

**BEFORE THE PENNSYLVANIA PUBLIC
UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
	:	
	:	
v.	:	DOCKET NO. R-2020-3018835
	:	
COLUMBIA GAS OF PENNSYLVANIA, INC.	:	

**REBUTTAL TESTIMONY OF
KEVIN W. O'DONNELL, CFA**

**ON BEHALF OF
OFFICE OF CONSUMER ADVOCATE**

August 26, 2020

1 **Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS FOR**
2 **THE RECORD.**

3 A. My name is Kevin W. O'Donnell. I am President of Nova Energy Consultants, Inc. My
4 business address is 1350 SE Maynard Rd., Suite 101, Cary, North Carolina 27511.

5
6 **Q. ON WHOSE BEHALF ARE YOU PRESENTING TESTIMONY IN THIS**
7 **PROCEEDING?**

8 A. I am testifying on behalf of the Pennsylvania Office of Consumer Advocate (OCA). The
9 OCA represents consumers before the Pennsylvania Public Utility Commission
10 (Commission).

11
12 **Q. MR. O'DONNELL, DID YOU SUBMIT PREFILED WRITTEN DIRECT**
13 **TESTIMONY ON BEHALF OF THE OFFICE OF CONSUMER ADVOCATE IN**
14 **THIS CASE?**

15 A. Yes.

16
17 **Q. MR. O'DONNELL, WHAT IS THE PURPOSE OF YOUR REBUTTAL**
18 **TESTIMONY IN THIS PROCEEDING?**

19 A. To review the testimony of Christopher Keller, Fixed Utility Financial Analyst with the
20 Pennsylvania Bureau of Investigation and Enforcement (I&E).

21

1 **Q. DO YOU AGREE WITH MR. KELLER’S RECOMMENDATION TO ALLOW**
2 **COLUMBIA GAS OF PENNSYLVANIA A RETURN ON EQUITY OF 9.86%?**

3 A. No. A 9.86% ROE is not reflective of current market conditions, and if accepted by the
4 Commission, will allow Columbia Gas of Pennsylvania to over-earn in a market
5 reflective of much lower capital costs.

6
7 **Q. PLEASE EXPLAIN WHY YOU BELIEVE MR. KELLER’S**
8 **RECOMMENDATION TO ALLOW COLUMBIA GAS OF PENNSYLVANIA A**
9 **9.86% ROE IS EXCESSIVE AND UNWARRANTED.**

10 A. The last rate case order from this Commission involving Columbia Gas of Pennsylvania
11 was Docket No. D-R-2018-2647577 and the Commission approved the rate settlement on
12 December 6, 2018.¹ The Company sought a 10.95% ROE in the last rate case.² The case
13 was eventually settled, but no ROE was presented in the settlement approved by the
14 Commission’s December 6, 2018 order.³ However, subsequent to December 6, 2018,
15 financial markets across the country have undergone tremendous change.

16
17 **Q. HOW HAVE INTEREST RATES CHANGED SINCE DECEMBER 6, 2018?**

18 A. On December 6, 2018, the yield on 30-year US Treasury bonds closed at the end of the
19 day at 3.14%. On July 17, 2020, the yield on the 30-year US Treasury bonds closed at the
20 end of the day at 1.33%. Subsequent to the order being issued in the Company’s previous

¹ Pa. P.U.C. v. Columbia Gas of Pennsylvania, Docket No. R-2018-2647577, Opinion and Order (Dec 6, 2018).

² Data obtained from snl.com, Date Accessed: July 20, 2020

³ *Id.*

1 rate case, the yield on 30-year US Treasury bonds have fallen 181-basis points. As such,
2 the cost of debt financing has fallen notably over the period outlined above.

3
4 **Q. HOW HAVE EQUITY MARKETS CHANGED SINCE THE COMMISSION'S**
5 **ORDER IN THE LAST COLUMBIA GAS OF PENNSYLVANIA RATE CASE?**

6 A. The Dow Jones Utility Index Average closed at 749.34 on December 6, 2018. On July
7 17, 2020, the Dow Jones Utility Index Average closed at 828.60. This change represented
8 an approximate 10.6% increase over the period outlined above. Such a strong upward
9 movement in the utility equity market is indicative of investors accepting a lower cost of
10 capital on their investments.

11
12 **Q. HOW DOES MR. KELLER'S RECOMMENDED ROE OF 9.86% COMPARE TO**
13 **THE NATIONAL AVERAGE ROE GRANTED BY STATE REGULATORS**
14 **ACROSS THE COUNTRY IN THE FIRST HALF OF 2020?**

15 A. In the first half of 2020, the national average ROE for gas utilities has been 9.40%.⁴ Mr.
16 Keller's recommended ROE of 9.86% is well above the 9.40% across the United States.
17 Of the 12 reported cases through June 30, 2020, only one case, Atmos Energy Corp. in
18 Texas, has a ROE (9.90%)⁵ higher than Mr. Keller's recommended ROE of 9.86%.

19

⁴ S&P Global Market Intelligence, RRA Regulatory Focus, "Gas ROE authorizations fall to new low in H1'20", August 11, 2020, p. 1

⁵ *Id.*, p. 3

1 **Q. WHAT ARE THE PRIMARY DIFFERENCES BETWEEN YOUR**
2 **RECOMMENDATION OF 8.50% AND I&E'S RECOMMENDATION OF 9.86%**
3 **IN THE CURRENT RATE CASE?**

4 A. The following points below drive the difference between my recommendation in this
5 current rate case, and that of I&E Witness Keller:

- 6
7 • Mr. Keller notes that his recommended ROE is 9.86% as this is the exact value
8 produced by his DCF model.⁶ I have instead placed the greatest weight on the
9 results produced by my DCF model, and decided upon my ultimate
10 recommendation based upon a variety of data inputs. I then used the CAPM and
11 Comparable Earnings methods as checks on the results produced by the DCF;
- 12 • Mr. Keller removed New Jersey Resources, Southwest Gas Holdings, and UGI
13 Corp. from the comparable proxy group used throughout his analysis;⁷
- 14 • Mr. Keller's DCF result (*i.e.*, 9.86%)⁸ was derived from a proxy group that
15 ultimately was comprised of 7 companies,⁹ utilized an average of a spot dividend
16 yield (*i.e.*, sourced from *Barron's*) and a 52-week dividend yield (*i.e.*, sourced
17 from *Value Line*) for the dividend yield value (*i.e.*, 3.34%) of his comparable
18 proxy group companies,¹⁰ and utilized 5-year forecasted values for his proxy
19 group companies (*i.e.*, sourced from *Yahoo Finance*, *Zacks*, *Morningstar*, and

⁶ I&E Witness Keller's Direct Testimony, page 25: line 4

⁷ I&E Witness Keller's Direct Testimony, page 9: line 3

⁸ I&E Witness Keller's Direct Testimony, I&E Exhibit No. 2, Schedule 8, Page 1

⁹ I&E Witness Keller's Direct Testimony, I&E Exhibit No. 2, Schedule 6, Page 1

¹⁰ *Id.*

1 *Value Line*) to develop the average growth rate (*i.e.*, 6.52%) for use within his
2 DCF model;¹¹ and

- 3 • Mr. Keller’s CAPM result (*i.e.*, 8.72%)¹² was derived using a risk-free of return
4 of 1.22% based upon various 10-year treasury note yields,¹³ an overall market
5 return of 10.35% based upon *Value Line* and *S&P 500* estimates,¹⁴ a resulting
6 equity risk premium of 9.13%, and an average beta value for his 7 company proxy
7 group sourced from *Value Line* (*i.e.*, 0.82).¹⁵

8

9 **Q. HOW DOES YOUR PROXY GROUP DIFFER FROM THAT OF MR. KELLER?**

10 A. As referenced in my pre-filed direct testimony, the number of available gas utilities has
11 been dwindling due to various acquisitions and mergers seen across the industry. As
12 such, I have opted to use the full 10 company comparable proxy group as provided by
13 Value Line. In contrast Mr. Keller opted to remove New Jersey Resources, Southwest
14 Gas Holdings, and UGI Corp from his comparable proxy group.¹⁶ In his direct testimony,
15 Mr. Keller notes that he removed New Jersey Resources and Southwest Gas Holdings
16 from his proxy group as these companies did not meet his “*first criterion that fifty*
17 *percent or more of the company’s revenues must be generated from the regulated gas*
18 *utility industry.*”¹⁷ I have not decided to perform a similar removal of companies from my
19 comparable proxy group as that of Mr. Keller largely given the limited number of 10
20 companies provided for the natural gas industry through *Value Line*. Throughout my

¹¹ I&E Witness Keller’s Direct Testimony, I&E Exhibit No. 2, Schedule 7, Page 1

¹² I&E Witness Keller’s Direct Testimony, I&E Exhibit No. 2, Schedule 12, Page 1

¹³ I&E Witness Keller’s Direct Testimony, I&E Exhibit No. 2, Schedule 10, Page 1

¹⁴ I&E Witness Keller’s Direct Testimony, I&E Exhibit No. 2, Schedule 11, Page 1

¹⁵ I&E Witness Keller’s Direct Testimony, I&E Exhibit No. 2, Schedule 9, Page 1

¹⁶ I&E Witness Keller’s Direct Testimony, page 9: line 3

¹⁷ I&E Witness Keller’s Direct Testimony, page 10: lines 10 – 11

1 experience providing rate of return testimony, I've always found analysts removal of
 2 certain companies within a proxy group to be inherently subjective. In addition, removing
 3 companies from a group that is already small can result in data integrity issues. As such,
 4 I've consistently maintained that unless a company is currently going through
 5 bankruptcy, or a merger/acquisition transaction, it should be included within a proxy
 6 group for transparency purposes.

7
 8 **Q. HOW DOES YOUR DCF ANALYSIS DIFFER FROM MR. KELLER'S?**

9 A. In Mr. Keller's DCF analysis, the results for his 7 company comparable proxy group
 10 were derived from his calculated dividend yield (*Average of (1) Spot Dividend Yield and*
 11 *(2) Average 52-Week Dividend Yield*) + *Average EPS Growth Rate*.¹⁸ Note however, that
 12 Mr. Keller removed a single growth rate for Northwest Natural as provided by *Value Line*
 13 as he deemed that this projected growth rate was "*extremely inconsistent and would have*
 14 *an unreasonable and unwarranted impact*"¹⁹ on his DCF analysis.

15 In contrast, I derived my DCF results by first utilizing Forecasted Annualized
 16 Dividend Yields based on three separate time periods (*i.e.*, 13-weeks, 4-weeks, and 1-
 17 week) provided by *Value Line*, plus the following growth rates for my 10 company
 18 comparable proxy group:

- 19 • Historical EPS, DPS, and BPS growth rates over a 10-year period and a 5-year
 20 period provided by *Value Line*;
- 21 • Forecasted EPS, DPS, and BPS growth rates from *Value Line*;

¹⁸ I&E Witness Keller's Direct Testimony, I&E Exhibit No. 2, Schedule 8, Page 1

¹⁹ I&E Witness Keller's Direct Testimony, page 24: lines 4 – 5

- 1 • Average plowback growth rate (*i.e.*, percent retained to common equity) provided
2 by *Value Line*;
- 3 • 3-year projected EPS growth rate provided by the *Center for Financial Research*
4 and *Analysis*; and
- 5 • 3 to 5-year EPS growth rate provided by *Charles Schwab*.

6 My DCF results are presented within **Exhibit KWO-1** and **Exhibit KWO-4** to my
7 originally pre-filed direct testimony. Within my pre-filed direct testimony, I have
8 included my reasoning for why I have utilized each of the above referenced dividend
9 yields and historical/forecasted growth rates.

10 I do not disagree with the specific data used as inputs by Mr. Keller in his DCF
11 model as his calculations approximate a portion of my own DCF calculations. However,
12 where I disagree with Mr. Keller, is in regard to the data he utilized being sufficient to
13 base the entirety of his DCF analysis on. I believe that analysts should utilize more than
14 just forecasted growth rates for each proxy group company included within their DCF
15 analysis in order to provide a more complete picture of the scenario based on all of the
16 available data.

17 As referenced in my pre-filed direct testimony, I strongly believe that historical
18 growth rates should be used as part the basis for an analyst's recommendation. Forecasted
19 growth rates are also very important, but they are just that, in that they represent forecasts
20 and estimates. I also believe that in light of the Covid-19 pandemic, the use of historical
21 growth rates is that much more important given the inherent uncertainties beset by the
22 pandemic. My use of forecasted annualized dividend yields over the various periods
23 previously identified, forecasted growth rates from a variety of sources, and also my use

1 of historical growth rates, have led to my ultimate DCF result being lower than that of
2 Mr. Keller.

3
4 **Q. HOW DOES YOUR CAPM ANALYSIS DIFFER FROM MR. KELLER'S?**

5 A. In Mr. Keller's CAPM analysis, he performed his calculation using a risk free rate of
6 return based on 10-year treasury bonds of 1.22%, an overall market return of 10.35%, a
7 resulting equity risk premium of 9.13%, and an average beta value for his 7 company
8 proxy group of 0.82. The end-result of Mr. Keller's CAPM was a ROE of 8.72%²⁰ as
9 compared to my CAPM range of 5.5% to 7.5%.²¹

10 In contrast, as shown in **Exhibit KWO-5** to my originally pre-filed direct
11 testimony, I've developed a range from which I determined my CAPM results by
12 utilizing a one year period of 30-year treasury bonds for a risk-free rate averaging 1.89%
13 (*i.e.*, with a high value of 2.61% and a low value of 0.99% over the previous annual
14 period examined), an equity risk premium range from 4.0% to 6.0%, and an average beta
15 value for my proxy group comprised of the average beta provided for my 10 company
16 proxy group over the most recent quarter (*i.e.*, 0.85).

17 The first difference in my CAPM analysis and that of Mr. Keller is my use of the
18 current quarter betas for my proxy group comprised of 10 companies, and Mr. Keller's
19 use of the average of the betas from the previous two quarters for his proxy group
20 comprised of 8 companies. This led to the beta that I utilized in my CAPM analysis being
21 0.85, in contrast to Mr. Keller's 0.82.²²

²⁰ I&E Witness Keller's Direct Testimony, I&E Exhibit No. 2, Schedule 12, Page 1

²¹ Witness O'Donnell's Direct Testimony page 68: line 16

²² I&E Witness Keller's Direct Testimony, I&E Exhibit No. 2, Schedule 9, Page 1

1 Secondly, another difference that led to the variance between my CAPM results,
2 and those of Mr. Keller, is that for his risk-free rate, Mr. Keller utilized forecasted 10-
3 year treasury bond yields from Q3'20 – Q4'20 and from 2022 – 2026²³, while I utilized
4 historical 30-year treasury bond yields over the previous one-year period from July 17,
5 2019 to July 17, 2020 as shown in **Exhibit KWO-5**. Our respective analyses led Mr.
6 Keller to use a risk-free rate in his CAPM of 1.22%, whereas I utilized an average of
7 1.89% (with a low to high annual range of 0.99% to 2.61%).

8 Lastly, Mr. Keller's results were influenced greatly by his utilized overall market
9 return of 10.35%, thus leading to his use of 9.13% as the equity premium, in comparison
10 to my 4.0% to 6.0% range for the equity premium. Within my pre-filed direct testimony,
11 I note that I have utilized this 4.0% to 6.0% equity premium range as it embodies the
12 approximate range of the historical and forecasted growth rates found in **Exhibit KWO-**
13 **4**. In contrast, Mr. Keller has based his use of an overall market return of 10.35% as an
14 average of the 12.87% return over the next 3 to 5 years for *Value Line's* 1700 stocks, and
15 the 7.83% over a 5-year period for the S&P 500 dividend yield and growth rates as
16 provided by *Barron's* and *Yahoo Finance/Morningstar*, respectively.²⁴ I do not find the
17 use of 10.35% as the overall market return to be realistic given the current economic
18 situation, even when examining market trends prior to the impacts felt by the Covid-19
19 pandemic. As I demonstrated in my pre-filed direct testimony, market experts are not
20 expecting the market to earn double-digit returns in the future.

²³ I&E Witness Keller's Direct Testimony, I&E Exhibit No. 2, Schedule 10, Page 1

²⁴ I&E Witness Keller's Direct Testimony, page 27: lines 15 – 20 and page 28: lines 1 – 2

1 **Q. ARE THERE ANY OTHER DIFFERENCES IN YOUR ANALYSIS VERSUS**
2 **THAT OF MR. KELLER?**

3 A. Yes. In addition to the differences in our analyses referenced above in terms of the ROE,
4 in Mr. Keller's overall rate of return recommendation of 7.39%, he accepted the
5 Company's requested capital structure of short-term debt of 3.59%, long-term debt of
6 42.22%, and common equity of 54.19%.²⁵ I have instead recommended that the
7 Company's capital structure be set at a 50% - 50% ratio between overall debt and
8 common equity as presented within **Table 2** of my originally pre-filed direct testimony.

9 Mr. Keller's direct testimony offers the explanation that he chose to utilize the
10 Company's claimed capital structure as "*it falls within the range of my proxy group's*
11 *capital structures*".²⁶ However, given the difference in the composition of my proxy
12 group, and that of Mr. Keller's, the average of the 2019 equity ratios for my proxy group
13 is 50.70%.²⁷ Additionally, within **Section IV** of my originally pre-filed direct testimony,
14 I've offered further reasoning behind my recommended capital structure ratios of 50%
15 debt and 50% equity in light of the common equity ratio for the companies included in
16 my comparable proxy group, as well as the average common equity ratios granted by
17 utility regulators across the country. Therefore, I believe the Commission should accept
18 my recommended capital structure of 50% debt and 50% equity.

19

²⁵ I&E Witness Keller's Direct Testimony, page 12: line 3

²⁶ I&E Witness Keller's Direct Testimony, page 12: lines 3 – 4

²⁷ Witness O'Donnell's Direct Testimony, page 34: line 9

1 **Q. ARE THERE ANY OTHER ITEMS YOU WOULD LIKE TO DISCUSS IN**
2 **REFERENCE TO YOUR RECOMMENDATION VERSUS THAT OF MR.**
3 **KELLER?**

4 A. The last item I would like to reference is the precedence that Columbia Gas of PA has set
5 with their request in this current rate case. As referenced within **Table 1** of the direct
6 testimony of Pennsylvania State University's (PSU) Witness James Crist, Columbia Gas
7 of PA has requested rate cases in 9 of the previous 12 years.²⁸ In this current rate case,
8 Columbia Gas of PA is now requesting an overall rate increase of \$100.4 million.²⁹
9 Given what I've laid out previously in this rebuttal testimony, the repeated annual rate
10 increase requests from Columbia Gas of PA as referenced above, the current economic
11 conditions brought on by Covid-19, and given the fact that Columbia Gas of PA has
12 previously implemented a Distribution System Improvement Charge (DSIC) to help
13 lessen the need of the Company to increase rates,³⁰ I believe that my rate of return
14 recommendation of 8.50% is more reasonable in light of the very low risk of Columbia
15 Gas of Pennsylvania than that of Mr. Keller's recommendation of 9.86%.

16
17 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

18 A. Yes, it does.

²⁸ PSU Witness James Crist Direct Testimony, page 6: table 1

²⁹ Data obtained from snl.com, Date Accessed: July 20, 2020

³⁰ PSU Witness James Crist Direct Testimony, page 6: lines 11 – 14; Docket No. P-2012-2338282

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

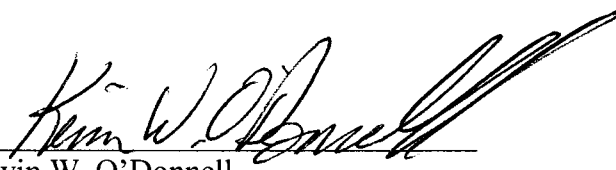
Pennsylvania Public Utility Commission :
 :
 v. : Docket No. R-2020-3018835
 :
 Columbia Gas of Pennsylvania, Inc. :

VERIFICATION

I, Kevin W. O'Donnell, hereby state that the facts set forth in my Rebuttal Testimony, OCA Statement 3-R, are true and correct (or are true and correct to the best of my knowledge, information, and belief) and that I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).

DATED: August 26, 2020
*294540

Signature:


Kevin W. O'Donnell

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