 14, 2023 and May 25, 2023 is the

11 best measure of expected earnings growth beginning five years

12 from now and extending indefinitely into the future.

13

14 **Q.** Do you agree with witness Garrett's assumption?

15

16 **A.** No, I do not. I recognize witness Garrett followed the

17 approach described in Damodaran's method, which Damodaran

18 refers to as a "default" assumption.[68] In terms of historical

19 experience, over the long-term the broad economy has grown at

20 a long-term compound average growth rate of approximately

21 6.09 percent.[69] Considered from another perspective, Kroll

22 reports the long-term rate of capital appreciation on Large

23 Company stocks to be 7.90 percent.[70] Witness Garrett's model

24 assumes, however, that the market index will grow by a rate

25 almost 280 basis points below that amount, 5.11 percent, over

1   the coming four years.[71]

2

3   Witness Garrett has not explained why growth beginning five

4   years in the future, and extending in perpetuity, will be

5   less than one-half of long-term historical growth.[72] From a

6   somewhat different perspective, assuming long-term inflation

7   will be approximately 2.00 percent[73] implies perpetual real

8   growth will be approximately 1.78 percent.[74] Nowhere in his

9   testimony has witness Garrett explained the fundamental,

10   systemic changes that would so dramatically reduce long-term

11   economic growth, or why they are best measured by the long-

12   term Treasury yield over 30 days between April 14, 2023 to

13   May 25, 2023.

14

15   Further, research by the Federal Reserve Bank of San Francisco

16   calls into question the relationship between interest rates

17   and macroeconomic growth. As the authors noted, "[o]ver the

18   past three decades, it appears that private forecasters have

19   incorporated essentially no link between potential growth and

20   the natural rate of interest: The two data series have a zero

21   correlation."[75]

22

23 Q.   Please briefly summarize your response to witness Garrett's

24   Implied Equity Risk Premium calculation.

25

1   A.   Witness Garrett's calculation is based on a series of

2   questionable assumptions, to which a small set of very

3   reasonable adjustments produces a market return estimate more

4   consistent with (yet still below) the historical experience

5   he considers relevant. Although the revised results still

6   produce ROE estimates far below any reasonable measure, they

7   do point out the sensitive nature of witness Garrett's

8   analyses, and the tenuous nature of the conclusions he draws

9   from them.

10

11 Q.   Does witness Garrett employ an Empirical CAPM ("ECAPM") in

12   his CAPM analysis?

13

14 A.   No, he does not. Witness Garrett fails to consider the ECAPM,

15   despite the fact that numerous tests of the CAPM have

16   confirmed that the empirical security market line ("SML")

17   described by the traditional CAPM is not as steeply sloped as

18   the predicted SML.   Because of the empirical findings

19   presented in my direct testimony[76], witness Garrett should

20   have considered the ECAPM in his CAPM analysis.

21

22 E.   **Adjustments to the Cost of Common Equity**

23 Q.   Does witness Garrett consider a business risk adjustment in

24   his recommended ROE for Peoples?

25

1   A.   No, he does not. Witness Garrett argues that "[i]nvestors do

2   not require additional compensation for assuming these firm-

3   specific business risks."[77] In addition, he states that firm-

4   specific risk factors should not be considered when

5   estimating Peoples' cost of equity.[78]

6

7   Q.   Do you agree with witness Garrett's observations?

8

9   A.   No, I do not. As discussed on pages 7-10 of my direct

10   testimony, when determining an appropriate ROE, the relevant

11   issue is where investors see the subject company in relation

12   to other similarly situated utility companies. To the extent

13   investors view a company as being exposed to higher risk, the

14   required return will increase, and vice versa. Peoples'

15   smaller size relative to the Utility Proxy Group companies

16   indicates greater relative business risk for the Company

17   because, all else being equal, size has a material bearing on

18   risk.

19

20   Q.   Did witness Garrett address the issue of a size premium in

21   his testimony?

22

23   A.   Yes. Witness Garrett lists several reasons for his decision

24   to not include a size premium in his recommendation,

25   including: (1) numerous studies show that "the performance of

1   large-cap stocks was basically equal to that of small cap

2   stocks,"[79] and (2) that the "discovery of the size effect

3   phenomenon likely caused its own demise."[80]

4

5   **Q.** Is witness Garrett's review of the size premium correct?

6

7   **A.** No, it is not. First, witness Garrett notes that after 1983,

8   U.S. small-cap stocks underperformed large-cap stocks.[81] The

9   issue with witness Garrett's position is that the size premium

10 measures the increased risk associated with a company's

11 smaller size; witness Garrett is only focused on returns. As

12 I discussed in my direct testimony, smaller companies face

13 increased business risk as they are less equipped to cope

14 with significant events that affect sales, revenues, and

15 earnings, as the loss of a few larger customers will have a

16 greater effect on a smaller company than a larger company.[82]

17

18 This is further evident when we consider that increasing

19 capital costs (i.e., risk) for one set of securities will put

20 downward pressure on those securities as investors transition

21 to securities with lower risk. Under this premise, the

22 underperformance is directly tied to the increase in risk.

23 As such, witness Garrett's premise that smaller companies'

24 underperformance indicates a reduction of risk is in fact the

25 opposite – underperformance indicates an increasing level of

1 risk.

2

3 Q. Witness Garrett points to a passage published in 2015 by

4   Ibbotson[83] that states that the size premium no longer exists.

5   What is your response?

6

7 A. Despite their findings, Kroll (which now owns Ibbotson)

8   continues to publish data on their findings on the presence

9   of a size premium in the market, and has provided additional

10   measures of size and relative risk premiums. In addition to

11   market capitalization, Kroll includes book common equity,

12   market value of invested capital, five-year average net

13   income, five-year average earnings before interest, taxes,

14   depreciation and amortization, total assets, total sales, and

15   total employees as valid measures of size from which relative

16   size premiums are derived. If Kroll found that the size

17   premium ceased to exist, it would not publish that it did.

18

19 Q. Do you agree with witness Garrett that the size effect no

20   longer exists?

21

22 A. No, I do not. While the historical returns of large companies

23   may have outperformed small utilities over the last several

24   years, risk is measured by volatility, not returns. A study

25   by Clifford Ang detailed the returns and volatility of returns

1   of companies by size, showing while larger companies out-

2   performed smaller companies, smaller companies exhibited more

3   risk.[84] Reviewing data from the same source as the Ang study,

4   I replicated the study through May 2023. Document No. 14

5   presents the largest monthly gain and loss for each value-

6   weighted decile for the period 1981 through May 2023. As

7   shown in Document No. 14, small capitalization stocks exhibit

8   more volatility (i.e., risk) in their returns than larger

9   capitalization stocks.

10

11 Further, SBBI-2023 shows that the total return of large-cap

12 stocks over the 1926-2022 period has a standard deviation of

13 19.8 percent, compared to 31.2 percent for small-cap stocks,

14 echoing the findings of Document No. 14.[85] The higher level

15 of risk indicates a higher level of required return.

16

17 **Q.** Did witness Garrett address the issue of flotation costs in

18   his testimony?

19

20 **A.** Yes. Witness Garrett reasons that flotation costs for stock

21   issuances are not out-of-pocket costs, which investors

22   already have considered when deciding to invest in a company's

23   shares at a given market price.[86] On that basis, he argues

24   against considering the effect of flotation costs in setting

25   the Company's ROE.

1 Q.   What is your response to witness Garrett regarding the need

2   to recover flotation costs?

3

4 A.   First, witness Garrett's observation that underwriter fees

5   are not "out-of-pocket" expenses[87] is a distinction without a

6   meaningful difference. Whether paid directly or indirectly

7   through an underwriting discount, the cost results in net

8   proceeds that are less than the gross proceeds. As shown in

9   Document No. 8, because those costs were incurred, the net

10   proceeds were less than the gross proceeds. Whether the

11   issuer wrote a check or received the proceeds at a discount

12   does not matter. What does matter is that issuance costs are

13   a permanent reduction to common equity, and absent a recovery

14   of those costs, the issuing company will not be able to earn

15   its required return.

16

17   Lastly, as shown in the illustrative examples provided in

18   Document No. 15,[88] because of flotation costs, an authorized

19   return of 10.85 percent would be required to realize an ROE

20   of 10.75 percent (i.e., a 10-basis point flotation cost

21   adjustment). If flotation costs are not recovered, the growth

22   rate falls and the ROE decreases to 10.65 percent (i.e., below

23   the required return).[89]

24

25 Q.   Is the fact that investors are aware of equity issuance costs

1   when they decide to purchase stock[90] relevant to the

2   determination of the appropriate compensation for those

3   costs?

4

5 **A.**   No, it is not. Although witness Garrett suggests current

6   prices account for flotation costs, he has not provided any

7   explanation as to how market prices compensate shareholders

8   for flotation costs or any analyses to support his position.

9   In that important respect, common stock is closely analogous

10   to long-term debt, both in the sense that its purpose is to

11   provide funding for long-term investments that are part of

12   rate base, and that it remains a part of the utility's

13   operations over the long run. Equity flotation costs and

14   debt issuance expenses both are necessary and legitimate

15   costs enabling the investment in assets needed to provide

16   safe and reliable utility service; both should be recovered.

17

18 **F.**   **Response to Witness Garrett's Critiques of Company**

19   **Testimony**

20 **Q.**   Does witness Garrett have any critiques of your analyses

21   presented in your direct testimony?

22

23 **A.**   Yes, he does. Witness Garrett's critiques of my direct

24   testimony are: (1) my requested ROE is in excess of the

25   investor-required return on the market; (2) my growth rates

1 used in the DCF model exceed GDP growth; (3) my MRP is

2 unreasonable because it is not in line with his MRP estimates;

3 (4) my use of the ECAPM; (5) my use of a non-regulated proxy

4 group; (6) my inclusion of a small size premium is

5 unnecessary; and (7) my application of flotation costs.

6

7 I have already addressed critiques 1, 2, 4, 6 and 7 previously

8 and will not address them here. I will discuss witness

9 Garrett's remaining arguments in turn.

10

11 **Q.** Witness Garrett states that your MRP is unreasonable in view

12 of his measures of MRP as presented in his CAPM analysis.[91]

13 Please respond.

14

15 **A.** I have discussed the inapplicability of witness Garrett's MRP

16 estimates for cost of capital purposes previously in this

17 rebuttal testimony and will not repeat that discussion here.

18 Since witness Garrett's MRP measures are not valid MRPs, they

19 cannot be comparable to my MRP estimates. Even though witness

20 Garrett has presented no reliable evidence upon which to gauge

21 the reasonableness of the MRP estimate, my estimates of 9.75

22 percent and 10.01 percent in my direct and rebuttal

23 testimonies, respectively, are consistent with actual

24 realized MRPs. As shown in Document No. 16, , my estimates

25 fall within the 53rd and 54th percentile of historical MRPs,

1   respectively.

2

3   Given all of the above, my calculation of the MRPs in my CAPM

4   and ECAPM analyses is reasonable in view of historical returns

5   and other expected measures of the MRP and is supported by

6   financial literature. Thus, witness Garrett's concern should

7   be dismissed.

8

9 **Q.** Please summarize witness Garrett's argument against using a

10   non-price regulated proxy group similar in total risk to a

11   utility proxy group to determine an indicated ROE for Peoples

12   in this proceeding.

13

14 **A.** Witness Garrett opines that there is no marginal benefit for

15   running a CAPM or DCF model on a group of non-regulated, non-

16   utility companies. Additionally, witness Garrett believes

17   that competitive firms typically have higher levels of risk

18   than utilities.[92]

19

20 **Q.** Do you agree with witness Garrett's reasoning?

21

22 **A.** No. As a preliminary matter, as noted on page 6 of my direct

23   testimony, in an effort to be conservative, I have not

24   directly considered the results of my Non-Price Regulated

25   Proxy Group analyses in determining my recommended ROE range.

1   However, I have used the results of those analyses as a check

2   on the reasonableness of my analytical models.

3

4   Regarding witness Garrett's claim that there is no marginal

5   benefit to running my Non-Price Regulated Proxy Group

6   analysis, this directly contradicts his own claim that "[i]t

7   is preferable to use multiple models because the results of

8   any one model may contain a degree of imprecision."[93] Because

9   regulation is a substitute for competition, the application

10   of cost of common equity models to comparable risk, non-

11   regulated companies produces a marginal benefit that cannot

12   be replicated using utility companies.

13

14 Q. Does witness Garrett discuss risk and relevance of risk for

15   cost of capital purposes in his testimony?

16

17 A. Yes. In Section V of his direct testimony, witness Garrett

18   discusses risk and return concepts in general. On page 28 of

19   his direct testimony, witness Garrett states: "Market risk is

20   the only type of risk that is rewarded by the market and is

21   thus the primary type of risk the Commission should consider

22   when determining the allowed return."

23

24 Q. How does your selection criteria for your Non-Price Regulated

25   Proxy Group fit into the above discussion?

1   **A.**   Following witness Garrett's logic, given that unadjusted

2   betas are measures of market risk (the primary measure of

3   risk according to witness Garrett), and one of my screening

4   criteria was to generate companies with similar unadjusted

5   betas as the Utility Proxy Group, my Non-Price Regulated Proxy

6   Group, by his definition, would be comparable to my Utility

7   Proxy Group.

8

9   **Q.**   Does witness Garrett look to non-price regulated companies in

10   any of his analyses?

11

12   **A.**   Yes.   In assessing Peoples' capital structure, witness

13   Garrett reviews the debt ratios of competitive industries.[94]

14   The major mistake in witness Garrett's analysis is the same

15   mistake he falsely accuses me of.   In his comparisons of the

16   capital structures of non-regulated industries to Peoples, he

17   does not evaluate the industries' market risk in comparison

18   to Peoples.   If witness Garrett evaluated the market risk

19   (i.e., unadjusted betas) of those industries, he would have

20   found that those industries are not comparable to utility

21   companies like Peoples.   Using witness Garrett's own source,

22   Damodaran, the average unadjusted beta of the industries that

23   have debt ratios over 45.32 percent is 0.56, whereas the

24   Utility (General) unadjusted beta is 0.41.

25

1 Q. Please summarize your discussion regarding the use of non-
2   price regulated proxy groups in cost of capital analyses for
3   regulated utilities.
4

5 A. The use of non-price regulated proxy groups in cost of capital
6   analyses for regulated utility companies should be considered
7   by regulatory commissions as another tool in the tool kit to
8   determine the ROE for a utility, provided that the non-price
9   regulated proxy group is shown to be of comparable risk. The
10   Non-Price Regulated Proxy Group used in my analyses was
11   screened using measures of systematic and unsystematic risk,
12   to show similar total risk. Witness Garrett's non-price
13   regulated industry study was not screened for any risk aside
14   from financial risk, which, as stated previously, is not a
15   proxy for total risk. For these reasons, my Non-Price
16   Regulated Proxy Group analyses should be considered by the
17   Commission while witness Garrett's non-price regulated
18   industry analyses should be rejected by the Commission.
19

20 V. **SUMMARY**

21 Q. Should any or all of the arguments made by witness Garrett
22   persuade the Commission to lower the ROE it approves for
23   Peoples below your recommendation?
24

25 A. No, they should not. Based on the analyses discussed

1   throughout my rebuttal testimony, and given the current

2   capital market conditions, I believe that the reasonable

3   range of ROE estimates for Peoples is from 9.89 percent to

4   12.03 percent, and 11.00 percent continues to be a reasonable,

5   although conservative, estimate of the Company's ROE.

6

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

8

9 **A.** Yes, it does.

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1   BY MR. MEANS:

2   **Q   And, Mr. D'Ascendis, did you also prepare and**

3   **cause to be filed in it your direct testimony DWD-1**

4   **consisting of 13 documents?**

5   A   I did.

6   **Q   And did you also prepare and cause to be filed**

7   **with your rebuttal testimony in Exhibit DWD-2 consisting**

8   **of 17 documents?**

9   A   Yes, sir.

10   MR. MEANS: Mr. Chairman, Peoples would note

11   for the record that Exhibits DWD-1 and 2 have been

12   identified on the comprehensive exhibit list as

13   Exhibits 20 and 30.

14   CHAIRMAN FAY: Okay. So noted.

15   BY MR. MEANS:

16   **Q   Mr. D'Ascendis, would you please summarize**

17   **your prepared direct and rebuttal testimony?**

18   A   Sure.

19   Good afternoon, Commissioners. Thank you for

20   the opportunity to appear today. My name is Dylan

21   D'Ascendis. I am a partner at ScottMadden, Inc.

22   The purpose of my testimony is to provide a

23   recommendation regarding the return on common equity,

24   also referred to as the ROE for the cost of equity for

25   Peoples Gas System, which I also refer to as Peoples, as

1   well as provide an assessment of the company's capital

2   structure to be used for ratemaking purposes.

3   Please note that I filed direct testimony on

4   behalf of Peoples, as well as submitted rebuttal

5   testimony to respond to Florida Office of Public Counsel

6   witness David J. Garrett with respect to the company's

7   ROE in this case.

8   In view of capital markets and the results of

9   the analytical models presented in my testimony, a

10 reasonable range of ROEs applicable to Peoples is

11 between 9.89 percent and 12.03 percent. Within that

12 range, I recommend that the Commission authorize an ROE

13 of 11 percent for Peoples. My recommended ROE considers

14 a variety of factors that affect the required return to

15 equity investors in the company.

16   My testimony discusses the multiple analytical

17 approaches that were evaluated to develop my ROE

18 recommenda -- recommendation -- sorry. My testimony

19 explains that no single model is so inherently precise

20 that it could be relied upon to the excuse -- to the

21 exclusion of other theoretically sound models. Using

22 multiple models adds to the reliability of the estimated

23 common equity cost rate with the prudence of using

24 multiple counts of common equity models are supported in

25 both the financial literature and regulatory process.

1   In my testimony, I discuss the market rates,

2   common equity cost rates of companies of relatively

3   similar but not necessarily identical risk to Peoples.

4   Because no proxy group can be identical in risk to any

5   single company, there must be an evaluation of relative

6   risk between the company and the proxy group to

7   determine if it is appropriate to adjust the proxy

8   group's indicated rate of return.

9   My testimony explains how the analysis to

10   determine an appropriate ROE is affected by the various

11   business and financial risks faced by the company. My

12   ROE -- my ROE recommendation considers such factors as

13   the effect of flotation costs and the company's smaller

14   size. Also, the company's high level of customer

15   growth, overall performance and capital investment plans

16   relative to the companies in my proxy group.

17   The analyses presented in my recommendation

18   support for the company requested ratemaking capital

19   structure, which consists of 40.48 percent long-term

20   debt and 54.68 percent common equity. That common

21   equity ratio is consistent with Peoples' historical

22   equity ratio and the range of equity ratio maintained by

23   the proxy group and their utility operating

24   subsidiaries.

25   Finally, my testimony responds to issues

1 raised by and addresses the shortcomings within Mr.

2 Garrett's testimony. None of his arguments changed my

3 conclusion that the company should be authorized the

4 opportunity to earn an ROE of 11 percent on its

5 jurisdictional rate base based on its proposed

6 ratemaking capital structure. Likewise, his analysis

7 should not persuade the Commission to include an ROE for

8 Peoples blow my recommendation.

9   Thank you.

10   CHAIRMAN FAY: All right. Yeah, go ahead.

11   MR. MEANS: Mr. Chairman, we tender Mr.

12   D'Ascendis for cross-examination.

13   CHAIRMAN FAY: Okay. Ms. Christensen?

14   MS. CHRISTENSEN: Yes. Thank you.

15   EXAMINATION

16 BY MS. CHRISTENSEN:

17   **Q   And good afternoon, Mr. D'Ascendis. I just**

18 **wanted to ask you --**

19   A   Good afternoon.

20   **Q   -- as a preliminary matter, do you have a copy**

21 **of your deposition that was taken?**

22   A   Yes, it's right in front of me.

23   **Q   Okay. Wonderful. And do you also have a copy**

24 **of Mr. Garrett's testimony in this matter available to**

25 **you?**

1   A   Yes. Right here.

2   **Q   Okay.**

3   A   I am sorry. I have a blurred background, but

4   yes, I have it.

5   **Q   Yeah, and I want to make sure that you, of**

6   **course, have a copy of your own direct and rebuttal**

7   **testimonies available to you as well.**

8   A   I do.

9   **Q   It's my intention, as we come across cross**

10   **exhibits, to email those to you one at a time. So if**

11   **you -- when I call out a cross-examination exhibit, if**

12   **you can be looking for those in your email, that would**

13   **be wonderful, and let us know when you receive them. So**

14   **we will see how that goes and we will just do the best**

15   **we can.**

16   A   Okay.

17   **Q   I want to refer you to page three of your**

18   **direct testimony. And you have identified document 13**

19   **attached to your direct testimony as your educational**

20   **background and the cases where you have appeared, is**

21   **that correct?**

22   A   Yes, ma'am.

23   **Q   And --**

24   A   Yeah.

25   **Q   -- according to that document, would it be**

1   correct to say that you have testified in over 130

2   cases?

3   A   That sounds about right. Yes.

4   Q   Okay. And would you agree that you only

5   testify on behalf of utility companies?

6   A   Yes, ma'am. And sometimes in evaluation cases

7   I will -- well, yeah, they are utility companies, not --

8   not investor-owned, so they are on the utility side, but

9   not necessarily investor-owned utilities.

10   Q   Okay. And you have testified or provided

11   information before approximately 35 state jurisdictions,

12   FERC and Canada, and I think you said one Rhode Island

13   court, is that correct?

14   A   Yes, the Superior Court of Rhode Island.

15   Q   And that would be a fair summation of the

16   jurisdictions that you have appeared before?

17   A   Also an American Arbitration panel.

18   Q   Okay. Would you agree that the awarded ROEs

19   in Florida are generally higher than the other

20   jurisdictions that you have testified before on average?

21   A   I mean, the ROE isn't specifically the number

22   one class within a rate case, but I would say generally

23   they are on the high end of the range of authorized

24   returns around the country, besides Alaska. I think we

25   went over that in our deposition.

1   **Q   Okay. And would you agree that there are**

2 **other jurisdictions with lower than average ROEs that**

3 **are considered highly constructive, like New York and**

4 **California?**

5   A   Yes, I would. And it is interesting, though,

6 concerning New York, they used to have ROEs in the 8.8

7 level, and this year, they raised their ROE up to around

8 9.25. So their ROEs have gone up 45 basis points over

9 the last probably 18 months.

10   **Q   Okay. And would you also agree that other**

11 **jurisdictions, like New York and California, have**

12 **infrastructure riders, like decoupling, fully forecasted**

13 **test years, multiple rate -- multiple year rate plans,**

14 **and things that, where even though the ROEs are lower,**

15 **the chances for them earning their ROE is higher; would**

16 **that be a fair assessment?**

17   A   I would agree with that. One thing I would

18 like to clarify about California. California, in the

19 energy side, they do have relatively high ROEs, but on

20 the waterside, they have lower ROEs than average. So

21 California, they authorize ROEs for San Diego Gas &

22 Electric, I think, is 10.20 this year. So I would say

23 that they are more higher than average, but in the water

24 companies, yes, they are significantly lower on their

25 authorized ROEs.

1   Q   And would you agree that Florida has similar

2   type infrastructure riders, such as bare steel fully

3   forecasted test years and fuel pass-through clauses?

4   A   I am not sure about the regulatory mechanisms.

5   Usually those type of mechanisms are common -- common to

6   all of the publicly traded utility companies, maybe not

7   the forward test year, but the various riders are fairly

8   common.

9   Q   Okay. And I think you said today that Alaska

10   is probably the only other jurisdiction in the 35 that

11   you testified before that award higher ROEs than Florida

12   during the same time period, is that a correct

13   statement?

14   A   That is.

15   Q   Okay. And you would agree that Alaska has

16   different risk, such as weather and remoteness, and high

17   costs that are higher than the lower 48 states that

18   would drive an Alaskan ROE higher, would that be fair?

19   A   Yes, it would be fair. But I would want to

20   back up just a little bit. I would -- I would say that

21   Georgia and Florida are pretty comparable. I haven't

22   testified in Georgia, so I don't know for certain based

23   on my own personal experience --

24   Q   You said Georgia?

25   A   -- but yes.

1   **Q**   **Okay. But the question was related to Alaska.**

2   A   Yes. Yes. I agree with your characterization

3 about that. I was going back to your prior question

4 about Florida being the second highest in the country.

5 I don't know if that's exactly true, but I know there

6 are, like I said, they are amongst the highest.

7   **Q**   **Okay. And would you also agree that the**

8 **factors we discussed related to Alaska being remote, and**

9 **having weather issues, and being higher costs than the**

10 **other lower 48, those are not similar factors to what**

11 **Florida has, correct?**

12   A   I wouldn't agree with that statement because

13 everybody has weather issues, especially -- I mean, I am

14 sitting here remote because of a hurricane that hit,

15 right, or I would have been there. So I wouldn't say

16 that weather is one of those things where you can say is

17 unique to Alaska. Now, the remoteness, and all those

18 factors, I would agree with you, but weather, I would

19 not agree.

20   **Q**   **Okay. And since we are discussing Alaska**

21 **having the highest awarded ROEs, do you -- do you recall**

22 **-- well, let me ask you this: Have you testified in**

23 **Alaska regarding ROE?**

24   A   I have.

25   **Q**   **Okay. And do you recall what you recommended**

1   **as an ROE for Alaska?**

2   A   Well, I have testified on a couple different

3   occasions for Alaska companies, and generally, those are

4   -- those are not contemporary. Generally, they are -- I

5   haven't testified for a gas company in Alaska, a

6   straight -- a normal local distribution company like

7   this one, so I wouldn't -- it wouldn't be a comparable

8   measure, so I don't -- I don't know what to say about

9   that.

10   **Q   Do you know what the average national --**

11 **natural gas awarded ROE has been since 2013?**

12   A   I don't, but I did look up in preparation for

13 this case, and then when Ms. Wesley was being

14 cross-examined, I took a look at some of the RRA data

15 that this was -- that I guess the confidential exhibit

16 was premised on, and it looked like in 2022, gas LDC

17 companies were approved in between a nine percent and a

18 10.20 percent in 2022. And that midpoint is 9.6, which

19 is higher than what was demonstrated in that last -- in

20 that one exhibit that you showed Ms. Wesley.

21   In this -- in 2023, so far this year, the

22 range is 9.25 percent to 10.44 percent, which would have

23 a midpoint of 9.85 percent.

24   **Q   Let me ask you this: Who was that -- or what**

25 **state was the 10.44 percent in?**

1   A   Virginia.

2   **Q   Okay. Let me discuss you with a little bit**

3 **about your PRM -- or PRPM model.**

4   A   Yes, ma'am.

5   **Q   Okay. Is it correct that in cases where you**

6 **have testified, regulators have adopted your particular**

7 **ROE recommendation only once?**

8   A   They have -- well, I mean, we'll back up.

9 Usually in rate cases is -- are just like marriage, half

10 of them end in a settlement. So it wouldn't be a

11 correct characterization that only one has been approved

12 out of that number -- that number of cases.

13   Second, generally, commissions don't speak the

14 specific model results or specific inputs to the model

15 results, which the PRPM is one of those, so --

16   And then, third, when you -- when you look at

17 other decisions they have accepted, like in North

18 Carolina, they have accepted my CAPM and my risk

19 premium, my total market risk premium, and the PRPM was

20 performed as performed in this case.

21   So sometimes they are approved in piecemeal.

22 Sometimes they are considered and not spoken about.

23 Some are considered and adopted, and then some are

24 considered and rejected. It depends on what the record

25 is in the case.

1   Q   Do you recall taking a deposition on August

2 1st, 2023?

3   A   Yes.

4   Q   And do you recall being asked this question:

5 How many cases have you testified in where the regulator

6 either has adopted your particular ROE recommendation,

7 if you know? And do you recall your response was:

8 Once?

9   A   And what page is that, please?

10   Q   Page 66, lines 11 through 14.

11   A   And then I said that it was in response to the

12 Interrogatory 109.

13   Q   Right. But my question was: Do you recall

14 having your deposition and answering that question?

15   A   Yes, ma'am, but --

16   Q   Thank you.

17   A   -- 109 refers to both.

18   Q   We'll get there.

19   A   Okay.

20   Q   I am going to go ahead and ask, since you have

21 already discussed the South Carolina case, was that a

22 South Carolina case in 2018, where you recommended a

23 10.5 ROE on behalf of the utility, which was at the low

24 end of your range; is that correct?

25   A   That's right.

1   Q   Okay. I am going to ask to have you sent OPC

2   73, and ask them to hand out our Exhibit 73, which is

3   your response to interrogatory 109, which I believe is

4   already marked for identification as hearing Exhibit

5   117.

6   A   Sure.

7   Q   Please let me know when you receive the email.

8   A   I will let you know. You said that it was the

9   response to staff's fifth set of interrogatories 109,

10   correct?

11   Q   That is correct.

12   A   So then it would -- it would start with -- I

13   have it in front of me --

14   Q   Okay.

15   A   -- if we want to --

16   Q   Yeah, if you --

17   A   I could read the question and then you just

18   make sure that I am on the right place.

19   Q   The question starts with, please refer to

20   witness D'Ascendis direct testimony, and then it goes

21   further to say, on page 35, et cetera; is that the

22   correct --

23   A   Yes, ma'am. I am there. Yeah.

24   Q   Okay.

25   CHAIRMAN FAY: Ms. Christensen, is it --

1   THE WITNESS: It depends how long it takes to

2   get there.

3   CHAIRMAN FAY: That's what I was going to say.

4   If he has it in front of him, is that, I mean,

5   sufficient? You are referencing a specific part of

6   that response.

7   MS. CHRISTENSEN: We can proceed if we -- we

8   weren't sure how quickly it would take to get an

9   email there. Usually it's only a minute or so.

10   But if he has got it in front of him, he can go

11   ahead with those questions.

12   CHAIRMAN FAY: Okay. That sounds -- I will be

13   comfortable if he has got it in front of him. This

14   is to a specific interrogatory, so it's much easier

15   to find. Some of the other ones, we might have to

16   wait for it to actually come in with him, but if

17   you are fine with that, and then we are go to go

18   label this one 180.

19   MS. CHRISTENSEN: Okay. It's already been

20   marked for identification as part of staff's -- the

21   exhibits as 117.

22   CHAIRMAN FAY: Oh, okay.

23   THE WITNESS: And I got it right now. So

24   that's the time.

25   MS. CHRISTENSEN: Okay.

1   CHAIRMAN FAY: We are all set. Go ahead.

2   THE WITNESS: I got it.

3   BY MS. CHRISTENSEN:

4   **Q   Okay. So in response to staff interrogatory**

5   **109, you cite two water cases, and I think you said one**

6   **was South Carolina, the other one was North Carolina, to**

7   **support your position that your Predictive Risk Premium**

8   **Model was relied on and provided excerpts from these**

9   **orders; is that correct?**

10   A   Yes, ma'am.

11   **Q   Okay. And in the Carolina order, on pages**

12 **nine and 10, which -- of the interrogatory response, the**

13 **Commission specifically cites the DCF model, but it did**

14 **not cite your Predictive Risk Premium Model; is that**

15 **correct?**

16   A   That's right. And it was the portion of the

17 DCF model that they asked for specifically. And if

18 everybody wants to look at it, it's the third line on

19 that Bates page 10, I guess, on the exhibit.

20   It's just saying -- it's confirming that my

21 use of analyst estimates for the DCF analysis is

22 supported by consensus --

23   **Q   Okay.**

24   A   -- and it used the arithmetic mean. So it's

25 more of pieces of -- pieces of the analysis that they

1 used.

2   **Q   Okay. So the answer to the question is, yes,**

3 **they just discussed the DCF model only?**

4   A   No, because the arithmetic mean model is a

5 part of the risk premium model and the CAPM model. They

6 talk about small size. So there are a bunch of pieces

7 that the Commission discusses, but, yes, you are right,

8 it doesn't specifically say anything about the PRPM, but

9 they do --

10   **Q   Okay.**

11   A   -- accept my --

12   **Q   Thank you.**

13   **Now, let's move to page 12 -- 11 and 12, which**

14 **is the North Carolina excerpt of that order that you**

15 **provided. And in that case, they approved a 9.5 ROE for**

16 **the company in that case, is that correct?**

17   A   That's right.

18   **Q   Okay. And they cite to your DCF results of**

19 **8.81 percent for the CAPM, and a result of nine point --**

20 **or I am sorry, 8.81 percent for the DCF, and a 9.2 -- or**

21 **9.29 percent result for your CAPM, and your risk premium**

22 **model result of 10 percent using current rates in the**

23 **first paragraph of the second sentence -- or the second**

24 **-- the first sentence of the second paragraph, is that**

25 **correct?**

1   A   Yes, ma'am.

2   **Q   However, if you look further down in the third**

3   **paragraph, the Commission specifically found and**

4   **concluded that the analysis using interest rate forecast**

5   **rely unnecessarily on projections. The Commission**

6   **approves the use of current interest rates rather than**

7   **projected near-term or long-term interest rates.**

8   **And they go on to further say, the Commission**

9   **finds witness D'Ascendis late filed exhibit risk premium**

10 **model and his late-filed CAPM analysis using the current**

11 **30-year treasury yield to be credible, probative and**

12 **entitled to substantive weight. Am I reading that**

13 **correctly?**

14   A   Yes, ma'am. So in that late-filed exhibit, I

15 took my projected interest rates and I replaced them

16 with current interest rates. In this case, it's --

17   **Q   Okay.**

18   A   -- in this case, the difference between the

19 current and expected interest rates are minimal.

20   **Q   In your Predictive Risk Premium Model uses**

21 **interest rates that are forecast -- interest rate**

22 **forecasts that are projected, is that correct?**

23   A   They use, but they didn't use the PRPM -- so

24 if you go back up to the top --

25   **Q   Okay.**

 1   A   -- that top little paragraph, that risk

 2   premium model that they are talking about is the Total

 3   Market Approach Risk Premium, not the PRPM with

 4   individual companies.

 5   **Q   Okay. Let's take a look at your response to**

 6   **interrogatory No. 112, subpart (a), and that's OPC's 74.**

 7   **And that would be your response to staff's interrogatory**

 8   **112. I believe that also has -- is part of the hearing**

 9   **exhibits already marked for identification as 117.**

10   A   So I do think I have it in front of me.

11   **Q   Okay.**

12   A   In part A, please explain for what time period

13   the indicated risk premiums in column five and indicated

14   ROEs in column seven are predictive.

15   **Q   That's correct.**

16   A   I just got an email too.

17   **Q   Okay. And isn't it correct that you respond**

18   **that, you say, the PRPM model produces a rates of return**

19   **on equity which is forward-looking in nature and, thus,**

20   **is not associated with a definite period as is the case**

21   **with other rate of return models?**

22   A   Yes.

23   **Q   Okay. I want to discuss you with a little bit**

24   **about your discounted cash flow model.**

25   **In your dis --**

1   A   Yes.

2   **Q   Okay, I am sorry. I don't want to talk over**

3 **you.**

4   A   Oh, I just -- I just -- I am sorry.

5   **Q   Okay. In the discounted cash flow model, you**

6 **use a proxy group of publicly traded gas companies to**

7 **estimate what you believe is an appropriate ROE,**

8 **correct?**

9   A   I do.

10   **Q   And you used a steady state growth rate**

11 **because the proxy group you chose is made of more mature**

12 **companies with monopoly territories, right?**

13   A   Amongst other things, there is significant

14 amount of testimony regarding, and financial literature,

15 regarding the superiority of using projected ECR growth

16 rates in the DCF. It's not only because -- and it's not

17 in my testimony, but that is what the companies and

18 mature monopolies --

19   **Q   Okay.**

20   A   -- say that I use DCF growth rates because

21 investors are looking at them, and it's supported by

22 literature.

23   I do say in my rebuttal --

24   **Q   Okay.**

25   A   -- Mr. Garrett why he shouldn't be using the

1   multistage DCF --

2   MS. CHRISTENSEN: Commissioner, could I ask

3   him to respond to the question that I am asking? I

4   mean, I don't mind an explanation, but it's getting

5   a little far afield.

6   CHAIRMAN FAY: Sure.

7   Mr. D'Ascendis, so our typical protocol is

8   that you provide a yes or no to a question

9   answered, and then you can provide an explanation

10   to it. And so I think -- I do think there is a

11   little bit of delay, so sometimes, I think when you

12   are trying to clarify a longer explanation, it's

13   just hard for us to kind of let you know that you

14   might be offtrack a little bit, but if you could

15   just try to simplify your answers to that, and then

16   I think that will help keep us better on track.

17   THE WITNESS: Sure. Thank you. I apologize.

18   BY MS. CHRISTENSEN:

19   **Q   Okay. And because you claim that PGS is**

20   **different from the proxy group, you make a business risk**

21   **adjustment and a floatation cost adjustment for PGS, is**

22   **that correct?**

23   A   Yes, ma'am.

24   **Q   But would you agree that you chose the**

25   **companies for your utility proxy group that have**

1   **comparable risk, is that right?**

2   A   Yes, ma'am, but comparable risk isn't

3   identical risk. And like I said in my opening

4   statement, that once you get an indicated ROE, you

5   should then look at it -- look at it in comparison to

6   the proxy group to determine whether or not you should

7   apply a relative adjustment --

8   **Q   Okay.**

9   A   -- I made that analysis -- I made that

10   analysis and found that the business risk adjustment

11   should be applied, and then because of -- because

12   transaction costs and floatation costs aren't reflected

13   in the models, you have to also apply a flotation cost

14   adjustment to the indicated ROE.

15   So that's -- that's why -- and I am sorry if I

16   am getting long-winded but you asked me to explain why,

17   so --

18   **Q   Okay. Let me ask you this: The proxy group**

19   **of utilities, you would agree, that you chose, they also**

20   **have similar type business risk there, similar natural**

21   **gas companies you chose to be representative of PGS in**

22   **your ROE model, correct?**

23   A   I agree with that. But like said, the company

24   is smaller, the company experiences higher CAPEX, which

25   is capital expenditures. These are all within my

1 testimony, my direct and my rebuttal testimony, that

2 that shows the company's risk is unique to the proxy

3 group, and because of that, you have to make a relative

4 risk adjustment.

5   **Q   And you would agree that the utility proxy**

6 **group that you chose also has floatation costs**

7 **associated with them when they have to issue debt or**

8 **anything else, correct?**

9   A   I do. But like I said, they are not reflected

10 in the model. So when you run a DCF and a CAPM, they

11 assume no transaction costs, because they don't assume

12 transaction costs, you have to put in the flotation

13 costs.

14   **Q   You would agree that a smaller company would**

15 **typically demand a higher return on equity, correct?**

16   A   Yes.

17   **Q   And you would agree --**

18   A   Well, all else equal -- I'm sorry -- all else

19 equal, a smaller company is riskier than a larger

20 company.

21   **Q   Okay.**

22   **CHAIRMAN FAY: Mr. D'Ascendis, just one more**

23 **time, just ask you to project the best that you can**

24 **and make sure our court reporter can get it all in**

25 **there. I realize that you are virtual, you know,**

1   because of this storm, but we still need to make

2   sure we get your comments on the record, so if you

3   could just try to project a little better.

4   THE WITNESS: Sure. I am sorry.

5   BY MS. CHRISTENSEN:

6   **Q   Would it be fair to say smaller companies face**

7   **more risk?**

8   A   Than larger companies?

9   **Q   Yes, than larger companies, all --**

10   A   All else being equal --

11   **Q   -- all things being equal?**

12   A   -- yes, ma'am.

13   **Q   And would you agree that the Commission's**

14 **water formula has an adjustment for risk based on small**

15 **sizes for water companies, correct?**

16   A   They do. And they also have a private

17 placement premium, which is equivalent to a flotation

18 cost.

19   **Q   Okay.**

20   MS. CHRISTENSEN: I would ask that we hand out

21   OPC 75, and we will need to mark this for

22   identification. This is a copy of the Commission's

23   Order Establishing Authorized Range of Return on

24   Common Equity for Water and Wastewater Companies.

25   CHAIRMAN FAY: Okay. We will mark this as

1   180.

2   BY MS. CHRISTENSEN:

3   **Q   And please let me know when you receive --**

4   A   I do not have that -- so I will let you know

5   when it comes in.

6   **Q   Thank you.**

7   MS. HELTON: Mr. Chairman, I am sorry, I am a

8   little confused. So the last two exhibits that Ms.

9   Christensen has testified to, we are just going to

10   use the CEL No. 117?

11   CHAIRMAN FAY: Yes, unless you prefer to --

12   MS. HELTON: No, I am fine with it. I just --

13   I was confused about what we are doing.

14   And then if I could -- I just feel compelled

15   to say, because this is an order of the Commission,

16   it does not need to be marked as an exhibit. This

17   is something that we will, you know, officially

18   recognize, and I am not sure if this is part of the

19   orders that Ms. Christensen had on the motion for

20   official recognition.

21   MS. CHRISTENSEN: I don't know whether it was

22   included in that motion for official recognition.

23   I do realize that it's Commission standard practice

24   to recognize their own orders. However, for

25   convenience and the sake of asking questions, I

1   provided a copy, and provided it as an exhibit so

2   that everyone can follow along during questioning.

3   CHAIRMAN FAY: Yeah, and I don't have a

4   problem with it either. I guess, to Mary Anne's

5   point, I mean, we either sort of continuously want

6   to mark these or not. So even if it is referenced

7   in another exhibit, if you parsed out a certain

8   portion of it, we could still mark and number it.

9   I think we are at 180 now with this -- with this

10   order. That's fine. We will move forward, and

11   then we will label it as we go, as long as you

12   don't have an issue with that, Ms. Christensen.

13   MS. CHRISTENSEN: No, I am just doing it for

14   ease and to ensure that the record is clear what

15   was passed out.

16   CHAIRMAN FAY: Yeah, I don't -- Ms. Helton, I

17   don't see any procedural issues in just going ahead

18   and label it and put it in. I know that we do

19   recognize these, and that probably goes against

20   that theory, but I don't see any reason not to at

21   this point.

22   So go ahead, Ms. Christensen.

23   MS. CHRISTENSEN: Thank you.

24   CHAIRMAN FAY: I apologize. Mr. Moyle, do you

25   have something to add.

1   MR. MOYLE: I just am trying to understand

2   where we are, because 117 was referenced, but now I

3   think we are going to do 180 for the response to

4   interrogatory 109, and 181 for response to

5   interrogatory 112, is that right?

6   MS. CHRISTENSEN: I only referenced them back

7   to the hearing -- the comprehensive exhibit list.

8   Those two are also included in the exhibit that's

9   already been marked, and I think it's been admitted

10   as 117.

11   CHAIRMAN FAY: So that's where the confusion

12   is. We could have continued to number them. Ms.

13   Christensen preferred to not mark them at that

14   time, so I gave her deference to do so, but it's

15   obviously caused confusion, and so going forward,

16   we will just mark any cross that we receive, even

17   if it pulls a specific component of a previous

18   exhibit --

19   MS. CHRISTENSEN: Okay.

20   CHAIRMAN FAY: -- we will just number it and

21   mark it and move forward so there is no confusion.

22   MS. CHRISTENSEN: Fine.

23   CHAIRMAN FAY: So to your point -- to Mr.

24   Moyle's point, so we would be labeling 180 as the

25   original, then 181 as the second excerpt, and 182

1   would be the order, does that sound correct?

2   MS. CHRISTENSEN: That's fine.

3   CHAIRMAN FAY: Okay. Let me make sure of

4   that. Mr. Thompson, are we good on your end?

5   MR. THOMPSON: That will work.

6   CHAIRMAN FAY: Okay.

7   MR. MOYLE: Thank you.

8   CHAIRMAN FAY: Sure.

9   (Whereupon, Exhibit Nos. 180-182 were marked

10   for identification.)

11   CHAIRMAN FAY: Okay. Ms. Christensen,

12   whenever you are ready, hopefully -- assuming he

13   has the email, I guess that's the --

14   BY MS. CHRISTENSEN:

15   **Q   Have you received it yet?**

16   A   Perfect timing, like, five seconds ago.

17   **Q   Oh, good. Okay.**

18   **And, Mr. D'Ascendis, are you familiar with**

19   **this order?**

20   A   I am as far as you showing it to me on the --

21   during the deposition.

22   **Q   Okay. And you would agree that the Commission**

23   **uses a proxy group consisting of natural gas and**

24   **wastewater and water utilities for its leverage formula?**

25   **I am sorry, I talked over you.**

1   A   I do. I do.

2   **Q   Thank you.**

3   **And you would agree that the Commission used a**

4   **multistage DCF model of publicly traded stock and that**

5   **are followed by Value Line, is that correct?**

6   A   I do, but I don't know the -- I agree that

7   they do a multistage DCF. I do not know their specific

8   growth rates used in those models.

9   **Q   Fair enough.**

10   **And they, for the cap -- capital asset pricing**

11   **model, do they rely on a market return for companies**

12   **followed by Value Line, the average projected yield on**

13   **the U.S. Treasury 30 year bonds as of May 1st, 2023,**

14   **published by BlueChip, and the weighted average betas**

15   **for the index of natural gas and water and wastewater**

16   **utilities?**

17   A   That sounds correct. I think that in their

18   market risk premium, they do a similar calculation to

19   mine to find the return on the market, but I don't think

20   it's -- I think it's similar. I don't think it's the

21   same, but I don't have anything to verify that --

22   **Q   Okay.**

23   A   -- but the other -- they are correct, yes.

24   **Q   And let's turn to page four of that order.**

25   **You would agree that the leverage formula also has a**

1   **50-basis-point adder for small utility risk premium**

2   **built in, as well as a 50-basis-point for private**

3   **placement premium, is that correct?**

4   A   Yes, ma'am.

5   **Q   Okay. And that private placement premium is**

6   **equivalent to what you have been discussing as a**

7   **floatation cost, is that correct?**

8   A   That's right.

9   **Q   So if you agree, subject to check, that if you**

10   **apply the leverage formula at the bottom of page four of**

11   **this order to PGS at the requested equity ratio of 54.68**

12   **percent, that the application of this formula would**

13   **result in a 9.98 -- or sorry, 9.68 ROE, is that correct?**

14   A   I wouldn't know because I didn't do the math.

15   I also wouldn't agree that this would be applicable to

16   that because, as I said in the deposition, water

17   companies are not gas companies, and because of that, it

18   would not be appropriate to use water companies as a

19   proxy for gas companies. So I don't think -- and I

20   don't think Mr. Garrett or myself used the leverage

21   adjustment as backup for their recommendations in this

22   case.

23   **Q   Well, if you look at page 13 of the order, you**

24   **would agree that you used Atmos Energy Corporation and**

25   **NiSource, Inc., in your proxy group, is that correct?**

1   A   You are saying 13?

2   **Q   Page 13 of the order.**

3   A   Oh, I am sorry. Okay.

4   **Q   And am I correct that you also included Atmos**

5 **Energy Corporation and NiSource Corporation as part of**

6 **your proxy group of natural gas companies?**

7   A   Yes, ma'am.

8   **Q   Okay. I have no further questions on that**

9 **order. Thank you.**

10   A   Okay.

11   **Q   And I want to ask you a few questions about**

12 **your CAPM estimates. You use a CAPM model in your**

13 **analysis, correct?**

14   A   I do.

15   **Q   And the CAPM uses the rate of return on the**

16 **market as a whole minus the risk-free rate of return**

17 **times the beta, and then adds back the risk-free rate,**

18 **is that a correct summation of the CAPM formula?**

19   A   Can you say it one more time so I could -- so

20 could I make sure? But I think you are right, I just

21 want to --

22   **Q   Sure.**

23   **The CAPM uses the return rate on the market as**

24 **a whole minus the risk-free rate of return times the**

25 **beta, which is the volatility relative to the market of**

1   utilities, and then adds back in the risk-free rate?

2   A   Yes, ma'am.

3   **Q   Okay.**

4   A   I agree.

5   **Q   Okay. Great.**

6   **And one of the key inputs to the CAPM is the**

7   **market risk premium, is that correct?**

8   A   It is.

9   **Q   And on page two of two of your Exhibit DW-1,**

10   **document five, and I am going to give you -- just take a**

11   **minute and get there in your testimony while I do the**

12   **same. Almost there.**

13   A   Okay. I am ready when you are.

14   **Q   Okay. Just give me a moment longer. I am**

15   **trying to find the -- okay, I am there as well.**

16   **Okay. On page two of two of document five of**

17   **your exhibit to your testimony, you combine measures**

18   **such as historical stock data going back 100 years, and**

19   **projected stock returns for three to five years to**

20   **create your implied market risk premium, is that**

21   **correct?**

22   A   There is a little bit more nuance to that, but

23   I use -- I use fixed measures -- well, I don't agree, I

24   guess. And then generally, I used fixed measures of the

25   risk premium, the market risk premium to derive my

1 market risk premium, I agree with the historical data

2 from Kroll. The other -- two of them use measures from

3 Value Line, and the last measure uses measure from --

4 **Q   Right. And then you --**

5 **CHAIRMAN FAY: Hold on one second, Ms.**

6 **Christensen.**

7 **Mr. D'Ascendis, if you can repeat the last**

8 **part of your answer, and I am sorry to hound this,**

9 **but if you can just project a little bit louder**

10 **just to make sure we can get your responses. It's**

11 **just we are having a little trouble hearing you.**

12 THE WITNESS: Yeah. I am getting an echo from

13 when I am talking, and I think it's because I am

14 hearing the hearing room and what I am saying, so

15 there might be a double feedback type thing there.

16 CHAIRMAN FAY: Well, we can hear you okay,

17 it's just you are a little bit muffled and a little

18 bit soft, and so if -- and you might be getting

19 that feedback but we are not in the hearing room,

20 so if there is any way you can just speak up a bit

21 I think it would help our court reporter.

22 THE WITNESS: All right.

23 CHAIRMAN FAY: And you -- Mr. D'Ascendis, just

24 real quick. You are not using speaker for your

25 audio, correct?

         1   THE WITNESS: What's that?

         2   CHAIRMAN FAY: You are not using the speaker

         3   on the phone or the computer for your audio, you

         4   are using earphones, correct?

         5   THE WITNESS: No. I have a microphone here.

         6   CHAIRMAN FAY: I think that's a little bit

         7   better. Yeah, I guess the question is how are you

         8   getting your audio?

         9   THE WITNESS: Oh, I am getting it straight

        10   from the computer.

        11   CHAIRMAN FAY: Okay. So if you put headphones

        12   in, I think would get rid of that feedback for you.

        13   THE WITNESS: I'll make do, I guess. I am

        14   more -- if you guys can hear me, I am fine with it.

        15   CHAIRMAN FAY: Okay. We can hear you, just I

        16   promise you, we just -- if you just speak up. I

        17   mean, I don't know if you have neighbors, but if

        18   you can just project a little bit louder, then I

        19   think we would be all right.

        20   THE WITNESS: I don't want to already seem --

        21   I don't want to seem more combative than I already

        22   am, so I will try to speak louder.

        23   CHAIRMAN FAY: You are not, you are really --

        24   that's better. We appreciate it.

        25   THE WITNESS: Okay. So I will restart the

1   answer.

2   Like I said, there were -- I had three

3   measures, three of them are measured using Kroll

4   historical data, two measures that are measured by

5   Value Line data, and the last measure is measured

6   by Bloomberg data.

7   BY MS. CHRISTENSEN:

8   **Q   Okay. And you said the Kroll is historical**

9   **data, and that's data that goes back 100 years, is that**

10   **correct?**

11   A   It goes back -- the data that I use goes from

12   1926 to 2021. That is not 100 percent years but it's

13   close to it --

14   **Q   Okay.**

15   A   -- I think there -- I think -- and there is

16   plenty of, I guess, academic literature that talks about

17   the predictive power of a long-term average of a random

18   string of data, which market returns are a random string

19   of data.

20   **Q   All right. But that's -- so it's 97 years**

21   **worth of data?**

22   A   Around there.

23   **Q   Okay. And then you also said that you used**

24   **Value Line, and that Value Line is current, or three to**

25   **five market -- three to five years worth of market**

1   **projections, correct, for the Value Line data that you**

2   **used?**

3   A   Yes, ma'am, that seems right. Measure 4 uses

4   three to five years on the Value Line depreciation

5   potential, and then if you are using the market return

6   as of market type DCF, that would be a three- to

7   five-year growth rate, so --

8   **Q   Okay. And then just to be clear, you use the**

9   **results of those six measures that you have created to**

10   **come up with an average of your risk premium that you**

11   **used in the model, is that correct?**

12   A   That's right.

13   **Q   And that risk premium that you used, or you**

14   **chose to use for your model, was 9.75, correct?**

15   A   It was, yes.

16   **Q   Okay. And you have reviewed Mr. Garrett's**

17   **testimony in this proceeding, correct?**

18   A   Yes, ma'am.

19   MS. CHRISTENSEN: Okay. And I would ask to

20   pass out OPC Exhibit No. 76.

21   BY MS. CHRISTENSEN:

22   **Q   If you have Mr. Garrett's testimony available**

23   **to you, I would ask you to look at page 55 of his**

24   **testimony. It will likely be quicker.**

25   CHAIRMAN FAY: Okay. And we are going to mark

1   **this 183.**

2   MS. CHRISTENSEN: Thank you.

3   (Whereupon, Exhibit No. 183 was marked for

4   identification.)

5   THE WITNESS: Okay.

6   BY MS. CHRISTENSEN:

7   **Q   Okay. Looking at Mr. Garrett's testimony, you**

8   **are aware that the average market risk premium reported**

9   **in the IESE Business School expert survey cited in Mr.**

10   **Garrett's testimony is only 5.7 percent, is that**

11   **correct?**

12   A   Yes, ma'am, but I don't agree with the use of

13   surveys in my end use for cost of capital purposes, nor

14   has Mr. Garrett provided any academic support that

15   surveys are an appropriate measure of the risk premium.

16   Generally, I have a response to the use of surveys on

17   pages 35 through 37 of my rebuttal testimony.

18   **Q   Okay. So in your rebuttal testimony, you**

19   **cited several points raised by Dr. Damodaran that are**

20   **critical of expert survey results, which I think you**

21   **just mentioned, correct?**

22   A   That's right.

23   **Q   Are you aware that Dr. Damodaran recently**

24   **estimated an average market risk premium of only 5.1**

25   **percent for May 2023?**

1   A   I do, and I -- and I also have an issue with

2   Dr. Damodaran's implied ERPs. No. 1, he uses -- as his

3   long-term growth rate, he uses the 30-year average T

4   bond for the last 30 days. So he uses the 30-day

5   average T bond for growth into forever. It is

6   unreasonable to use that. You can see over the last

7   several years that that would come up with wildly

8   unreasonable -- wildly different results, so I don't

9   agree with it. And like I said, I have it in my

10 rebuttal testimony --

11   **Q   Okay.**

12   A   -- and that would be pages 38 through 42 --

13   **Q   Okay.**

14   A   -- 43 in my rebuttal testimony.

15   **Q   As part of your ROE analysis in this case, you**

16 **cite to data published by a company called Kroll, which**

17 **was formally called Duff & Phelps, is that correct?**

18   A   Yes, ma'am.

19   **Q   Are you aware that Kroll published a market**

20 **risk premium of only six percent, as cited to by Mr.**

21 **Garrett in his direct testimony?**

22   A   I do.

23   **Q   And are you also aware that Kroll recently**

24 **calculated the market risk premium of 5.5 percent?**

25   A   I don't agree with the term calculated.

1   **Q   Okay.**

2   A   Kroll's -- Kroll's one -- and the reason is

3   this is, Kroll's recommended market return and return on

4   the market that they publish, they don't calculate, does

5   not show any type of calculation. It's just an up or

6   down difference between a whole bunch of factors that is

7   not observed or observable by the general public.

8   **Q   Okay.**

9   A   When you look at what historical data that

10   Kroll publishes, it is easily -- easily observed and

11   absorbable. The way that they do those, it was an

12   intense study, the historical studies, they are all

13   backed up by academic literature that Kroll recommended

14   market risk premium that just frankly isn't, and it

15   shouldn't be used at all by anybody.

16   **Q   All right. Well, let me ask you this: You**

17   **would agree, then, that they recently published a**

18   **recommended market risk premium of 5.5 percent?**

19   A   I agree to that. Yes.

20   **Q   And would you also agree that no other**

21   **professionals, other than the professionals at your**

22   **firm, use this total risk premium market approach that**

23   **you have adopted in this case?**

24   A   I agree that they don't use it in the way that

25   I use it, but I would say that other ROE witnesses use

1   facets of the approach. So generally -- and I will -- I

2   will stop there. But generally they don't use the

3   combination of the approach that I do. Some use -- some

4   use the regression analysis, some use a buildup method,

5   things like that, so -- but there are ways, but I just

6   add them all together.

7   **Q   Okay.**

8   A   And from what -- and from what I say in my

9   opening statement is that multiple models are better.

10 They provide you more insight to the cost of equity.

11   **Q   Okay. So you agreed with me that nobody else**

12 **uses the PRMP the way that you use it, correct?**

13   A   Yes. I wouldn't say the way. I would say

14 that I don't -- they don't combine it the way that I do.

15   **Q   Okay. Fair enough.**

16   A   They give assets and models -- assets in the

17 models people use, just all of them at once, I don't

18 anybody does.

19   **Q   Okay. Fair enough.**

20   **Let me refer you to your rebuttal testimony on**

21 **page nine, and let me know when you get there.**

22   A   Yes, ma'am.

23   **Q   Okay. And starting on page nine, line 25**

24 **through page 10, line six, this is where you have your**

25 **criticism of witness Garrett's testimony, and you say**

1   that witness Garrett argues that the Commission should

2   apply the ratemaking concept of gradualism to move

3   Peoples' ROE higher than his purported ROE based on his

4   analytical results because he recognizes that the ROE,

5   if implemented, would be confiscatory and illegal, and

6   he needs a different policy argument to avoid the

7   results, citing to pages seven and eight of his direct

8   testimony; is that correct summary of your testimony?

9   A   It is, but I am going to turn to seven and

10   eight really quick to see.

11   Q   Yeah, if you can -- I would ask you to go to

12   Mr. Garrett's testimony, pages seven, and let me know

13   when you are there.

14   A   I am there.

15   Q   Okay. And wouldn't you agree that what Mr.

16   Garrett actually said on -- in his direct testimony, at

17   page seven, lines 18 through 21, is the reason that he

18   recommends his 9.0 percent rather than his CAPM results

19   of 8.5 percent is primarily due to the fact that PGS's

20   current awarded ROE of 9.9 percent it significantly

21   exceeds any reasonable estimate of the company's

22   market-based cost of equity. So one could argue that

23   it's preferable to -- for awarded ROEs to gradually

24   change rather than abruptly; is that a correct summation

25   of his actual testimony?

1   A   Yes, ma'am. Now, I don't agree with

2   gradualism in a ROE sense --

3   CHAIRMAN FAY: Mr. D'Ascendis --

4   MS. CHRISTENSEN: That goes beyond --

5   CHAIRMAN FAY: -- if I could interrupt you

6   just real quick. If you could try to answer, and

7   if you need to provide clarity, you can do so, but,

8   you know, do your best to try to answer yes or no

9   on these.

10   BY MS. CHRISTENSEN:

11   **Q   Okay. And isn't it --**

12   A   Yes, I said yes, and I apologize if it didn't

13   come through on the microphone.

14   CHAIRMAN FAY: Okay.

15   BY MS. CHRISTENSEN:

16   **Q   Okay. And isn't it also true that he further**

17   **explained that an awarded ROE of 9.0 percent would**

18   **partially mitigate the excess transfer of wealth from**

19   **Florida customers to shareholders while gradually moving**

20   **the company towards an actual market-based ROE?**

21   A   That's what he says. I don't agree with it --

22   **Q   Okay.**

23   A   -- I do not. I mean, that's -- that's the

24   words that he said. I don't agree with it, because

25   gradual -- cost of capital is a point of time

1   measurement, not a gradual measure.

2   Q   Okay. In referring back to your testimony,

3   your rebuttal testimony at page nine again, and let me

4   back there, and looking specifically at lines seven

5   through 15.

6   A   Yes, ma'am.

7   Q   Okay. And that is where you also criticize

8   Mr. Garrett's use of gradualism in the 20200051 case,

9   and you say his analysis indicated a market-based ROE of

10 6.9 percent, yet he recommended a 9.5 percent ROE,

11 citing to page 13 of that testimony in your footnote

12 six, is that correct?

13   A   Give me a second. Yes, ma'am, that's what it

14 says.

15   MS. CHRISTENSEN: Okay. And I would ask to

16   have OPC 77 passed out.

17   CHAIRMAN FAY: Okay. 184, Ms. Christensen?

18   MS. CHRISTENSEN: Yes, please.

19   (Whereupon, Exhibit No. 184 was marked for

20 identification.)

21 BY MS. CHRISTENSEN:

22   Q   And please let me know when you receive the

23 email.

24   A   It might be a while -- oh, no, we got it.

25   Q   There we go. We are improving gradually.

1   **Okay.**

2   A   Well, that might be the only way that

3   gradualism works, but, yeah, we have it.

4   **Q   Okay. And can you take a look at that? Are**

5   **those pages, page 13 and I sent -- I think -- I believe**

6   **I also sent you 14. Are those the pages in that order**

7   **that you cite to in your testimony, specifically the**

8   **page 13?**

9   A   Yes, ma'am, and --

10   **Q   Okay. And is --**

11   A   -- what I am -- what I am looking at what you

12   just sent, because, you know, it takes a little bit of

13   time to refresh your memory.

14   All right. Go ahead.

15   **Q   I was going to ask, if page 13 -- there is a**

16   **question on page 13, and he says: Please summarize your**

17   **recommendation for the company. And you would agree**

18   **that his response to that question continues on the rest**

19   **of page 13 and is fully completed on page 14, is that**

20   **correct?**

21   A   Yes. And if you look at lines 11 through 14

22   of that, and it reads: If the Commission were to make a

23   significant sudden change in the awarded ROE anticipated

24   by regulatory stakeholders, it would have the

25   undesirable effect of notably increasing the company's

1   risk profile, and would arguably be at odds with the

2   Hope court's end result doctrine.

3   So when you -- so -- so -- I mean, I know that

4   I may have -- it's not in Mr. Garrett's testimony in

5   this case, but he is aware that an ROE at the level of

6   what he is recommending in this case, or what his true

7   ROE, or the measures of his models are, are enough to be

8   at odds with the end result doctrine.

9   **Q   Well, and what he is specifically saying is**

10 **that the sudden move to a market-based ROE would create**

11 **a shock to the market. Isn't that exactly what his**

12 **testimony on gradualism is about talking about?**

13 A   Like I said earlier, gradualism is not an ROE

14 concept. It's a rate design concept.

15   ROE is a measurement of an investor required

16 return at that time. It would be that return at that

17 time. You can't then say, oh, well, it might be

18 something else, but we are going to say that it's this

19 now, because when the investor puts their money down,

20 they are requiring that return at the time they put the

21 money down --

22 **Q   Well, wouldn't you also have to --**

23 A   -- they talk about -- so when you are talking

24 about gradualism, it just doesn't exist in ROE, so --

25 **Q   Well, doesn't --**

 1   A   -- the number is the number. So if the number

 2 is the number, if Mr. Garrett believes that --

 3   MS. CHRISTENSEN: Can --

 4   CHAIRMAN FAY: Mr. D'Ascendis -- Mr.

 5   D'Ascendis, I think you answered the question. I

 6   think Ms. Christensen has a follow-up.

 7   THE WITNESS: Okay.

 8   MS. CHRISTENSEN: I just have a couple of

 9   follow-ups.

10 BY MS. CHRISTENSEN:

11   **Q   In the case of looking at the market, isn't**

12 **the market, in a regulated environment, include looking**

13 **at what awarded ROEs are in that marketplace that have**

14 **been awarded by a commission?**

15   A   I mean, I -- I --

16   MR. MOYLE: Yes/no?

17 BY MS. CHRISTENSEN:

18   **Q   Is that a yes, or would you agree with that or**

19 **disagree with that?**

20   A   It's a sticky question, because it depends on

21 whether or not the market conditions are the name as the

22 recent past. So when you are looking at authorized

23 returns, and you are looking at the current required

24 return, if the -- if the current state isn't like the

25 past state, then you are looking at a misspecification

1 of the return requirement. So while it can be a valid

2 benchmark during calm periods, I don't think that it --

3 I don't think it's a good measurement this period. I

4 think actually the --

5   **Q   Well, that was -- that actually wasn't my**

6 **question. And when you actually are looking at the**

7 **ROEs, you have to consider the awarded ROEs in a**

8 **regulated utility environment when you are making a**

9 **recommendation for ROEs in front of a regulated utility,**

10 **or regulatory commission, correct?**

11   A   I disagree with that.

12   **Q   Okay. And were you aware that in Docket No.**

13 **20080318-GU, PGS was awarded an ROE of 10.75, which was**

14 **right after the 2008 crash?**

15   A   I did not know about that, but like I said,

16 that was the authorized or required return at that time,

17 so it's not one of those things where they are

18 independent pieces of data.

19   MS. CHRISTENSEN: Can we -- can I just have

20   one second?

21   CHAIRMAN FAY: Sure.

22   MS. CHRISTENSEN: I have no further questions.

23   CHAIRMAN FAY: Okay. Mr. Moyle.

24   THE WITNESS: Thank you.

25   MR. MOYLE: Thank you, I have some questions

 1   for the witness.

 2   EXAMINATION

 3   BY MR. MOYLE:

 4   **Q   You had mentioned you are unable to appear**

 5   **with us in person because of a storm. Where are you**

 6   **located physically?**

 7   A   I am in New Jersey, Mount Laurel.

 8   **Q   And the storm you are referencing is the**

 9   **hurricane that came through Florida a few weeks ago?**

10   A   Yes, sir.

11   **Q   In response to a question previously, you**

12   **referenced a document that I believe you said was part**

13   **of cross-examination of a witness earlier. Do you**

14   **recall that?**

15   A   Yes, sir. I think you are the one who

16   presented it --

17   **Q   And --**

18   A   -- but, yes, I recall talking about it. Yes,

19   sir.

20   **Q   Okay. And let's just make sure that we are**

21   **clear on the record as to the document, because I want**

22   **to ask you a couple of questions about it. So could you**

23   **identify it, or maybe --**

24   MR. MOYLE: Do you guys think this is still

25   confidential, this document, this ROE document?

1   MR. MEANS: I mean, to the extent that Ms.

2   Wesley articulated some of the contents of it, I

3   would agree that those aren't confidential anymore.

4   MR. MOYLE: Right. But I mean, I think the

5   whole document, in my review, is largely ROE based

6   on previous decisions entered in -- entered by

7   commissions.

8   MR. MEANS: Mr. Chairman, can we have just a

9   second?

10   CHAIRMAN FAY: Yeah. You need a minute to

11   review it?

12   MR. MEANS: Yes. Thank you.

13   CHAIRMAN FAY: Okay. Mr. Moyle?

14   MR. MOYLE: Yes.

15   CHAIRMAN FAY: Okay.

16   MR. MOYLE: Mr. Chair, thank you for the

17   opportunity to have a brief conversation with

18   counsel for TECO. We've discussed this page of the

19   document, and they have agreed to withdraw the

20   classification of confidential for this page only.

21   So I think we are -- for the record, I will

22   identify it. I believe the witness has a copy of

23   it, and you all have a copy of it, but we will make

24   clear that it is not a confidential page of this

25   document going forward.

1   CHAIRMAN FAY: Sure. And, Mr. D'Ascendis, did

2   you fully understand that, so just this specific

3   page is what counsel has referred to as not being

4   confidential. Everything else that still falls

5   within that exhibit would be confidential still?

6   THE WITNESS: Yes, Mr. Chairman. I don't have

7   any other page. I just got a snapshot from it from

8   counsel while Ms. Wesley was being crossed this

9   morning.

10   CHAIRMAN FAY: Okay.

11   MR. MOYLE: Okay. And just for the record,

12   it's, what has previously been marked as OPC

13   Exhibit 4. I believe it's also Exhibit 174. And

14   the page in question is OPC page four, and it has a

15   Bates number of 020582. It's entitled, Rate Case

16   Decisions, Return on Equity.

17 BY MR. MOYLE:

18   **Q   Sir, I believe -- I made a note when you were**

19 **being asked questions about this previously, and what**

20 **is -- what is your view as to what the average ROE was**

21 **in the year 2022?**

22   A   So in reviewing this document, I went to

23 Regulatory Research Associates, which was the source of

24 this graph, to see whether or not -- to check the low

25 and the high to make sure that it was correct, and it

1   wasn't correct.

2   **Q   So you said 9.6 based on independent review**

3   **that you did over the lunch hour?**

4   A   I mean, I could share my screen. I have the

5   source data open right now. But -- but the -- so the

6   2022 gas authorized ROEs ranged from 9.0 to 10.20, and

7   that midpoint is 9.6 instead of 9.4.

8   **Q   Yeah, that would be great if you could share**

9   **your screen.**

10   A   Sure. Now, I pulled up both '22 and '23. I

11 am not allowed to share as of right now.

12   **Q   So on -- we were just talking about 2022,**

13 **right?**

14   A   Yes, sir, but I can't share my screen. I

15 could provide it to you in a late-filed exhibit if you

16 want.

17   MR. MOYLE: All right. Why don't we keep this

18   as an open item. I will work with counsel to see

19   if I have any questions based on this new

20   information.

21   CHAIRMAN FAY: Yeah, if we can go -- move on

22   and then see if --

23   MR. MOYLE: Okay.

24   CHAIRMAN FAY: -- it's something that needs to

25   be submitted, we can address it then.

1   BY MR. MOYLE:

2   **Q   Do you know why there was this discrepancy?**

3   **Did you ask PGS, this document was prepared for a**

4   **February meeting, you know, why didn't you get the right**

5   **number?**

6   A   Well, I just got it, so I didn't. But if you

7   look at the electric authorized ROEs, the low in 2022

8   was 7.85 for an Illinois formula rate plan case. So I

9   have the suspicion that it was an electric case on that

10   2022, but I didn't verify any other ROEs going back over

11   that period, so I don't know for sure, but I would think

12   that that 7.9 is applicable to a formula rate plan ROE

13   for an electric company in Illinois.

14   **Q   When you are determining an ROE, do you look**

15   **to try to group together natural gas companies kind of**

16   **in one bucket and not include electric companies, or**

17   **either directly or indirectly in any way, shape or form?**

18   A   So usually, when you are putting together a

19   comparable group, you want it to be comparable in

20   business risk, so that would automatically disqualify

21   electric companies as a comparable company.

22   **Q   But in years past, when PGS was before the**

23   **Commission, the way they were quarterly structured, they**

24   **had both electric and natural gas under the same parent,**

25   **correct?**

1   A   That's true, but each company would have their

2 own cost of capital, given their -- given their

3 different business risks. I wouldn't say that they are

4 -- any of them are higher or lower in risk. They are

5 just different.

6   And when you are talking about setting rates,

7 they didn't come in together. They came in separately.

8 So the Commission is setting rates for the gas company

9 in one case and the electric company in that case, so

10 you wouldn't want to use the resulting capital one way

11 or the other.

12   **Q   So I take it from that answer, for the proxy**

13 **group that you used, that none of the proxy companies**

14 **have any interest in electric companies, either directly**

15 **or indirectly?**

16   A   I think NiSource may have some electric

17 utilities, but generally it's a gas company. It's

18 specified as a gas company in Value Line -- in Value

19 Line. I guess the different Value Line group that you

20 get in division companies.

21   **Q   Did you weigh that factor differently when you**

22 **were doing your analysis, that it had electric company**

23 **operations within that member company of your proxy**

24 **group?**

25   A   No, sir, because when I selected -- when I

1   selected my proxy group, I have a bogey or a treat

2   criteria on a certain amount of regulated gas

3   distribution operations.

4   **Q   Did you find any other errors on the rate case**

5   **decisions return on equity document?**

6   A   Like I said, I only -- when I saw that 7.9 on

7   the 2022, I just wanted to verify that. I didn't look

8   at anything else other than that. And actually, I

9   looked at 2023, and I already discussed that.

10   **Q   You would agree that in your experience of**

11 **serving as an expert, that the cost of debt is less than**

12 **the cost of equity, correct?**

13   A   Generally, yes. It depends on the risk of the

14 company and how levered they are generally.

15   **Q   But as the Chair has indicated, you know, you**

16 **are in the yes category on that, generally speaking?**

17   A   Generally, yes --

18   **Q   Okay.**

19   A   -- I would agree with it.

20   **Q   Okay. And I am going to try to move along a**

21 **little bit on our questions, so yes, no, if I feel like**

22 **I need an explanation, I will pursue it. If counsel for**

23 **PGS feels like they need an explanation, they will ask**

24 **you on redirect.**

25   **CHAIRMAN FAY: Yeah, Mr. D'Ascendis, I know**

1   it's hard virtually to kind of get a read on that,

2   but if you can just give us, you know, a yes or no

3   and a brief clarification if needed, because I know

4   we've got witness Watson today too, and I just want

5   to make sure we get through everything.

6   THE WITNESS: Sure.

7   CHAIRMAN FAY: Okay.

8   BY MR. MOYLE:

9   Q   Just to confirm, the current ROE that PGS has

10   is among the leaders in the country, correct, in terms

11   of being highest? Yes, no?

12   A   No. No, it's not.

13   Q   If the Commission adopts your recommendation,

14   which is that the top end of 11 percent with 100 basis

15   points, would that be the leader in the country for PGS,

16   a 12-percent return?

17   A   Well, I am recommending 11 percent.

18   Q   Do you have 100 basis points associated with

19   it? Yes, no, 100 basis points?

20   A   That's not my recommendation. My

21   recommendation is 11 percent.

22   Q   So you don't think that a gap of 100 basis

23   points should be part of what this commission would

24   decide?

25   A   Generally, I don't -- I know that's how the

1   Commission rules, but my point estimate is 11 percent.

2   **Q   And would that put Florida and PGS at the top**

3   **of the range as a national leader on ROEs for gas**

4   **companies?**

5   MR. MOYLE: Yes, no -- yes, no, please, Mr.

6   Chair. Mr. Chair --

7   CHAIRMAN FAY: Mr. D'Ascendis, yeah --

8   MR. MOYLE: Could he just give me a yes, no,

9   please?

10   CHAIRMAN FAY: Yes.

11   Hold on, Mr. D'Ascendis. One second.

12   So, Mr. Moyle, I appreciate us wanting the

13   efficiencies. There may need to be a clarification

14   to the premise of your question, and so if it's a

15   general question of where would this put this, he

16   might have to say, based on the context of what you

17   are asking in that question.

18   Now, I understand your point about him going

19   on and on after a yes or no question, so we

20   obviously want to minimize that, but I do think he

21   should be given the opportunity to understand the

22   question.

23   MR. MOYLE: How about if I rephrase and see if

24   I can --

25   CHAIRMAN FAY: Perfect.

1   MR. MOYLE: -- get him to give me a yes or a

2   no.

3 BY MR. MOYLE:

4   **Q   Your recommendation of 11 percent based on**

5 **return on equities provided, would that put Florida at**

6 **or near the top of ROEs for natural gas companies**

7 **nationally?**

8   A   Did you say at or near?

9   **Q   At or near.**

10   A   I don't know.

11   **Q   Do you track ROEs that are issued by regulated**

12 **bodies around the country on a realtime basis?**

13   A   Generally yes, but there are -- the tracking

14 services that I use are limited in scope, and if you

15 want me to keep going.

16   **Q   No. No. I will just do a quick follow-up.**

17   **So would that lead you to conclude that the**

18 **tracking services don't have the best information**

19 **available with respect to ROEs?**

20   A   I would say that they have the best tracking

21 available to ROEs, but they don't -- they don't pick up

22 all of the pie.

23   For instance, Regulatory Research Associates,

24 they only follow a case when the company requests a rate

25 change of at least five million, or has an authorized

1 rate change of at least three million.

2   So because there are several companies that

3 don't fit that criteria, I don't know for sure whether

4 or not PGS would be the leader, or at the top authorized

5 ROEs for gas companies.

6   **Q   Based on your experience, is a rate increase**

7 **of 130 million near top of a range for a gas**

8 **transmission company?**

9   A   The company we are at is a distribution

10 company, correct?

11   **Q   That's right?**

12   A   A transmission company is not --

13   **Q   My bad. Distribution company.**

14   A   I don't -- I don't follow the rate increases,

15 so I don't know the actual dollars.

16   **Q   Could you -- you were asked some questions**

17 **about the PSC's approach to ROEs with respect to water**

18 **cases. Do you have an understanding of that?**

19   A   Yes, sir.

20   **Q   And my understanding of it is, is that,**

21 **generally, it follows a formulaic approach, is that**

22 **consistent with your understanding?**

23   A   It is, but they do have periodic reviews of

24 the formula whether or not it produces reasonable

25 results.

1   Q   Okay. In response to one of my earlier

2 questions when we were talking, you had referenced an

3 ROE that was derived by using a formulaic approach. I

4 take it from that answer that you are aware of other

5 regulatory bodies that use formulas for determining ROE,

6 is that fair?

7   A   Yes, but --

8   Q   Okay. Thank you.

9   MR. MOYLE: That's all I need.

10   CHAIRMAN FAY: Okay.

11 BY MR. MOYLE:

12   Q   I am curious, given that there is a way to

13 apparently do ROEs through a formulaic approach, maybe

14 even an algorithm or Chat GP, tell me the role that

15 judgment plays with respect to determining -- in your

16 work, in what you have done in this case, tell me --

17 tell me the role that judgment plays in making a

18 recommendation to the Commission of an ROE?

19   A   Now, this isn't a yes/no question.

20   Q   No. That's right. I have opened myself up

21 widely here, so go ahead.

22   A   Okay. All right. So, I mean, generally,

23 judgment takes into -- come into play when you are

24 looking at several different model results. So like I

25 said in my opening statements, I use multiple models. I

1   will use my DCF model, my CAPM model, my risk premium

2   models. Those models applied to nonregulated proxy

3   group companies.

4   Other witnesses have other models and they

5   believe other things, and they have their -- and those

6   models, you hit a range of reasonable, and then when you

7   look at market conditions, the distribution of the model

8   results --

9   **Q   Okay.**

10   A   -- you use judgment to recommend an ROE.

11   **Q   I was taking a look at your testimony, and I**

12 **think I have an understanding of the process, so thank**

13 **you for that answer.**

14   **One follow-up. The nonregulated proxy group,**

15 **why -- if you are trying to determine ROEs for natural**

16 **gas distribution companies, why you would use a**

17 **nonregulated proxy group as compared to looking at**

18 **regulated gas companies, if you could find that**

19 **information? Is the answer to that because, well, most**

20 **of them are embedded in larger holding companies and you**

21 **can't get at that information in and of itself?**

22   A   Well, I guess it's a two-parter, right?

23   So you are first question was why do you use a

24 non-reg, and then the second one -- and non-reg meaning

25 nonregulated company -- and then the second part was,

1   why don't you just look at operating company ROEs, were

2   those the two parts?

3   **Q   That's right.**

4   A   Okay. The first -- the first one regarding

5   the nonregulated companies, when you are looking at the

6   nature of regulation, it is supposed to be a substitute

7   for competition. And so then when you are looking at

8   the corresponding risk standard, you would be able to

9   measure an appropriate rate of return if you could find

10 comparable companies. And it doesn't matter whether or

11 not it's a utility company or whether it's not a utility

12 company.

13   **Q   Okay. The document --**

14   A   When you look at -- when you look at certain

15 measures of risk -- and then I will cut this one short

16 because I didn't rec -- I didn't use it in my case and

17 in my recommendation. But if you could find those

18 companies then you could use them as an appropriate

19 measure.

20   For the second part, for the regulated

21 subsidiary portion, you don't have market data. A lot

22 of the -- a lot of the realized rates of returns are

23 accounting based, and they wouldn't be responsive to the

24 needs of the market, so you can't really use accounting

25 measures, or things like that, when you measure an ROE

1   for a company because the ROE is market-based.

2   **Q   Back to the exhibit that we have been**

3   **referencing that was declassified with respect to return**

4   **on equity --**

5   A   Yes.

6   **Q   -- it says in that exhibit that this graph**

7   **illustrates ROE percentages from 2013 through 2022 for**

8   **natural gas local distribution companies across the**

9   **nation. To me, that reads as that's a natural gas**

10   **distribution group of companies that were looked at,**

11   **would you agree with that?**

12   A   Can you rephrase it? In don't -- I don't

13   understand it. I didn't understand your question.

14   **Q   You have a copy of this exhibit, do you not?**

15   A   Yes, sir. I am looking at it.

16   **Q   And it was sent to you over the lunch hour, is**

17   **that right?**

18   A   During the cross of Ms. Wesley.

19   **Q   Okay. The second sentence says that this is a**

20   **comparison of natural gas local distribution companies.**

21   **Do you have any reason -- I mean, do you disagree with**

22   **that? You just think that's not what this document is?**

23   A   I agree that it's the intent of it. I

24   don't -- like I said, the 2022 is wrong. The 2022 data

25   is wrong.

1   Q   Okay. And that's the only area you have

2   identified, one company you believe, correct?

3   A   No, because the top end of the range is wrong,

4   too, right? The top end of the range is 10.2, not 9.9.

5   Q   Do you believe that it's relevant and material

6   information to look at information like this, with

7   respect to return on equity, what other jurisdictions

8   have done? And yes, no?

9   A   I think it's a -- no, because -- no,

10 because --

11   Q   That's all I need. You can -- you can just

12 tell me -- you can just tell me this document that was

13 given to the Board of Directors for their review about

14 ROEs is not relevant and not important to ROEs, so I am

15 okay with that.

16   A   Well, that may be different, but when you are

17 looking at it going forward, when you are looking at the

18 ROE going -- when you are looking at the ROE going

19 forward, that's not a good measure.

20   Q   When you did your evaluation with the risk

21 associated with PGS, did you look at the specific

22 operations of PGS and try to make a risk determination

23 based on their specific facts and circumstances? Yes,

24 no?

25   A   I did. I did.

1   **Q   Okay. So with respect to their most**

2 **significant risk, what did you determine their most**

3 **significant risk to be?**

4   A   Well, if you take a look at -- in my direct

5 testimony, if you take a look at Documents 9 and 10,

6 that was my relative risk analysis of the company as

7 compared to the proxy group.

8   Now, there were two things that I focused on.

9 The first -- the first thing was size. And as you can

10 see on page one of document nine, Peoples Gas is

11 significantly smaller than the proxy group, and the

12 indicated size adjustment from that measure was 62 basis

13 points.

14   Now, if you look at document number 10, the

15 other measure that I looked at compared to the proxy

16 group, or the company compared to the proxy group, was

17 its growth as measured by its capital expenditures, or

18 CAPEX, relative to net plant. And on page one of

19 document number 10, it shows that the company has higher

20 capital expenditures relative to net plant than the rest

21 of the proxy group. So from that, I made an adjustment

22 from David's points to account for those relative risks

23 compared to the proxy group.

24   **Q   You cite some Standard & Poor's and Moody's in**

25 **your testimony. You are familiar with the rating**

1 **agencies and the role they play?**

2 A Not as well as Mr. McOnie, but I am familiar,

3 yeah.

4 **Q Okay. You would agree that rating agencies,**

5 **when they issue a downgrade of a company, that**

6 **directionally that impacts the ability of the company to**

7 **obtain debt by putting upward pressure on the market**

8 **interest rates that can be obtained, correct? Yes, no?**

9 A I would agree with that, but there is

10 additional -- there is additional factors to that.

11 **Q I will let your counsel ask you about that on**

12 **redirect.**

13 A We are on the same page.

14 **Q I have a question with respect to the proxy**

15 **group. You used -- you spent time looking at capital**

16 **structure, have you not?**

17 A Let me see if I have it in my direct or my

18 rebuttal testimony. Yes, if you take a look at document

19 number two, pages two and three --

20 **Q Right.**

21 A -- you will see the capital structures of the

22 proxy group --

23 **Q And what are you -- what are you recommending?**

24 A -- subsidiaries.

25 **Q Tell me -- tell me what you are recommending**

1   **for the capital structure.**

2   A   I didn't recommend the capital structure. I

3   deemed the reasonableness of it. I supported the

4   capital structure. I didn't recommend the capital

5   structure.

6   **Q   So what is your understanding of what it is?**

7   A   What it is -- what the company's request is --

8   **Q   Right.**

9   A   -- is that what you are asking?

10   **Q   Yes.**

11   A   So they are asking for a capital structure

12   which consists of 40.48 percent long-term debt it,

13   4.4 -- or 4.84 percent short-term debt, and 54.68

14   percent equity.

15   **Q   So roughly speaking, 54 equity, 46 debt, both**

16   **long-term and short-term?**

17   A   That's fine, generally, yes, I agree.

18   **Q   And in your research, you identified within**

19   **your proxy group a company that has a 33 percent equity**

20   **component, is that right? Page 24, line 13 of your**

21   **direct.**

22   A   You could also look at document number two,

23   page two of three. That has the same thing, but in

24   number form.

25   **Q   Right. And if includes a company with a**

1   **33-percent equity ratio, correct?**

2   A   It does, sir.

3   **Q   It does?**

4   A   That's what I said. Yes.

5   **Q   I am having a little difficulty with the**

6   **audio.**

7   **And then on page 25, line three, you**

8   **reference, I believe it to be another company, because**

9   **you say that it is a closely held operating utility**

10   **subsidy that has a 38-percent equity component, is that**

11   **right?**

12   A   Yes, sir, but the point of the exercise is

13   that the companies within the range set by the proxy

14   group and their regulated subsidiary companies.

15   **Q   During your research, did you spend any time**

16   **looking at a company called SeaCoast?**

17   A   No.

18   MR. MOYLE: Okay. Those are all the questions

19   I have.

20   CHAIRMAN FAY: Okay. Staff.

21   THE WITNESS: Thank you.

22   EXAMINATION

23   BY MR. THOMPSON:

24   **Q   Good afternoon, Mr. D'Ascendis. How are you**

25   **doing?**

1   A   Good afternoon.

2   **Q   Right there at the end of your cross with Mr.**

3   **Moyle, we were talking about capital expenditures and**

4   **net plant. I want to return back to that real quick.**

5   A   Yes, sir.

6   **Q   So one of the factors in your analysis was**

7   **this ratio of projected capital expenditure relative to**

8   **net plant?**

9   A   Yes, sir.

10   **Q   And specifically, you testified on direct that**

11   **Peoples' capital investment plans made them riskier than**

12   **the proxy group in part because of this --**

13   A   Yes.

14   **Q   Is that in part because of this ratio?**

15   A   Yes, and it's more about when you are -- when

16   you are expending capital, you have to raise capital,

17   and the more that you raise, the more risk you have of

18   defaulting on that capital.

19   **Q   So that's a yes, that Peoples, in your opinion**

20   **is riskier because --**

21   A   Yes.

22   **Q   Okay. And partly as a result of that**

23   **additional risk, you recommended an upward adjustment to**

24   **the ROE of 20 basis points, is that correct?**

25   A   Yes, sir. That, and the size.

1   Q   Okay. Logistically, do you have access to

2   Case Center or no?

3   A   I do.

4   MR. THOMPSON: Okay. And for the parties in

5   the room, I am going to be using Case Center and

6   pushing out page direction for everybody.

7   THE WITNESS: That doesn't mean it's going to

8   work, but, yes, I have it open, and it worked when

9   you ran through it earlier in the week, so --

10   CHAIRMAN FAY: Yeah. Mr. Thompson, if you

11   don't mind also just stating where you are

12   directing us --

13   MR. THOMPSON: I certainly will.

14   CHAIRMAN FAY: -- so if for some reason it

15   doesn't come through for somebody, they are able to

16   go to the page and line of that testimony.

17   MR. THOMPSON: Will do.

18   So I just sent out a page direction. I am

19   currently looking at Exhibit 20, document number

20   10.

21   BY MR. THOMPSON:

22   Q   Do you see that, Mr. D'Ascendis.

23   A   I do. Is there any way that you can shrink it

24   a little bit, because it's kind of blown up on mine?

25   Q   You can on your end. I can't do it for you,

1   though. On the View tab in Case Center, there as zoom

2   out button.

3   A   Yeah, okay. Awesome. Thank you.

4   Q   You are welcome.

5   All right. So this is, again, Exhibit 20,

6   document number 10. For the record, this is master

7   D9-654.

8   This is the comparison of capital expenditures

9   to net plant that you conducted, right?

10   A   Yes, sir.

11   Q   And in yellow is Peoples Gas?

12   A   Yes, sir.

13   Q   The ratio that you calculated was 60 percent

14   for Peoples?

15   A   It was.

16   Q   Okay. Would you agree that the median for

17   this proxy group is 39.5 percent?

18   A   I will agree to your math. I don't -- I don't

19   know.

20   Q   Okay.

21   A   But it looks right. It's in between 38 and

22   41, so --

23   Q   Okay. Thank you.

24   So if the ratio for Peoples is 60 percent, and

25   the median is 39.5, that's a difference of it 20.5

1   percent?

2   A   Yes, sir.

3   Q   Okay. And you performed this same capital

4   expenditures ratio analysis in your rebuttal testimony,

5   is that correct?

6   A   I did.

7   Q   Okay. So I am now looking at Exhibit 30,

8   document number 10, and I have also sent a page

9   direction. Do you see that as well?

10   A   I do. Thank you.

11   Q   Is this the recalculated ratio with your

12 rebuttal testimony?

13   A   Yes, sir. It updated it to 2022 --

14   Q   Okay.

15   A   -- because 2022 already happened, so it would

16 be '23 and '24.

17   Q   Okay. So with it this updated information,

18 like you said, that's the annual report information from

19 2022, PGS's ratio dropped from 60 to 33 percent?

20   A   Yes, sir.

21   Q   And would you agree that the median for this

22 group is 26.5 percent?

23   A   I would.

24   Q   And so the difference between the -- between

25 Peoples and the median in this document is only

1   **six-and-a-half percent, is that correct?**

2   A   I would agree with that, sir.

3   **Q   Okay. So for the original -- and that was on**

4   **direct -- the difference was 20.5 percent, and the new**

5   **difference is 6.5 percent; is that correct?**

6   A   Right. And that would respect the capital

7   going in during that year -- or the year 2022.

8   **Q   So would you agree that that shows that the**

9   **relative risk for Peoples decreased from your direct to**

10   **your rebuttal testimony?**

11   A   I would say, yeah, based on -- based on these

12   numbers, but I don't know whether or not they -- well, I

13   guess, yeah, I mean, I would agree with that, but the

14   debt would still be outstanding, like, the capital would

15   still be outstanding. But, yes, I would agree that

16   going forward, the company is less risky than when they

17   were when they filed based on this measure.

18   **Q   Okay. Thank you.**

19   **The proxy group that you selected, is that**

20   **comprised of holding companies?**

21   A   Atmos is not a holding company.

22   **Q   Atmos is not?**

23   A   I think they -- I think. And then I also

24   think that ONE Gas is not a holding company, but I am

25   not positive on that one.

1   **Q   Okay.**

2   A   But Atmos -- Atmos is absolutely an operating

3 utility.

4   **Q   Okay.**

5   A   And each of their operating subsidiaries are

6 -- or not subsidiaries, all of their operations are

7 different divisions.

8   **Q   Do you know if Atmos has companies located in**

9 **Texas, or if it -- I will leave it at that. Do you know**

10 **if Atmos has companies in Texas?**

11   A   Yes, sir.

12   **Q   They do?**

13   A   Yes.

14   **Q   Do they have any companies in other states?**

15   A   Yes, sir.

16   **Q   Okay. PGS is an operating company, correct?**

17   A   That's right.

18   **Q   Would you agree that comparing PGS to other**

19 **operating companies is a more like to like comparison**

20 **than comparing PGS to holding companies?**

21   A   I would agree, but in the idea -- I would

22 agree, but the issue with that is that there are -- like

23 I said, there is only one publicly traded LDC company.

24 So with the absence of that, you have to go to the next,

25 I guess, level, which would be a gas holding company.

1   And I think like what we said in the

2   deposition, that these companies' assets and net

3   operating income on average are around 80 percent --

4   **Q   Okay.**

5   A   -- so, I mean, generally you would consider

6   them gas operations.

7   **Q   Okay. Is it fair to say that a holding**

8   **company's net plant would be much higher than an**

9   **operating company's net plant?**

10   A   I would absolutely agree with that. I think

11   -- and I think we went through this on the deposition

12   too.

13   When you -- when you look at these companies,

14   you could say that it's kind of the culmination of the

15   plant. Let's say Atmos has eight different operating

16   subsidiaries, that would all be pulled into Atmos, so

17   these numbers would reflect the operating subsidiaries

18   of those companies. But I do agree that their net plant

19   is significantly higher -- well, some are, some aren't.

20   **Q   So with all else held equal then, higher net**

21   **plant would reduce the ratio that we have been talking**

22   **about?**

23   A   You mean -- let me -- let me try and clarify

24   this.

25   So you are saying 100 -- 100 of -- $100 worth

1   of new capital would -- would comprise a lower percent

2   for a higher total net plant than a lower total net

3   plant, is that where you are -- is that where you are

4   going -- or is that what you are asking?

5   **Q   I am not sure I understood you either, like as**

6   **has been said, it's been soft and muffled, so I want to**

7   **make sure I am getting this cross correctly.**

8   **If capital expenditures are equal, so all else**

9   **held equal, would a higher amount of net plant result in**

10 **a lower ratio that we have been looking at?**

11   A   It would.

12   **Q   Okay. So why did you use holding companies**

13 **instead of operating companies when performing this**

14 **analysis?**

15   A   I think we went over this in the deposition as

16 well.

17   The issue with the operating companies is that

18 we wouldn't have expected levels of CAPEX, so we got the

19 expected levels of CAPEX through Value Line. There are

20 no services that provide projections of net plant for

21 operating gas utilities.

22   **Q   Okay. I know it's been talked about today,**

23 **the RRA. Is that the S&P Global Market Intelligence and**

24 **Regulatory Research Associates?**

25   A   It is, sir.

1   **Q   And I take it you are familiar with them?**

2   A   I am.

3   **Q   Do they provide any information on operating**

4 **company net plant or rate base?**

5   A   They do, but they don't provide projections.

6   **Q   Okay. They don't provide projections.**

7   **Do they publish a database or a list of major**

8 **gas utility rate cases?**

9   A   They do.

10   **Q   Could you use to obtain information about the**

11 **operating companies?**

12   A   I guess in my -- in my risk premium analysis,

13 when I ran my regression analysis, I would use the

14 authorized returns or for the operating subsidiaries of

15 holding companies, or just companies that aren't held by

16 anybody.

17   **Q   Okay. Is it your opinion that net plant**

18 **information for the operating company isn't available,**

19 **or that it's just more difficult to find than for the**

20 **holding companies?**

21   A   Operating company net plant is available.

22 Projected net plant is not. It doesn't exist. So you

23 can't make the study of projected capital expenditures

24 when the data doesn't exist.

25   **Q   Okay. And you used historical net plant,**

1   **correct?**

2   A   I used data, so historical net plant, but -- I

3   am sorry, projected capital expenditures. So the net

4   plant, the historical net plant is available, the

5   projected CAPEX is not available for the operating

6   subsidiaries. I apologize.

7   **Q   Okay. Would you agree that a company with a**

8   **higher equity ratio has less financial risk than one**

9   **with a lower equity ratio, all else held equal?**

10   A   I would agree.

11   **Q   Okay. And I know it was discussed there at**

12   **the end of the last cross, but for its projected capital**

13   **structure, PGS is requesting an equity ratio of about**

14   **54.7 percent?**

15   A   Yes, sir.

16   **Q   Okay. I am looking at Exhibit 30, document**

17   **number two, page two, and sent out a page direction. Do**

18   **you see that as well?**

19   A   I do.

20   **Q   Okay. This has each of the proxy groups, and**

21   **then at the bottom, there is a row for the proxy group**

22   **as a whole, is that correct?**

23   A   Yes, sir.

24   **Q   Okay. Now, these are the capital structure**

25   **ratios for each of the holding companies or operating**

1   **companies in the proxy group, right?**

2   A   Page two is holding companies. Page three is

3   operating subsidiaries.

4   **Q   Okay. So if I am looking at page two, the**

5   **holding companies, the average equity ratio for the**

6   **proxy group was 48.83 percent?**

7   A   I would agree with that.

8   **Q   And that's a lower equity ratio than PGS's**

9   **requested equity ratio, is that right?**

10   A   I would agree with that.

11   **Q   Did you consider a downward adjustment to your**

12   **recommended ROE in light of that lower financial risk?**

13   A   No, I didn't.

14   **Q   Okay. There has been a lot of discussion**

15   **today about the risk premium models -- oh, sorry, one**

16   **moment.**

17   **Why did you not consider a downward**

18   **adjustment?**

19   A   So if you take a look at pages two and you

20   look at page three, you can see that the operating

21   utility companies have more comparable number, and more

22   comparable levels of common equity. So when you look at

23   both of them, you would -- you would -- well, at less my

24   opinion is, is that there isn't a difference in risk to

25   the capital structure.

1   **Q   Okay. But why use the operating companies for**

2 **the financial risk comparison if you are using the**

3 **holding companies to calculate the market cost of**

4 **equity?**

5   A   Well, I agree with you there, where there is a

6 piece where you are looking at holding companies to

7 derive a market risk premium for the market return on

8 equity, and then you are looking at the operating

9 companies for the common -- for the common equity cost

10 rate. So I understand the difference.

11   We agreed earlier that these holding company

12 -- or the operating of subsidiaries are more comparable

13 to the companies than -- let me start over again.

14   The operating subsidiary companies are more

15 similar in risk to the target company, in this case is

16 PGS. So when you can get through that type of analyses,

17 you use that. You can't -- you can't get -- I guess --

18 let's try -- so you can't get market data for an

19 operating subsidiary company. You can -- and that's why

20 you can't do an ROE analysis on those companies --

21   **Q   Okay. Operating companies are --**

22   A   -- on the other hand --

23   **Q   I am sorry. My apologies. Please continue.**

24   A   I am sorry. I hear the echo, so that's why

25 there is pauses between everything I say.

1   So you use -- so when you -- like I said, the

2   operating companies don't issue -- don't issue equity

3   but they do issue debt. And when you look at the common

4   -- when you can look and observe data for the operating

5   companies, I agree with you, that the operating

6   companies is a better comparison.

7   **Q   Okay. And operating companies don't issue**

8   **stock, I think you -- sorry once again.**

9   A   Yeah. Yep.

10   **Q   Operating companies don't issue stock, though,**

11   **right? I think you just said that.**

12   A   Yes, sir.

13   **Q   So they are not publicly traded, but you**

14   **relied on the price of the stock from the holding**

15   **companies that have lower security ratios to determine**

16   **the ROE?**

17   A   Try -- can you say that again, please?

18   **Q   You relied on the price of the stock from the**

19   **holding companies that have lower equity ratios to**

20   **determine the ROE, is that correct?**

21   A   That's right. And I mean, and like I said, if

22   you look at Atmos, on page one, that's the only one

23   that's not a holding company, and you can see that their

24   common equity ratio is 62 percent.

25   **Q   Okay. Thank you.**

1   **So there was a lot of discussion about risk**

2   **premium models earlier. It's my understanding that**

3   **there are two different risk premium models, is that**

4   **correct?**

5   A   That I present, sir?

6   **Q   Correct, that you presented in your direct and**

7   **rebuttal testimony.**

8   A   Yes.

9   **Q   So there is the Predictive Risk Premium Model**

10 **and the Total Market Approach Risk Premium Model?**

11   A   Yes, sir.

12   **Q   Okay. So that's the PRPM and the TMARPM.**

13   **My understanding is you performed the TMARPM**

14 **but did not use it in this case to craft your**

15 **recommended ROE, is that correct?**

16   A   No, sir. So if you go to -- I guess, right

17 now I am on -- if you go on document one, page two. Are

18 you there?

19   **Q   I am.**

20   A   So if you look at document one, page two, and

21 you look at line number five, you will see my range --

22 my unadjusted range of result, and that would include

23 the high end and the low end. The low is the DCF cost

24 rate at 9.6, and the CAPM result of 11.74. The 11.42

25 percent is subsumed in that. I do not use the non-price

1   regulated companies in my determination in this case.

2   **Q   Right. And so the non-price regulated**

3   **companies is the TMA approach, is that correct?**

4   A   NO, it's not.

5   Yeah, so if you -- the TMA approach would be

6   contained in document seven in my direct and rebuttal

7   testimony. The TMA approach starts on page four -- or

8   page three of document number four.

9   **Q   Okay. Thank you for that clarification.**

10   A   Sure.

11   **Q   I am looking at Exhibit 30, document number**

12   **four, page one, and sent a page direction for it. That**

13   **is E5-176. Do you see that?**

14   A   Yes.

15   **Q   Okay. So this is a summary, or conclusion of**

16   **the Predictive Risk Premium Model being performed,**

17   **correct?**

18   A   Yes, the top -- the top row is the results of

19   the PRPM, and the second -- the second is the RPTMA. I

20   might take that from you. I like the shortened from

21   total market approach.

22   **Q   Six words is a mouthful.**

23   **Okay. So your PRPM analysis resulted in**

24   **indicated ROE of 11.82 percent?**

25   A   That's right.

1   Q   And that was either than either your DCF or

2   CAPM?

3   A   It was.

4   Q   Okay. All right. I am now looking at what

5   has been entered as Exhibit 132. This is Attachment 16

6   to that, and it's master page F3030. Do you see that?

7   A   Yes, sir.

8   Q   All right. This is an article titled

9   Comparative Evaluation of the Predictive Risk Premium

10 Model, the Discounted Cash Flow Model and the Capital

11 Asset Pricing Model for Estimating the Cost of Common

12 Equity, correct?

13   A   Yes, sir.

14   Q   You coauthored this article?

15   A   Yes, I did.

16   Q   And it was published in 2013?

17   A   It was.

18   Q   You noticed approximately six people that have

19 testified about or endorsed this model?

20   A   That sounds about right. Yeah.

21   Q   And so that includes you and the co-authors of

22 the article?

23   A   Yes.

24   Q   And then a Robert Hebert who is now retired?

25   A   He is the CFO of Unitele, so I don't know if

1   he is retired, but out of the industry I mean -- out of

2   the testifying rank for the ROE anyway.

3   **Q   One moment.**

4   A   That might have been a discrepancy in the

5   deposition.

6   **Q   Okay. Would you -- if you -- would it be**

7   **possible that you said he was retired in the deposition?**

8   A   I think so, because it said retired up in

9   Alaska, and that's like that's -- I definitely wasn't

10 what I said, so --

11   **Q   Okay. And then there was one other individual**

12 **that you are aware of?**

13   A   Yes, sir. His name is Perkins, his last name

14 is Perkins. He used it in a -- to my knowledge, he used

15 it in a case up in Maine for Emera Maine.

16   **Q   Okay. All right. Further into this article**

17 **-- I sent out a page direction. It's master page F3034.**

18 **I am looking Figure 4 of the article. Do you see that?**

19   A   I do.

20   **Q   This figure compares the indicated return on**

21 **equity using the PRPM model against the indicated ROEs**

22 **for the DCF and CAPM methods, is that correct?**

23   A   Yes, sir.

24   **Q   Now, this particular figure, Figure 4, is**

25 **comparing only the results for gas companies, right?**

1   A   That's right. It based on the AUS Utility

2   Report gas companies, but they are all considered gas

3   companies. They are not necessarily proxy companies in

4   this case, though.

5   **Q   Okay. Starting at the far left, the line near**

6   **the top, beginning near about 14.5 percent, because**

7   **these aren't colored, and it's a scan, it's kind of hard**

8   **to tell, but is that line the indicated ROE for the**

9   **PRPM?**

10   A   The top line is, yeah.

11   **Q   Okay. And then below that, starting between**

12 **10-and-a-half and 11-and-a-half percent, is that the**

13 **CAPM model?**

14   A   It is.

15   **Q   And then the last one would be the DCF model?**

16   A   It is.

17   **Q   So for the more than five-year period analyzed**

18 **in this article, the PRPM resulted in a higher indicated**

19 **ROE than the DCF or the CAPM every single time?**

20   A   It looks like there might be some in the

21 beginning of -- in the beginning of or the middle of

22 2011. But, yes, I would say that over that period, the

23 PRPM was higher. Sometimes it's lower, but, like, for

24 in this -- in this case, if you -- if you look at the

25 PRPM results of 11.82, they are higher but comparable to

1   the CAPM results of 11.74.

2   **Q   Okay.**

3   MS. CHRISTENSEN: Commissioner, can we

4   interrupt? We are not -- we didn't get the copy of

5   the article that you pushed out.

6   MR. THOMPSON: I can send the page direction

7   again.

8   CHAIRMAN FAY: Yeah, we can also just direct

9   you to the master number.

10   MR. THOMPSON: F3034.

11   CHAIRMAN FAY: F3034.

12   MS. CHRISTENSEN: Where are we? In his

13   direct, or rebuttal, or --

14   MR. THOMPSON: This is an interrogatory

15   response, or a production for document filed

16   response.

17   MS. CHRISTENSEN: And where would we find

18   that?

19   MR. THOMPSON: This is PGS's response to OPC's

20   sixth POD.

21   MR. MOYLE: And what got pushed out to me is

22   page five of six, is that right, only that one

23   page?

24   MR. THOMPSON: Correct.

25   MR. MOYLE: I didn't get it the first time,

1   but I did get it just now. Thank you.

2   MR. THOMPSON: Okay.

3   MS. CHRISTENSEN: No.

4   MS. HELTON: Under the find button, do you

5   have either direction turned on, Ms. Christensen?

6   Just --

7   CHAIRMAN FAY: So if in Case Center, you go to

8   the find, like Ms. Helton is talking about, there

9   is an auto direction button you click on, and when

10   you do that it will --

11   MS. CHRISTENSEN: Yeah, I have auto direct on

12   and page direct. Let me try refresh.

13   Go ahead. He will share.

14   MR. THOMPSON: Okay.

15   BY MR. THOMPSON:

16   **Q   Mr. D'Ascendis, still on page five of this,**

17   **there is some text columns. In the center column near**

18   **the middle, or near the bottom, the article states**

19   **Figures 2 through 5 clearly show that, for the most**

20   **part, the PRPM produces a higher average indicated ROE**

21   **than both the DCF and the CAPM. Did I read that right?**

22   A   That is right.

23   **Q   Okay. I am now looking at Exhibit 30,**

24   **document number four, page two, which is master E5177.**

25   **If you are looking at this, and you want, if you click**

1   on the view tab, there is an option to rotate to the

2   right so you don't have to angle your neck. Just a

3   suggestion.

4   A   Perfect. I was looking for that.

5   Q   Okay. Do you see this, Mr. D'Ascendis?

6   A   Yes, sir.

7   Q   Okay. What is this document we are looking

8   at?

9   A   These are the results of the PRPM.

10   Q   Okay. On the far right, column seven, is that

11   the ROE indicated by the RPM -- PRPM?

12   A   It is.

13   Q   Okay.

14   A   It is.

15   Q   There is a row labeled ONE Gas, and at the end

16   it says, NMF. NMF means nonmeaningful figure, is that

17   correct?

18   A   That's correct.

19   Q   And the foot notes on this page, specifically

20   Footnote 5, specifies that column seven is calculated by

21   adding columns five and six; is that right?

22   A   That's right.

23   Q   If you were to add columns five and six for

24   ONE Gas, that would result in an indicated ROE of 19.1

25   percent, is that right?

1   A   It would.

2   **Q   And then you removed that because, in your**

3 **opinion, it was too high?**

4   A   That, and the GARCH coefficient, which is

5 column four, that GARCH coefficient is not statistically

6 significant.

7   **Q   Okay.**

8   A   Now --

9   CHAIRMAN FAY: Mr. Thompson, I don't want to

10   interrupt you. I just want to get an idea on your

11   time just to make sure we give the court reporter a

12   break.

13   MR. THOMPSON: I think I am probably about

14   90 percent done.

15   CHAIRMAN FAY: Okay.

16   MR. THOMPSON: My apologies, that was not a

17   pleasant sound.

18 BY MR. THOMPSON:

19   **Q   Mr. D'Ascendis, the PRPM model, your article**

20 **stated that the model is stable and consistent over**

21 **time, right?**

22   A   That's right.

23   **Q   Okay. All right. Now I am staying in Exhibit**

24 **30, but moving to document number three, page one,**

25 **another one where it might be convenient to rotate the**

1   **page.**

2   **Do you see that, Mr. D'Ascendis?**

3   A   I do.

4   **Q   Column seven -- well, what is this document?**

5   A   It's my application of the DCF model.

6   **Q   Okay. And so column seven is the ROE**

7   **indicated by the DCF model?**

8   A   It is.

9   **Q   And for ONE Gas, the DCF model indicated an**

10   **ROE of 8.84 percent?**

11   A   That's right.

12   **Q   Still in Exhibit 30, now looking at document**

13   **number five, page one. What is this document?**

14   A   This is the application of the CAPM to my

15   proxy group company.

16   **Q   Column six is the ROE indicated by the**

17   **traditional CAPM?**

18   A   It is.

19   **Q   And for ONE Gas, the CAPM indicated an**

20   **appropriate ROE of 10.91 percent, is that correct?**

21   A   That's right.

22   **Q   The DCF and CAPM methodologies are widely used**

23   **by regulatory bodies across the country?**

24   A   They are.

25   **Q   And I believe I said earlier, but you**

1 **testified approximately 130 times on behalf of**

2 **utilities?**

3   A   Around there, yes.

4   **Q   And in that time, two jurisdictions have**

5 **accepted one of the risk premium models?**

6   A   The PRPM.

7   **Q   Okay. I did want to follow up on that. I**

8 **don't want to repeat South Carolina, because I know that**

9 **was asked and answered already. But for North Carolina,**

10 **my notes said that that was the -- you indicated that**

11 **was the total market approach model, is that correct?**

12   A   That's right. Yeah. So it was -- it accepted

13 the CAPM, which includes the PRPM calculation of the

14 market risk premium, and then the total market approach,

15 where it's used in two of, I guess if you roll off -- if

16 you roll off two pages from where you directed us to --

17   **Q   Okay.**

18   A   -- you will see that -- you will se the piece

19 of the PRPM on line 3 there. So they approve -- they

20 were fine with that calculation. And then if you roll

21 up to page eight of 12 on that document four, if you

22 look at line three, they -- they accepted that in the --

23 in their order in North Carolina.

24   So the application was page eight, line three

25 of document four, line three of page 11 of document

1   four, and page -- and then measure three on page two of

2   document five.

3   **Q   Okay. You might have lost me on a few of**

4   **those. I apologize.**

5   A   I will try it again.

6   So line three on page eight of four.

7   **Q   Document four, page eight, line three?**

8   A   Line three, yes. Page 11, same line. And

9   then on page two of document five, measure three.

10   **Q   Okay. So in the -- you provided an**

11 **interrogatory response related to these two orders, is**

12 **that correct?**

13   A   Yes, sir.

14   **Q   And the question that this was responding to**

15 **was -- give me just a moment -- please list any utility**

16 **regulatory jurisdictions or agencies that have accepted**

17 **and relied upon witness D'Ascendis' GARCH methodology to**

18 **determine the authorized ROE for a regulated gas or**

19 **electric utility in the United States of America.**

20   **You provided these two cases, one in South**

21 **Carolina and one in North Carolina. The South Carolina**

22 **commission does not directly reference either of the RPM**

23 **models, is that correct?**

24   A   That's right. They just took my

25 recommendation --

1   Q   Okay. And to be clear, they ultimately --

2   A   -- with --

3   Q   I'm sorry?

4   A   I'm sorry. I'm sorry. But them accepting my

5 position would imply the acceptance of the model, at

6 least that my opinion.

7   Q   Okay. And the Commission ultimately approved

8 an R -- the South Carolina commission, that is --

9 ultimately approved an ROE on the low end of Mr.

10 D'Ascendis' range, is that correct?

11   A   That's right.

12   Q   And then for the North Carolina utility

13 commission, that was not the Predictive Risk Premium

14 Model, is that correct?

15   A   It was -- they accepted the pieces that we

16 just went over.

17   Q   Okay. That you delineated?

18   A   Not the -- not the application of the model to

19 the individual utility companies.

20   Q   Okay. And ultimately, the North Carolina

21 commission approved a return on equity, rate of return,

22 or a return on equity, that was below what that risk

23 premium model indicated, is that correct?

24   A   Yes. That's correct, because, I mean, all --

25 all commissions -- well, all commissions should, I

1 guess, look at multiple models and not rely on one. So

2 I'm not surprised that it was -- that it was a

3 combination of all of the models that they said in that

4 order.

5   **Q   Okay. Would you agree that the DCF model can**

6 **be verified using a simple algebraic calculation?**

7   A   Can you repeat that? I am sorry.

8   **Q   Would you agree that the DCF model can be**

9 **easily verified by using a simple algebraic equation?**

10   A   Yes.

11   **Q   Okay. Would you agree to the same for the**

12 **CAPM?**

13   A   Yes.

14   **Q   And would you agree to the same for the PRPM?**

15   A   No, it wouldn't be simple Algebra.

16   **Q   Okay. To estimate the coefficients and the**

17 **monthly variances, you had to use a statistical**

18 **software?**

19   A   You do.

20   **Q   And is that statistical software called**

21 **EViews?**

22   A   You could use any statistical software. There

23 isn't -- so S -- S -- LIMSI -- there is a couple of

24 them. SRATS, I think it's called, but there is several.

25 You don't need to use if 15 views if you have access to

1   any type of statistical model. You could run the GARCH

2   mo-- you could run the GARCH model using inputs that I

3   provided.

4   **Q   Is EViews free or does it require payment?**

5   A   I am sorry?

6   **Q   Is EViews free or does it require payment?**

7   A   You have to pay for it, but I remember in my

8   responses to interrogatories, where I volunteered myself

9   on the software to verify the data, and wasn't taken up

10 on it.

11   MR. THOMPSON: Mr. Chair, one moment.

12   CHAIRMAN FAY: Okay.

13 BY MR. THOMPSON:

14   **Q   Last two questions for you, Mr. D'Ascendis.**

15 **So you published the PRPM model in the Electricity**

16 **Journal in 2013?**

17   A   Yes, sir.

18   **Q   Okay. And it's been accepted twice since**

19 **then?**

20   A   Yes, that sounds right.

21   **Q   Okay. Is the PRPM, as you used it, generally**

22 **accepted and available, or used by investors to**

23 **calculate ROEs?**

24   A   I would say yes. The GARCH methodology is

25 ubiquitous within the investor community, so I would say

1   yes.

2   MR. THOMPSON: Okay. No further questions.

3   CHAIRMAN FAY: Okay.

4   THE WITNESS: Thank you.

5   CHAIRMAN FAY: Commissioners?

6   Okay. Redirect?

7   MR. MEANS: No redirect, Mr. Chairman.

8   CHAIRMAN FAY: Okay. Enter in some exhibits?

9   MR. MEANS: Yes, Mr. Chairman. We ask that

10   Exhibits 20 and 30 on the comprehensive exhibit

11   list be moved into the record.

12   CHAIRMAN FAY: Okay. Showing no objection,

13   show those entered.

14   (Whereupon, Exhibit Nos. 20 & 30 were received

15   into evidence.)

16   MR. MEANS: And may the witness be excused?

17   CHAIRMAN FAY: Let's enter in OPC's exhibits

18   first.

19   MR. MEANS: Oh, I am sorry.

20   MS. CHRISTENSEN: Yes, I would ask --

21   CHAIRMAN FAY: That's okay.

22   Go ahead, Ms. Christensen.

23   MS. CHRISTENSEN: I would ask to have Exhibit

24   180 through 184 admitted into the record.

25   CHAIRMAN FAY: Okay. Without objection, show

1   those entered.

2   (Whereupon, Exhibit Nos. 180-184 were received

3 into evidence.)

4   CHAIRMAN FAY: Mr. Moyle.

5   MR. MOYLE: That stand-alone exhibit that was

6   declassified, I probably would like to get that

7   entered into the record so it's easily accessible

8   for briefing purposes.

9   CHAIRMAN FAY: Okay. Just that page?

10   MR. MOYLE: We will do it -- that's right,

11   that one page. I will work with the parties and,

12   at another time, offer it as an exhibit if that's

13   okay.

14   CHAIRMAN FAY: Okay. That's fine. And then,

15   yeah, just whenever you want to introduce it, just

16   remind me that we are bringing it back up and we

17   will enter it in, I presume without any objection.

18   MR. MOYLE: Thank you.

19   CHAIRMAN FAY: Yep. Thanks.

20   All right. With that, Mr. Means?

21   MR. MEANS: Yes, Mr. Chairman, may Mr.

22   D'Ascendis be excused?

23   CHAIRMAN FAY: He may be excused. Yes.

24   MR. MEANS: Thank you.

25   THE WITNESS: Thank you.

1   (Witness excused.)

2   CHAIRMAN FAY: All right. Commissioners,

3   would going to take a break and then come back with

4   Mr. Watson as the next witness.

5   What I would like, though, is to make sure our

6   IT and our folks get Mr. Watson teed up and we've

7   got everything tested, so when we come back here --

8   and I am going to give us until 4:30 just to make

9   sure everybody gets set up and give the court

10   reporter a little break, because we ran a little

11   long on that witness.

12   So any questions before we break?

13   MR. WAHLEN: Just wondering if you expect Mr.

14   Watson to be the last witness today?

15   CHAIRMAN FAY: It would depend on how much

16   cross we have for him, I think that would -- that

17   would vary.

18   OPC or Mr. Moyle, do you have any thoughts in

19   general? We are not asking you to limit it by any

20   means, but just do get a general idea.

21   MS. CHRISTENSEN: I am assuming it's going to

22   run probably about the same as Mr. D'Ascendis, so

23   maybe an hour, hour and 15 minutes, depending on

24   how the witness responds.

25   CHAIRMAN FAY: Okay. Mr. Moyle?

1   MR. MOYLE: I think there is a lot riding on

2   how yes/no versus narratives, so for the good of

3   the order, I will try to make it shorter than it

4   was previously.

5   CHAIRMAN FAY: Did you just dodge my question

6   by giving an elaborate answer, Mr. Moyle?

7   MR. WAHLEN: He didn't answer yes or no. He

8   just explained.

9   CHAIRMAN FAY: All right. Staff?

10   MR. THOMPSON: Tentatively, staff has no cross

11   for Mr. Watson, but obviously that's subject to

12   change depending on --

13   CHAIRMAN FAY: Okay. I would presume there is

14   a probability he would be the last witness, I mean,

15   unless something changes and a deposition gets

16   entered or something, I think at this point, that

17   probably will take us until later tonight.

18   MR. WAHLEN: Okay. Mr. O'Connor is here. We

19   are going to allow him to relax back at the hotel,

20   I suppose, until tomorrow. You want to --

21   CHAIRMAN FAY: I would like to keep him

22   here --

23   MR. WAHLEN: Okay, very well.

24   CHAIRMAN FAY: -- depending, to see how this

25   goes.

1   MR. WAHLEN: Okay.

2   CHAIRMAN FAY: Okay. Thank you, Mr. Wahlen.

3   MR. WAHLEN: Yep.

4   (Brief recess.)

5   (Transcript continues in sequence in Volume

6   4.)

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1   CERTIFICATE OF REPORTER

2   STATE OF FLORIDA   )
    COUNTY OF LEON   )

3

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5   I, DEBRA KRICK, Court Reporter, do hereby

6   certify that the foregoing proceeding was heard at the

7   time and place herein stated.

8   IT IS FURTHER CERTIFIED that I

9   stenographically reported the said proceedings; that the

10 same has been transcribed under my direct supervision;

11 and that this transcript constitutes a true

12 transcription of my notes of said proceedings.

13   I FURTHER CERTIFY that I am not a relative,

14 employee, attorney or counsel of any of the parties, nor

15 am I a relative or employee of any of the parties'

16 attorney or counsel connected with the action, nor am I

17 financially interested in the action.

18   DATED this 16th day of September, 2023.

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21

22 _____
    DEBRA R. KRICK

23 NOTARY PUBLIC
    COMMISSION #HH31926

24 EXPIRES AUGUST 13, 2024

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