

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission,	:	
	:	
Complainant	:	
	:	
v.	:	Docket No. R-2018-3006818
	:	
Peoples Natural Gas Company LLC,	:	
	:	
Respondent	:	

**REJOINDER TESTIMONY OF
PAUL R. MOUL, MANAGING CONSULTANT
P. MOUL & ASSOCIATES
ON BEHALF OF
PEOPLES NATURAL GAS COMPANY LLC**

Concerning
Rate of Return

DATE SERVED: June 17, 2019

Peoples Statement No. 9-RJ

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1 **Q. Please state your name, occupation and business address.**

2 A. My name is Paul R. Moul and I am Managing Consultant at the firm P. Moul &
3 Associates. My business address is 251 Hopkins Road, Haddonfield, NJ 08033-3062.

4 **Q. Mr. Moul, have you previously submitted direct and rebuttal testimony in this**
5 **proceeding?**

6 A. Yes. My direct testimony was submitted with the Company's case-in-chief on
7 January 18, 2019 and my rebuttal testimony was submitted on May 28, 2019.

8 **Q. What is the purpose of your rejoinder testimony?**

9 A. Peoples Natural Gas Company, LLC ("Peoples" or the "Company") has requested
10 that I respond to the surrebuttal testimony presented by Christopher M. Henkel, a
11 witness appearing on behalf of the Commission's Bureau of Investigation and
12 Enforcement ("I&E"), and Mr. Kevin W. O'Donnell a witness appearing on behalf of
13 the Office of Consumer Advocate ("OCA").

14 **Q. Based on your review of the surrebuttal testimony of Messrs. Henkel and**
15 **O'Donnell, do you propose any change in your recommended return for Peoples**
16 **in this proceeding?**

17 A. No. There was nothing contained in the surrebuttal testimony of Messrs. Henkel and
18 O'Donnell that changes my position that Peoples is entitled to an 11.25% rate of
19 return on common equity. The proposals of Messrs. Henkel and O'Donnell of 8.75%
20 and 8.97%, respectively, are entirely too low by reference to returns set in other
21 public utility rate cases. The Commission has recently set a 9.85% rate of return on
22 common equity for an electric utility that included a 0.05% increment for
23 management performance. Further, the Company's DSIC rate is currently 10.10%,

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1 which includes no factor for management performance. Please note that when setting
2 the Company's DSIC return for gas utilities, the Commission set it at a higher rate
3 than established for the electric utilities. And this determination does not support Mr.
4 Henkel's claim on page 30 of his surrebuttal testimony that DSIC returns establish a
5 benchmark to determine whether a utility is "overearning." These returns clearly
6 demonstrate that the proposals by the I&E and OCA are defective. This is
7 particularly true for the OCA, which is 135 basis points below prevailing DSIC return
8 for gas utilities in Pennsylvania.

9 **Q. On pages 2 through 6 of his surrebuttal testimony Mr. O'Donnell responds to my**
10 **rebuttal concerning the TCJA. And on pages 6 and 7, Mr. O'Donnell discusses**
11 **capital structure. Has Mr. O'Donnell considered the linkage between these two**
12 **issues?**

13 A. No. While it is true that TCJA has been in effect for over one year, Mr. O'Donnell
14 has not disputed the fact that TCJA has reduced the cash flow of public utilities and
15 has lowered the pre-tax interest coverage for them. Yet Mr. O'Donnell persists in his
16 position that the Company should have weaker credit metrics after implementation of
17 TCJA.

18 **Q. How has Mr. O'Donnell done this?**

19 A. He advocates weaker credit metric through both a lower equity return and a more
20 highly leveraged capital structure that contains more debt than Peoples actually has in
21 its capital structure. Mr. O'Donnell mentions the UGI electric order by the
22 Commission in his surrebuttal. But he fails to acknowledge that the Commission set
23 the equity return at 9.85% using a 54.02% common equity ratio for UGI Electric. On

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1 the other hand, Mr. O'Donnell advocates an 8.75% equity return and a 50.09%
2 common equity ratio that together will provide far less credit support for the
3 Company, than the Commission's determination in the UGI Electric case.

