BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

DOCKET NO. 20200051-GU

PETITION FOR RATE INCREASE BY PEOPLES GAS SYSTEM.
________________________________/

DOCKET NO. 20200166-GU

PETITION FOR APPROVAL OF 2020 DEPRECIATION STUDY BY PEOPLES GAS SYSTEM.
________________________________/

DOCKET NO. 20200178-GU

PETITION FOR APPROVAL TO TRACK, RECORD AS A REGULATORY ASSET, AND DEFER INCREMENTAL COSTS RESULTING FROM THE COVID-19 PANDEMIC, BY PEOPLES GAS SYSTEM.
________________________________/

VOLUME 4
PAGES 684 - 911

PROCEEDINGS: HEARING

COMMISSIONERS PARTICIPATING: CHAIRMAN GARY F. CLARK
COMMISSIONER ART GRAHAM
COMMISSIONER JULIE I. BROWN
COMMISSIONER DONALD J. POLMANN
COMMISSIONER ANDREW GILES FAY

DATE: Thursday, November 19, 2020

TIME: Commenced: 11:00 a.m.
Concluded: 11:27 a.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: DEBRA R. KRICK
Court Reporter

APPEARANCES: (As heretofore noted.)

PREMIER REPORTING
114 W. 5TH AVENUE
TALLAHASSEE, FLORIDA
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I N D E X

WITNESSES

EXHIBITS

NUMBER:		ID	ADMITTED
1	Comprehensive Exhibit List	893	893
2-79	As identified on the CEL	893	894

P R O C E E D I N G S

(Transcript follows in sequence from Volume 3.)

(Whereupon, prefiled rebuttal testimony of Dylan D'Ascendis was inserted.)

BEFORE THE PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY

OF

DYLAN W. D'ASCENDIS

ON BEHALF OF PEOPLES GAS SYSTEM

I. INTRODUCTION

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

A. My name is Dylan W. D'Ascendis. My business address is 3000 Atrium Way, Suite 241, Mount Laurel, NJ 08054. I am a Director at ScottMadden, Inc. (ScottMadden).

Q. On whose behalf are you submitting this testimony?

A. I am submitting this rebuttal testimony before the Florida Public Service Commission ("Commission") on behalf of Peoples Gas System ("Peoples" or the "Company").

Q. Did you submit direct testimony in this proceeding?

A. No, I did not.

Q. Do you intend to adopt the direct testimony sponsored by

Robert B. Hevert in this proceeding?

A. Yes, I am adopting and incorporating as my own the direct testimony and Exhibit, as well as all responses to discovery requests, sponsored by Robert B. Hevert in this proceeding. In adopting witness Hevert's direct testimony, I refer to his direct testimony as my own in my rebuttal testimony. Mr. Hevert is no longer employed at ScottMadden, taking a position at Unitil Corporation as the Senior Vice President effective July 23, 2020, and subsequently elected Chief Financial Officer and Treasurer, effective July 31, 2020.

Q. Please describe your educational and professional background.

A. I have offered expert testimony on behalf of investor-owned utilities in over 20 state regulatory commissions in the United States, one Canadian province, and one American Arbitration Association panel on issues including, but not limited to, common equity cost rate, rate of return, valuation, capital structure, relative investment risk, class cost of service, and rate design.

On behalf of the American Gas Association ("AGA"), I calculate the AGA Gas Index, which serves as the benchmark against which the performance of the American Gas Index Fund (“AGIF”) is measured on a monthly basis. The AGA Gas Index and AGIF are a market capitalization weighted index and mutual fund, respectively, consisting of the common stocks of the publicly traded corporate members of the AGA.

I am a member of the Society of Utility and Regulatory Financial Analysts (“SURFA”). In 2011, I was awarded the professional designation "Certified Rate of Return Analyst" by SURFA, which is based on education, experience, and the successful completion of a comprehensive written examination.

I am also a member of the National Association of Certified Valuation Analysts and was awarded the professional designation “Certified Valuation Analyst” in 2015.

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

The details of my educational background and expert witness appearances are shown in Attachment A to my rebuttal testimony.

II. PURPOSE AND OVERVIEW OF TESTIMONY

Q. What is the purpose of your rebuttal testimony in this proceeding?

A. The purpose of my rebuttal testimony is two-fold. First, I update my analytical results. Second, I respond to and address serious shortcomings in the prepared direct testimony of witness David J. Garrett, testifying on behalf of the Florida Office of Public Counsel ("OPC"), regarding the Company's Cost of Common Equity ("ROE").

Q. Please summarize your conclusions.

A. As discussed in Section III below, due to the fluid market conditions as a result of the COVID-19 pandemic, I have updated my ROE analyses as of August 31, 2020. Based on my updated analyses, I reaffirm the range of reasonable ROEs attributable to Peoples is between 10.00 percent to 11.00 percent and maintain my specific recommendation of 10.75 percent as an appropriate measure of ROE applicable to Peoples at this time. In view of current markets and the results of my ROE models, ROEs of 6.50 percent and 7.30

percent,[1] proffered by witness Garrett, are woefully inadequate.

Q. Please summarize your interpretation of current capital markets.

A. As explained in my direct testimony[2] and discussed in Section IV below, the turmoil in capital markets attributable to the COVID-19 pandemic has increased risk for the entire economy, generally, and utilities, specifically. Key takeaways include:

- The full impact and duration of the COVID-19 pandemic are unknown, and outcomes are still highly uncertain;
- This uncertainty increases capital market volatility; and volatility increases the risk of investment losses. As a result, investors tend to flee to bonds to limit their investment losses, which is known as a "flight to safety". Increased levels of bond purchases increase their price and drive down their yields, *i.e.*, interest rates. Because of this, the current low-interest rate environment is due to increased volatility in the market, and not a steady lowering of the cost of debt over time; and

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[1] The ROE estimates of 6.50 percent and 7.30 percent reflect the results of witness Garrett's CAPM and Quarterly DCF models, respectively.

[2] Prepared Direct Testimony and Exhibit of Robert B. Hevert, at 14-34.

- The same increased market volatility that caused investors' "flight to safety" also created a situation where utilities traded in tandem with market indices. The correlated returns of utility stocks and market indices, in combination with increased volatility, increases Beta coefficients (a measure of risk), and by extension, investor-required returns.

Q. Please summarize your response to OPC's witness Garrett.

A. In my response to witness Garrett's estimate of the Company's ROE (*see*, Section V below), I explain the shortcomings of witness Garrett's analyses and conclusions, including, but not limited to:

- How far disconnected his recommended ROE is from his own analytical results and observable and relevant data;
- His misinterpretation of the relationships between various returns;
- His misunderstanding of the nature of utility regulation;
- His misapplication of the Discounted Cash Flow ("DCF") model;
- His misapplication of the Capital Asset Pricing Model ("CAPM"); and

- His refusal to consider flotation costs and other Company-specific factors in his ROE recommendation.

In addition, I also respond to witness Garrett’s unfounded critiques of my direct testimony.

Q. Have you prepared an exhibit supporting your rebuttal testimony?

A. Yes, I have. My analyses and conclusions are supported by the data presented in Document Nos. 1 through 20 of Exhibit No. __ (DWD-1), which have been prepared by me or under my direction and supervision.

III. UPDATED ROE ANALYSIS

Q. Have you revisited your analyses to reflect current market conditions?

A. Yes, I have. As stated above, as a result of the fluid nature of current market conditions since my direct testimony, I re-ran my ROE analyses as of August 31, 2020. The results are summarized in Document No. 1, and the analyses are contained in Document Nos. 2 through 8 of my Exhibit.

Q. Have you applied the ROE models in the same manner and to the same proxy group as you applied them in your direct testimony?

A. Yes, I have. The range of results[3] produced by my four approaches using more recent data are as follows:

- The Constant Growth DCF method median results indicate an ROE in the range of approximately 7.27 percent to 11.41 percent (please refer to Document No. 2);
- The CAPM model suggests an ROE in the range of approximately 12.00 percent to 14.93 percent; and the Empirical CAPM ("ECAPM") model indicates an ROE in the range of approximately 12.45 percent to 15.18 percent (please refer to Document No. 6);
- The Bond Yield Plus Risk Premium approach suggests an ROE in the range of 9.90 percent to 10.38 percent (*see*, Document No. 7); and
- The Expected Earnings approach indicates an ROE in the range of approximately 9.14 percent to 9.29 percent (*see*, Document No. 8).

IV. CAPITAL MARKET CONDITIONS

Q. Have capital market conditions changed significantly since

[3] My estimate of the indicated range is narrower than the overall range of model results.

you filed your direct testimony?

A. No, they have not. Since the filing of my direct testimony, capital markets have continued to be characterized by high levels of volatility and market instability, and utility returns have continued to be highly correlated with the overall market.

Q. Please briefly summarize witness Garrett's observations of utility stocks in relation to the capital market and the conclusions he reached.

A. While witness Garrett provides no discussion of the capital market environment, in general, and the effects of the recent capital market dislocation on the utility sector, in particular, he argues that the Company's "true" Cost of Equity is low because "utilities are defensive firms that experience little market risk and are relatively insulated from market conditions."[4]

Q. Do you agree with witness Garrett's statements that utilities are "low risk" investments and "relatively insulated from market conditions" in the current capital market?

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[4] Direct Testimony of David J. Garrett, at 40.

A. No, I do not. While witness Garrett considers utility stocks as "low-risk" investments, in this period of extreme market volatility, they are not.

Q. Have you conducted an analysis to determine whether natural gas distribution utility stocks are "low-risk" investments in the current market?

A. Yes, I have. Specifically, I analyzed the relative performance and annualized volatilities[5] of my proxy group, the Dow Jones Utility Average ("DJU"), the Utilities Select SPDR ("XLU"), the Dow Jones Industrial Average ("DJI"), and the S&P 500 to gauge whether utilities weathered the COVID-19 pandemic better than the overall market. As shown in Document No. 9 of my exhibit, from January 31, 2020[6] to August 31, 2020, utilities were generally more volatile (*i.e.*, risky) than the market indices, and had returns that underperformed the DJI and the S&P 500.

In addition to the analysis in Document No. 9, I also calculated the correlation coefficients of the price

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[5] The annualized volatility of a stock is measured by taking the standard deviation of the price changes within the sample and multiplying by the square root of 252 (the assumed number of trading days in a year).

[6] I chose January 31, 2020 because on June 8, 2020, the National Bureau of Economic Research determined that a peak in monthly economic activity occurred in the U.S. economy in February 2020. The peak marks the end of the expansion that began in June 2009 and the beginning of a recession. https://www.nber.org/cycles/june2020.html.

changes of the utility groups relative to the S&P 500 and the DJI from February 1, 2020 to August 31, 2020. Specifically, in Document No. 10 of my exhibit, I calculated correlation coefficients for the following relationships:

- The price changes of the S&P 500 relative to the price changes of my proxy group;
- The price changes of the S&P 500 relative to the price changes of the DJU;
- The price changes of the S&P 500 relative to the price changes of the XLU;
- The price changes of the DJIA relative to the price changes of my proxy group;
- The price changes of the DJIA relative to the price changes of the DJU; and
- The price changes of the DJIA relative to the price changes of the XLU.

As shown in Document No. 10 of my Exhibit, the correlations between utility stocks and the market indices are similar indicating that utility stocks have been trading in tandem with market indices during the current market dislocation, which is consistent with the risk and return data shown in Document No. 9 of my exhibit. The behavior of utility stocks to move in tandem with the market during market distress is not limited to the current period. During the

Great Recession (December 2007 to June 2009), correlations between these same groups were also similar, as also shown in Document No. 11 of my exhibit.

Thus, in view of the above, witness Garrett's statements regarding the "low-risk" nature of utility stocks should be dismissed, especially in this volatile capital market.

Q. Witness Garrett claims that "awarded ROEs have appropriately been decreasing in accordance with declining capital costs."[7] Is he correct?

A. No, he is not. As stated in my direct testimony[8] and demonstrated in Exhibit No. __ (RBH-1), Document No. 16, awarded ROEs have not followed the decline in interest rates, but remained relatively consistent since 2015. Thus, witness Garrett's claim should be dismissed.

Q. What conclusions did you draw from your review of the current capital market and its implications on the Company's Cost of Equity?

A. In view of the above and my direct testimony, current

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[7] Direct Testimony of David J. Garrett, at 7.

[8] Prepared Direct Testimony and Exhibit of Robert B. Hevert, at 24.

capital markets are indicating higher investor-required returns for utility companies due to the COVID-19 pandemic. Because of this, witness Garrett's "true" Cost of Equity of 6.90 percent and his recommended ROE of 9.50 percent are woefully inadequate, and my recommended range of ROEs between 10.00 percent and 11.00 percent is reasonable. Within that range, my recommended point estimate of 10.75 percent for the Company is appropriate, if not conservative.

V. <u>RESPONSE TO OPC WITNESS GARRETT</u>

Q. Please provide a brief summary of witness Garrett's analyses and recommendations regarding the Company's Cost of Equity.

A. Although witness Garrett believes the Company's "true" Cost of Equity is 6.90 percent, he recommends an ROE of 9.50 percent.[9] Witness Garrett estimates the Cost of Equity using the Quarterly DCF model (7.30 percent) and the CAPM (6.50 percent).[10]

Q. Are witness Garrett's analytical results and recommendation reasonable measures of the Company's Cost of Equity?

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[9] Direct Testimony of David J. Garrett, at 13; and Exhibit DJG-12. Witness Garrett specifically argues the models he applies estimate the "true cost of equity"; the average of his model results is 6.90 percent.

[10] Exhibits DJG-6 and DJG-11, respectively.

A. No, they are not. Witness Garrett's recommended ROE of 9.50 percent is fundamentally disconnected from his own analyses and conclusions; and his analytical model results of 7.30 percent and lower are far removed from observable and relevant data, including the 2019 average authorized ROEs provided in his testimony of 9.64 percent and 9.67 percent for electric and gas utilities, respectively.[11] Throughout his testimony, witness Garrett believes his analytical results indicate that the "true" Cost of Equity for the Company is 6.90 percent. He views the decisions of utility commissions to have been significantly and consistently wrong, but suggests moving all the way to the "true" Cost of Equity would be "a significant, sudden change in the awarded ROE anticipated by regulatory stakeholders" that "could have the undesirable effect of notably increasing the Company's risk profile and would arguably be at odds with the *Hope* Court's 'end result' doctrine."[12] On those points, we agree. However, while I appreciate the need for judgment in developing ROE recommendations, I believe there should be some empirical basis for them. Since witness Garrett's 9.50 percent recommendation is so far removed from his analytical model results, we cannot assess the basis of his ultimate recommendation, empirical

[11] Exhibit DJG-14.
[12] Direct Testimony of David J. Garrett, at 14.

or otherwise. To justify his recommendation for an ROE which has no connection to his analytical results, witness Garrett argues that the Commission should apply the ratemaking concept of "gradualism" to move the Company's ROE to his "true" Cost of Equity.[13]

Q. Do you agree with witness Garrett's recommendation to the Commission regarding the use of "gradualism" in determining the appropriate ROE for the Company?

A. No, I do not. The role of ROE witnesses is to testify regarding the return required by equity investors, *i.e.*, the Cost of Equity, as will be discussed in detail below. It is the Commission's difficult task in fixing just and reasonable rates to balance that cost with all other elements of the revenue requirement. As witness Garrett himself stated, "gradualism" is "usually applied from the customer's standpoint to minimize rate shock,"[14] and therefore would not be applicable to the ROE recommendation. In view of the above, witness Garrett's recommendation is without merit and should be given no weight by the Commission.

[13] *Ibid.*
[14] *Ibid.*

Q. In what key areas are witness Garrett's analyses and recommendations incorrect or unsupported?

A. In addition to recommending a specific ROE with seemingly no empirical basis, there are several areas in which witness Garrett's analyses and conclusions are incorrect or unsupported, including: (1) his incorrect assessment of the relationships between returns and their applicability to the Company's ROE; (2) his incorrect observation that authorized ROEs have exceeded the investor-required return on the market for 30 years; (3) his misapplication of the DCF model; (4) his misapplication of the CAPM; and (5) his refusal to consider flotation costs and other Company-specific risk factors in his ROE recommendation. Those points are discussed in turn, below.

1. <u>Incorrect Assessment of Relationships Between Various Returns and Applicability to the Company's ROE</u>

Q. Please summarize witness Garrett's views on the relationship between the Cost of Equity, the investor-required ROE, earned ROE, and awarded ROE for regulated utilities.

A. Witness Garrett believes the above specified returns are all interrelated, but technically different.[15] He summarizes his view on the relationship between the returns on page 4 of his testimony in the following sentence: "If the awarded ROE reflects a utility's cost of equity, then it should allow the utility to achieve an earned ROE that is sufficient to satisfy the required return of its investors."[16] Witness Garrett also discusses another type of return, the "expected" return, which in his words, "has nothing to do with what the investor 'expects' the ROE awarded by a regulatory commission to be."[17]

Q. Does witness Garrett's views regarding the relationship between allowed and investor-required ROEs for utilities change throughout the course of his testimony?

A. Yes. On page 11 of his testimony, witness Garrett contradicts his earlier assertion, stating that awarded ROEs and Cost of Equity (*i.e.,* investor-required returns) are very different concepts because of the regulatory process being carried out by elected and appointed officials.[18]

However, on page 23 of his testimony, witness Garrett again

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[15] *Ibid.,* at 3.
[16] *Ibid.,* at 4.
[17] *Ibid.*
[18] *Ibid.,* at 11.

changes track, stating:

> The *Hope* Court makes it clear that the allowed return should be based on the actual cost of capital. Under the rate base rate of return model, a utility should be allowed to recover all its reasonable expenses, its capital investments through depreciation, and a return on its capital investments sufficient to satisfy the required return of its investors. The "required return" from the investors' perspective is synonymous with the "cost of capital" from the utility's perspective. Scholars agree that the allowed rate of return should be based on the actual cost of capital:
>
> > Since by definition the cost of capital of a regulated firm represents precisely the expected return that investors could anticipate from other investments while bearing no more or less risk, and since investors will not provide capital unless the investment is expected to yield its opportunity cost of capital, the correspondence of the definition of the cost of capital

with the court's definition of legally required earnings appears clear.[19,20]

Witness Garrett continues to change his position regarding the equivalency, or non-equivalency, of the allowed and required ROE, sometimes in consecutive sentences. For example, on page 24 of his testimony, witness Garrett states that "The two concepts [allowed and required ROEs] are related in that the legal and technical standards encompassing this issue require that the awarded return reflect the true cost of capital. On the other hand, the two concepts are different in that the legal standard do not mandate that awarded returns exactly match the cost of capital."[21]

Q. What is your reaction to witness Garrett's views on the relationship between allowed and required ROEs for utility companies?

A. Witness Garrett is unnecessarily complicating a simple relationship. For regulated utilities, the ROE equals the investor-required ROE which equals the allowed ROE, as

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19 A. Lawrence Kolbe, George A. Read, Jr, George Hall, *The Cost of Capital: Estimating the Rate of Return for Public Utilities*, The MIT Press, 1984, at 21.

20 Direct Testimony of David J. Garrett, at 23.

21 *Ibid.,* at 24. Clarification and emphasis added.

reflected in the *Hope* and *Bluefield* Supreme Court decisions cited in both my direct testimony[22] and witness Garrett's testimony.[23] This relationship holds because utility regulation by regulatory commissions acts as a substitute for competition.

Q. Is the concept of utility regulation as a substitute for market competition widely accepted as a fact and reflected as such in academic literature?

A. Yes, it is. The *Cost of Capital Manual*, which is the training manual for SURFA, of which witness Garrett and I are members, states:

> In a sense, the "visible hand of public regulation was (created) to replace the invisible hand of Adam Smith in order to protect consumers against exorbitant charges, restriction of output, deterioration of service, and unfair discrimination."[footnote omitted]
>
> ***
>
> As indicated above, regulation of public utilities reflects a belief that the competitive mechanism alone cannot be relied upon to protect

[22] Prepared Direct Testimony and Exhibit of Robert B. Hevert, at 28-31.
[23] Direct Testimony of David J. Garrett, at 23.

> the public interest. Essentially, it is theorized that a truly competitive market involving utilities cannot survive and, thereby, will fail to promote the general economic welfare. But this does not mean that regulation should alter the norm of competitive behavior for utilities. On the contrary, the primary objective of regulation is to produce market results (*i.e.,* price and quantity supplied) in the utility sectors of the economy closely approximating those conditions which would be obtained if utility rates and services were determined competitively.[24]

Additionally, in *Principles of Public Utility Rates*, Dr. Bonbright states:

> Lest the reader of this chapter gain the impression that it is intended to deny the relevance of any tests of reasonable rates derived from the theory or the behavior of competitive prices, let me state my conviction that no such conclusion would be warranted. On the contrary, a study of price behavior both

[24] David C. Parcell, *Cost of Capital Manual*, Society of Utility and Regulatory Financial Analysts, 2010 Edition, at 3-4.

under assumed conditions of pure competition and under actual conditions of mixed competition is essential to the development of sound principles of utility rate control. Not only that: any good program of public utility rate making must go a certain distance in accepting competitive-price principles as guides to monopoly pricing. For rate regulation must necessarily try to accomplish the major objectives that unregulated competition is designed to accomplish, and the similarity of purpose calls for a considerable degree of similarity of price behavior.

Regulation, then, as I conceive it, is indeed a substitute for competition; and it is even a partly imitative substitute. But so is a Diesel locomotive a partly imitative substitute for a steam locomotive, and so is a telephone message a partly imitative substitute for a telegraph message. What I am trying to emphasize by these crude analogies is that the very nature of a monopolistic public utility is such as to preclude an attempt to make the emulation of competition very close. The fact, for example, that theories of pure competition leave no room

> for rate discrimination, while suggesting a reason for viewing the practice with skepticism, does not prove that discrimination should be outlawed. And a similar statement would apply alike to the use of an original-cost or a fair value rate base, neither of which is defensible under the theory or practice of competitive pricing.[25]

Finally, Dr. Phillips states in *The Regulation of Public Utilities*:

> Public utilities are no longer, if they were ever were, isolated from the rest of the economy. It is possible that the expanding utility sector has been taking too large a share of the nation's resources, especially of investment.[footnote omitted] At a minimum, regulation must be viewed in the context of the entire economy – and evaluated in a similar context. Public utilities have always operated within the framework of a competitive system. They must obtain capital, labor and materials in competition with unregulated industries. Adequate profits are not guaranteed

[25] James C. Bonbright, *Principles of Public Utility Rates*, Columbia University Press, 1961, at 106-107.

> to them. Regulation then, should provide incentives to adopt new methods, improve quality, increase efficiency, cut costs, develop new markets and expand output in line with customer demand. In short, regulation is a substitute for competition and should attempt to put the utility sector under the same restraints competition places on the industrial sector.[26]

In view of the legal standard cited by me and witness Garrett, and treatises on regulation likening regulation of utilities and the competitive market, it is plain to see that allowed returns and investor-required returns are also equal.

Q. What is the relationship between the earned ROE and the required/allowed ROE for utility companies?

A. The earned ROE is the return realized by the utility. The regulatory commission allows the utility an opportunity to earn its required return, but what the utility earns is generally subject to several factors, which may include regulatory lag and management efficiency.

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[26] Charles F. Phillips, *The Regulation of Public Utilities*, Public Utility Reports, Inc., 1993, at 173.

Q. What is the relationship between expected returns and required/allowed ROE?

A. In this instance, I agree with witness Garrett that the expected return has nothing to do with what the investor expects the required/allowed return should be. Expected returns from investment houses or pension funds are expectations of what earned returns will be, not what investors require, which means that expected returns have no bearing on ROE determinations.

2. <u>Incorrect Observations that Allowed ROEs for Utilities Exceed the Investor-Required Return on the Market</u>

Q. Please summarize witness Garrett's claim that allowed returns for utility companies exceed the required return on the market.

A. Witness Garrett estimates the investor-required return on the market by adding the annual average 10-year Treasury bond yield to a market risk premium (MRP) calculated by the New York University School of Business for the period 1990–2019. He then compares that return to the average annual authorized returns for electric and gas utilities over that same period[27] to support his argument that "awarded ROEs have been consistently *above* the market cost of equity for many years."[28] Witness Garrett further argues that the excess returns awarded to utilities result in a transfer of wealth from customers to shareholders.[29]

Witness Garrett also refers to an article published in *Public Utilities Fortnightly*,[30] suggesting that utility stocks have outperformed the broader market and will continue to do so in the future.

Q. What is your response to witness Garrett's observations, and the conclusions he draws from them?

A. Witness Garrett's observations and resulting conclusions are misplaced. As a preliminary matter, witness Garrett's conclusion that allowed returns for utility companies exceed the required return on the market is his opinion and driven by the inputs he has chosen to estimate the required return on the market. As discussed below, applying more reasonable models and inputs demonstrate allowed ROEs average about 70.00 percent of the required return on the

[27] *See*, for example, Direct Testimony of David J. Garrett, Figure 4; and Exhibit DJG-14.
[28] Direct Testimony of David J. Garrett, at 27.
[29] *Ibid.*, at 77.
[30] *Ibid.*, at 28.

market, consistent with utility betas over the period from 1990-2019.

Regarding the *Public Utilities Fortnightly* article, it was published in August 2016, shortly after the 30-year Treasury yield fell to its prior cyclical low of 2.11 percent on July 8, 2016. Between July and December 2016, the utility sector, as represented by witness Garrett's proxy group, lost 2.77 percent of its value as the broader market (measured by the S&P 500) increased by 6.71 percent. That is, despite the article's conviction that utilities would continue to outperform the market, shortly after its publication utility stocks meaningfully underperformed the broad market. From August 2016 through August 2020, the utility sector (measured by the XLU, and the Dow Jones Utility Average) significantly underperformed the S&P 500.[31]

Finally, regarding witness Garrett's required return on the market, I disagree with his calculation of the implied MRP because reasonable changes in his assumptions have considerable effects on the calculation (as will be discussed in detail in my critique of witness Garrett's CAPM analysis).

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[31] The XLU and DJU gained 13.61 percent and 13.01 percent, respectively, while the S&P 500 gained 61.24 percent. Source: S&P Capital IQ.

Q. Have you calculated the investor-required return on the market for the period from 1990–2019?

A. Yes, I have. Using the Predictive Risk Premium Model (PRPM), I calculated the investor-required MRP for every month in the period from 1990–2019. I then averaged the monthly MRPs for each year and added the average 30-year Treasury bond yield to those averages to arrive at investor-required returns on the market for each year.

Q. Please explain the PRPM.

A. The PRPM, as published in the Journal of Regulatory Economics (JRE)[32] and The Electricity Journal (TEJ),[33] was developed from the work of Dr. Robert F. Engle, who shared the Nobel Prize in Economics in 2003, "for methods of analyzing economic time series with time-varying volatility (ARCH)"[34] (with "ARCH" standing for autoregressive conditional heteroskedasticity). Based on his work, Dr. Engle found that the volatility in market prices, returns,

[32] *See*, Pauline M. Ahern, Frank J. Hanley and Richard A. Michelfelder, Ph.D., *A New Approach for Estimating the Equity Risk Premium for Public Utilities,* The Journal of Regulatory Economics, December 2011, 40:261-278.

[33] *See*, Pauline M. Ahern, Richard A. Michelfelder, Ph.D., Rutgers University, Dylan W. D'Ascendis, and Frank J. Hanley, *Comparative Evaluation of the Predictive Risk Premium Model™, the Discounted Cash Flow Model and the Capital Asset Pricing Model*, The Electricity Journal, May 2013.

[34] *See*, www.nobelprize.org.

and equity risk premiums cluster over time, making them highly predictable and available to predict future levels of risk and risk premiums.

The PRPM estimates the risk/return relationship directly as the predicted equity risk premium is generated by the predictability of volatility, or risk. Thus, the PRPM is not based on an estimate of investor behavior, but rather on the evaluation of the actual results of that behavior, *i.e.*, the variance of historical equity risk premiums.

Q. How did you derive the investor-required return on the market using the PRPM?

A. The inputs to the PRPM are the historical returns on large capitalization stocks minus the historical monthly yield on long-term U.S. Treasury securities for the period from January 1990 through December 2019.[35] Using a generalized form of ARCH, known as GARCH, each projected MRP was determined using Eviews© statistical software. When the GARCH model is applied to the historical returns data, it produces a predicted GARCH variance series[36] and a GARCH

[35] Source: 2020 SBBI® Yearbook, Stocks, Bonds, Bills, and Inflation®, Appendix A-1.

[36] Illustrated in Columns [1] and [2] on page 2 of Exhibit No. (DWD-1) Document No. 20.

coefficient.[37] I then averaged the monthly investor-required return for each year to determine an annual investor-required return, and then added the annual average long-term government bond yield for each year[38] to arrive at annual investor-required returns on the market for the period from 1990-2019.

Next, I compared the investor-required return on the market to the average allowed ROEs for gas and electric utilities for each year. As shown on Document No. 12, the investor-required return on the market is consistently, and significantly, higher than the allowed returns for utility companies. These results make intuitive sense, as the ratio of allowed ROE versus required market return averages about 0.70 percent, which is consistent with utility betas over the period. Given the above, witness Garrett's claim that allowed ROEs for utilities exceed investor-required market returns is misplaced. In addition, witness Garrett's claim that the excess returns awarded to utilities result in a transfer of wealth from customers to shareholders[39] is misplaced as well since Document No. 12 shows that utilities have not been earning excess returns.

[37] Illustrated in Column [4] on page 2 of Exhibit No. (DWD-1) Document No. 20.

[38] Source: 2020 SBBI® Yearbook, Stocks, Bonds, Bills, and Inflation®, Appendix A-7.

[39] Direct Testimony of David J. Garrett, at 77.

3. Misapplication of the DCF Model

Q. Please briefly describe witness Garrett's Constant Growth DCF analyses and results.

A. Witness Garrett applies a quarterly form of the Constant Growth DCF Model, which produces an ROE estimate of 7.30 percent. For the dividend yield component, witness Garrett relies on announced quarterly dividend payments and 30-day average stock prices as of July 21, 2020.[40] To estimate expected growth, witness Garrett looks to three measures, including: (1) nominal GDP, (2) inflation, and (3) the current Risk-Free rate.[41] Of those three measures, he chooses the highest estimate, 3.90 percent.[42]

Q. What are your general concerns with the growth rates on which witness Garrett's DCF analyses rely?

A. First, witness Garrett assumes a single, perpetual growth rate of 3.90 percent for all his proxy companies.[43] By reference to the Congressional Budget Office's ("CBO") expected inflation rate of 2.00 percent, witness Garrett's method assumes his proxy companies all will grow at real

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[40] Exhibits DJG-3 and DJG-4.
[41] Exhibit DJG-5.
[42] Direct Testimony of David J. Garrett, at 57.
[43] Exhibit DJG-6.

rates of approximately 1.90 percent, in perpetuity.[44] It is unlikely an investor would be willing to assume the risks of equity ownership in exchange for expected growth only modestly greater than expected inflation. The risk simply is not worth the expected return.[45]

As to witness Garrett's remaining growth rate estimates (presented in his Exhibit DJG-5), none are appropriate measures of growth for his DCF analysis. As a practical matter, because they are generic in nature, his estimates fail to account for the risks and prospects faced by the proxy companies.

Q. Do you agree with the 3.90 percent growth rate assumed for all companies in witness Garrett's DCF analysis?

A. No, I do not. Witness Garrett's 3.90 percent growth rate is not based on any measure of company-specific growth, or growth in the utility industry in general. Rather, his proxy group serves the sole purpose of calculating the dividend yield. Under the DCF model's strict assumptions, however, expected growth and dividend yields are inextricably related. Witness Garrett's assumption that

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44 Direct Testimony of David J. Garrett, at 50.

45 In the risk/return space, debt securities, with a higher yield and considerably less risk of capital loss (if held to maturity) may be the preferred alternative.

one growth rate applies to all companies, even though dividend yields vary across those companies, has no basis in theory or practice.

Q. Witness Garrett also offers his thoughts regarding the need for qualitative analyses in developing expected growth rates.[46] What is your response to witness Garrett's observations?

A. Witness Garrett suggests that although equity analysts may consider such quantitative factors as historical growth in revenues or earnings, they also should consider "qualitative" factors, such as how a given company may meet some level of "sustainable" growth.[47] He further observes unregulated companies have options not available to utilities, and suggests it would be more appropriate to consider factors such as load growth in measuring growth rate expectations.[48]

There is no question analysts consider qualitative factors. To that point, I reviewed Spire, Inc.'s (one of the companies in witness Garrett's proxy group) second quarter 2020 conference call held on May 8, 2020. Analysts from

[46] Direct Testimony of David J. Garrett, at 51-56.
[47] *Ibid.*, at 46-47.
[48] *Ibid.*, at 52-54.

several firms attended the call, including Bank of America, Crédit Suisse, JP Morgan Chase, and Sidoti & Company. During the call, analysts asked, and were given answers to a number of issues bearing directly on the factors relating to the Return on Common Equity, including sales estimates; earnings growth targets; capital expenditure plans; state regulatory mechanisms; and pending legislative action.[49]

In Spire Inc.'s third quarter 2020 conference call (which took place on August 5, 2020), analysts were provided with updated and additional information. During the course of the call, the company's management reaffirmed its earnings growth targets and guidance, and discussed the regulatory environment in which it operates. After the company's presentation, the analysts asked questions along several lines, all of which are relevant to witness Garrett's construct, including: investment and development of new storage opportunities; effect of legislative outcomes; O&M expenses; and the impact of COVID-19.[50] These inquiries reflect the type of considerations analysts typically consider for utility companies.

In the case of just one of his proxy companies, therefore,

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[49] *See*, Spire, Inc., Q2 2020 Earnings Call Transcript, May 8, 2020.
[50] *See*, Spire, Inc., Q3 2020 Earnings Call Transcript, August 5, 2020.

the level of fundamental research performed by analysts on issues directly related to long-term growth reflected a variety of factors, both quantitative and qualitative. They certainly go beyond "mere increases to rate base or earnings."[51] The analysts' research also far exceeded witness Garrett's limited perspective that load growth forecasts, together with other "qualitative factors" support his 3.90 percent expected growth rate.

Q. Why is long-term growth in GDP not an upper limit for terminal growth as witness Garrett contends?

A. First, GDP is not a market measure – rather, it is a measure of the value of the total output of goods and services, excluding inflation, in an economy. While I understand that earnings per share (EPS) growth is also not a market measure, it is well established in financial literature that projected growth in EPS is the superior measure of dividend growth in a DCF model.[52] Furthermore, GDP is simply the sum of all private industry and government output in

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[51] Direct Testimony of David J. Garrett, at 54.

[52] *See*, for example, Robert Harris, *Using Analysts' Growth Forecasts to Estimate Shareholder Required Rate of Return*, Financial Management, Spring 1986; Christofi, Christofi, Lori and Moliver, *Evaluating Common Stocks Using Value Line's Projected Cash Flows and Implied Growth Rate*, Journal of Investing, Spring 1999; Robert Harris and Felicia Marston, *Estimating Shareholder Risk Premia Using Analysts'* Growth Forecasts, Financial Management, Summer 1992; and Vander Weide and Carleton, *Investor Growth Expectations: Analysts vs. History*, The Journal of Portfolio Management, Spring 1988.

the United States, and its growth rate is simply an average of the value of those industries. To illustrate, Document No. 13 presents the compound annual growth rate ("CAGR") of the industries that comprise GDP from 1947 to 2019. Of the 15 industries represented, seven industries, including utilities, grew faster than the overall GDP, and eight industries grew slower than the overall GDP.[53]

Q. Is there a realistic possibility that a single industry would become the entire economy with a perpetual, "sustainable" growth rate higher than the GDP growth rate as witness Garrett contends?[54]

A. No, and even if one assumed it was realistically possible, it would take an extraordinary amount of time to do so. To illustrate this point, I used the value added by industry from 1947 to 2019 in Document No. 13 and applied the CAGR for the highest growth rate industry (*i.e.*, Educational Services, Healthcare, and Social Assistance at 8.71 percent per year) to see when that industry would comprise the entire economy. In the year 2244, or 297 years from the 1947 starting point, the industry would comprise over 50 percent of GDP, and in the year 5449, 3,502 years after the

[53] *See*, Exhibit No. (DWD-1) Document No. 13.
[54] Direct Testimony of David J. Garrett, at 16.

1947 starting point, the industry would comprise 100 percent of GDP.[55] Therefore, witness Garrett's example[56] and his argument are without merit.

Q. Please respond to witness Garrett's comment regarding "steady-state" growth rates.

A. On page 48 of his direct testimony, witness Garrett states, "…it is not necessary to use multi-stage DCF Models to analyze the cost of equity of regulated utility companies. This is because regulated utilities are already in their 'terminal,' low growth stage." While I agree with witness Garrett's statement regarding regulated utilities being in the "mature" stage in the company/industry life cycle, I disagree with his conclusion regarding the long-term growth rates of regulated utilities.

As witness Garrett describes, the multi-stage DCF and its growth rates reflect the company/industry life cycle, which is typically described in three stages: (1) the growth

[55] To put the amount of time that will take these two milestones to happen in perspective, 300 years ago, in the year 1719, France and Spain were at war in New France (now Louisiana), and approximately 3,476 years ago, in the year 1457 BC, the first recorded battle in military history, the Battle of Megiddo, was waged between the Egyptians, led by Pharaoh Thutmose III against Kadesh, Canaanite, Mitanni, and Amurru forces. *See also*, Zager and Evans, *In the Year 2525*, *on* 2525 (Exordium & Terminus) (RCA 1968).

[56] Direct Testimony of David J. Garrett, at 16.

stage, which is characterized by rapidly expanding sales, profits, and earnings. In the growth stage, dividend payout ratios are low in order to grow the firm; (2) the transition stage, which is characterized by slower growth in sales, profits, and earnings. In the transition stage, dividend payout ratios increase, as their need for exponential growth diminishes; and (3) the maturity (steady-state) stage, which is characterized by limited, slightly attractive investment opportunities, and steady earnings growth, dividend payout ratios, and returns on equity.

Since the utility industry is in the mature phase of the company life cycle, it is the company-specific projected EPS growth rate, not the projected GDP growth rate, that is the appropriate measure of growth in a Constant Growth DCF model.

Q. Are there examples in basic finance texts that support your position?

A. Yes. For example, in *Investments*, life cycles and multi-stage growth models are discussed:

> As useful as the constant-growth DDM (dividend discount model) formula is, you need to remember that it is based on a simplifying assumption,

namely, that the dividend growth rate will be constant forever. In fact, firms typically pass through life cycles with very different dividend profiles in different phases. In early years, there are ample opportunities for profitable reinvestment in the company. Payout ratios are low, and growth is correspondingly rapid. In later years, the firm matures, production capacity is sufficient to meet market demand, competitors enter the market, and attractive opportunities for reinvestment may become harder to find. In this mature phase, the firm may choose to increase the dividend payout ratio, rather than retain earnings. The dividend level increases, but thereafter it grows at a slower pace because the company has fewer growth opportunities.

Table 18.2 illustrates this pattern. It gives Value Line’s forecasts of return on assets, dividend payout ratio, and 3-year growth in earnings per share for a sample of the firms in the computer software industry versus those of east coast electric utilities…

By in large, the software firms have attractive investment opportunities. The median return on assets of these firms is forecast to be 19.5%, and the firms have responded with high plowback ratios. Most of these firms pay no dividends at all. The high return on assets and high plowback result in rapid growth. The median growth rate of earnings per share in this group is projected at 17.6%.

In contrast, the electric utilities are *more representative of mature firms*. Their median return on assets is lower, 6.5%; dividend payout is higher, 68%; and median growth is lower, 4.6%.

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To value companies with temporarily high growth, analysts use a multistage version of the dividend discount model. Dividends in the early high-growth period are forecast and their combined present value is calculated. Then, once the firm is projected to settle down to *a steady-growth phase, the constant-growth DDM is applied to value the remaining stream of dividends*.[57]

[57] Bodie, Z., Kane, A., and Marcus, A. J., *Investments*, 7th Edition, McGraw-Hill Irwin, 2008, at 616-617.

(Clarification and emphasis added)

The economics of the public utility business indicate that the industry is in the steady-state, or constant-growth stage of a multi-stage DCF, which would mean that the three- to five-year projected growth rates for each company would be the "steady-state" or terminal growth rate appropriate for the DCF model for utility companies, not the GDP growth rate, which is not a company-specific growth rate, nor is it an upward bound for growth, as discussed previously.

Q. Witness Garrett expressed a concern about using analysts' projected EPS growth rates because he asserts that analysts consider rate base growth in their projected growth rates and that utilities' natural financial incentive is to increase rate base regardless of customer needs.[58] Please respond.

A. The overall premise of witness Garrett's concern is without merit and should be dismissed. First, regulated utilities are only allowed to earn returns on and of assets that are considered used and useful in serving the needs of its customers. As the U.S. Supreme Court decision in *Duquesne Light Co. v. Barasch* states:

[58] Direct Testimony of David J. Garrett, at 52-53.

> To the extent utilities' investments turn out to be bad ones (such as plants that are cancelled and so never used and useful to the public), the utilities suffer because the investments have no fair value and so justify no return.[59]

Additionally, capital projects undertaken by utility companies are often subject to prudency reviews from regulatory commissions, which would allow commissions to review and deny any capital project not deemed in the public interest. These two facts would eliminate any type of investment by the utility that is not needed to expressly provide safe, reliable service to their customers. Because of this, equity analysts correctly consider growth in rate base in determining their recommended growth rates for utilities.

Finally, as a depreciation expert, witness Garrett should recognize two things: (1) utility assets degrade over time and eventually need to be replaced; and (2) the assets replacing the degraded assets are usually significantly more expensive than the degraded assets. Because of this, rate base will grow consistently *ad infinitum*, which supports both the utility industry's mature position on the

[59] U.S. Supreme Court, *Duquesne Light Co. v. Barasch*, No. 87-1160 (1989).

company/industry life cycle regarding steady and predictable growth, and the use of company-specific projected analysts' EPS growth rates for use in the Constant Growth DCF model.

Q. Witness Garrett claims undue reliance on projected EPS growth rates in the DCF model will lead to upward spiraling ROEs for utility companies due to a feedback loop.[60] Please respond.

A. As witness Garrett shows in his Figure 1 concerning annual authorized returns, and as illustrated in Exhibit (RBH-1), Document No. 16 of my direct testimony concerning individual authorized returns, an upward spiraling ROE simply does not exist. The independence of authorized ROEs and market data is consistent with conclusions reached by Dr. Bonbright, who states:

> In the first place, commissions cannot forecast, except within wide limits, the effect their rate orders will have on the market prices of the stocks of the companies they regulate. In the second place, *whatever the initial market prices may be, they are sure to change not only with the changing prospects for earnings, but with the*

[60] Direct Testimony of David J. Garrett, at 54-55.

> *changing outlook of an inherently volatile stock market*. In short, market prices are beyond the control, though not beyond the influence of rate regulation. Moreover, even if a commission did possess the power of control, any attempt to exercise it ... would result in harmful, uneconomic shifts in public utility rate levels.[61] (Emphasis added)

Given this, witness Garrett's concerns should be dismissed.

4. <u>Misapplication of the Capital Asset Pricing Model</u>

Q. Please summarize witness Garrett's CAPM analysis and results.

A. Witness Garrett's CAPM estimate relies on a risk-free rate of 1.41 percent, an average Market Risk Premium of 6.00 percent, and Beta coefficients as reported by Value Line. Those assumptions combine to produce an average CAPM estimate of 6.50 percent.[62]

Q. Do you agree with witness Garrett's CAPM analysis?

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[61] James C. Bonbright, Albert L. Danielsen and David R. Kamerschen, *Principles of Public Utility Rates*, Public Utilities Reports, Inc., 1988, at 334.

[62] Exhibit DJG-11.

A. No, I disagree with witness Garrett’s sole reliance on historical Treasury yields to estimate the risk-free rate and the various methods he uses to estimate the Market Risk Premium. Just as important as our methodological differences, however, is our difference regarding the reasonableness and reliability of an analysis that produces ROE estimates of 6.50 percent.

Q. Turning to the risk-free rate component of the CAPM, do you agree with witness Garrett’s use of the average 30-year Treasury yield?

A. Although I agree it is appropriate to consider the current average 30-year Treasury yield, because the Cost of Equity is forward-looking, it also is important to reflect forward-looking expectations of the risk-free rate. For that reason, I relied on the current 30-day average 30-year Treasury yield, as well as the projected near-term 30-year Treasury yield and the projected long-term 30-year Treasury yield as reported by *Blue Chip Financial Forecast*.[63] Relying on projected Treasury bond yields is especially important considering their recent significant volatility as shown on Document No. 14.

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[63] Prepared Direct Testimony and Exhibit of Robert B. Hevert, at 70-71 and Document No. 6 of Exhibit No. (RBH-1).

Q. How did witness Garrett derive his MRP estimate?

A. Witness Garrett estimates his MRP by reviewing: (1) surveys of expected returns from IESE Business School and Graham and Harvey (5.6 percent and 4.4 percent, respectively); (2) an expected return reported by Duff & Phelps (6.0 percent); (3) an implied MRP from Dr. Damodaran (5.7 percent); and (4) an "Implied Equity Risk Premium" calculation (5.8 percent).[64] Based on those results, witness Garrett concludes that 6.00 percent, the high end of his range, is appropriate.

Q. Do you have any concerns regarding witness Garrett's use of an expected MRP as his selected MRP in his CAPM analysis?

A. Yes, I do. The Duff & Phelps MRP selected by witness Garrett is an expected return, which has no relevance to the investor-required return. As discussed previously, both witness Garrett and I agree that expected returns "have nothing to do with what the investor expects the ROE awarded by a regulatory commission to be."[65]

Widely used finance texts recommend the use of multiple

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[64] Direct Testimony of David J. Garrett, at 71 and Exhibit DJG-10.
[65] *Ibid.*, at 4

models in estimating the Cost of Equity, in particular the DCF, CAPM, and Risk Premium approaches. I reviewed articles published in financial journals, as well as additional texts that speak to the methods used by analysts to estimate the Cost of Equity. An article published in Financial Analysts Journal surveyed financial analysts to determine the analytical techniques that are used in practice.[66] Regarding stock price valuation and cost of capital estimation, the author asked respondents to comment only on the DCF, CAPM, and Economic Value-Added models. Nowhere in that article did the author consider asking whether surveys of expected returns are relevant to the determination of the Cost of Capital.

Given witness Garrett's correct view that expected returns have nothing to do with the investor-required return and the lack of use by practitioners, his recommendation to use expected MRPs should be dismissed by the Commission.

Q. Do the surveys referenced by witness Garrett provide reasonable MRP estimates for the purpose of estimating the Company's Cost of Equity?

[66] *See*, Stanley B. Block, *A Study of Financial Analysts: Practice and Theory*, Financial Analysts Journal, July/August 1999.

A. No, they do not. For example, the Graham and Harvey survey suggests an expected return on the overall market of 6.79 percent, based on a risk-free rate of 2.37 percent and an MRP of 4.42 percent.[67] Combining those estimates with witness Garrett's average Beta coefficient estimate of 0.85 produces a Cost of Equity estimate of 6.13 percent, approximately 77 basis points below witness Garrett's estimate of the "true" Cost of Equity. Because utility stocks tend to be somewhat less risky than the broad market, if the Graham and Harvey survey results are meaningful, witness Garrett's ROE recommendation would be no more than 6.79 percent. In fact, his recommendation exceeds the Graham and Harvey estimate by 271 basis points.

As shown in Document No. 15 of my exhibit, in the past the Graham and Harvey survey respondents have provided forecasts that significantly underestimated actual market returns. As Document No. 15 demonstrates, from 2012 through 2018 the average market return was 13.27 percent, about 2.50 times greater than the Graham and Harvey survey average expected return of 5.30 percent.

Graham and Harvey also have noted a distinction between the

[67] *See*, Graham and Harvey, *The Equity Risk Premium in 2018*, at 7 for Q4 2017.

expected market return on one hand, and the "hurdle rate" on the other. In the Third Quarter 2017 survey, the authors reported an average hurdle rate, which is the return required for capital investments, of 13.50 percent. The authors further reported the average Weighted Average Cost of Capital, which includes the cost of debt, was 9.20 percent even though the expected market return was 6.50 percent.[68] As a result, I do not believe the Graham and Harvey surveys are a reasonable reflection of the expected MRP going forward.

Q. Do any of the surveys cited by witness Garrett provide support for your approach to estimating the current MRP?

A. Yes. As discussed in my direct testimony,[69] I calculated the *ex-ante* MRP in a similar manner to a study by Pablo Fernandez, *et al* (cited by witness Garrett), using the market capitalization weighted Constant Growth DCF calculation on the individual companies in the S&P 500 Index.[70]

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68 *See*, Duke/CFO Magazine Global Business Outlook survey – U.S., Third Quarter 2017.

69 Prepared Direct Testimony and Exhibit of Robert B. Hevert, at 71-72.

70 *See*, Pablo Fernandez, Alberto Ortiz, and Isabel Fernandez Acín, *Market Risk Premium used in 71 countries in 2016: a survey with 6,932 answers*, IESE Business School, May 9, 2016, at 10. Specifically, the study states:

> [t]he [implied equity premium] is the implicit [required equity premium] used in the valuation of a stock (or market

Q. Is there academic literature that supports the conclusion that MRPs using surveys are not widely used by practitioners?

A. Yes. Dr. Damodaran, who was cited several times by witness Garrett throughout his testimony, states the following about the applicability of survey MRPs:

> While survey premiums have become more accessible, very few practitioners seem to be inclined to use the numbers from these surveys in computations and there are several reasons for this reluctance:
>
> 1. Survey risk premiums are responsive to recent stock prices movements, with survey numbers generally increasing after bullish periods and decreasing after market decline. Thus, the peaks in the SIA survey premium of individual investors occurred in the bull market of 1999, and the more moderate

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index) that matches the current market price. The most widely used model to calculate the [implied equity premium] is the dividend discount model: the current price (P_0) is the present value of expected dividends discounted at the required rate of return (K_e). If d_1 is the dividend per share expected to be received in year 1, and g the expected long-term growth rate in dividends per share:

$P_0 = d_1 / (Ke - g)$, which implies:

[implied equity premium] = $d_1/P_0 + g - R_f$

premiums of 2003 and 2004 occurred after the market collapse in 2000 and 2001.

2. Survey premiums are sensitive not only to whom the question is directed at but how the question is asked. For instance, individual investors seem to have higher (and more volatile) expected returns on equity than institutional investors and the survey numbers vary depending upon the framing of the question. [footnote omitted]

3. In keeping with other surveys that show differences across sub-groups, the premium seems to vary depending on who gets surveyed. Kaustia, Lehtoranta and Puttonen (2011) surveyed 1,465 Finnish investment advisors and note that not only are male advisors more likely to provide an estimate but that their estimated premiums are roughly 2percent lower than those obtained from female advisors, after controlling for experience, education and other factors.[footnote omitted]

4. Studies that have looked at the efficacy of survey premiums indicate that if they have any predictive power, it is in the wrong

> direction. Fisher and Statman (2000) document the negative relationship between investor sentiment (individual and institutional) and stock returns.[footnote omitted] In other words, investors becoming more optimistic (and demanding a larger premium) is more likely to be a precursor to poor (rather than good) market returns.

> As technology aids the process, the number and sophistication of surveys of both individual and institutional investors will also increase. However, it is also likely that these survey premiums will be more reflections of the recent past rather than good forecasts of the future.[71]

Q. Please now describe the method by which witness Garrett calculated his third estimate, the implied Market Risk Premium.

A. As witness Garrett points out, his method develops the Internal Rate of Return that sets equal the current value of the market index to the projected value of cash flows

[71] Aswath Damodaran, Stern School of Business, *Equity Risk Determinants, Estimation and Implications – The 2020 Edition*, Updated March 2020, at 26-27.

associated with owning the market index.[72] i Witness Garrett observes that Dr. Damodaran "promotes the implied ERP method."[73] Although there are some differences, witness Garrett's approach is similar to the model Dr. Damodaran provides on his website.[74]

Witness Garrett's method, which is a two-stage form of the DCF model, calculates the present value of cash flows over the five-year initial period, together with the terminal price (based on the Gordon Model[75]), to be received in the last (*i.e.*, fifth) year. The model's principal inputs include the following assumptions:

- Over the coming five years, the S&P 500 Index (the "Index") will appreciate at a rate equal to the compound growth rate in "Operating Earnings" from 2014 through 2019;
- Cash flows associated with owning the Index will be equal to the historical average Earnings, Dividends, and Buyback yields, applied to the projected Index value each year; and
- Beginning in the terminal year, the Index will appreciate, in perpetuity, at a rate equal to the 30-day average yield on 30-year Treasury securities, as

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[72] Direct Testimony of David J. Garrett, at 68-71.
[73] *Ibid.*, at 71.
[74] *See*, http://pages.stern.nyu.edu/~adamodar.
[75] Exhibit DJG-9.

of July 21, 2020.[76]

As discussed below, reasonable changes to those assumptions have a considerable effect on witness Garrett's calculated expected market return.

Q. Do you have any observations regarding witness Garrett's assumed first-stage growth rate?

A. Yes. Witness Garrett's 5.37 percent growth rate relates to growth in operating earnings, and does not reflect capital appreciation, growth in dividends, or buy-backs.[77] In addition, if witness Garrett's position is that historical growth rates are meant to reflect expected future growth, they should reflect year-to-year variation (that is, uncertainty). That is best accomplished using the arithmetic mean. I therefore calculated the average growth (arithmetic mean) for the four metrics included in witness Garrett's exhibit. The average growth rate, 7.35 percent, produces an estimated market return of about 7.91 percent,[78] which is still well below historical experience.

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[76] Exhibits DJG-7 and DJG-9. The model also assumes that all payments are received at year-end, rather than during the year. That assumption also tends to under-state the Implied Market Risk Premium.

[77] Exhibit DJG-9. Whereas the compound average growth rate in operating earnings was 5.37 percent, dividends and buybacks grew by 6.74 percent and 5.66 percent, respectively.

[78] *See*, Document No. 16 of Exhibit No. (DWD-1), page 2.

Q. Why did the market return increase by only 70 basis points (from 7.21 percent to 7.91 percent) when the first-stage growth rate increased by 198 basis points (from 5.37 to 7.35 percent)?

A. Because witness Garrett's model assumes the first stage lasts for five years (and the terminal stage is perpetual), the results are sensitive to changes in the assumed terminal growth rate. To put that effect in perspective, the terminal value (which is directly related to the terminal growth rate) represents approximately 77.15 percent of the "Intrinsic Value" in witness Garrett's analysis.[79]

Q. How did witness Garrett develop his assumed terminal growth rate?

A. The terminal growth rate represents investors' expectations of the rate at which the broad stock market will grow, in perpetuity, beginning in the terminal year. Witness Garrett assumes terminal growth is best measured by the average yield on 30-year Treasury securities over the 30 days ended July 21, 2020. That is, witness Garrett assumes the average 30-year Treasury yield between June 2020 and

[79] *See*, Document No. 16 of Exhibit No. (DWD-1). Please note that regardless of the assumed first and terminal-stage growth rates, the terminal stage consistently represents approximately 76.00 percent of the Intrinsic Value.

July 2020 is the best measure of expected earnings growth beginning five years from now and extending indefinitely into the future.

Q. Do you agree with witness Garrett's assumption?

A. No, I do not. I recognize witness Garrett followed the approach described in Dr. Damodaran's method, which Dr. Damodaran refers to as a "default" assumption.[80] In terms of historical experience, over the long-term the broad economy has grown at a long-term compound average growth rate of approximately 6.09 percent.[81] Considered from another perspective, Duff & Phelps reports the long-term rate of capital appreciation on Large Company stocks to be 7.90 percent.[82] Witness Garrett's model assumes, however, that the market index will grow by less than one-half that amount, 2.25 percent, over the coming four years.[83]

Witness Garrett has not explained why growth beginning five years in the future, and extending in perpetuity, will be less than one-half of long-term historical growth. From a somewhat different perspective, assuming long-term

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80 *See*, http://pages.stern.nyu.edu/~adamodar.

81 Source: Bureau of Economic Analysis for the years 1929 to 2019. https://www.bea.gov/data/gdp/gross-domestic-product

82 Duff & Phelps, 2020 SBBI® Yearbook, 6-17.

83 *See*, Exhibit DJG-9. (3428/3137)^(1/4)- 1 = 2.25%.

inflation will be approximately 2.00 percent[84] implies perpetual real growth will be approximately -0.578 percent.[85] Again, witness Garrett assumes in the long run, real growth will in fact be negative in perpetuity. Nowhere in his testimony has witness Garrett explained the fundamental, systemic changes that would so dramatically reduce long-term economic growth, or why they are best measured by the long-term Treasury yield over 30 days between June 2020 to July 2020.

Further, research by the Federal Reserve Bank of San Francisco calls into question the relationship between interest rates and macroeconomic growth. As the authors noted, "[o]ver the past three decades, it appears that private forecasters have incorporated essentially no link between potential growth and the natural rate of interest: The two data series have a zero correlation."[86]

Lastly, over the 30 trading days ended July 21, 2020, the 30-year Treasury yield fell by 28 basis points, a decline

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84 For example, in line with the Federal Reserve's target average rate of inflation. *See also*, Exhibit DJG-5.

85 -0.578% = [(1.0141/1.02)-1]. Please note that the long-term historical average rate of inflation, measured by the difference between real and nominal GDP growth, has been approximately 2.79 percent, which would also imply perpetual negative real growth.

86 FRBSF Economic Letter, *Does Slower Growth Imply Lower Interest Rates?*, November 10, 2014, at 3.

of about 17.61 percent.[87] Witness Garrett has not explained why such an abrupt and meaningful decline in Treasury yields should be taken as a measure of a sudden and abrupt decline in expected earnings growth five years from now.

Q. Please briefly summarize your response to witness Garrett's Implied Equity Risk Premium calculation.

A. Witness Garrett's calculation is based on a series of questionable assumptions, to which a small set of very reasonable adjustments produces a market return estimate more consistent with (yet still below) the historical experience he considers relevant. Although the revised results still produce ROE estimates far below any reasonable measure, they do point out the sensitive nature of witness Garrett's analyses, and the tenuous nature of the conclusions he draws from them.

Q. Does witness Garrett employ an Empirical CAPM in his CAPM analysis?

A. No, he does not. Witness Garrett fails to consider the ECAPM, despite the fact that numerous tests of the CAPM have confirmed that the empirical Security Market Line

[87] Exhibit DJG-7.

(SML) described by the traditional CAPM is not as steeply sloped as the predicted SML as described in my direct testimony.[88] Because of the empirical findings presented in my direct testimony, witness Garrett should have considered the ECAPM in his CAPM analysis.

5. Refusal to Consider Flotation Costs and Other Company-Specific Factors in his ROE Recommendation

Q. Did witness Garrett address the issue of flotation costs in his testimony?

A. Yes. Witness Garrett reasons that flotation costs for stock issuances are not out-of-pocket costs, which investors already have considered when deciding to invest in a company's shares at a given market price.[89] On that basis, he argues against considering the effect of flotation costs in setting the Company's ROE.

Q. What is your response to witness Garrett regarding the need to recover flotation costs?

A. First, witness Garrett's observation that underwriter fees are not "out-of-pocket" expenses[90] is a distinction without

[88] *See*, Prepared Direct Testimony and Exhibits of Robert B. Hevert, at 42, 74-78.
[89] Direct Testimony of David J. Garrett, at 60-61.
[90] *Ibid.*, at 60.

a meaningful difference. Whether paid directly or indirectly through an underwriting discount, the cost results in net proceeds that are less than the gross proceeds. Witness Garrett points out that under federal law, the underwriters' compensation must be disclosed in the offering prospectus. I agree. In fact, those prospectuses are the source of the issuance costs included in Document No. 19 of Exhibit No. __ (RBH-1) to my direct testimony. Because those costs were incurred, the net proceeds to the issuing company were less than the gross proceeds. Whether the issuer wrote a check or received the proceeds at a discount does not matter. What does matter is that issuance costs are a permanent reduction to common equity, and absent a recovery of those costs, the issuing company will not be able to earn its required return.

Lastly, as shown in Document No. 17 of my Exhibit,[91] because of flotation costs, an authorized return of 10.85 percent would be required to realize an ROE of 10.75 percent (*i.e.*, a 10-basis point flotation cost adjustment). If flotation costs are not recovered, the growth rate falls and the ROE decreases to 10.65 percent (*i.e.*, below the required

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[91] This example is based on an analysis performed by Dr. Roger Morin. *See,* Roger A. Morin, *New Regulatory Finance*, Public Utility Reports, Inc., 2006, at 330-332.

return).[92]

Q. Is the fact that investors are aware of equity issuance costs when they decide to purchase stock relevant to the determination of the appropriate compensation for those costs?[93]

A. No, it is not. Although witness Garrett suggests current prices account for flotation costs, he has provided no explanation as to how market prices compensate shareholders for flotation costs or any analyses to support his position. In that important respect, common stock is closely analogous to long-term debt, both in the sense that its purpose is to provide funding for long-term investments that are part of rate base, and that it remains a part of the utility's operations over the long run. Equity flotation costs and debt issuance expenses both are necessary and legitimate costs enabling the investment in assets needed to provide safe and reliable utility service; both should be recovered.

Q. Does witness Garrett consider the Company's overall growth and performance in his ROE recommendation for Peoples?

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[92] Document No. 17 of Exhibit No. (DWD-1) is provided for illustrative purposes only. Please note that I have not relied on the results of the analysis in determining my recommended ROE or range.

[93] Direct Testimony of David J. Garrett, at 60-61.

A. No, witness Garrett does not consider any company-specific growth or risk factors in his analyses and ROE recommendation. As discussed above, witness Garrett's DCF analysis assumes one single growth rate for all companies in his proxy group. In addition, witness Garrett argues that "Because utilities are in their maturity stage, their real growth opportunities are primarily limited to the population growth within their defined service territories, which is usually less than 2%."[94] In his recommendation, witness Garrett fails to consider Peoples' total number of customers has increased significantly over the past several years[95] and most recently, from July 2019 to July 2020, the Company's growth in customer counts was approximately 5.20 percent.[96] Unlike witness Garrett, I've taken into account several Company-specific factors, including the Company's superior performance and growth factors, in determining a reasonable ROE for Peoples. As discussed in my direct testimony, setting an ROE that recognizes the Company's significant customer growth and sustained high level of performance is an appropriate element of the Commission's regulatory discretion and supported by past Commission precedent.[97]

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94 *Ibid.*, at 49.
95 *See*, Prepared Direct Testimony and Exhibit of Robert B. Hevert, at 53.
96 *See*, Rebuttal Testimony and Exhibit of Sean P. Hillary, at 23; and Exhibit SPH-2.
97 Prepared Direct Testimony and Exhibit of Robert B. Hevert, at 53-55.

Q. Witness Garrett suggests company-specific risks should not be reflected in the Company’s Cost of Equity, because those risks are diversifiable.[98] What is your response to witness Garrett on that point?

A. Looking to witness Garrett’s Exhibit DJG-8, the Beta coefficients used in his CAPM analysis range from 0.80 to 0.95, a difference of 0.15. Even if we were to apply that difference to witness Garrett’s unduly low Market Risk Premium estimate of 6.00 percent, the implied range of CAPM results would be 0.90 percentage points (90 basis points). Similarly, applying the standard deviation of witness Garrett’s Beta coefficients (0.065) to his 6.00 percent Market Risk Premium produces a range of 0.39 percent (39 basis points). Because the range of witness Garrett’s Beta coefficients (0.15) is within one standard deviation (0.39), we cannot say with certainty that company-specific risks are diversifiable (as witness Garrett suggests they will be). Because the range of Beta coefficients produces a rather wide range of CAPM estimates (even assuming witness Garrett’s Market Risk Premium), I continue to believe it is reasonable to consider company-specific risks in determining the Company’s Cost of Equity.

[98] Direct Testimony of David J. Garrett, at 35-38.

Q. Should the Commission consider Peoples as a stand-alone company?

A. Yes, it should. Because it is the Company's rate base to which the overall rate of return set forth in this proceeding will be applied, the Company should be evaluated as a stand-alone entity. To do otherwise would be discriminatory, confiscatory, and inaccurate. It is also a basic financial precept that the use of the funds invested give rise to the risk of the investment. As Brealey and Myers state:

> The true cost of capital depends on the use to which the capital is put.
>
> ***
>
> ***Each project should be evaluated at its own opportunity cost of capital; the true cost of capital depends on the use to which the capital is put.***[99] (Italics and bold in original)

Dr. Morin confirms Brealey and Myers when he states:

> Financial theory clearly establishes that the cost of equity is the risk-adjusted opportunity cost of the investors and not the cost of the

[99] Richard A. Brealey and Stewart C. Myers, *Principles of Corporate Finance*, McGraw-Hill, Inc., 1988, at 173, 198.

> specific capital sources employed by the investors. The true cost of capital depends on the use to which the capital is put and not on its source. The *Hope* and *Bluefield* doctrines have made clear that the relevant considerations in calculating a company's cost of capital are the alternatives available to investors and the returns and risks associated with those alternatives.[100]

Additionally, Levy and Sarnat state:

> The firm's cost of capital is the discount rate employed to discount the firm's average cash flow, hence obtaining the value of the firm. It is also the weighted average cost of capital, as we shall see below. The weighted average cost of capital should be employed for project evaluation… only in cases where the risk profile of the new projects is a "carbon copy" of the risk profile of the firm[101]

Although Levy and Sarnat discuss a project's cost of capital relative to a firm's cost of capital, these principles apply

[100] Roger A. Morin, *New Regulatory Finance*, Public Utility Reports, Inc., 2006, at 523.

[101] Haim Levy & Marshall Sarnat, *Capital Investment and Financial Decisions*, Prentice/Hall International, 1986, at 465.

equally to the use of a proxy group-based cost of capital. Each company must be viewed on its own merits, regardless of the source of its equity capital. As *Bluefield* clearly states:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; [102]

In other words, it is the "risks and uncertainties" surrounding the property employed for the "convenience of the public" which determines the appropriate level of rates. In this proceeding, the property employed "for the convenience of the public" is the rate base of the Company. Thus, it is only the risk of investment in the Peoples' rate base that is relevant to the determination of the cost of common equity to be applied to the common equity-financed portion of that rate base.

[102] *Bluefield Water Works Improvement Co. v. Public Serv. Comm'n*, 262 U.S. 679 (1923), at 6.

Consistent with the financial principle of risk and return discussed previously, and the stand-alone nature of ratemaking, company-specific characteristics must be considered in determining the appropriate investor-required return for any particular company, including Peoples.

6. <u>Response to witness Garrett's Critiques of Company Testimony</u>

Q. Does witness Garrett have any critiques of your analyses presented in your direct testimony?

A. Yes, he does. Witness Garrett's critiques of my direct testimony are summarized below:

1) My requested ROE is in excess of the investor-required return on the market;
2) My growth rates used in the DCF model exceed GDP growth;
3) Flotation costs should not be included in the ROE;
4) My MRP is unreasonable because it is unconventionally derived and not in line with his MRP estimates;
5) My Risk Premium Model (RPM) is not a "real" risk premium model (not based on Nobel Prize-winning work) and is only used by utility witnesses; and
6) The approved returns used in my RPM are all in excess of market returns.

I have addressed critiques 1 through 3 and 6 during the course of this rebuttal testimony. I will discuss witness Garrett's remaining critiques in turn.

Q. At page 16 of his testimony, witness Garrett criticizes your method of calculating the expected market return by pointing to the expected growth rate for a single company. What is your response to witness Garrett on that point?

A. Witness Garrett's criticism has no merit. In determining the expected growth rate that underlies the expected market return, the salient points are twofold: (1) investors rely on analysts' growth rate projections to frame their investment decisions; and (2) because we are estimating the market return, it is the expected return on the 500 companies in the S&P 500 that matters.

As to the first point, witness Garrett has not shown investors avoid analysts' projections. He certainly has not shown investors find his 7.20 percent expected market return (based on his Implied Equity Risk Premium analysis) more reliable than the combined estimates of the many analysts that follow the companies comprising the S&P 500. Regarding the second point, over time the average annual total return on large company stocks has been about 12.10

percent.[103] From 2014-2019, the period on which witness Garrett's Implied Equity Risk Premium is based, the average return was 12.66 percent.[104]

Additionally, although witness Garrett observes one company in my analysis with a high, positive growth rate, he fails to point out the several with negative growth rates. At any time, the market includes both high and low-growth companies. For example, the expected return on the market, as calculated in Document No. 4 of Exhibit No. (RBH-1) using Bloomberg data, includes 40 growth rates equal to or lower than the 2.00 percent inflation estimate[105] witness Garrett considers in his DCF analysis. Thirty-one of those growth rates are negative, as low as negative 63.83 percent. Although negative growth companies will not exist over the long-term (a company cannot shrink forever), my approach does not remove them; doing so would introduce the sort of "survivorship bias" with which witness Garrett is concerned.[106] The purpose of the analysis is to estimate the return investors expect for the market as a whole, including high and low-growth companies, not to estimate the aggregate return for companies that witness Garrett believes have proper growth rates.

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103 Duff & Phelps, 2020 SBBI® Yearbook, 6-17.
104 Duff & Phelps, 2020 SBBI® Yearbook, Appendix A-1.
105 Direct Testimony of David J. Garrett, at 50.
106 *Ibid.*, at 66-67.

Finally, my MRP estimates are consistent with actual realized MRPs. As shown on Document No. 18, MRPs of 12.51 percent and 12.46 percent are in the 59th percentile of historical MRPs.

Q. Is the calculation of the *ex-ante* return using the DCF model on the constituent companies of a market index a commonly accepted practice?

A. Yes, it is. The Chartered Financial Analyst ("CFA") Institute Research Foundation states the following:

> Approaches to estimating the ERP fall into three broad categories:
>
> 1. Methods based on a dividend discount model (DDM), earnings discount model, or cash-flow-to-the-investor discount model: forward-looking methods with their roots in discounted cash flow (DCF) analysis, wherein the value of an asset is regarded as the present value of the cash flows the asset is expected to generate… The earliest estimates of the ERP were derived by estimating the expected return on an equity portfolio using the DDM and then subtracting the expected return or yield on the riskless asset. This "DDM approach" which made a comeback at the end of the

> 20th century, is the method most widely used today.[107]

In *New Regulatory Finance*, Dr. Morin states:

> A second approach is to estimate the MRP is prospective in nature and consists of applying the DCF model to a representative market index, such as the Standard & Poor's 500 Index, *Value Line* Composite, or the New York Stock Exchange index… If risk premiums are volatile, this method of directly measuring Rm is preferred. Subtracting the current risk-free rate from that estimate produces a valid estimate of the market risk premium.[108]

Finally, Brigham and Daves state:

> An alternative to the historical risk premium is to estimate a forward-looking, or *ex-ante* risk premium. The most common approach is to use the Discounted Cash Flow (DCF) model to estimate the expected market rate of return, $r\text{^} = r_m$, and then calculate RP_m as $r_m - r_{rf}$[109]

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[107] CFA Institute Research Foundation, Literature Review, *The Equity Risk Premium: A Contextual Literature Review*, at 2.

[108] Roger A. Morin, *New Regulatory Finance*, Public Utility Reports, Inc., 2006, at 159-160.

[109] Eugene F. Brigham and Phillip R. Daves, *Intermediate Financial Management*, 9th Edition, Thomson/Southwestern, 2007, at 325.

Q. Witness Garrett states that your MRP is unreasonable in view of his measures of MRP as presented in his CAPM analysis.[110] Please respond.

A. I have discussed the inapplicability of witness Garrett's MRP estimates for cost of capital purposes previously in this rebuttal testimony and will not repeat that discussion here. Since witness Garrett's MRP measures are not valid MRPs, they cannot be comparable to my MRP estimates. In prior proceedings, I have applied several different methods to estimate the estimated market return. As shown in Document No. 19, applying the methods I have used in other testimonies result in estimated returns on the market substantially similar to the estimated market returns applied in this proceeding, which would translate into similar MRPs as calculated in my direct testimony.

Given all of the above, my calculation of the *ex-ante* MRP in my CAPM and ECAPM analysis is reasonable in view of historical returns and other expected measures of the MRP and is supported by financial literature. Thus, witness Garrett's concern should be dismissed.

Q. Does witness Garrett agree with your application of the

[110] Direct Testimony of David J. Garrett, at 10, 75.

RPM?

A. No, he does not. Witness Garrett disagrees with the analysis because he believes "these types of risk premium 'models' are merely clever devices used to perpetuate the discrepancy between awarded ROEs and market-based cost of equity."[111] Witness Garrett further believes the Bond Yield Plus Risk Premium analysis is unnecessary because "we already have a real risk premium model to use: the CAPM."[112] He then asserts "the risk premium models used by utility witnesses are almost exclusively found in the texts and testimonies of such witnesses."[113] Lastly, witness Garrett suggests my Bond Yield Plus Risk Premium analysis contradicts my position that Cost of Equity is a forward-looking concept.[114]

Q. What is your response to witness Garrett's assertion that authorized returns are disconnected from the "true" Cost of Equity?[115]

A. I disagree. As explained in detail above, allowed returns are indeed measures of the investor-required return and the

[111] *Ibid.*, at 76.
[112] *Ibid.*, at 77.
[113] *Ibid.*, at 78.
[114] *Ibid.*, at 76.
[115] *Ibid.*, at 76-77.

allowed returns for utility companies are indeed lower than the investor-required return on the market. Despite witness Garrett's concerns, authorized returns and their associated proceedings reflect the same type of market-based analyses at issue in this proceeding. Because authorized returns are publicly available (the proxy companies disclose authorized returns, by jurisdiction, in their 2019 SEC Form 10-Ks),[116] it therefore is reasonable to conclude that data is reflected, at least to some degree, in investors' return requirements.

Further, although there is no disagreement that every case has its unique set of issues and circumstances, reviewing approximately 1,160 cases over many economic cycles and using that data to develop the relationship between the Equity Risk Premium and interest rates mitigates that concern. As such, witness Garrett's concerns that authorized returns may be influenced by factors other than objective market drivers is unfounded.

Q. Is witness Garrett correct when he asserts that Bond Yield Plus Risk Premium models are not covered in financial texts,

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[116] *See, for example*, Atmos Energy Corporation, SEC Form 10-K for the year ended September 30, 2019, at 7-8; Southwest Gas Corporation., SEC Form 10-K for the year ended December 31, 2019, at 9-12; Northwest Natural Gas Company, SEC Form 10-K for the year ended December 31, 2019, at 39.

but almost exclusively found in texts written by utility witnesses?[117]

A. No, witness Garrett's statement is incorrect in several respects. Although once again witness Garrett does not explain what he means by "almost exclusively" in this context, the Bond Yield Plus Risk Premium approach generally is covered in basic finance texts, including for example, Brigham and Gapenski:

> Whereas debt and preferred stocks are contractual obligations which have easily determined costs, it is not at all easy to estimate [the Cost of Equity]. However, three methods can be used: (1) the Capital Asset Pricing Model (CAPM), (2) the discounted cash flow (DCF) model, and (3) the bond-yield-plus-risk-premium approach. These methods should not be regarded as mutually exclusive-no one dominates the others, and all are subject to error when used in practice. Therefore, when faced with the task of estimating a company's cost of equity, we generally use all three methods and then choose among them on the basis of our confidence in the data used for each

[117] Direct Testimony of David J. Garrett, at 78.

in the specific case at hand.[118]

The point made by my Risk Premium approach, which is that the Equity Risk Premium is inversely related to interest rates, also is the subject of published academic research, as noted at page 79 of my direct testimony. Although witness Garrett believes such research is only provided by utility witnesses, public academic research performed by Staff members of the Virginia Corporation Commission (*i.e.*, Maddox, Pippert, and Sullivan) has also shown the Equity Risk Premium to be inversely related to interest rates.[119] Those authors also found that the Equity Risk Premium is not stable over time, and increases as interest rates decrease. In short, witness Garrett's assertion is highly questionable, but the important finding that Equity Risk Premiums are nonconstant and vary with interest rates is not.

Lastly, witness Garrett's statement that Risk Premium models are "almost" exclusively found in utility witness' testimony is dubious, as well. In recent cases, I have seen regulatory staff witnesses include Risk Premium

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118 Eugene F. Brigham, Louis C. Gapenski, *Financial Management, Theory and Practice*, The Dryden Press., 1994, at 341.

119 Farris M. Maddox, Donna T. Pippert, and Rodney N. Sullivan, *An Empirical Study of Ex Ante Risk Premiums for the Electric Utility Industry*, Financial Management, Autumn 1995, at 89-95.

analyses in Texas (PUC Docket Nos. 49421 and 49494), North Carolina (Docket No. G-9, Sub 743), and Arkansas (Docket No. 19-008-U). I am not sure what witness Garrett intends by "almost exclusively", but his assertions that the method "is used to justify a cost of equity that is much higher than one that would be dictated by market forces"[120], and that the model is "used to perpetuate the discrepancy between awarded ROEs and market-based cost of equity"[121], simply are incorrect. An alternative, and a more likely interpretation, is that witness Garrett's view that the Cost of Equity is less than 7.30 percent is inconsistent with the findings of regulatory commissions who have considered expert testimony from many sources over many years.

Q. What is your response to witness Garrett's position that your Bond Yield Plus Risk Premium analysis is not forward-looking?[122]

A. Witness Garrett's conclusion is incorrect. The approach quantifies the longstanding principle that the Equity Risk Premium is not constant, but varies over time, and with market conditions. The model I have applied reflects

120 Direct Testimony of David J. Garrett, at 78.
121 *Ibid.*, at 76.
122 *Ibid*.

variable market conditions in changing interest rates. Applying forward-looking (that is, projected) interest rates will produce varying estimates of the Equity Risk Premium (*see*, Document No. 7 of Exhibit No. (RBH-1) and Document No. 7 of Exhibit No. (DWD-1)). The model, and its results, therefore, are forward-looking.

Q. Do you have a response to witness Garrett's claim that your RPM is not a "real" RPM because it is not based on Nobel Prize-winning work?

A. While my RPM is not based on Nobel Prize-winning work, it is based on considerable empirical research, as noted above. Additionally, the DCF model is not based on Nobel Prize-winning work, either, but it does not prevent me or witness Garrett from considering the DCF model's results in our ROE analyses. Finally, I performed the PRPM (which is based on Nobel Prize-winning work, as discussed above) on the companies in my proxy group. As shown on Document No. 20, PRPM results for my proxy group range from 9.38 percent to 11.90 percent, averaging 10.39 percent. Despite witness Garrett's concerns, all of these models provide valuable insight into the investor-required ROE.

VI. SUMMARY AND CONCLUSIONS

Q. Should any or all of the arguments made by witness Garrett persuade the Commission to lower the ROE it approves for Peoples below your recommendation?

A. No, they should not. Based on the analyses discussed throughout my rebuttal testimony, and given the current capital market conditions, I continue to believe that the reasonable range of ROE estimates is from 10.00 percent to 11.00 percent, and within that range 10.75 percent continues to be a reasonable, although conservative, estimate of the Company's Cost of Equity. It will provide Peoples with sufficient earnings to enable it to attract necessary new capital efficiently and at a reasonable cost.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

(Whereupon, prefiled rebuttal testimony of Sean P. Hillary was inserted.)

BEFORE THE PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY

OF

SEAN P. HILLARY

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

A. My name is Sean P. Hillary. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed as the Controller of Peoples Gas System ("Peoples" or the "Company"), a division of Tampa Electric Company.

Q. Are you the same Sean P. Hillary who filed direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address serious errors and shortcomings in the prepared direct testimony of witness Andrea C. Crane, testifying on behalf of the Office of Public Counsel ("OPC").

Q. Have you prepared an exhibit supporting your rebuttal testimony?

A. Yes, I have. My Exhibit No. __ (SPH-2), consisting of two documents prepared by me or under my direction and supervision.

Document No. 1	Moody's Updated Inflation Forecast
Document No. 2	Customer Growth – Customer Count July 2020 vs July 2020

Q. Please summarize the key concerns and disagreements you have regarding the substance of witness Crane's testimony.

A. I will not address all of the Company's concerns and disagreements with witness Crane's testimony. That responsibility is being apportioned between Company and expert witnesses filing rebuttal testimony. Globally, I am very concerned with witness Crane's overall recommendation to only provide for a revenue increase of no more than $18.6 million, or approximately 30 percent of the Company's $61.7 million request. Witness Crane's reckless suggestion gives no consideration to the fact it has been twelve-years since Peoples' last rate case. Commission acceptance of witness Crane's recommendation would put immense pressure on Peoples' financial integrity immediately in 2021 and would result in reduced system reliability, customer service, and the ability to meet customer demand as described in the rebuttal testimony of Company witnesses Richard F. Wall and Timothy O'Connor.

Furthermore, the specific key concerns and disagreements addressed in my rebuttal testimony are as follows:

1. Witness Crane's exclusion of all 2021 capital expenditures in determining 2021 projected test year rate base,
2. Witness Crane's exclusion of the Company's O&M payroll costs and related employee costs for 2020 and 2021 new positions,
3. Witness Crane's exclusion of cost increases due to inflation for trending 2019 Non-Labor O&M costs to the 2021 projected test year,
4. Witness Crane's exclusion of a portion of short-term incentive compensation costs included in the Company's claim,
5. Witness Crane's exclusion of a portion of the Company's American Gas Association membership dues,
6. Witness Crane's exclusion of increased costs for Marketing and Advertising expenses, and

7. Witness Crane’s errors made in her calculations that inflate her recommended adjustments.

Q. Are there any other items you will address in your rebuttal testimony regarding witness Crane’s proposals?

A. Yes. Witness Crane does not contest certain O&M costs included in the Company’s claim, but she does propose amortization and recovery of these costs over a 5-year period. I will discuss her proposals and my agreement or disagreement with each.

<u>1. Exclusion Of All 2021 Capital Expenditure From Determination Of 2021 Projected Test Year Rate Base</u>

Q. Please summarize the rate base adjustments witness Crane recommended in her testimony regarding Gross Plant in Service and Construction Work in Process (“CWIP”).

A. Witness Crane arbitrarily uses the Company’s projected December 31, 2020 balances for Gross Plant and CWIP in determining the 13-month average of the 2021 test year for her rate base adjustments shown on Exhibit ACC-2, Schedules 4 and 5. In doing this, witness Crane is in effect converting the Company’s claim from one based on a projected 2021 “test year” to a randomly determined December 31, 2020 single point in time based “test date”.

Q. Please explain further your concern and disagreement with witness Crane’s recommended adjustments to Gross Plant in Service and CWIP.

A. Witness Crane’s simplistic methodology for determining the 2021 test year rate base totally disregards the 2021 capital expenditure activity that should be factored into the ratemaking process of determining a 13-month average balance for Gross Plant in Service and CWIP. Witness Crane has not provided any systematic or detailed mathematical analysis to justify the total exclusion of the Company’s 2021 capital expenditures in her recommended adjustments. Instead, the only analysis witness Crane has presented is simply to (i) compare the total 2020 and 2021 budgeted capital expenditures with the 2015-2019 budgeted amounts, (ii) state the amount of rate base growth between 2009 to 2021, and (iii) calculate growth in Gross Plant in Service and CWIP from 2009 to 2019 and 2019 to 2021. As a result of these three calculations, witness Crane arbitrarily and inexplicably determined that Peoples should use the Company’s December 31, 2020 balances for Gross Plant in

Service and CWIP and should not be allowed recovery of any capital expenditures occurring in the 2021 projected test year. The only explanation proffered up by witness Crane for this conclusion is that the "Company's claim is based on speculative projections" while conceding that her adjustments will "also be subjective" (see witness Crane testimony page 12, lines 5-10).

Q. Are the Company's capital budgets "speculative"?

A. No. The Company's capital expenditure budgets for 2020 and 2021 specifically identify projects and recurring capital that can be analyzed and reviewed in detail. Evaluating capital projections on their merits at a detailed level is a well-established process undertaken by the Commission in prior projected test year rate cases for this Company and other utilities. The Commission should not unsystematically remove a complete year of capital spending activity based on witness Crane's "subjective" belief that "some adjustment to the Company's proposed revenue requirement is appropriate" (see witness Crane testimony page 12, lines 2-6). To do so would be arbitrary and manifestly unfair to Peoples and would put its customers at risk.

Q. Does the Company's actual capital spending typically vary from the projected budgets?

A. Yes. Because the Company's budget process is finalized months before the budgeted year, changes do occur. As discussed in the rebuttal testimony of witness Wall, these changes occur for a variety of reasons. As shown in the Peoples' response to OPC's First Set of Interrogatories No. 30, the Company's actual capital spending from 2015 to 2019 has varied from the budget, however, the actual variance was only five percent lower over the 5-year period. In 2019, Peoples' capital budget was $240.0 million, and the Company's actual capital expenditures were $234.2 million, which was within 2.4 percent of the budgeted amount. Although capital construction may vary based on typical project changes, that alone does not justify the suggestion of removing the capital expenditures in the test year.

Q. Has Peoples recently updated its forecast of the 2020 and 2021 Capital expenditures?

A. Yes. The most up-to-date capital expenditure forecast for all projects is being provided in response to Staff's Seventh Request for Production of Documents No. 15, which is being filed coincident with this testimony. In addition, in response to Staff’s Seventh Set of Interrogatories No. 58, updated CWIP and AFUDC balances by project, year and month are also provided. The Company’s response to Staff’s Seth Request for Production of Documents No. 15 includes highlighted changes and explanations by project and by recurring capital item. This updated 2020 and 2021 capital spending forecast reflects delayed, canceled, and new capital projects added since the Company’s original rate case filing 2020 and 2021 budgets were completed. For added projects, the response to Staff’s Seventh Request for Production of Documents No. 15 includes documentation similar to what was provided in response to Staff’s First Set of Interrogatories No. 1. For 2020 and 2021, the Company is now projecting capital expenditures to exceed the budgets contained in the rate case by $8.4 million and $31.0 million, respectively.

Q. Do you agree with witness Crane’s analysis shown in the table at the top of page 9 in her testimony related to growth in Gross Plant in Service and CWIP for the periods 2009 to 2019 and 2019 to 2021?

A. No. Witness Crane’s calculations of growth for the two periods fails to properly recognize that Cast Iron Bare Steel Rider ("CI/BSR") investments had been made during the 2009 to 2019 period. Although these investments were not included in adjusted rate base during that period, they should be included in determining the actual growth of Gross Plant in Service and CWIP for the 2009 to 2019 period. Instead, witness Crane's calculations are made on the incorrect assumption that the entirety of the cumulative CI/BSR investments made from the inception of the program in 2013 through 2020, totaling $200.7 million were in effect made in the 2019 to 2021 period. Therefore, witness Crane's analysis is misleading in that it dramatically overstates the true 2019 to 2021 period growth percentage.

Q. Does witness Crane fail to acknowledge the CI/BSR investments made through 2019 elsewhere in her testimony?

A. Yes. On page 14, line 6-9 of witness Crane's testimony she states that her recommendation results in an increase in gross plant-in-service and CWIP of approximately $570 million from the Base Year (2019) to the Projected Test Year (2021) which she justifies as reasonable because it is a very significant increase relative to the Company's historic spending levels. Witness Crane's calculation of the $570 million amount once again fails to properly reflect the cumulative investments made in CI/BSR from 2013 through the 2019 base year that are included in the $200.7 million being rolled into adjusted rate base at the beginning of 2021.

Q. What do you suggest the Commission do with witness Crane's recommendation on Gross Plant in Service, CWIP and other related items?

A. Witness Crane's recommendation is an attempt to shortcut the ratemaking process of evaluating the Company's 2021 test year capital expenditures and assessing them for inclusion in the test year rate base. I suggest that the Commission reject what witness Crane has proffered on Exhibit ACC-2, Schedules 3-5.

Q. Do you have concerns with witness Crane's other plant related recommendations?

A. Yes. For reasons previously stated, I suggest the Commission reject witness Crane's related fall-out adjustments to (i) Depreciation Expense reflected on her Exhibit ACC-2, Schedule 20, (ii) Property Tax Expense reflected on Exhibit ACC-2, Schedule 22, and (iii)

Interest Synchronization reflected on Exhibit ACC-2, Schedule 23.

2. Exclusion of Any New Positions over Trended 2019 O&M Payroll Costs and Removal of Other Related Expenses

Q. Please summarize the Operating Income adjustments witness Crane recommended in her testimony regarding Additional Employee Expense.

A. In witness Crane's Additional Employee Expense adjustment shown on Exhibit ACC-2, Schedule 8, she proposes removing all O&M payroll costs related to every new position included in the Company's claim for 2020 and 2021. In other words, witness Crane has recommended that the Company's revenue requirement should only reflect the O&M workforce level that existed during the 2019 historical base year, ignoring the effects of the significant customer growth and system expansion she otherwise acknowledges have in fact occurred when arguing that there is no need for an increase in marketing expenses. (See pages 33 and 34 of her testimony).

Q. How does the Company's filing reflect O&M requirements related to the workforce that existed in the 2019 historical test year and the new hires after 2019?

A. As correctly noted on page 21 of witness Crane's testimony, the Company has trended it's 2019 actual O&M related payroll costs of $34,671,527 by three percent annually to the 2021 test year, resulting in $36,783,023 of 2021 O&M payroll costs. This is reflected on MFR Schedule G-2, page 19, total "Payroll trended". Payroll O&M costs related to 2020 and 2021 new hires were reflected on the "Payroll not trended" line in that MFR and totaled $4,282,254 for the year 2021. This is the amount witness Crane is recommending be removed from O&M costs on Exhibit ACC-2, Schedule 8. Details by position of the $4,282,254 of "Payroll not trended" was provided in response to OPC's First Set of Interrogatories No. 50.

Q. Please describe further what was included in the Company's response to OPC's First Set of Interrogatories No. 50?

A. Peoples' response to OPC's First Set of Interrogatories No. 50 provided a detailed listing of each new positions budgeted to be added in 2020 and 2021, the start month/year, and the O&M related payroll cost for each year. In addition, the response indicated the positions that had been filled at the time of the response. For each position that was unfilled in 2020 or budgeted for

2021, the Company provided an explanation of the position need in the response.

Q. Regarding the positions that were indicated as being filled, how much of the $4,282,254 is related to those filled positions?

A. The 2020 filled positions account for $1,375,027 of the $4,282,254 and is reflected on pages 4 and 5 of the Company's response to OPC's First Set of Interrogatories No. 50 (highlighted positions are unfilled, non-highlighted positions are filled).

Q. Did witness Crane acknowledge the filled positions or reference the Company's response to OPC's First Set of Interrogatories No. 50?

A. No. There is no reference to OPC's First Set of Interrogatories No. 50 in witness Crane's testimony nor any acknowledgement that some of the positions accounting for the $4,282,254 have already been filled.

Q. Regarding the 2020 unfilled positions shown on the Company's response to OPC's First Set of Interrogatories No. 50, why has the Company not filled those positions?

A. Although the Company's customer growth is very strong and exceeding its 2020 budget, warm winter weather and the COVID-19 pandemic impacts on commercial customers operations has resulted in Peoples year-to-date August 2020 base revenues being well below its 2020 budget projections included in its filing. As a result, Peoples is earning well below the 9.25 percent bottom of the ROE range at 8.46 percent ROE (see Peoples June 2020 Earnings Surveillance Report), which is also well below what was included in its 2020 budget. Therefore, due to the unplanned temporary earnings challenges and initial difficulties in onboarding and training new employees due to the pandemic, Peoples had temporarily held off filling 20 of the 33 positions budgeted for O&M in year 2020 as shown on pages 4-5 of its response to OPC's First Set of Interrogatories No. 50.

Q. Please provide an overview of the 2020 unfilled positions and 2021 budgeted positions reflected on the response to OPC's First Set of Interrogatories No. 50?

A. In general, the need for the 2020 unfilled and budgeted 2021 positions is related to (i) the Company's strong customer growth, (ii) ensuring safe operations of an expanding system, (iii) meeting increasing and rapidly evolving customer expectations, and (iv) increased resources to support business development and data analytics. As mentioned previously, a need explanation for each of the 2020 unfilled positions and new 2021 budgeted positions were provided in the response to OPC's First Set of Interrogatories No. 50, pages 2-3. Further details are included in the rebuttal testimony of witnesses Wall, O'Connor and Buzard.

Q. What do you suggest the Commission do with witness Crane's recommendation to eliminate all O&M costs related to the Company's new 2020 and 2021 positions?

A. Once again witness Crane is making an arbitrary recommendation to sweep out the Company's claim with no specific support. Justifications for the unfilled 2020 positions and to be filled positions in 2021 have been provided. Therefore, I recommend the Commission reject witness Crane's indiscriminate recommendation to not include <u>any</u> new positions above the 2019 workforce included in the Company's 2021 claim for O&M related payroll.

Q. Do you agree with witness Crane's other recommendations related to the new 2020 and 2021 positions?

A. No. After recommending elimination of all 2020 and 2021 new positions O&M payroll costs, witness Crane then suggests a reduction to related Payroll Tax Expense, 401K Expense and to remove O&M costs associated with additional employees such as travel, meals, mileage, uniforms etc. These recommended adjustments are included in Exhibit, AAC-2, Schedules 11 and 12. As stated above, justification for the 2020 and 2021 new positions has been provided which also supports the Company's claim for these related expenses. In addition, I disagree with witness Crane's recommendation to completely remove the Company's claim for incremental increases in Information Technology ("IT") of $607,242, Human Resources ("HR") of $246,994 and Other Shared Services Expenses of $65,652 (see page 26 and 27 of her testimony and Exhibit ACC-2, Schedule 12), on the basis of my response to her previous recommendation to eliminate all new positions. I also note that on page 26 of her testimony, witness Crane made a transposition error on the HR item by stating it was $264,994 rather than the correct amount of $246,994 shown on Exhibit ACC-2, Schedule 12.

Q. Please explain further your disagreement with witness Crane's recommendations on the IT, HR and Other Shared Services Allocation Expense?

A. I generally agree with witness Crane' statement that increased headcount is the cost causative driver for assessing IT, HR and Other shared services. However, witness Crane is incorrect in her implied inference that both the 2020 and 2021 budgeted new positions impact the IT, HR and Other shared services assessments. The three referenced shared services assessments for 2021 were budgeted based on the 2020 budgeted positions. Therefore, Peoples' 2021 budgeted new positions did not affect the 2021 IT, HR or Other shared service assessments. In addition, regarding the $607,242 of incremental 2021 IT assessments, approximately 33 percent of this is due to increased costs for additional enterprise software system support in the IT department at Tampa Electric, as indicated in the Company's response to OPC's First Set of Interrogatories No. 50, page 7. Therefore, approximately one-third of the $607,242 is not related to Peoples adding new positions as inferred by witness Crane.

3. Exclusion of Any Inflation Considerations for Trending 2019 Non-Labor Costs to 2021

Q. Please summarize the adjustment witness Crane recommended in her testimony regarding Other (Non-Labor) Trended Expense.

A. As reflected in witness Crane’s Exhibit ACC-2, Schedule 13, she proposes eliminating any inflation consideration in trending 2019 non-labor O&M expense to the 2021 projected test year. The primary basis of witness Crane’s proposal is to not use Consumer Price Index (“CPI”) forecasts for general inflation trending of non-labor O&M expense.

Q. Please explain your disagreement with witness Crane’s recommendation to not use CPI forecasts for trending Non-Labor O&M expense.

A. Witness Crane’s recommendation disregards the Commissions long-standing practice of utilizing Consumer Price Index – All Urban (“CPI-U”) as an acceptable general inflation index for evaluating and assessing utilities cost of service trends over years. Specifically, the Commission has precedent in utilizing CPI-U on MFR Schedules C-34 and C-37. In addition, in the Company’s prior rate case filings it has used CPI-U to trend its non-labor costs on MFR Schedule G-2, and it has been accepted by the Commission. For witness Crane to question the use of CPI-U for trending historical base year cost to the projected test year is questioning the judgment and decisions made by all the prior Commissions in prior rate case orders. The CPI-U is a reasonable indication of general inflation for use in determining the projected test O&M revenue requirements for projected test years rate cases. Furthermore, witness Crane's statements regarding using CPI for Energy Services and for CPI Gas Service is inappropriate and unreasonable as volatility in those indexes primarily reflects reductions in commodity prices of natural gas and oil.

Q. Is Peoples use of Moody's inflation forecast of 2.2 percent for 2020 and 2021 consistent with the Commission's prior acceptance of Moody's in the Company's last rate case?

A. Yes. In Order No. PSC-09-0411-FOF-GU, page 22-23, the CPI-U forecast from Moody's Economy.com was ultimately used by the Commission for determining the Inflation trend factor.

Q. Has the Company received an updated forecast from Moody's?

A. Yes. Moody's updated forecast now being used by the Company reflects expected CPI-U inflation of 2.5 percent for 2021, 2.8 percent in 2022 and 2.4 percent from 2023-

2027 (see Exhibit No. __ SPH-2, Document No. 1). As mentioned by witness Crane on page 28 of her testimony, the CPI-U data for the twelve months ended July 2020 reflects a 1.0 percent inflation rate. This low 1.0 percent CPI-U rate was significantly impacted by decreases in energy prices including natural gas, which has rebounded due in part to production disruption from Hurricane Laura in late August. Moody’s forecast for 2021 forward reflects increased inflationary pressures from the $2 trillion CARES Act fiscal stimulus package and the potential for further stimulus, including Federal Reserve actions, to bolster the U.S. economy through the pandemic. On August 27, 2020, Federal Reserve Chairman Jerome Powell announced a major policy shift to “average inflation targeting”, which signals the central bank will be more inclined to allow inflation to run higher than the standard two percent target before hiking interest rates. This was further reiterated by the Federal Reserve announcement on September 16, 2020. In summary, assuming zero inflation in this docket as recommended by witness Crane is not reasonable.

Q. Witness Crane mentions on page 27 of her testimony that certain costs were adjusted by a Customer Growth X Inflation factor. As mentioned previously, for the twelve-months ended July 2020, witness Crane stated that CPI-U was 1.0 percent. Over that same period, what was Company’s actual Customer Growth?

A. From July 2019 to July 2020, the Company’s customer count has grown from 398,228 to 418,813 (see Exhibit No. __ SPH-2, Document No. 2). That represents a 5.2 percent customer growth rate compared to the 3.32 percent rate assumed for 2020 on MFR Schedule G-2, pages 10-19.

Q. What do you suggest the Commission do regarding any changes to the trend factors on MFR Schedule G2, pages 10-19?

A. As previously stated, there is a strong long-standing Commission precedent in utilizing the CPI-U as the general inflation factor. Therefore, that precedent should be recognized. If the Commission does ultimately update the CPI-U based Inflation factor, then an update to the Customer Growth factor should also be reflected in the final trend factors. Although 2020 has been a very volatile year with July actual CPI-U data suggesting 2020 general inflation has been lower and fiscal stimulus and Federal Reserve policy changes suggesting 2021 and beyond inflation will be higher, overall the 2.2 percent rate assumed in the Company's filing for both years appears to remain a reasonable inflation factor considering Moody's long-term forecast for CPI-U that reaches as high as 2.8 percent in 2022.

4. **<u>Misunderstanding of Short-Term Incentive Compensation Costs included in the Company's Claim</u>**

Q. Do you agree with witness Crane's recommended adjustments to incentive compensation as shown on her Exhibit ACC-2, Schedule 9?

A. No. As discussed in the rebuttal testimony of Company witness McQuaid, the Company overall disagrees with witness Crane's recommendations on removing financial metric-based short and all long-term incentive compensation from the revenue requirement as shown on her Exhibit ACC-2, Schedule 9. In addition, I have specific disagreement with witness Crane's proposed adjustment that deals with her misunderstanding of the actual short-term incentive compensation included in the Company's claim. Witness Crane is correct that 50 percent of the potential PSP short-term incentive awards are based on financial metrics as provided in the Company's response to OPC's First Set of Interrogatories No 10. However, what witness Crane did not understand is that there are zero dollars in the Company's claim related to achievement of the PSP net income financial goal. The PSP net income goal is only paid out to PSP program participants if the Company achieves earnings above the budget, which makes this a self-funded goal. Therefore, the Company did not include any O&M in its 2021 revenue requirement for the PSP net income goal that is worth five percent of the 12 percent potential payout. The other financial metric incentive in the PSP program is the cash flow from operations goal that is worth one percent of the 12 percent potential payout that was included in the Company's claim.

Q. Did witness Crane make any other errors in her statement that 50 percent of the Company's short-term incentive awards are based on financial metrics?

A. Yes. In Peoples' response to OPC's First Set of Interrogatories No. 10, which is referenced in witness Crane's Exhibit ACC-2, Schedule 9, the Company provided the current Peoples Balanced Scorecard summary document. This document on Bates Stamp page 9, clearly shows the financial metric goals for net income of 35 percent and cash flow of five percent. This adds to 40 percent, not the 50 percent as stated in witness Crane's testimony.

The 40 percent total was also reflected in the Company’s response to OPC’s First Request for Production of Documents No. 14, Bates Stamp page 2070, which reflects the 2020 Balanced Scorecard Program.

5. <u>Adjustment to American Gas Association’s (“AGA”) Membership Dues</u>

Q. Do you agree with the adjustment witness Crane has recommended on pages 30-31 of her testimony regarding lobbying activities conducted by AGA?

A. No. Witness Crane claims the AGA is under reporting their lobbying activities on the invoices provided to Peoples for membership dues, which effectively is questioning AGA’s integrity. After reviewing statements, she read on the AGA’s website, she breezily and without evidence concludes that AGA’s lobbying activities must constitute 20 percent of membership dues and that the 3.5 percent explicitly stated on AGA’s invoice is incorrect. She provides nothing of substance to support that conclusion. The Company’s claim is based on the 3.5 percent stated on AGA’s invoice for lobbying activities. Therefore, I recommend that the Commission reject this proposed $36,343 adjustment by witness Crane.

6. Removal of Additional Marketing and Advertising Expenses

Q. Do you agree with witness Crane's recommendation on page 34 of her testimony to exclude $829,871 of additional Advertising and Marketing expense from the Company's claim on the basis that Peoples has been successful in its past marketing efforts as evidenced by its relatively strong growth rate?

A. No. Although Peoples has had strong customer growth exceeding Florida's population growth, there is still potential for further market penetration and retention of customers. Retaining and adding new customers provides benefits to existing customers by increasing economies of scale and spreading fixed costs over more customers and therms. Although Peoples is a regulated utility, using natural gas is a choice in Florida, which makes marketing an essential component to the success of the Company's long-term customer and sales growth.

Q. What is the current natural gas market penetration in Florida?

A. Currently, the market penetration of natural gas in Florida is only about 10 percent. And while Peoples has good market penetration across its installed infrastructure, it is not at 100 percent. In colder U.S. climates, natural gas is a staple in most buildings as a main heating energy resource. Due to Florida's tropical climate, there is very little heating demand which makes natural gas less prevalent and more of a choice. Therefore, there is significant room for increased market penetration as well as increased usage in the long-term if additional marketing and advertising efforts are consistently made to customers, land developers and business leaders. As Peoples expands its system to unserved areas, it is equally as important to advertise and market to these future customers about natural gas service coming to these communities.

Q. Regarding customer retention, what is the opportunity for potential improvement?

A. For the three-year period 2017 through 2019, almost 7,800 residential and over 1,500 commercial customer premises left Peoples' system. Every year thousands of customers either leave Peoples' system entirely or take single appliances off the system and replace them with electric. Peoples can retain customers by educating them on the reasons why natural gas is an affordable, safe, and reliable energy resource as well as their options for financing appliances and connecting them with qualified installation contractors and dealers of gas appliances.

Q. What specifically would the increased marketing and advertising expenses cover?

A. The additional marketing and advertising expenses include outside services for creative development and production of new marketing collateral and videos; digital, radio, print and television advertisements across the Company's 14 service areas, digital assets like microsites, videos, applications and interactive media elements. Other costs include web hosting and gas industry-focused presentation material. Some of these service areas cover some of the most expensive media markets in Florida, which require additional expense to reach targeted audience in these markets.

Q. Do you agree with witness Crane's recommendation on page 34 of her testimony to eliminate the $35,000 of additional customer communications?

A. No. As mentioned in the Company's response to OPC's Second Set of Interrogatories No. 109, the objective of the additional communications is to improve the customer's experience through customer research and segmentation. As discussed on page 5 of the testimony of Company witness Monica A. Whiting and adopted by witness Karen Sparkman, the Company recognizes that customers' needs and expectations are quickly changing and will continue to evolve. As part of Peoples' "Voice of the Customer" program, these costs are associated with customer research and surveys to gain insight into customers' needs, wants, perceptions, preferences, and expectations. As well, "digitalization" of commerce and the evolution of customer expectations is accelerating even faster as a result of the COVID-19 pandemic. The need for further research and customer segmentation is driven by the need to keep up with these changing expectations.

7. <u>Errors made by witness Crane</u>

Q. Have you noted any other errors made in OPC witness Cranes testimony that are impacting her recommended adjustments?

A. Yes. Below is a listing of errors made by witness Crane in her testimony that happen to inflate her recommended adjustments.

1. On her Exhibit ACC-2, Schedule 7, witness Crane has

used a recommended pre-tax amount of $1,064,871 for Advertising and Marketing Expense from her Schedule 16 rather than the correct after-tax amount of $803,745. Witness Crane makes a similar mistake again on Schedule 7 in using a recommended pre-tax amount of $325,676 for 401K Expense from her Schedule 11 rather than the correct after-tax amount of $245,814. The impact of these errors is the income tax amounts of $79,862 from Schedule 11 and $261,126 from Schedule 16, which is then carried into her Exhibit ACC-2, Schedule 26 and multiplied by the 1.3361 Revenue Multiplier, which results in a total error of $455,594.

2. On page 26, lines 1-3, witness Crane indicates she did not include the long-term incentive compensation in her recommended payroll tax adjustment because these awards are not made in cash and have potentially different tax treatment. However, she then includes long-term incentive compensation in her payroll tax adjustment calculation in Schedule 10. The impact of this error is overstating her recommended payroll tax adjustment on Schedule 10 by $89,998, which is then carried into her Exhibit ACC-2, Schedule 26 and multiplied by the 1.3361 Revenue Multiplier, which results in a total error of

$120,246.

3. On page 26, lines 4-8, witness Crane states:

> "it is my understanding the Company's 401K claim is based on total compensation, including short-term incentive compensation awards that are made in cash. Therefore, I made an adjustment in Exhibit ACC -2, Schedule 11 to eliminate the Company's 401K match on the labor and short-term incentive compensation costs that I recommend be disallowed."

This implies that she has only included short-term incentive compensation and she has not included the long-term incentive compensation in her recommended 401K match adjustment, which would be correct. However, in her calculated adjustment on Schedule 11 she does include long-term incentive compensation in her 401K Expense adjustment, which is incorrect. The impact of this error is overstating her recommended adjustment on Schedule 11 by another $47,319, which is then carried into her Exhibit ACC-2, Schedule 26 and multiplied by the 1.3361 Revenue Multiplier, which results in a total additional 401K Expense adjustment error of $63,223 on top of the

401K Expense error impact mentioned in item 1. above.

Q. Does witness Crane make any other errors in her testimony?

A. Yes. On page 45, line 18 of her testimony in her overall summary she states that her recommendation reflects revenue requirement adjustments of $42,103,332. However, on her Revenue Requirement Summary shown on Exhibit ACC-2, Schedule 1, it indicates total adjustments of $43,103,332. This inconsistency makes it unclear which amount is her total recommendation.

7. <u>Proposed Amortization and Recovery of Certain O&M Costs Over 5-year Periods</u>

Q. Please summarize witness Crane's proposals to amortize or recover certain O&M costs over 5-year periods.

A. First, on Exhibit ACC-2, Schedule 17, witness Crane proposes amortizing the Company's Rate Case Expense over a five-year period. Second, on Exhibit ACC-2, Schedule 19, and on page 40 of her testimony, witness Crane proposes a five-year recovery of the New Work Asset Management O&M Expenses that cannot be capitalized by the Company due to FASB accounting rules codified under ASC

350-40-25. Similarly, on page 37 and 38 of witness Crane’s testimony, she proposes that the Commission normalize Transmission Integrity Management Program (“TIMP”) Pipeline Reassessment and Risk Analysis costs using a five-year average of the anticipated costs, based on the Company’s current schedule for 2021-2025. In none of the three items does witness Crane dispute the Company’s cost amounts, just the annual expense amount recognized in its 2021 test year revenue requirements.

Q. Do you agree with witness Crane’s proposal to amortize rate case expense over 5 years?

A. No. While it is difficult to predict when Peoples will file its next best rate case, I am relatively certain it will be less than five years. Three years is an appropriate amortization period for rate case expense and no adjustment should be made.

Q. Do you disagree with witness Crane’s recommendation to amortize over 5 years the software implementation costs not capitalized under GAAP rules?

A. No. I do not disagree with this alternative proposal to allow the Company to amortize software implementation costs not capitalizable over a 5-year period. This proposed accounting treatment would be similar to rate case expenses that are amortized over a period of time, which is a long-standing Commission practice.

Q. Do you disagree with witness Crane's recommendation to normalize TIMP Pipeline Reassessment and Risk Analysis costs to reflect a five-year average of the anticipated costs?

A. No. I do not disagree with witness Crane's alternative proposal to annually amortize $1,439,980 as shown on Exhibit ACC-2, Schedule 18, as long as implementation of this alternative proposal to normalize the TIMP costs is fair to both customers and the Company. There is Commission precedent to levelize certain costs where significant fluctuations occur through reserve accounting. In Order No. PSC-98-0739-FOF-GU, pages 2-3, the Commission approved the Company's request for reserve accounting due to wide fluctuations in annual costs for environmental remediation expense. Reserve accounting treatment levelizes the expenses included in revenue requirements and the earnings impact on Peoples, thereby being fair to both customers and the Company. As stated by witness Crane on page 38 of her testimony, these TIMP

Pipeline Reassessment and Risk Analysis costs can vary so significantly from year-to-year. Therefore, I recommend that if the Commission adopts witness Crane's proposal to normalize TIMP Pipeline Reassessment and Risk Analysis costs at $1,439,980 annually, then Commission should also authorize the Company to apply reserve accounting treatment for these fluctuating TIMP costs consistent with the prior Commission decision in Order No. PSC-98-0739-FOF-GU.

SUMMARY

Q. Please summarize your rebuttal testimony.

A. I have delineated my concerns and disagreements regarding the recommendations included in the testimony of witness Crane. Many of witness Crane's assertions contain positions that are inaccurate, unreasonable, inappropriate, and/or not in accordance with prior Commission practice and decisions. I have presented facts and information that support the Company's petition, the reasonableness and prudence of amounts and positions presented by Peoples, and the appropriateness of the revenue requirement contained in its filing.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

(Whereupon, prefiled rebuttal testimony of Valerie Strickland was inserted.)

BEFORE THE PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY

OF

VALERIE STRICKLAND

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

A. My name is Valerie Strickland. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed by Peoples Gas System ("Peoples" or the "Company").

Q. Are you the same Valerie Strickland who filed direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to rebut the direct testimony of witness Crane, testifying on behalf of the Office of Public Counsel.

Q. Please summarize the areas of disagreement in witness

Crane’s testimony that you are addressing in your rebuttal testimony.

A. I disagree with witness Crane in the following three areas:

1. Witness Crane’s arguments presented on pages 43 – 45 of her testimony about the application of F.A.C Rule 25-14.004, Effect of Parent Debt on Federal Corporate Income Tax.
2. Witness Crane’s position on page 44 of her testimony on the amount of federal tax expense the Company has requested in the projected test year.
3. Witness Crane’s proposal on page 45 of her testimony to adjust the parent company interest adjustment using Emera Incorporated’s (“Emera”) capital structure.

Q. Why do you disagree with Witness Crane’s interpretation of F.A.C Rule 25-14.004, “Effect of Parent Debt on Federal Corporate Income Tax”?

A. Witness Crane’s logic for applying the Parent Debt Adjustment Rule misapprehends the intent of the rule. The intent of F.A.C. Rule 25-14.004 is to require an adjustment to the income tax expense of a regulated company to reflect the income tax benefit of the parent debt that may have been invested as equity of the subsidiary, and has nothing to do with cash payments made to the Internal Revenue Service ("IRS") by a utility or its parent company. To the extent the rule applies, MFR Schedule C-26 properly reflects the application of the rule to Peoples.

Q. Witness Crane states that there is a major disconnect between the statutory rate used to calculate the federal income taxes for ratemaking purposes and the actual taxes being paid by the consolidated group. Do you agree with this statement?

A. No. The total tax expense has been calculated consistent with the Commission's longstanding policy of determining a utility's revenue requirement by calculating income tax expense on a stand-alone basis. Witness Crane has not identified a valid reason for departing from the Commission's policy for calculating income tax expense.

Q. Witness Crane recommends a parent debt adjustment using the capital structure of Emera. Do you agree with this conclusion?

A. No. On August 31, 2020, the Company responded to Staff's Fourth Set of Interrogatories, No. 36, which requested a parent debt adjustment calculation using Emera's capital structure. Peoples' response explained that that it correctly applied the rule as provided in F.A.C Rule 25.14.004 "Effect of Parent Debt on Federal Corporate Income Tax" when it concluded that Emera U.S. Holdings, Inc ("EUSHI") and not Emera, should be the parent company used for purpose of calculating a parent debt adjustment. As noted in my direct testimony, Peoples is a division of Tampa Electric Company, which is a wholly owned subsidiary of TECO Energy, Inc. TECO Energy, Inc. is a subsidiary of EUSHI, which is a subsidiary of Emera, a Canadian company. Peoples files a consolidated U.S. income tax return with EUSHI. Emera is a Canadian company that is not a party to the U.S. federal consolidated tax return, so the plain language of the rule does not impose the adjustment at the Emera level. The rule states: "the income tax expense of a regulated company shall be adjusted to reflect the income tax expense of the parent debt that may be invested in the equity of the subsidiary where a parent - subsidiary relationship exists <u>and the parties to the relationship join in the filing of a consolidated income tax return</u>" (emphasis added).

Additionally, paragraph (2) of this rule provides that "where the regulated utility is a subsidiary of tiered parents, the adjusted income tax effect of the debt of all parents invested in the equity of the subsidiary utility shall reduce the income tax expense of the utility". Since EUSHI is the highest tiered parent and the ultimate parent company which files the U.S. consolidated tax return, and Emera does not join in the filing of a consolidated U.S. income tax return with Peoples, the Company used the capital structure of EUSHI parent for the purpose of calculating the parent debt adjustment. Witness Crane's view of how the parent debt adjustment rule should be applied misapplies the plain language of the rule.

SUMMARY

Q. Please summarize your rebuttal testimony.

A. I have described the concerns and disagreements I have regarding the substance of witness Crane's testimony. Her assertions contain a variety of points that are not only inaccurate, but also in contradiction with the Commission's longstanding policy. I have presented facts and information that support Peoples' position on the parent company debt adjustment and the appropriateness of the conclusions reached by Peoples with respect to the parent company debt adjustment.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

(Whereupon, prefiled rebuttal testimony of Charlene M. McQuaid was inserted.)

BEFORE THE PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY

OF

CHARLENE MCQUAID

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

A. My name is Charlene McQuaid. My business address is 5151 Terminal Road, Halifax, Nova Scotia, Canada. I am employed by Emera Inc. (the “Company”).

Q. Are you the same Charlene McQuaid who filed direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address serious errors and shortcomings in the prepared direct testimony of witness Andrea C. Crane, testifying on behalf of the Office of Public Counsel.

Q. Have you prepared an exhibit supporting your rebuttal testimony?

A. No, I have not.

Q. Please summarize the key concerns and disagreements you have regarding the substance of witness Crane's testimony.

A. I disagree with witness Crane’s recommendation that incentive compensation costs that are tied to financial metrics be removed from the rate case and instead be recovered from the Company’s shareholders. I further disagree that these costs do not benefit or could harm Peoples’ customers.

INCENTIVE COMPENSATION

Q. Do you agree with witness Crane that incentive compensation based in financial metrics is inconsistent with a utility’s mandate?

A. No, I do not. Financial measures are a standard and expected component of balanced incentive compensation plans. The argument that financial measures are not in the best interest of customers because they are tied to shareholder success is a fallacy as the two are most definitely not diametrically opposed. It is absolutely possible that both groups can be aligned and benefit from the Company's financial performance.

Strong financial performance is good for the shareholder and can also mean low cost to deliver natural gas. This is good for customers. Strong financial performance can be derived from operational efficiencies and system growth yields opportunities to expand and strengthen the service into areas where it does not exist, which is good for customers. Strong financial performance provides the funds to invest in social programs that are important to the public good. Strong financial performance allows the Company to maintain/improve its credit rating, which is important to ensure Peoples can continue to provide energy in an affordable manner.

Q. Witness Crane recommends that the costs related to financial measures in the incentive programs be excluded from revenue requirement. Is that recommendation appropriate?

A. No. There is no basis for any adjustment to incentive compensation, which includes Peoples' short-term incentive (STIP) and long-term incentive (LTIP) plans. Witness Crane has provided no study or any other evidence to suggest that

Peoples’ total compensation program is either imprudent or unreasonable. She does not suggest an alternative method of determining how employees should be paid for the work they perform or how the prudency or reasonableness of their compensation should be judged. Incentive compensation is a portion of the total Peoples’ market-based compensation program. Incentive compensation is at risk and may or may not be paid, depending on whether or not certain goals are or are not achieved. As described in detail above and in my testimony, Peoples’ incentive compensation is part of an overall total compensation program. The goals provide safe, reliable service with consideration for cost containment and financial prudency. Peoples’ witness Sean P. Hillary’s rebuttal testimony speaks specifically to the costs included in the Company’s revenue requirement.

Accepting witness Crane’s recommendation to disallow components of the incentive program as identified in witness Hillary’s rebuttal testimony would adversely affect the Company's ability to attract and retain a high-quality skilled workforce. If the financial component of incentive pay was removed, then total compensation would be below market for comparable jobs putting Peoples at a competitive disadvantage in the challenge to attract and retain a talented workforce.

It is also worthy to note that using incentive compensation programs can be less costly than increasing base salary because incentive compensation is “at risk” and by definition not guaranteed and based on achieving objectives. The “at risk” component motivates employees to perform at high levels and can drive more efficiency which translates to direct benefits for Peoples’ customers. With a balance of goals, participation in these plans helps ensure the Company’s goals of providing customers with safe and reliable service is achieved. The participation also focuses on ensuring adequate return to the Company’s shareholders. Both these objectives benefits customers. The first benefits customers who rely on natural gas to meet their energy needs and the second benefits customers by having a company that can attract needed capital at a reasonable cost to provide service.

SUMMARY

Q. Please summarize your rebuttal testimony.

A. Each component of the Company’s total compensation program, including the STIP and LTIP are beneficial to customers and directly consistent with the mandate to provide safe and reliable customer service at fair prices. Incentive compensation plans are particularly important as the amount of award paid depends on the achievement of results. This motivates officers, leaders and employees to achieve goals focused directly or indirectly achieving the Company mandate. Peoples' total compensation program ensures the Company continues to attract and retain the skilled and talented employees needed to support achieving the Company mandate.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

(Whereupon, prefiled rebuttal testimony of Luke A. Buzard was inserted.)

BEFORE THE PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY

OF

LUKE A. BUZARD

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

A. My name is Luke A. Buzard. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed by Peoples Gas System ("Peoples" or the "Company").

Q. Are you the same Luke A. Buzard who filed direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address serious errors and shortcomings in the prepared direct testimony of witness Andrea C. Crane, testifying on behalf of the Office of Public Counsel.

Q. Have you prepared an exhibit supporting your rebuttal testimony?

A. No.

Q. Please summarize the key concerns and disagreements you have regarding the substance of witness Andrea C. Crane's testimony.

A. My key concerns and disagreements are as follows:

1. I disagree with witness Crane’s conclusion that the increase of $200,000 in incremental pipeline safety awareness advertising should be disallowed.
2. I disagree with witness Crane’s conclusion that $98,000 in additional A&G employee expenses for “additional preventive staffing” in the Pipeline Safety Compliance Department should be disallowed.

PIPELINE SAFETY AWARENESS ADVERTISING

Q. Why is the public awareness program important for Peoples?

A. Peoples is the largest natural gas company in the state of Florida and receives over 560,000 locate request annually, with a historical annual increase of +\- seven percent. This growth is expected to increase and parallel the construction growth forecasted for Florida.

Pipeline damages caused by excavation associated with this growth, continues to subject the public, first responders, Peoples' team members, and the Company's pipeline facilities to the dangers of a hazardous and potentially fatal incident. Over 50 percent of Peoples' pipeline damages are by excavators digging without a locate request/ticket. Witness Crane ignores these facts in her testimony, favoring the elimination of funding for programs designed to prevent these occurrences.

Q. How will the increase of $200,000 to the public awareness program improve safety for the general public, Peoples' customers and team members?

A. This increase in funding for advertising and awareness will enhance pipeline damage prevention, awareness, outreach, and education of the dangers of hitting a natural gas main across the state.

Industry best practices have shown that targeted awareness campaigns and education materials directed to industries and associated contractor's increases the awareness to the requirements of calling for a locate request and safe digging practices and contributes to the reduction of hazardous pipeline damages.

Q. Are there further benefits to Peoples increasing spending in the damage prevention and public awareness campaigns?

A. Yes. Not only will the increase in the campaign positively influence safety, the investment in these campaigns will have a positive impact on customer rates in the future. Every instance of pipe damage results in costs to Peoples from pipeline repairs and associated expenses, legal expenses and potentially other liability costs. By increasing awareness messaging promoting safe digging practices and further protecting pipelines, in a state that only very recently made changes to enforcement rules surrounding underground damages, Peoples is improving safety for customers, the general public and team members.

Not only does the prevention of a damage impact Peoples and its customers, it furthers reliability by preventing a potential outage to businesses and reduces the need for other first responders and municipal services to deal with the damage.

ADDITIONAL PREVENTIVE STAFFING

Q. Does witness Crane ignore why damage prevention activities are important to Peoples?

A. Yes. Witness Crane does not appear to have any understanding of why these programs are important to the Company, to its customers and to the public at large. Based on industry data, Peoples arguably experiences the most damages per miles of mains and services of any other gas utility of similar size in customer base. These conditions are due to the significant amount of residential and commercial growth in Florida and the corresponding roadway construction, which in conjunction with lacking enforcement actions, results in significant underground pipeline damages compared to other areas of the country.

Peoples' Damage Prevention team is dedicated to work with contractors to ensure the process of locating and protecting underground facilities prevents damage to an underground pipeline from ever occurring.

Florida has one of the highest volumes of locate ticket requests in the country and it is critical that Peoples continues to improve programs to enhance safety and reliability for its customers. Peoples’ experiences over 1,300 damages per year and although Peoples works diligently to drive to a lower damages per 1,000 ticket requests it requires the continued pursuit of improvement to our systems and programs to reduce damages.

Q. Contrary to witness Crane’s conclusion, why does Peoples need additional staffing in damage prevention?

A. Peoples serves essentially all the major metropolitan areas across Florida. Due to that geographic challenge and given the Company’s high damage rate, the Company is pursuing additional staffing to have more onsite presence at active state and municipal expansion of roadway and water/sewer construction projects to proactively coordinate with contractors and protect a potential damage to a gas line. Industry best practice of onsite presence at active construction sites to collaborate with contractors has proven to significantly contribute to lowering the occurrence of a damage.

Peoples is also adding staffing to continue to enhance quality control and quality assurance over locating activities. The accuracy and reliability of these processes are critical to assist with preventing excavation damages to pipelines.

Q. What is the need for the additional A&G of $98,000 employee expenses for additional preventive staffing in the 2021 test year?

A. As Peoples expands the staffing of the damage prevention and quality assurance teams, it is necessary to expand the employee expenses to support their annual activities. These damage prevention coordinators and quality assurance associates incur employee expenses related to tools and equipment, uniforms, training, travel and other incidental expenses. The increase of $98,000 to A&G is to adequately provide for the expansive territory being served by critical resources that are dedicated to reducing the occurrence of underground excavation damages to natural gas pipelines in our service area.

SUMMARY

Q. Please summarize your rebuttal testimony.

A. The increase of $200,000 to Peoples' Public Awareness campaign is reasonable and necessary due to the conditions that persist in the state of Florida surrounding underground excavation damage to gas lines.

Due to over 50 percent of damages being driven by excavators not calling prior to digging, Peoples has an obligation to further advance these efforts in the interest of protecting the safety of the general public, team members and customers.

The increase to A&G expenses of $98,000 associated with employee expenses for preventive safety staffing is justified due to the expansion of resources to further protect underground gas pipelines. Witness Crane's recommendation to eliminate these expenses ignores their necessity to ensure compliance and safe operations.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

(Whereupon, prefiled rebuttal testimony of Dane Watson was inserted.)

DOCKET NO. 20200051-GU
DOCKET NO. 20200166-GU
FILED: 09/21/2020

BEFORE THE PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY

OF

DANE A. WATSON

ON BEHALF OF PEOPLES GAS SYSTEM

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

A. My name is Dane A. Watson. My business address is 101 E. Park Blvd, Suite 220, Plano, TX 75704. I am a Partner with Alliance Consulting Group.

Q. Are you the same Dane A. Watson who filed direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address serious errors and shortcomings related to depreciation recommendations in the prepared direct testimony of witness David J. Garrett, testifying on behalf of the Florida Office of Public Counsel ("OPC").

Q. Please explain how your rebuttal testimony is organized.

A. OPC witness Garrett has made recommendations for selected life and net salvage parameters which produce lower depreciation rates than those I recommend. First, I will discuss the issues with witness Garrett's life recommendations. Next, I will discuss his differing positions on net salvage parameters.

Q. Have you prepared an exhibit supporting your rebuttal testimony?

A. Yes, I have. My Exhibit No.__ (DAW-2), consisting of six documents prepared by me or under my direction and supervision.

Document No. 1	Email response to discovery questions sent from OPC, dated September 9, 2020.
Document No. 2	Comparison of Account 380 - Steel Services Observed Life Table using witness Garrett's non-existent 1970-2020 experience band compared to the actual longest experience band of 1983-2018.
Document No. 3	RTU Detail for Accounts

Document No. 4	Account 378 - M&R Stations Sum of squared differences computations (correcting witness Garrett's calculations).
Document No. 5	Account 380 - Steel Services sum of squared differences computations (correcting witness Garrett's calculations).
Document No. 6	Account 385 - Industrial M&R Stations Sum of squared differences revised computations (correcting witness Garrett's calculations).

Q. Please summarize the key concerns and disagreements you have regarding the substance of witness Garrett's testimony.

A. My key concerns and disagreements are as follows:

1. The four life parameter changes recommended by OPC witness Garrett are inappropriate and based on flawed analysis.
2. The six-net salvage parameter changes recommended by OPC witness Garrett are arbitrary, not supported by Company experience and should be rejected.

PROPOSED LIFE PARAMETERS

Q. What recommendations does witness Garrett make with regard to various account service lives?

A. Witness Garrett suggests that the proposed service lives for four distribution accounts should be extended.[1]

Q. How does witness Garrett's proposed lives and survivor curves for the four accounts at issue compare with those currently approved for Peoples' and your proposals?

A. Table 1 below compares my proposals to witness Garrett's proposals for the existing life and survivor parameters for the four accounts at issue.

TABLE 1

				Company		OPC	
		Existing		Proposed		Proposed	
Acct		Life	Curve	Life	Curve	Life	Curve
378	M&R Station Equipment	31	R1	40	R1.5	46	R1
380	Services – Steel	50	R0.05	52	R0.5	57	R0.5
380	Services –Plastic	55	R1.5	55	R1.5	64	R1.5
385	Industrial M&R Station	32	R4	37	R3	41	R3

[1] Witness Garrett's Direct Testimony, page 91.

Q. Do you agree with witness Garrett's recommendations?

A. No. Witness Garrett's proposed service lives for the four distribution mass property accounts are unreasonable and are not based on sound depreciation practices. Witness Garrett's recommendations should be rejected, and my proposed service lives should be adopted.

Q. Would you elaborate on your disagreement with witness Garrett's life selections?

A. Yes. There are a number of global and systematic errors in witness Garrett's analysis which lead to inappropriate life recommendations. I will address those in this section. Later, I will discuss account-specific issues with witness Garrett's four life recommendations.

Q. Would you describe the global errors in witness Garrett's analysis?

A. Yes. Witness Garrett's analysis:

- Used a non-existent experience band <u>as his only band</u> that included 12 or more years with no retirements. This skewed his analytical results and ultimately his recommendations.

- Violated the principles behind actuarial analysis by only using one placement and experience band (the full band) thereby not analyzing trends in life through time.
- Discarded relevant data in analyzing his single band by using a novel (non-industry standard) approach that cut off and ignored Company-specific experience.
- Ignored both company-specific operational information and reasonable engineering expectations for the life of assets.

ERRONEOUS EXPERIENCE BAND

Q. What band(s) did witness Garrett use in his life analysis?

A. Based on witness Garrett’s testimony, workpapers and response to a Data Request (See Exhibit DAW-1), his analyses solely used a single placement/experience band as shown below[2]:

[2] See witness Garrett’s Exhibit 23 and my Exhibit No. __ (DAW-1)

Table 2: Garrett Band for Each Account

Account	OPC Placement Band	OPC Experience Band
378	1940-2019	1970-2020
380 Steel	1910-2020	1970-2020
380 Plastic	1959-2020	1970-2020
385	1958-2019	1970-2020

Q. Do these bands witness Garrett used match the underlying data he used?

A. No. Witness Garrett responded to a data request in Exhibit No. __ (DAW-1) that he used the same data for his analysis as contained in the Company's Depreciation Study ("Study"). This admission points out the error in witness Garrett's band selections. The data for the Company's Study did not contain transactions back to 1970 (which would be necessary for an experience band back to 1970) and the data did not contain transactions from 2019 or 2020 since the study date was at December 31, 2018.

Q. Would you expand on the issue with using an experience band starting in 1970?

A. Yes. Witness Garrett's life analysis experience bands of 1970-2020 or 1970-2019 include periods where no Peoples' history is available. The Company's available actuarial history begins in 1983, consistent with other depreciation studies the Company has presented before this Commission. Witness Garrett's inclusion of experience band periods where data does not exist (including 1970-1982 and 2019-2020) makes it appear (incorrectly) that the Company had no retirements of any kind during those periods. This created a flawed analysis that witness Garrett then used as the basis of his recommendations.

Q. Has Peoples used historical data prior to 1983 in its previous Study?

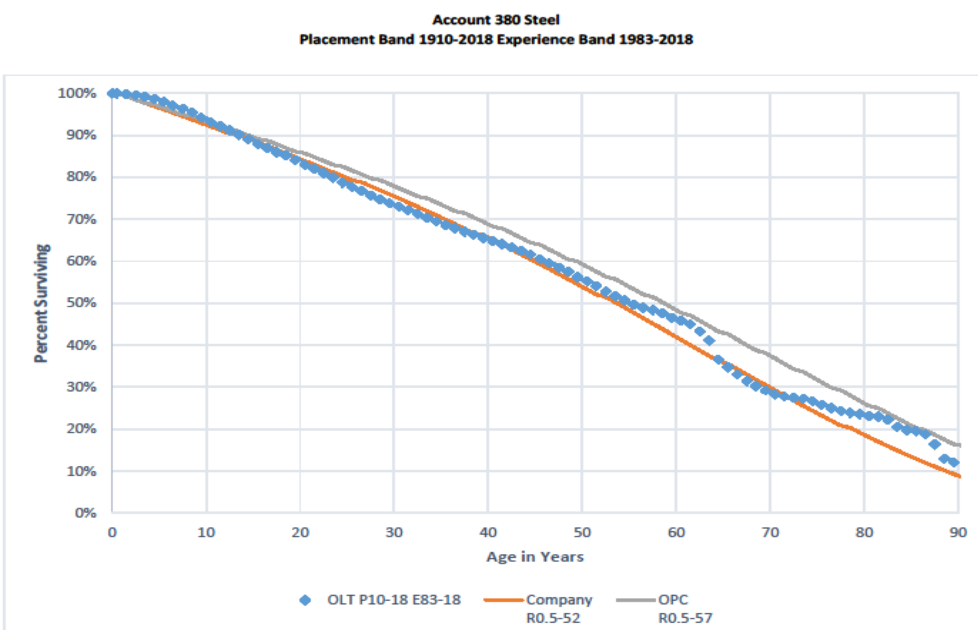
A. No. Consistent with the current Study, in Account 378, the Company retirement history is shown on pages 215-224 of the 2016 Study ending in transaction year 1983. In Account 380-Steel Services, Company retirement history is shown on pages 296-309 of the 2016 Study ending in transaction year 1983. In Account 380 Plastic Services, the Company retirement history is shown on pages 333-340 of the 2016 Study ending in transaction year 1986. In Account 385, the Company retirement history is shown on pages 504-511 of the 2016 Study ending in transaction year 1985. Although in the past Study (and the current Study), there is no historical experience available between 1970 and 1982, witness Garrett still included that period in his analysis.

Q. Why does it matter if the experience band uses 1970-2018 instead of the correct 1983-2018?

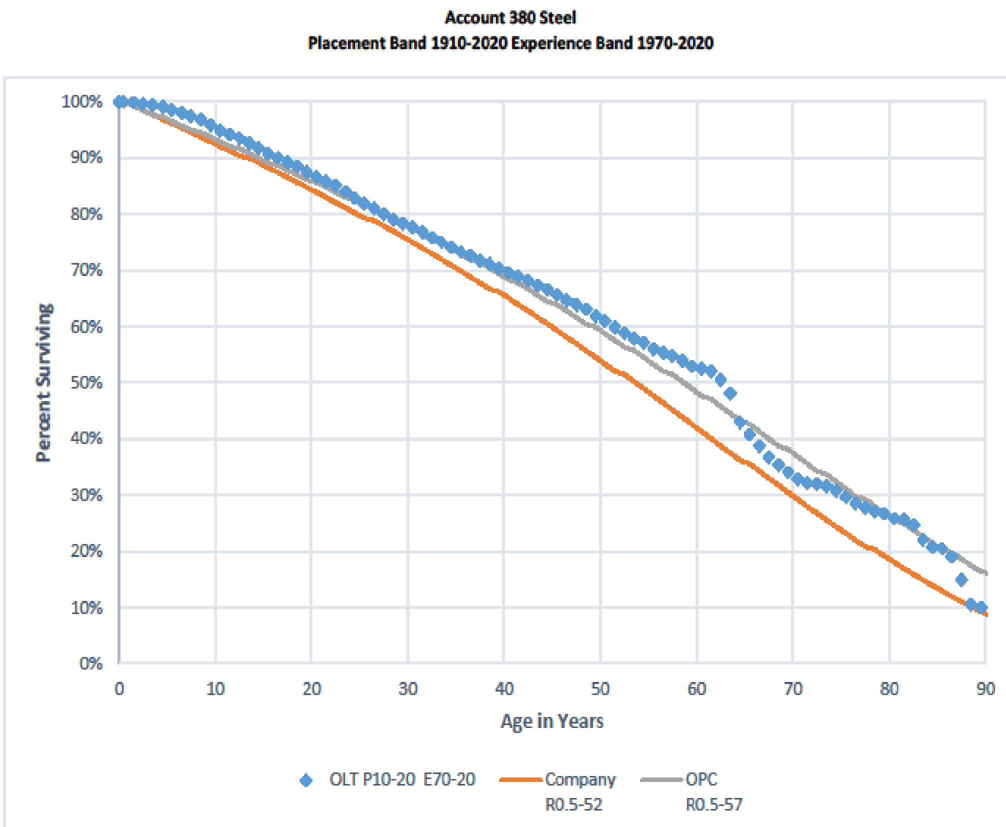
A. The use of the non-existent years creates different results in the observed life table if the experience band is the incorrect 1970-2018 as compared to the actual 1983-2018 range. In some accounts, the difference can be large. For example, in Account 380 Steel Services, the wider experience band of 1970-2020 (of which the first 12 years do not exist in reality) produced curve points as much as **7.15 percent** higher than the correct 1983-2018 band. See my Exhibit No. __ (DAW-2), Document No. 2, to show the computations for Account 380-Steel Services. This may not seem significant on the surface; it can erroneously move the life observed in the analysis by several years in the graphical analysis. Additionally, given witness Garrett's reliance on mathematical fitting, the life with the best least squares curve fit will also erroneously change if curve points related to Company experience are overstated by including the blank years. In the individual account discussions, I will show how using the correct experience band can calculate statistical matches that are better under my recommendation than witness Garrett's.

Q. Would you demonstrate how using this erroneous experience band will skew the results of the graphical analysis?

A. Yes. Below is my recommendation and witness Garrett's recommendation for Account 380-Steel Services using the correct experience band.



As seen, my recommendation is a much better match to the Company's actual experience. Next is a graph of the mine and witness Garrett's recommendations using his erroneous band.



Using the erroneous band, witness Garrett's recommendation would appear to be a better match, however, it based on inaccurate calculations. Demonstrated another way, the graph below shows the observed life table data points using the correct calculation (i.e. the actual range of Company experience) and using witness Garrett's erroneous band.

Simply using an erroneous experience band in his calculation skewed the data to incorrectly suggest a longer life than is experienced by the Company in reality. For this reason (if no other), witness Garrett's life recommendations should not be accepted.

SINGLE BAND

Q. What placement and experience bands did witness Garrett use in his analysis?

A. Witness Garrett only used one placement and experience band in his testimony and workpapers for each account, as summarized in Table 2.

Q. Do you agree with witness Garrett's decision to use only one placement and experience band?

A. No. The erroneous experience band was discussed above. witness Garrett's use of only one placement and experience band is an additional issue that does not follow sound depreciation practice or guidance, and in my expert opinion, does not lead to accurate results in this case. NARUC's *Public Utility Depreciation Practices* advocates the use of multiple bands:

> Banding is compositing a number of years of data in order to merge them into a single data set for further analysis. Often, several bands are analyzed. By making determinations of the life and retirement dispersion in successive bands, the analyst can get a clear indication of whether there is a trend in either the life of the plant or in the dispersion of the retirements.[3]

[3] NARUC, *Public Utility Depreciation Practices*, at 113 (1996).

Another learned treatise, *Depreciation Systems*, offers similar guidance:

> The analyst must use good judgment when determining band widths. Many empirical procedures governing this choice have been developed. These include the selection bands of fixed width, often 3, 5, or 10 years; rolling bands, in which one band overlaps the next; and shrinking bands, in which the width of the band systematically decreases.
>
> A preferred approach is to select the bands based on the history and the activities that occurred during the period defined by the bands. Because placement bands are often used to describe property of a particular technology, a band could be chosen that will be wide enough to include all property of a similar technology. Experience bands may be chosen to include the calendar years during which a single force of retirement was of particular interest.
>
> Bands may be chosen to detect change in the survivor characteristics.[4]

[4] F.K. Wolf and W. C. Fitch, *Depreciation Systems*, at 186 (1994).

Witness Garrett does not explain why he has decided not to follow this guidance and instead choose only one placement and experience band.

Q What placement and experience bands did you use for purposes of your Study?

A. I used five or more placement/experience bands for each account at issue in this proceeding. I ran an overall placement band with two experience bands: the overall experience band, 1983–2018, and 1999–2018 to isolate experience in those transaction years. I also ran the 1969–2018 placement band with the 1983–2018 and 1999–2018 experience bands. If sufficient data existed for life analysis, I also ran an overall band of 1999–2018.

CURVE TRUNCATION

Q. Do you agree with witness Garrett's proposal to remove certain portions of the OLTS for the purpose of making mathematical comparisons?

A. No. By eliminating certain relevant data, witness Garrett seeks to match only the top segment of the curve.

TABLE 3

Account	OLT Matched by Garrett
378	100% to 55.24%[1]
380 Steel Services	100% to 40.79%[2]
380 Plastic Services	100% to 84.16%[3]
385	100% to 68.12%[4]

[1] Exhibit DJG-19 page 1

[2] Exhibit DJG-20, page 2

[3] