OCA Statement No. 3S

BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

SURREBUTTAL TESTIMONY OF

KEVIN W. O'DONNELL, CFA

ON BEHALF OF

OFFICE OF CONSUMER ADVOCATE

September 16, 2020

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I. INTRODUCTION

Q. MR. O'DONNELL, DID YOU SUBMIT PRE-FILED WRITTEN DIRECT TESTIMONY AND REBUTTAL TESTIMONY ON BEHALF OF THE OFFICE OF CONSUMER ADVOCATE IN THIS CASE?

A. Yes.

Q. HAVE YOU REVISED YOUR RECOMMENDED OVERALL COST OF CAPITAL RECOMMENDATION?

A. Yes. Within **Section III** of this surrebuttal testimony I outline the updates the Company made to their cost of debt. Within his rebuttal testimony, Mr. Moul recognized the impacts of the Company's March 2020 debt issuance and updated the Company's embedded long-term cost of debt from 4.70% to 4.73%.[1] I have accepted the Company's updated cost of debt, which is now 4.52% on a blended long-term debt and short-term debt basis, and now recommend an overall rate of return of 6.51% as shown in **Table 1S** below:

Table 1S: OCA Overall Recommended Rate of Return

Component	Capital Structure Ratio (%)	Cost Rate (%)	Wgtd. Cost Rate (%)
Debt	50.00%	4.52%[2]	2.26%
Common Equity	50.00%	8.50%	4.25%
Total Capitalization	**100.00%**		**6.51%**

[1] Witness Moul's Rebuttal Testimony, page 6: lines 21 – 22.
[2] Reflects blended 4.73% cost of long-term debt and 2.06% cost of short-term debt as found in Exhibit No. 400 (Updated), p. 13, Schedule 6 (3 of 3).

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

A. To respond to the rebuttal testimony of Columbia Gas of Pennsylvania (CPA) Witness Paul R. Moul and Witness Andrew S. Tubbs on cost of capital, and the rebuttal testimony of Office of Small Business Advocate (OSBA) Witness Robert D. Knecht. To the extent that I do not address rebuttal testimony which relates to identification of the appropriate cost of capital for Columbia Gas, such lack of discussion does not indicate my agreement with such rebuttal positions.

Q. DO YOU AGREE WITH MR. MOUL'S CONTINUED RECOMMENDATION TO ALLOW COLUMBIA GAS OF PENNSYLVANIA A RETURN ON EQUITY OF 10.95%?

A. No, I do not. In his direct testimony, as well as his rebuttal testimony, Mr. Moul has recommended a 10.95% ROE.[3] In my rebuttal testimony, I identified flaws and improper adjustments used by Mr. Moul to arrive at such an overstated cost of equity claim. I also explained why I&E Witness Christopher Keller's 9.86% ROE recommendation is overstated and not appropriate for adoption by the Commission.

In his rebuttal testimony, Mr. Moul has now recalculated his entire cost of capital analysis to include some six months of actual data, including information that was available prior to the Company's April 2020 base rate filing. Mr. Moul opined that the recalculations included within his rebuttal testimony support the Company's 10.95% ROE claim. However, I do not need to recalculate my cost of capital analyses to know

[3] Witness Moul's Pre-Filed Rebuttal Testimony, page 37: line 20.

that the Company's cost of capital request, inclusive of a 10.95% ROE, is still overstated. Adoption of Mr. Moul's recommendation, or even I&E's direct case position, would allow Columbia Gas of Pennsylvania to over-earn in a marketplace that is reflective of much lower capital costs.

Q. PLEASE LIST MR. MOUL'S REBUTTAL TESTIMONY POSITIONS THAT YOU WILL RESPOND TO.

A. In this surrebuttal testimony, I will respond to the following points:

- Mr. Moul's position that a 10.95% ROE is appropriate for CPA, inclusive of an upward adjustment of 20-basis points to recognize his perceived effectiveness of the Company's management;[4]
- Mr. Moul's opposition to my recommended capital structure;[5]
- Mr. Moul's update to the Company's cost of debt;[6]
- Mr. Moul's position that investment risk for CPA is heightened in the current COVID-19 environment;[7]
- Mr. Moul's criticism and misunderstanding of the proxy group as utilized within my direct testimony;[8]
- Mr. Moul's inclusion of recalculated cost of capital results within his rebuttal testimony;
- Mr. Moul's criticism of my discounted cash flow (DCF) model analysis;[9]

[4] Witness Moul's Rebuttal Testimony, page 37: lines 20 – 21.
[5] Witness Moul's Rebuttal Testimony, page 3: line 16.
[6] Witness Moul's Rebuttal Testimony, page 6: line 14.
[7] Witness Moul's Rebuttal Testimony, page 13: line 13.
[8] Witness Moul's Rebuttal Testimony, page 14: line 23.
[9] Witness Moul's Rebuttal Testimony, page 16: line 18.

- Mr. Moul's comments regarding my capital asset pricing model (CAPM) analysis.[10]

Q. DO YOU AGREE WITH MR. KNECHT'S CRITICISMS OF YOUR COST OF CAPITAL RECOMMENDATION?

A. No, I do not. Mr. Knecht has stated that there are biases in my "calculations for the cost of equity capital"[11] that were "in favor of utility shareholders."[12] As such, his opinion was that my ROE recommendation for CPA should have been lower than 8.50%. In this surrebuttal I will respond to the following points:

- Mr. Knecht's position that I should not have placed reliance upon the DCF model, but instead should have placed more reliance on "a model based on a risk premium over current capital market interest rates";[13]
- Mr. Knecht's disagreement with various inputs to my CAPM.[14]

[10] Witness Moul's Rebuttal Testimony, page 26: line 1.
[11] Witness Knecht's Rebuttal Testimony, page 2: lines 17 – 19.
[12] *Id.*
[13] Witness Knecht's Rebuttal Testimony, page 20: lines 5 – 7.
[14] Witness Knecht's Rebuttal Testimony, page 24.

II. MR. MOUL'S 20-BASIS POINT UPWARD ADJUSTMENT FOR EXEMPLARY MANAGEMENT PERFORMANCE

Q. DO YOU AGREE WITH MR. MOUL'S 20-BASIS POINT ADJUSTMENT FOR EXEMPLARY MANAGEMENT PERFORMANCE?

A. No, I do not. Columbia Gas has an obligation to provide service that is safe, adequate, reasonable and efficient. A 20-basis point increment to a proper, market-based cost of equity would impose a significant additional cost on ratepayers. Columbia Gas has not demonstrated that its performance since its last base rate case has been superior or especially effective to justify the additional cost to ratepayers. OCA Witness Roger Colton reviewed aspects of the Company's operational efforts and concluded that the Company's performance has not been exemplary in various areas of importance.[15] Mr. Colton's surrebuttal responds to Company Witness Tubbs regarding certain metrics.

Q. HAS THE COMPANY REBUTTED CONCERNS THAT ITS PERFORMANCE IN THE AREA OF GAS SAFETY IS NOT SUPERIOR?

A. No. Mr. Tubbs stated that the Company's service performance since 2018 has been exemplary in the area of gas system improvements, including damage reduction.[16] However, Mr. Tubbs did not address the gas safety concerns raised in public input hearing testimony by Mr. Culbertson. Mr. Culbertson pointed to news reports of a July 31, 2019 house explosion linked to a Columbia Gas pipeline replacement project in North Franklin Township in Washington County.[17] The Company confirmed in discovery that

[15] Witness O'Donnell's Direct Testimony, page 91: lines 15 – 20.
[16] Witness Tubbs' Rebuttal Testimony, p. 28, lines 9-18.
[17] Public Input Hearing Exh. 1, pp. 12-13 (Statement of Richard Culbertson).

the house explosion occurred in an area where Columbia Gas was replacing pipeline and installing gas regulators; that Columbia Gas accepted responsibility for the personal injuries, property damage, and clean-up; and that service to some 60 homes was disrupted.[18] The Company's Incident Report stated that its project review of materials, maps, and records did not identify the house as connected to the particular main, so no gas regulator was installed there as part of the project.[19] Columbia Gas paid over $1.3 million for claims related to this event in the historic test year (HTY).[20]

Some analysts downgraded NiSource Inc. following news of the house explosion.[21] For example, Credit Suisse downgraded NiSource Inc. "to Neutral after another explosive incident occurred in Pennsylvania" and that the incident was "minor but bears striking similarities to the events that occurred in Massachusetts in Sept. 2018." (Copy attached as **Exhibit KWO-1S**.)

Columbia Gas is required to provide safe, adequate, reasonable, and efficient service. Based upon these considerations and Mr. Colton's review, I do not agree with Mr. Moul and Mr. Tubbs that the Company is providing service which is superior as to justify an increase to the return on equity for exemplary management performance of any increment.

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[18] OCA-IX-1; OCA-IX-2, Att. A; OCA-IX-04, Subpart a); PSU-1-004, Att. C, p. 3 (Columbia Gas of PA Incident Report to the U.S. Dept. of Transportation, Pipeline and Hazardous Materials Safety Administration, dated 8/30/2019). See also, Aug. 1, 2019 news release: "Columbia Gas Provides Update on Washington County Incident." https://www.columbiagaspa.com/our-company/news-room/article/columbia-gas-provides-update-on-washington-county-incident

[19] PSU-1-004, Att. C, p. 9.

[20] OCA-IX-5, Subpart b).

[21] Columbia Gas of Pennsylvania, Inc. 2020 General Rate Case Filing Standard Data Request GAS-ROR No. 10 (Cont.)-23 Volume 3 of 3, Att. G, p. 11 (Wolfe Research, Aug. 4, 2019), Att. G, p. 17 (Credit Suisse, Aug. 7, 2019).

III. MR. MOUL'S DISCUSSION OF THE COMPANY'S CAPITAL STRUCTURE

Q. HOW DO YOU RESPOND TO MR. MOUL'S CLAIM THAT YOUR CAPITAL STRUCTURE RECOMMENDATION IS CONTRARY TO COMMISSION PRECEDENT?

A. Mr. Moul states the Commission's establishment of the cost of capital for an electric utility in 2018 with 54.02% common equity is the most relevant benchmark for this case and justifies use of the Company's higher common equity ratio.[22] I disagree. The Commission should evaluate whether Columbia Gas' actual capital structure is reasonable and fair to determine an appropriate cost of capital in this proceeding which does not overburden ratepayers. As I explained in my direct, equity is more costly as the dollars collected in rates are subject to taxes. The information contained in **Table 5** to my direct testimony are comparative benchmarks that investors consider when making investment decisions. As such, the equity ratios included within **Table 5** to my direct are more closely aligned with market expectations in this case than citing Commission precedent in a previous electric rate case decision. Even in light of the related Commission precedent, I believe that the 54.19% requested by CPA in this case as the capital structure is too heavily weighted towards equity and, therefore, too expensive for consumers.

Q. WHICH DATA POINTS DID YOU BASE YOUR CAPITAL STRUCTURE RECOMMENDATION UPON?

[22] Witness Moul's Rebuttal Testimony, page 4: lines 14 – 21.

A. I based my capital structure recommendation upon figures such as the average common equity ratio granted by state regulators across the country for the Natural Gas Industry during 2019 (*i.e.*, 51.75%), the average common equity ratio granted by state regulators across the country for the Natural Gas Industry over the previous 15-year period (*i.e.*, 49.91%), and the average common equity ratio of each of the companies included within my cost of capital analyses (*i.e.*, 50.70%). I have not placed more reliance on one specific measure than another, despite claims to the contrary made by Mr. Moul in his rebuttal.[23]

[23] Witness Moul's Rebuttal Testimony, page 4: lines 4 – 5.

IV. MR. MOUL'S REVISION TO THE COMPANY'S COST OF DEBT

Q. DID CPA UPDATE ITS COST OF DEBT AS PART OF ITS REBUTTAL TESTIMONY?

A. Yes. The Company filed this rate case on April 24, 2020, but Mr. Moul did not account for CPA's March 2020 debt issuance within his direct testimony. However, in his rebuttal testimony, filed on August 26, 2020, Mr. Moul recognized the March 2020 debt issuance and updated the overall cost of debt from 4.70% to 4.73%.[24]

Q. DO YOU ACCEPT THIS EMBEDDED COST OF DEBT?

A. Yes. The coupon rate for CPA's debt issuances appears reasonable for both the March 2020 issuance, as well as the expected March 2021 issuance. I have included the Company's updated cost of debt in my revised overall cost of capital recommendation as set forth in **Table 1S** above.

Q. DOES YOUR ACCEPTANCE OF THIS NEW COST OF DEBT CHANGE YOUR RECOMMENDED OVERALL COST OF CAPITAL?

A. Yes, it does. **Table 1S** at the beginning of this testimony provides the calculations for my now-recommended overall rate of return of 6.51%.

[24] Witness Moul's Rebuttal Testimony, page 6: lines 21 – 22.

V. MR. MOUL'S STANCE ON COLUMBIA GAS OF PENNSYLVANIA'S INVESTMENT RISK

Q. PLEASE EXPLAIN WHY YOU BELIEVE MR. MOUL'S RECOMMENDATION TO ALLOW COLUMBIA GAS OF PENNSYLVANIA A 10.95% ROE IS EXCESSIVE AND UNWARRANTED.

A. The last rate case order from this Commission involving Columbia Gas of Pennsylvania was Docket No. R-2018-2647577 and the Commission approved the rate settlement on December 6, 2018.[25] The Company sought a 10.95% ROE in the last rate case.[26] The case was eventually settled, but no ROE was presented in the settlement approved by the Commission's December 6, 2018 order.[27] However, subsequent to December 6, 2018, financial markets across the country have undergone tremendous change.

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

A. On December 6, 2018, the yield on 30-year US Treasury bonds closed at the end of the day at 3.14%. On July 17, 2020 (*i.e.*, the date that the data was provided within my direct testimony), the yield on the 30-year US Treasury bonds closed at 1.33%. Subsequent to the order being issued in the Company's previous rate case, the yield on 30-year US Treasury bonds have fallen 181-basis points. As such, the cost of debt financing has fallen notably over the period outlined above.

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[25] Pa. P.U.C. v. Columbia Gas of Pennsylvania, Docket No. R-2018-2647577, Opinion and Order (Dec 6, 2018).
[26] Data obtained from snl.com, Date Accessed: July 20, 2020.
[27] *Id.*

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

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

Q. DOES MARKET VOLATILITY SUGGEST THAT THE APPROPRIATE COST OF EQUITY FOR COLUMBIA GAS HAS RISEN?

A. No. Mr. Moul noted that the VIX volatility index averaged 35.52 since April 2020[28] as reasoning for why he believed that CPA's cost of equity has risen. I disagree. The Dow Jones Utility Average (DJUA) has largely rebounded from its low in March 2020 brought on by the COVID-19 pandemic as referenced within the above Q&A. Additionally, interest rates have remained at low levels for a sustained period of time. Simply pointing to a higher VIX is erroneous and misleading.

Mr. Moul's recommended 10.95% ROE was overstated when the Company filed in April 2020. Economic and financial changes in the intervening months do not show that a 10.95% return on equity is necessary to account for Mr. Moul's perceived change in risk. Mr. Moul's recommendation would allow Columbia Gas to over-earn in a marketplace that is reflective of much lower capital costs.

[28] Witness Moul's Rebuttal Testimony, page 13: lines 20 – 21.

Q. SHOULD THE COMMISSION BE GUIDED BY 2008 AND 2009 CONSIDERATIONS?

A. No. Within his rebuttal, Mr. Moul suggested that the Commission look:

> back to the last time when the VIX was showing high risk. That time would be for the years 2008 and 2009 during the Financial Crisis. The average VIX for 2008 and 2009 was 34.04 and 32.83, respectively. During that the time, natural gas distribution utilities were on average granted returns on equity of 10.39% in 2008 rate cases and 10.22% in 2009 rate cases decided during a period of similar market turmoil.[29]

I disagree with Mr. Moul's implication and do not believe in any such correlation. As shown below within **Table 2S**, the average granted returns on equity were in excess of 10% each year during the period from 2005 – 2010, regardless of what the VIX showed during those years.

Table 2S: VIX Volatility Index in Relation to Annual Average Allowed Nat Gas ROE's

Year	Average Annual Allowed Natural Gas ROE[30]	Average Annual VIX Volatility Index[31]
2005	10.41%	12.81
2006	10.40%	12.81
2007	10.22%	17.54
2008	10.39%	32.69
2009	10.22%	31.48
2010	10.15%	22.55

Contrary to Mr. Moul's suggestion, the Commission should not use past average annual VIX values from 2008 and 2009 as a guide to set Columbia Gas' ROE in this proceeding.

[29] Witness Moul's Rebuttal Testimony, page 13: lines 22 – 26, and page 14: line 1.
[30] S&P Global Market Intelligence Rate Case Statistics; Date Range: 15 Years; Service Type: Natural Gas; Chart Items: Return on Equity (%); Date Accessed: September 3, 2020.
[31] CBOE VIX Index Historical Data, http://www.cboe.com/products/vix-index-volatility/vix-options-and-futures/vix-index/vix-historical-data, Date Accessed: September 8, 2020.

If one simply looks at the years before and after the period from 2008 – 2009, they would see that the average annual allowed ROE's for natural gas utilities were high during this period regardless of the VIX. As shown within **Chart 4** to my direct testimony, the allowed ROE's for natural gas utilities have been consistently trending down for the period from 2005 – 2019.

If the Commission considers changes in the VIX in 2020, the Commission should also consider the pandemic-related facts as noted by OCA Witness Rubin. Specifically, as noted by Witness Rubin:

- Approximately 38 percent of Pennsylvania's workforce filed an unemployment claim in the past 6 months;[32]
- 50% of households in Pennsylvania have lost at least some of their employment income through the week of July l4;[33]
- At the end of June, 41% of Pennsylvania's small businesses expected it to take six months or more to return to a normal level of operations, with another 12% saying their business would never fully recover.[34]

The facts as reported by Mr. Rubin are stark. Citizens of Pennsylvania are suffering. Placing any rate increase on citizens at this time will serve to only compound the economic suffering now being endured by consumers.

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[32] OCA Witness Rubin, Surrebuttal Testimony, p. 2.
[33] *Id.*
[34] *Id.*

Q. MR. O'DONNELL, WHAT IS A "REGULATORY PREMIUM" AS NOTED BY MR. MOUL IN HIS TESTIMONY?

A. A regulatory premium is defined as the difference between an allowed return on equity (ROE) and interest rates. An example would be the difference between an allowed ROE of 8.5% and the prevailing interest rate of a 30-year US Treasury bond of 1.5%. In this example, the regulatory premium would be 7.0% (8.5% less 1.5%).

Q. DO YOU AGREE WITH MR. MOUL'S CLAIM THAT ALTHOUGH REGULATED ROE'S HAVE TRENDED DOWNWARD, REGULATORY PREMIUMS HAVE INCREASED?

A. Yes, but Mr. Moul's claim is based on simple math and does not imply the cost of capital has not fallen for regulated utilities.

Utility regulators across the country tend to move slowly in regard to changes in allowed ROEs. As such, it is not surprising that allowed ROEs have not fallen at the same pace as interest rates. The net result of the slow fall of allowed ROEs, as compared to the decline in interest rates over time, is an increase in the "regulatory premium" as noted by Mr. Moul. The situation as noted by Mr. Moul is simply a function of regulators being concerned about making changes to allowed ROEs at a faster pace than an abrupt decrease in interest rates. Such an observation is inherent in regulation. It does not, however, negate the fact that the cost of capital in today's market is lower than it was a year ago as evidenced by the decrease in interest rates and the bounce back in the utility equities market.

VI. MR. MOUL'S DISCUSSION OF THE PROXY GROUP UTILIZED IN MY DIRECT TESTIMONY

Q. DOES YOUR SEPARATE ANALYSIS OF A COST OF EQUITY FOR COLUMBIA GAS' PARENT NISOURCE INC. PROVIDE USEFUL INFORMATION?

A. Yes. Due to the outcomes of the Hope/Bluefield cases, as referenced in my direct testimony, commissions across the country use proxy groups to set the return on equity in regulated rate cases. I conducted a cost of equity analysis based upon a proxy group and also conducted a separate analysis of NiSource.

Mr. Moul claimed that I have not provided any valid reason to examine NiSource separately in this case.[35] I disagree. The data produced by the analysis performed specifically on NiSource provides value in this rate case proceeding given the direct link between NiSource and Columbia Gas. Indeed, one of the most useful analyses is to examine the financial details of NiSource since the cost of capital of NiSource is so closely related to the cost of capital for Columbia Gas. As an example, utility subsidiary credit ratings are often closely linked to the credit rating of their parent company's credit rating. Hence, it is naïve to think the equity cost of capital for NiSource is not determinative as to the equity cost of capital for Columbia Gas.

To avoid the problem of circularity, I have included nine gas utilities in my comparable group that I examined, along with a separate, stand-alone analysis of NiSource. In doing so, I have provided the Commission with a well-rounded examination of several different proxy companies for Columbia Gas of Pennsylvania. Such a holistic

[35] Witness Moul's Rebuttal Testimony, page 15: lines 10 – 12.

analysis is far better than picking and choosing companies that may or may not provide information as to the proper cost of capital for Columbia Gas of Pennsylvania.

VII. MR. MOUL'S INCLUSION OF RECALCULATED COST OF CAPITAL RESULTS WITHIN HIS REBUTTAL TESTIMONY

Q. DO MR. MOUL'S REVISED COST OF EQUITY ANALYSES JUSTIFY THE COMPANY'S 10.95% ROE REQUEST?

A. No. Mr. Moul recalculated his cost of equity models, in part because the market data included in his direct testimony was only updated through December 2019.[36] The impact of Mr. Moul's recalculations included within his rebuttal testimony are that his DCF and CAPM results increased by 101- and 230-basis points, respectively, as shown within Schedule 1 to his rebuttal.[37] Mr. Moul's update does not justify the Company's 10.95% ROE. As set forth in my direct testimony, Mr. Moul's DCF and CAPM cost of capital analyses are flawed and include improper adjustments. Using the same cost of capital analyses and adjustments with more current data does not improve the reliability of his results. As I discuss below, Mr. Moul's direct testimony and rebuttal testimony analyses are not comparable as Mr. Moul also changed the measure of certain inputs.

Q. DO YOU BELIEVE THAT THE COMPANY'S REQUIRED ROE IS NOW HIGHER THAN IT WAS PRIOR TO THE COVID-19 PANDEMIC?

A. No, I do not. As stated previously within this testimony, the DJUA has largely rebounded from its low in March 2020 brought on by the COVID-19 pandemic, and interest rates have decreased as well. In light of these simple facts, CPA's cost of capital is not higher now than it was when its most recent previous rate case concluded, or since the beginning

[36] Witness Moul's Rebuttal Testimony, page 7: lines 12 – 15.
[37] Witness Moul's Rebuttal Testimony, Schedule 1, page 2 of Exhibit No. 400.

of the COVID-19 pandemic, despite Mr. Moul's claim that "the pandemic has materially increased CPA's cost of common equity."[38]

Mr. Moul's recalculated results within the schedules included in Exhibit No. 400 to his rebuttal testimony now includes data through July 2020. However, within the text of his rebuttal, Mr. Moul claims that he reviewed his ROE recommendation with respect to the COVID-19 pandemic based on the "significant turmoil that has rocked the stock and bond markets in the February-May 2020 time frame."[39] In performing such a review, Mr. Moul has not utilized all of the available data as he has not taken into consideration the drastic rebound seen within the stock and bond markets from June – August 2020.

Q. MR. MOUL ALSO CITED DECLINES WITHIN THE PRICE OF CRUDE OIL AS A REASON TO REEVALUATE HIS RECOMMENDATION. DO YOU AGREE WITH THIS STANCE?

A. No. While Mr. Moul is correct in that the price of crude oil did decline during the onset of the COVID-19 pandemic,[40] such an analysis is too narrow in its view. There are many more factors to consider when evaluating an appropriate cost of capital as part of the Commission's determination of just and reasonable rates. For instance, the monthly national civilian unemployment rate from April – August 2020, was 7.87% above the monthly average civilian unemployment rate for the entirety of 2019.[41] The Company claims that it requires a higher ROE, but the associated rate increase will have to be paid

[38] Witness Moul's Rebuttal Testimony, page 7: lines 4 – 5.
[39] Witness Moul's Rebuttal Testimony, page 7: lines 15 – 18.
[40] Witness Moul's Rebuttal Testimony, page 7: lines 16 – 18.
[41] https://www.bls.gov/charts/employment-situation/civilian-unemployment-rate.htm

for by consumers beholden to pay these higher rates to CPA, many of who have been unemployed or underemployed throughout the majority of the current calendar year.

Q. DO YOU AGREE WITH THE OVERALL APPROPRIATENESS OF MR. MOUL'S INCLUSION OF UPDATED DATA WITHIN HIS REBUTTAL TESTIMONY?

A. No, I do not agree with this either. The following selection from my direct testimony still holds true in regard to the Company's current rate case:

> The Company did adjust the timing of its base rate filing from March 2020 to April 24, 2020 based upon consideration of the Coronavirus pandemic. The Company filed after Pennsylvania Governor Wolf's March 16, 2020 Disaster Proclamation. The Coronavirus pandemic began to significantly impact financial markets in March 2020, as exhibited within the CNN article, "The Global Coronavirus Pandemic is Beginning," published on March 16, 2020. However, the content of the Company's base rate filing does not account for the impacts of the Coronavirus pandemic on its consumers or economic conditions. In particular, the Company's cost of capital request presented by Mr. Paul Moul is largely based on information through late 2019. The Company requests a return on equity (10.95%) at the same level it requested in its previous base rate case filed in early 2018, when there was no pandemic, no state-wide Disaster Proclamation, and no economic crisis. The Company's request includes 20 basis points of ROE for shareholders as a reward for what the Company claims has been exemplary management. The Company made its rate filing with knowledge of the pandemic and scope of the Disaster Proclamation.[42]

In his rebuttal testimony, Mr. Moul confirmed the market data that he "originally used in this case contained information through December 2019."[43]

Simply put, CPA made the decision to continue to file their base rate case during the midst of a global pandemic after delaying the filing of the rate case for a month. Mr. Moul's rebuttal incorporates an additional six months of data from

[42] Witness O'Donnell's Direct Testimony, page 13: lines 1 – 16.
[43] Witness Moul's Rebuttal Testimony, page 7: lines 14 – 15.

January 2020 – July 2020 that was not included in his direct testimony, despite the fact that the majority of this additional data was readily available at the time of the Company's rate filing on April 24, 2020. This data may be new to the Company's case as of Mr. Moul's rebuttal testimony, but my direct testimony already captured and incorporated financial and market data available as of July 17, 2020.

Q. IS THE ONLY CHANGE WITHIN MR. MOUL'S RECALCULATED COST OF EQUITY MODELS THAT HE INCLUDED MORE RECENT DATA?

A. No. Mr. Moul has also changed how he performed certain calculations. For example, Schedule 7 of Witness Moul's Direct Testimony, and his Rebuttal Testimony, include his DCF results. Within this schedule in his Direct Testimony, Mr. Moul calculated his forward-looking dividend yield using the trailing <u>6-month average</u> as provided by *Morningstar*. However, within his recalculation of these results within the schedule included within his Rebuttal Testimony, Mr. Moul calculated his forward-looking dividend yield using the trailing <u>3-month average</u> as provided by *Morningstar*.

Q. PLEASE SUMMARIZE YOUR ASSESSMENT OF MR. MOUL'S REVISED COST OF EQUITY ANALYSES?

A. The results of Mr. Moul's cost of equity analyses continue to be unsound and inappropriate due to Mr. Moul's use of upward adjustments. Mr. Moul's recalculations includes data for six additional months subsequent to the December 2019 endpoint for the data included in Mr. Moul's direct testimony, which claimed a 10.95% ROE as appropriate for Columbia Gas. However, as noted above, the majority of the additional

2020 data now included within Mr. Moul's recalculations in his rebuttal have already been incorporated in the cost of equity analyses presented in my direct testimony and those of other opposing parties. No other party has concluded that a 10.95% ROE (or 10.75% without the management adder) is appropriate for Columbia Gas. Additionally, Mr. Moul's rebuttal does more than just plug-in new data. Mr. Moul made a change to the time period for which he calculated the dividend yield for use in the DCF model. In doing so, Mr. Moul provides a slight change to this DCF model, but the model is still beset with the fundamental flaw of his use of a leverage adjustment.

VIII. MR. MOUL'S CRITICISM OF MY DCF CALCULATION INPUTS AND ASSOCIATED RESULTS

Q. IS MR. MOUL'S CRITICISM OF YOUR DCF GROWTH RATES VALID?

A. No. In my direct testimony and associated exhibits, I included EPS, DPS, and BPS growth rates from a historical and forecasted perspective, as well as plowback (*i.e.*, percent retained to common equity) growth rates. Mr. Moul responded to my use of these metrics in his rebuttal testimony by stating:

> …Mr. O'Donnell presents EPS, DPS, and BPS growth rates. Mr. O'Donnell is incorrect to believe that DPS and BPS have any role in the DCF Model.[44]

Mr. Moul also faults my use of plowback (*i.e.*, percent retained to common equity) growth rates.[45] I disagree with the arguments presented by Mr. Moul, and note that there are various academic articles and journals that specifically call into question the accuracy of earnings predictions and forecasts. For example, in November 2003, Louis K. C. Chan, Jason Karceski and Josef Lakonishok published an article entitled "Analysts' Conflict of Interest and Biases in Earnings Forecasts" in the *Journal of Finance*. The conclusion of the paper stated:

> . . . it is commonly suggested that one group of informed participants, security analysts, may have some ability to predict growth. The dispersion in analysts' forecasts indicates their willingness to distinguish boldly between high- and low-growth prospects. IBES long-term growth estimates are associated with realized growth in the immediate short-term future. Over long horizons, however, there is <u>little forecastability in earnings, and analysts' estimates tend to be overly optimistic</u>.[46]

[44] Witness Moul's Rebuttal Testimony, page 20: lines 13 – 15.
[45] Witness Moul's Rebuttal Testimony, page 21: lines 9 – 24, and page 22: lines 1 – 12.
[46] K. Chan, L., Karceski, J., & Lakonishok, J., "The Level and Persistence of Growth Rates," *Journal of Finance* (2003), page 683. (underline emphasis added).

I recognize that there are other academic articles and journals that support the opposite viewpoint. However, given the fact that this remains a debated topic, I have historically always included EPS, DPS, BPS, and plowback growth rates within my analysis. By relying entirely on EPS growth rates, and specifically only relying on those provided from a forecasted perspective as Mr. Moul has within his analysis, an analyst has not considered all of the available data. I also evaluated certain forecasted EPS growth rates within my own analysis, however I believe that relying entirely upon forecasted EPS growth rates produces unrealistically high returns on equity numbers that cannot be sustained indefinitely.

Q. DO YOU AGREE WITH MR. MOUL'S DISCUSSION REGARDING HIS SOLE USE OF FORECASTED GROWTH RATES FOR APPLICATION WITHIN THE DCF?

A. No, I do not agree. Historical growth rates, in conjunction with my use of forecasted growth rates, helped me arrive at my ultimate recommendation of a 4.0 – 6.0% growth rate for application within my DCF model.[47] Mr. Moul criticized my use of historical growth rates by stating the following within his rebuttal:

> …forecast earnings growth is the only valid measure of growth for DCF purposes.[48]

As I stated in direct testimony, investors examine a wide variety of growth rate metrics to inform their investment decisions. One of my main purposes when presenting testimony to a Commission is to provide analysis that is as complete and thoroughly researched as

[47] Witness O'Donnell's Direct Testimony, page 55: lines 24 – 25.
[48] Witness Moul's Pre-Filed Direct Testimony, page 22: lines: 20 – 21.

possible. That is the reasoning behind my inclusion of EPS, DPS, and BPS growth rates from a historical and forecasted perspective, and my use of plowback growth rates. I want the data included within my testimony to speak for itself without feeling the need to make various modifications to the data or adjustments to the final results.

Additionally, there is an inconsistency in Mr. Moul's testimony. On one hand, Mr. Moul expresses concern that Columbia Gas' risk is higher than other comparable companies, especially given the inherent uncertainty provided by the COVID-19 pandemic. On the other hand, Mr. Moul relies solely upon forecasted growth rates for application within the DCF. The historical growth rate data is readily available. It appears that Mr. Moul has omitted such data from his analysis simply because historical growth rates are less than forecasted growth rates, and use of such historical growth rates would result in DCF results being lower than Mr. Moul would need in order to support his inflated 10.95% ROE recommendation in this case.

Q. MR. MOUL CLAIMED THAT YOU DID NOT REFUTE HIS PROPOSED 172-BASIS POINT LEVERAGE ADJUSTMENT AND THAT THE ADJUSTMENT SHOULD BE ACCEPTED. IS THIS CORRECT?

A. No, this is not correct. In his rebuttal testimony, Mr. Moul stated the following:

> The I&E and OCA witnesses have not refuted the accuracy of the Company's leverage adjustments to the DCF and beta component of the CAPM. Without such opposition, these should be accepted.[49]

In including the above statement within his rebuttal testimony, Mr. Moul has not acknowledged the section of my direct testimony which stated the following:

[49] Witness Moul's Rebuttal Testimony, page 3: lines 5 – 7.

> **Q. DO YOU AGREE WITH MR. MOUL'S USAGE OF THE 172-BASIS POINT LEVERAGE ADJUSTMENT.**
>
> A. No. This adjustment stems from Mr. Moul's apparent belief that investors are unaware of debt on the Company's books and, therefore, they must be compensated for the additional risk.[50]

Within pages 78 – 79 following the above Q&A from my direct testimony, I outlined in detail why I do not agree conceptually with the principles behind Mr. Moul's leverage adjustment and why I believe that this leverage adjustment is simply an attempt to justify an unreasonable return on equity for the Company.

Additionally, the selection from Mr. Moul's rebuttal above says that "The I&E and OCA witnesses have <u>not refuted the accuracy</u> of the Company's leverage adjustments…"[51] However, within Mr. Moul's direct testimony, he goes as far to admit that he knows "<u>of no means to mathematically solve for the 1.72% leverage adjustment</u> by expressing it in the terms of any particular relationship of market price to book value. <u>The adjustment is merely a convenient way to compare</u> the 11.91% return computed directly with the Modigliani & Miller formulas to the 10.19% return generated by the DCF model…based on a market value capital structure."[52] Based on the previously referenced sections from Mr. Moul's direct testimony, he has, himself, refuted the accuracy of his own adjustment.

The inclusion of such a leverage adjustment by Mr. Moul stems from his belief that investors, when purchasing an equity, are unaware that the market price of a security is different than the book value of the underlying security. Such a belief is simply

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[50] Witness O'Donnell's Direct Testimony, page 78: lines 6 – 10.
[51] Witness Moul's Rebuttal Testimony, page 3: lines 5 – 7. (underline emphasis added)
[52] Witness Moul's Pre-Filed Direct Testimony, page 29: lines 24 – 26, and page 30: lines 1 – 4. (underline emphasis added)

irrational. Mr. Moul's market-to-book adjustment is, again, another attempt to justify a higher allowed ROE than what is currently being found in the marketplace.

Q. MR. MOUL LATER CLAIMS WITHIN HIS REBUTTAL TESTIMONY THAT YOU DID REFUTE HIS PROPOSED 172-BASIS POINT LEVERAGE ADJUSTMENT. IS THIS CORRECT?

A. Yes. Mr. Moul later contradicted himself within his rebuttal and stated that I actually did disagree with his leverage adjustment,[53] despite stating the opposite previously.[54] As referenced in the Q&A above, I stated within my direct testimony the reasoning for why I do not agree in principle with Mr. Moul's leverage adjustment. However, I again call attention to Mr. Moul's response to two separate data requests in which Mr. Moul noted that he had proposed a leverage adjustment within his DCF model in over thirty different rate cases on behalf of a Pennsylvania public utility in the past ten years,[55] and that Mr. Moul was not aware of any such cases within the past ten years in which the Commission had approved one of these leverage adjustments.[56] These data request responses can be found in **Exhibits KWO-3S** and **KWO-4S** to this surrebuttal testimony. Mr. Moul has not provided sound reasons why the Commission should adopt this leverage adjustment in determining an appropriate cost of equity for Columbia Gas and the Company's ratepayers in this proceeding.

[53] Witness Moul's Rebuttal Testimony, page 25: lines 18 – 19.
[54] Witness Moul's Rebuttal Testimony, page 3: lines 5 – 7.
[55] Witness Moul's response to Question No. OCA-III-10. (**Exhibit KWO-3S**)
[56] Witness Moul's response to Question No. OCA-III-11. (**Exhibit KWO-4S**)

IX. MR. MOUL'S CRITICISM OF MY CAPM CALCULATION INPUTS AND ASSOCIATED RESULTS

Q. MR. MOUL CRITICIZED YOUR CAPM MODEL FOR NOT INCLUDING FORWARD-LOOKING DATA SPECIFIC TO THE RISK-FREE RATE OF RETURN. DO YOU HAVE A RESPONSE TO THIS CLAIM?

A. Yes. Within his rebuttal testimony, Mr. Moul makes the assertion that

> Mr. O'Donnell's CAPM approach suffers from the infirmity of not positioning the risk-free rate of return in a forward-looking manner – rather he used historical results obtained from the past year.[57]

Within my direct testimony and related exhibits, I noted that I developed my CAPM results of 5.50% – 7.50%[58] based partially upon my use of the maximum, average, and minimum values of the 30-year U.S. Treasury Bond Yields from July 17, 2019 to July 17, 2020 to approximate the risk-free rate. The average value for this period was 1.89%,[59] and the value as of July 17, 2020 was 1.33%.[60] Mr. Moul criticized my use of such data for my risk-free rate and opined that if had I used expectational data to develop my risk-free rate for use within the CAPM, my results would have been markedly different.

However, an article recently published by the *Wall Street Journal* stated that in accordance with recently approved strategy by the Federal Reserve, "…it may be a very long time before the Fed considers raising interest rates…".[61] As outlined within this

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[57] Witness Moul's Rebuttal Testimony, page 29: lines 15 – 18.
[58] Witness O'Donnell's Direct Testimony, page 68: line 16.
[59] Witness O'Donnell's Direct Testimony Exhibit KWO-5.
[60] https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield.
[61] Timiraos, N. (2020, August 27). Fed Approves Shift on Inflation Goal, Ushering In Longer Era of Low Rates. Retrieved August 27, 2020, from https://www.wsj.com/articles/feds-powell-headlines-virtual-jackson-hole-economic-conference-11598486400?mod=hp.

article, interest rates are not expected to return to the levels asserted by Mr. Moul at any point in the near term or even the next several years. The 30-year US Treasury Bond yield has not been as high as Mr. Moul's contended risk-free rate of 2.75% since May 23, 2019.[62] Mr. Moul stated that he used a risk free rate of 2.75% based upon such expectational results, but the actual current market conditions are that the risk free bond yield is currently well below 2.00%, has not come close to approximating what Mr. Moul is asserting is appropriate in nearly 1.5 years, and forecasts are not anticipating it to reach such levels either.

Additionally, in January 2019 in a different natural gas utility base rate case, Mr. Moul claimed that the forecasted risk-free rate for use within the CAPM was appropriate to be set at 3.75%.[63] For context, at the start of 2019, the 30-year US Treasury Bond yield was 2.97%, decreased to 2.39% as of the end of 2019 (prior to the impacts of the COVID-19 pandemic), and then decreased to 1.33% as of July 17, 2020.[64] Mr. Moul's own previous forecasts in this regard have simply missed the mark badly. Putting any faith in Mr. Moul's interest rate forecasts is an exercise in futility.

Q. MR. MOUL CRITICIZED YOUR USE OF THE GEOMETRIC MEAN IN EVALUATING HISTORICAL RETURNS DATA. HAVE YOU ONLY RELIED UPON THE GEOMETRIC MEAN IN ANALYZING SUCH RETURNS?

A. No. Mr. Moul included the following passage within his rebuttal testimony:

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[62] https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield.
[63] Pa. P.U.C. v. UGI Utilities – Gas Div., Docket No. R-2018-3006814, Company Rate Filing, Book IV, UGI Gas St. 5, Paul R. Moul Direct Testimony, p. 46.
[64] https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield.

> Mr. O'Donnell has incorrectly used the geometric mean in his historic analysis of the total market returns.[65]

In the selection above from Mr. Moul's rebuttal testimony, he referenced page 65 of my direct testimony. However, within the table included on page 65 of my direct testimony, I included both the geometric and arithmetic mean returns as provided by the Ibbotson SBBI Annual Yearbook for the purpose of the comparison of these returns to the forecasted market return and resulting risk premium used by Mr. Moul. Nowhere within my testimony have I said that I singularly relied upon the geometric mean instead of the arithmetic mean, or that I afforded the arithmetic mean no weight in my analysis. Again, I presented both the geometric average return and the arithmetic average return to give the Commission as much information as possible. Mr. Moul's comments on my reliance upon geometric mean versus arithmetic mean is simply misplaced, and incorrect.

Q. MR. MOUL CRITICIZED YOUR USE OF CERTAIN FORECASTED MARKET RETURNS.[66] WHAT DO THESE MARKET RETURN PROJECTIONS SHOW AND WHY DO YOU FEEL THEY ARE MORE APPROPRIATE THAN THE 11.83%, 8.93%, AND 11.81%[67] USED BY MR. MOUL?

A. On Pages 66 – 67 of my direct testimony in this case, I presented various forecasted market returns from a multitude of sources that all project significantly lower forecasted market returns than that which Mr. Moul contends of 11.83%, 8.93%, and 11.81%.[68]

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[65] Witness Moul's Rebuttal Testimony, page 29: lines 25 – 26.
[66] Witness Moul's Rebuttal Testimony, page 31: lines 15 – 19.
[67] Witness Moul's Direct Testimony, Schedule 13, page 24 of Exhibit No. 400.
[68] *Id.*

In response to these forecasted market return expectations that indicate that future return expectations for U.S. equities will be lower than what they have been historically, Mr. Moul claims that the sources I provided on Pages 66 – 67 of my testimony were "non-standard sources."[69] In other sections of his rebuttal testimony, Mr. Moul claims that I have failed to incorporate expectational inputs into my cost of equity evaluations specific to the ex-ante CAPM. In essence, when the expectational inputs relied upon by Mr. Moul fit his desired goal of raising his ROE recommendation for his client, he feels that such analysis should be performed with these expectational inputs, but when certain expectational inputs do not align with his desired goal of raising his ROE recommendation, he questions the accuracy of such sources and refers to them "non-standard".

Additionally, as noted with my direct testimony, I included reference to NiSource's (*i.e.,* CPA's parent company) own pension plan estimates. In response to data request **OCA-III-1**, NiSource noted that they have assumed a large cap market return of 8.25%, and an overall rate of return for actuarial purposes of 5.70%, which are both far from Mr. Moul's forecasted market returns.[70] This data request response can be found within **Exhibit KWO-2S** to this surrebuttal testimony.

Mr. Moul himself provided the data request response to **OCA-III-1**. Ultimately, Mr. Moul's forecasted return is simply illogical and directly conflicts with Columbia's own pension forecast, upon which the pension revenue requirement in this case is calculated.

[69] Witness Moul's Rebuttal Testimony, page 31: lines 16 – 17.
[70] Witness Moul's response to Question No. OCA-III-1. (**Exhibit KWO-2S**)

Q. IN HIS REBUTTAL TESTIMONY, MR. MOUL STATED THAT THE ADJUSTMENTS HE MADE TO HIS CAPM MODEL WERE APPROPRIATE. DO YOU HAVE A RESPONSE TO THIS SPECIFIC CLAIM?

A. Yes. I still oppose Mr. Moul's leverage and size adjustments in his CAPM analysis. As I noted above in response to Mr. Moul's similar claim for his DCF result upward adjustment, the adjustment Mr. Moul employs in his CAPM only serves as a measure to artificially inflate his ROE recommendation.

I stated in detail within my direct testimony my reasoning for why I do not agree with Mr. Moul's CAPM firm size adjustment in principle. Columbia Gas of Pennsylvania is a large gas utility doing business in the state. In this case, the Company is seeking a rate increase of over $100 million with a rate base of $2.4 billion. The size adjustment as espoused by Mr. Moul is simply unwarranted for a utility the size of Columbia Gas.

Furthermore, I want to again call attention to Mr. Moul's response to two separate data requests wherein Mr. Moul noted that he had proposed a firm size adjustment within his CAPM models in over thirty different rate cases on behalf of a Pennsylvania public utility in the past ten years,[71] and that Mr. Moul was not aware of any such cases within the past ten years in which the Commission had approved one of these such firm size adjustments.[72] These data request responses can be found in **Exhibits KWO-3S** and **KWO-4S** to this surrebuttal testimony. As has been historical precedence over the past ten years for the cases in Pennsylvania that Mr. Moul has testified, his firm size adjustment should yet again be given no weight in this rate case.

[71] Witness Moul's response to Question No. OCA-III-10. (**Exhibit KWO-3S**)
[72] Witness Moul's response to Question No. OCA-III-11. (**Exhibit KWO-4S**)

X. MR. KNECHT'S CRITICISM OF MY DCF METHODOLOGY

Q. MR. KNECHT CRITICIZES YOUR USE OF THE DCF MODEL AS THE PRIMARY MODEL FOR WHICH YOU BASED YOUR ROE RESULTS ON. HOW DO YOU RESPOND?

A. OSBA witness Knecht identified items that he constituted as "material biases in favor of utility shareholders"[73] within my cost of equity capital direct testimony in this case. This is the first time in my 35 years of experience that I have been accused by another witness of being biased towards utility shareholders.

Mr. Knecht's primary argument seems to be in relation to my reliance upon the DCF Model. Mr. Knecht correctly noted that the DCF model is based upon (1) a dividend yield and (2) an expected perpetual growth rate.[74] However, he disagreed with my using the DCF model based upon the fact that the expected perpetual growth rate input is "not directly observable"[75] and is "dependent on past regulatory awards."[76] Mr. Knecht then questioned the use of the DCF in this rate case given that he felt as though "assuming continued growth with the overall economy is optimistic"[77].

Instead, Mr. Knecht believed that it would have been more appropriate to utilize "a model based on a risk premium over current capital market interest rates."[78] However, every cost of equity model in use today is based on inputs that can be evaluated from both a historical and forecasted perspective. The key in

[73] Witness Knecht's Rebuttal Testimony, page 2: line 19.
[74] Witness Knecht's Rebuttal Testimony, page 20: lines 15 – 17.
[75] Witness Knecht's Rebuttal Testimony, page 20: line 25.
[76] Witness Knecht's Rebuttal Testimony, page 21: lines 6 – 7.
[77] Witness Knecht's Rebuttal Testimony, page 22: lines 13 – 14.
[78] Witness Knecht's Rebuttal Testimony, page 20: lines 6 – 7.

performing such an analysis is to maintain a balance between how much weight is placed upon such historical and projected inputs as I have exhibited within my testimony.

XI. MR. KNECHT'S CRITICISM OF MY CAPM INPUTS

Q. MR. KNECHT CRITICIZED THE ACCURACY OF INPUTS TO YOUR CAPM HOW DO YOU RESPOND?

A. Mr. Knecht first took issue with my equity risk premium. Mr. Knecht asserted that I recommended a "risk premium of 785-basis points…"[79] However, his assertion in this matter is incorrect. Mr. Knecht calculated his 785-basis point risk premium that he attributes to me by taking my overall ROE recommendation of 8.50% and subtracting a 0.65% value approximating the yield of the 10-Year T-Bond at the time of the writing of Mr. Knecht's rebuttal testimony.[80] Mathematically, 8.50% – 0.65% does equal 7.85% or 785 basis points. However, the 0.65% data point is Mr. Knecht's selection, not mine.

I utilized the 30-Year T-Bond to approximate my risk-free rate over the period from July 17, 2019 through July 17, 2020. As shown in **Exhibit KWO-5** to my direct testimony, the maximum 30-Year T-Bond Rate over this period was 2.61%, the average was 1.89%, and the minimum was 0.99%. I performed my CAPM analysis in this manner to mitigate the impacts of any recent anomalous events, such as the COVID-19 pandemic.

Mr. Knecht has not performed his analysis in this manner. Instead, Mr. Knecht has simply taken the 0.65% return for 10-Year T-Bonds from August 2020 and used this rate across the entirety of his CAPM discussion. If one were to look at the return for 10-Year T-Bonds at the beginning of the year, they would see the return was 1.88% on January 2, 2020, for instance. Picking only a one-month time period for use in the CAPM would invalidate Mr. Knecht's results as he would be singularly utilizing a risk-free rate

[79] Witness Knecht's Rebuttal Testimony, page 19: lines 1 – 2.
[80] Witness Knecht's Rebuttal Testimony, page 18: line 17, and page 19: lines 1 – 2.

obtained during the middle of a global pandemic. My preference, so as to mitigate fluctuations in the marketplace, is to analyze a longer time period, such as my one-year time period.

Mr. Knecht later stated that he felt that a "risk premium award of 690 basis points"[81] was "commendable" in relation to the 785-basis point risk premium that he incorrectly assumed I had utilized. However, had Mr. Knecht subtracted a 1.89% risk-free rate, which represents the average 30-Year T-Bond from July 17, 2019 through July 17, 2020, from my overall recommendation of 8.50%, the resulting calculated risk premium would have been 661-basis points (*i.e.,* 8.50% - 1.89%). This 661-basis point difference is actually below the 690-basis point figure that Mr. Knecht considered "commendable."

Q. MR. KNECHT ALSO FAULTED YOUR USE OF THE BETA VALUES FOR YOUR COMPARABLE GROUP PROVIDED BY *VALUE LINE*. WHAT IS YOUR RESPONSE?

A. Mr. Knecht included the following within his rebuttal testimony:

> …The end result is that Mr. O'Donnell uses a beta of 0.85…One contributor to bias comes from Mr. O'Donnell's source for beta estimates, namely *Value Line*…*Value Line* then adjusts the beta using a "Blume" mechanism. Many analysts do not rely on the Blume adjustment, given its relatively weak empirical basis.[82]

Mr. Knecht has accused my recommendation of being biased towards utility shareholders in part simply because I sourced such data from *Value Line*. Mr. Knecht makes the wide sweeping generalization that "many analysts do not rely on the Blume

[81] Witness Knecht's Rebuttal Testimony, page 19: lines 7 – 9, and page 20: lines 1 – 2.
[82] Witness Knecht's Rebuttal Testimony, page 24: lines 11 – 23.

adjustment" without providing a basis for this claim. I do not agree with Mr. Knecht's assertion in regard to beta for use in the CAPM. In my 35-years of experience providing cost of capital testimony around the United States, I have found that *Value Line* is, far and away, the standard bearer for financial information used by analysts employed by utilities as well as consumer advocates.

Additionally, Mr. Knecht later makes the claim that I had "no evidence supporting the use of a Blume adjustment for NGDCs."[83] Mr. Knecht is referring to a data request response that I provided to the OSBA asking for me to provide any evidence that the Blume adjustment was appropriate for utility betas. I responded in kind that I had not performed such an analysis. Again, as I referenced earlier, I have provided testimony in rate of return cases for over 35 years, and this is the first time I can remember that anyone has criticized my use of betas sourced from *Value Line*. I did not provide such evidence to the OSBA in response to the data request in question as I, along with many other analysts, have long relied on the values provided by *Value Line* and believe in the relative accuracy of the values provided by the valuation firm.

Q. DO YOU HAVE ANY OTHER POINTS IN MR. KNECHT'S TESTIMONY THAT YOU WOULD LIKE ADDRESS?

A. The only other point I would like to address is the following statement from Mr. Knecht's rebuttal:

> …when the Commission evaluates the return on equity issue in this proceeding, I hope it will recognize that Mr. O'Donnell, rather than advocating a position that is extremely favorable to ratepayers, has in fact

[83] Witness Knecht's Rebuttal Testimony, page 25: lines 3 – 4.

> advanced a recommendation that is materially biased in favor of utility shareholders.[84]

In this rate case, my ROE recommendation is 8.50%,[85] which is beneath the 10.95% recommendation of Mr. Moul,[86] and the 9.86% recommendation of I&E witness Keller.[87] By stating that my recommendation of 8.50% is materially biased in favor of utility shareholders, Mr. Knecht is implying that every individual other than himself in this case is materially biased towards shareholders. He is also implying the same in reference to the Commission should it authorize an allowed ROE to CPA at or above 8.50% Needless to say, I disagree with Mr. Knecht's assertion.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.

[84] Witness Knecht's Rebuttal Testimony, page 26: lines 12 – 15.
[85] Witness O'Donnell's Direct Testimony, page 69: line 10.
[86] Witness Moul's Pre-Filed Direct Testimony, page 5: line 4.
[87] Witness Keller's Direct Testimony, page 21: line 14.

Columbia Gas of Pennsylvania, Inc.
2020 General Rate Case
Docket No. R-2020-3018835
Standard Data Request
GASROR No. 10(Cont.) -23
Volume 3 of 3

CREDIT SUISSE

7 August 2019
Americas/United States
Equity Research
Natural Gas

NiSource Inc. (NI)

DOWNGRADE RATING

Rating	(from OUTPERFORM) NEUTRAL
Price (05-Aug-19, US$)	28.11
Target price (US$)	(from 33.00) 29.00
52-week price range (US$)	30.04 - 24.31
Market cap(US$ m)	10,495
Enterprise value (US$ m)	20,135

Target price is for 12 months.

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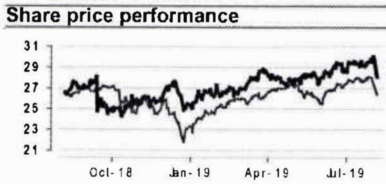
Downgrade to Neutral on Gas Operations Risk

- **Downgrade to Neutral after another explosive incident occurred in Pennsylvania last week.** On Thursday, Aug 1, NI's Columbia Gas of Pennsylvania reportedly accepted responsibility for causing a house explosion in North Franklin Township, PA. Apparently, the cause of the accident was the failure to install a pressure regulator during main replacement in the neighborhood. Columbia Gas President Mike Huwar told the press that the house involved had "slipped through both the initial design and secondary field survey". As a result, town supervisors issued "cease and desist" orders to Columbia Gas barring them from work until further notice.
- **Incident is minor but bears striking similarities to the events that occurred in Massachusetts in Sept 2018.** Recall that in the Greater Lawrence case, high pressure gas was also released into a low pressure system by accident, with NTSB preliminarily citing a "faulty work package" as a contributing factor (the final NTSB report is expected in 3Q19). We note that the PA accident occurred even as the company has taken aggressive steps across all jurisdictions to implement procedural changes and safety enhancements designed to prevent another similar incident from occurring.
- **We see elevated risk around gas operations for now.** There were no fatalities in PA and the incident itself is relatively immaterial. NI also enjoys favorable regulatory treatment across most jurisdictions with a $30B long-term capital opportunities driving 8%-10% ratebase growth (70%+ trackers) and 5%-7% EPS growth. Nevertheless, we think it prudent to reduce to Neutral pending possible wider consequences/implications given a repeated error. See our 2Q19 earnings report for the positive side of the story.
- **Valuation:** Our estimates are unchanged. We are reducing our TP to $29 from $33, with -$2/sh from a lower peer gas utility 2021 multiples within our SoTP and another -$2 from reducing the 1.5x premium we had applied to the gas utility segment to a -0.5x discount for increased operational and regulatory risk pending more clarity and certainty over safety management system installations across all NI gas service territories.

Share price performance



On 05-Aug-2019 the S&P 500 INDEX closed at 2844.74
Daily Aug06, 2018 - Aug05, 2019, 08/06/18 = US$26.79

Quarterly EPS	Q1	Q2	Q3	Q4
2018A	0.77	0.07	0.10	0.38
2019E	0.82	0.05	0.09	0.34
2020E	0.87	0.08	0.09	0.35

Financial and valuation metrics

Year	12/18A	12/19E	12/20E	12/21E
EPS (CS adj.) (US$)	1.30	1.30	1.39	1.48
Prev. EPS (US$)	-	-	-	-
Revenue (US$ m)	5,541.0	5,915.4	6,158.5	6,423.2
EBITDA (US$ m)	1,530.8	1,729.0	1,829.2	1,943.4
P/OCF (x)	5.9	6.1	5.9	5.7
EV/EBITDA (current)	12.9	11.5	10.8	10.2
Net debt (US$ m)	9,020	9,641	10,215	10,720
ROIC (%)	5.03	5.20	5.19	5.27

Number of shares (m)	373.35	IC (current, US$ m)	14,770.70
Net debt (Next Qtr., US$ m)	9,527.0	Dividend (current, US$)	0.76
Net debt/tot eq (Next Qtr.,%)	162.7		

Source: Company data, Refinitiv, Credit Suisse estimates

COLUMBIA GAS OF PENNSYLVANIA INC.

R-2020-3018835

Data Requests

Office of Consumer Advocates – Set 3

Question No. OCA 3-001:

Please provide the assumed market return on equity in the NiSource/CGP pension plan.

Response:

The assumed market returns are below and are based on 2019 projections for the 2020 plan year.

Large Cap	8.25%
Small Cap	9.00%

COLUMBIA GAS OF PENNSYLVANIA INC.

R-2020-3018835

Data Requests

Office of Consumer Advocates – Set 3

Question No. OCA 3-010:

Please provide a list of cases, by name and docket number, in which Mr. Moul's presented testimony on behalf of a Pennsylvania public utility in the past 10 years. Of these cases:

a) Identify each case in which Mr. Moul used forecasted Treasury yields in a CAPM application;
b) Identify each case in which Mr. Moul proposed a leverage adjustment;
c) Identify each case testimony in which Mr. Moul proposed an adjustment based upon the size of the utility.

Response:

Please refer to the list of cases provided in OCA 3-010 Attachment A to this response.

Utility	Docket No	Date	a) Case in which Mr. Moul used forecasted Treasury yields in a CAPM application	b) Case in which Mr. Moul proposed a leverage adjustment	c) Case in which Mr. Moul proposed an adjustment based upon the size of the utility
UGI Utilities, Inc. – Gas Division	R-2019-3015162	January 28, 2020	Yes	Yes, DCF and CAPM	Yes, CAPM only
UGI Utilities, Inc. – Gas Division	R-2018-3006814	January 28, 2019	Yes	Yes, DCF and CAPM	Yes, CAPM only
Peoples Natural Gas Company LLC	R-2018-3006818	January 28, 2019	Yes	Yes, DCF and CAPM	Yes, CAPM only
Aqua Pennsylvania, Inc.	R-2018-3003068	August 17, 2018	Yes	Yes, DCF and CAPM	Yes, CAPM only
The York Water Company	R-2018-3000019	May 30, 2018	Yes	Yes, DCF and CAPM	Yes, CAPM only
PECO Energy Company - Electric Division	R-2018-3000164	March 29, 2018	Yes	Yes, DCF and CAPM	Yes, CAPM only
UGI Utilities, Inc. – Electric Division	R-2018-3006814	January 26, 2018	Yes	Yes, DCF and CAPM	Yes, CAPM only
Columbia Gas of Pennsylvania, Inc.	R-2018-2647577	March 16, 2018	Yes	Yes, DCF and CAPM	Yes, CAPM only
Duquesne Light Company	R-2018-3000019	March 28, 2018	Yes	Yes, DCF and CAPM	Yes, CAPM only
UGI Penn Natural Gas Company	R-2016-2580030	January 19, 2017	Yes	Yes, DCF and CAPM	Yes, CAPM only
Columbia Gas of Pennsylvania, Inc.	R-2016-2529660	March 17, 2016	Yes	Yes, DCF and CAPM	Yes, CAPM only
UGI Utilities, Inc. – Gas Division	R-2015-2518438	January 19, 2016	Yes	Yes, DCF and CAPM	Yes, CAPM only
PPL Electric Utilities Corporation	R-2015-2469275	March 31, 2015	Yes	Yes, DCF and CAPM	Yes, CAPM only
Columbia Gas of Pennsylvania, Inc.	R-2015-2468056	March 19, 2015	Yes	Yes, DCF and CAPM	Yes, CAPM only
Columbia Gas of Pennsylvania, Inc.	R-2015-2468981	March 27, 2015	Yes	Yes, DCF and CAPM	Yes, CAPM only
Columbia Gas of Pennsylvania, Inc.	R-2014-2406274	March 21, 2014	Yes	Yes, DCF and CAPM	Yes, CAPM only
Pennsylvania-American Water Company	R-2013-2355276	April 30, 2013	Yes	Yes, DCF and CAPM	Yes, CAPM only
Peoples TWP LLC	R-2013-2355886	April 30, 2013	Yes	Yes, DCF and CAPM	Yes, CAPM only
Duquesne Light Company	R-2013-2372129	August 2, 2013	Yes	Yes, DCF and CAPM	Yes, CAPM only
The York Water Company	R-2012-2336379	May 28, 2013	Yes	Yes, DCF and CAPM	Yes, CAPM only
Columbia Gas of Pennsylvania, Inc.	R-2012-2321748	September 28, 2012	Yes	Yes, DCF and CAPM	Yes, CAPM only
Aqua Pennsylvania, Inc.	R-2011-2267958	November 18, 2011	Yes	Yes, DCF and CAPM	Yes, CAPM only
Peoples Natural Gas Company LLC	R-2012-2285985	February 29, 2012	Yes	Yes, DCF and CAPM	Yes, CAPM only
PPL Electric Utilities Corporation	R-2012-2290597	March 30, 201	Yes	Yes, DCF and CAPM	Yes, CAPM only
Pennsylvania-American Water Company	R-2011-2232243	April 29, 2011	Yes	Yes, DCF and CAPM	Yes, CAPM only
Columbia Gas of Pennsylvania, Inc.	R-2010-2215623	January 14, 2011	Yes	Yes, DCF and CAPM	Yes, CAPM only
UGI Central Penn Gas Company	R-2010-2214415	January 14, 2010	Yes	Yes, DCF and CAPM	Yes, CAPM only
Peoples Natural Gas Company LLC	R-2010-2201702	October 28, 2010	Yes	Yes, DCF and CAPM	Yes, CAPM only
Pennsylvania-American Water Company	R-2010-2166214	April 23, 2010	Yes	Yes, DCF and CAPM	Yes, CAPM only
PPL Electric Utilities Corporation	R-2010-2161694	March 31, 2010	Yes	Yes, DCF and CAPM	Yes, CAPM only
The York Water Company	R-2010-2157140		Yes	Yes, DCF and CAPM	Yes, CAPM only
T. W. Phillips Gas and Oil Co.	R-2010-2167797		Yes	Yes, DCF and CAPM	Yes, CAPM only
Duquesne Light Company	R-2010-2179522	July 23, 2010	Yes	Yes, DCF and CAPM	Yes, CAPM only
Columbia Gas of Pennsylvania, Inc.	R-2009-2149262	January 28, 2010	Yes	Yes, DCF and CAPM	Yes, CAPM only
PECO Energy Company - Electric Division	R-2010-2161575	March 31, 2010	Yes	Yes, DCF and CAPM	Yes, CAPM only
PECO Energy Company - Gas Division	R-2010-2161592	March 31, 2010	Yes	Yes, DCF and CAPM	Yes, CAPM only
Aqua Pennsylvania, Inc.	R-2009-2132019	November 18, 2009	Yes	Yes, DCF and CAPM	Yes, CAPM only

COLUMBIA GAS OF PENNSYLVANIA INC.

R-2020-3018835

Data Requests

Office of Consumer Advocates – Set 3

Question No. OCA 3-011:

Does Mr. Moul review the orders of the Pennsylvania Public Utility Commission in cases where he participated as a witness? If "yes," please identify by case name and docket number those cases in the past 10 years in which the Commission:

a) Used forecasted Treasury yields in a CAPM application;
b) Approved a leverage adjustment in an ROE model;
c) Adjusted the cost of capital based upon consideration of utility size.

Response:

a) The Commission utilized forecast Treasury yields in its Order entered October 25, 2018 in UGI Utilities, Inc. – Electric Division at Docket No. R-2017-2640058.

b)
- January 10, 2002 for Pennsylvania-American Water Company in Docket No. R-00016339 -- 60 basis points adjustment.
- August 1, 2002 for Philadelphia Suburban Water Company in Docket No. R-00016750 -- 80 basis points adjustment.
- January 29, 2004 for Pennsylvania-American Water Company in Docket No. R-00038304 (affirmed by the Commonwealth Court on November 8, 2004) -- 60 basis points adjustment.
- August 5, 2004 for Aqua Pennsylvania, Inc. in Docket No. R-00038805 -- 60 basis points adjustment.
- December 22, 2004 for PPL Electric Utilities Corporation in Docket No. R-00049255 -- 45 basis points.
- February 8, 2007 for PPL Gas Utilities Corporation in Docket No. R-00061398 -- 70 basis points adjustment.

c) Mr. Moul is not aware of any cases.

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 Surrebuttal Testimony, OCA Statement 3-S, 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: September 16, 2020
*296084

Signature: Kevin W. O'Donnell
Kevin W. O'Donnell

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