4 **Q. In his surrebuttal testimony, Mr. O'Donnell opines that it is the "Duty of the**
5 **Commission" to send a signal to Peoples that customers can no longer afford**
6 **unnecessarily high common equity ratios. Is the admonition warranted?**

7 A. No. The Commission has a long history of imposing hypothetical capital structure
8 ratios on the utilities it regulates when the actual capital structure ratios are not
9 reasonable. Contrary to Mr. O'Donnell's assertion that neither I or the Commission
10 have an upper limit on a reasonable equity ratio, the Commission's policy on capital
11 structure does indeed place an upward limit on the amount of common equity in a
12 capital structure that triggers the imposition of a hypothetical capital structure. That
13 limit is the high end of the range of equity ratios employed by the barometer group
14 companies. As I explained in my rebuttal testimony (see Peoples Statement No. 9R at
15 page 7), the actual common equity ratio of 54.02% fully complies with its standards.

16 **Q. On page 22 of his surrebuttal testimony, Mr. Henkel claims that less weight**
17 **should be given to more distant forecasts because they are less reliable. Please**
18 **respond.**

19 A. I find his observations to conflict with his use of five-year projections of earnings
20 growth in his DCF analysis. If reliance upon five-year projections is appropriate for
21 DCF purposes, then there is no reason to discount any of the projections of Treasury
22 yields when assessing the appropriate risk-free rate of return in the CAPM.

23 **Q. Mr. Henkel seems to imply that the evidence you used to support the size**

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1 **adjustment in the CAPM is not specific to utility stocks. Is this correct?**

2 A. No. Mr. Henkel states on pages 23-25 that the Fama/French study is not specific to
3 utility stocks. But what Mr. Henkel has not acknowledged is that utility stock
4 performance was used in the Fama/French study that makes the size adjustment
5 relevant to utilities, and appropriate to consider in this case.

6 **Q. On pages 31-34 of his surrebuttal testimony, Mr. Henkel claims that**
7 **management performance need not be considered as an issue in this case. Is that**
8 **correct?**

9 A. No. The Commission has a long history of recognizing management performance
10 (either positively or negatively) in rate case decisions. As I noted in my rebuttal
11 testimony, the Commission has an Above Average/3 ranking by RRA. If the
12 Commission were to abandon its constructive ratesetting approaches, such as
13 recognition of management performance, or to significantly reduce the return to levels
14 suggested by Mr. Henkel, then its ranking by RRA would surely suffer.

15 **Q. Mr. O'Donnell claims at pages 7-9 of his surrebuttal that the RRA Regulatory**
16 **Rankings are from the standpoint of investors and that the Commission should**
17 **not be swayed by them. Do you agree?**

18 A. No. Regardless of the perspective of RRA, their system of ranking state commissions
19 provides a relative basis for comparison. So, all state commissions are viewed within
20 the same context, even if it is from an investor perspective. So, it is vitally important
21 that the Commission is viewed as a supportive regulator because it permits the
22 attraction of capital from investors at reasonable rates. This is extremely important
23 due to the significant capital needed by Pennsylvania utilities which require the

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1 attraction of investor-provided capital.

2 **Q. Mr. O'Donnell continues to argue at page 10 of his surrebuttal for the use of the**
3 **geometric mean in the CAPM. Is his assertion correct?**

4 A. No. He has provided no evidence in support of his position. He merely states that he
5 also used the arithmetic mean in his CAPM analysis. Using both a correct mean (i.e.,
6 arithmetic) and an incorrect mean (i.e., geometric), does not make reliance on the
7 geometric mean proper. Since we are using a measure of central tendency in
8 analyzing the historical returns, the influence of outliers is minimized through use of
9 the arithmetic mean. Moreover, the central tendency of the arithmetic returns is far
10 less dependent upon the initial and terminal values that represent the sole determinants
11 in the geometric mean. That is to say, the geometric mean that Mr. O'Donnell also
12 advocates is totally dependent upon the initial and terminal values, while the
13 intervening values are not relevant to the final result. This unrealistic assumption
14 does not conform with investors' expectations that consider return possibilities each
15 and every year. Therefore, the arithmetic mean is the only measure that provides a
16 less biased result than the geometric mean. And with the single period specification
17 of the CAPM, it is the arithmetic mean that properly fulfills the requirements of the
18 model.

19 **Q. Does this conclude your rejoinder testimony?**

20 A. Yes.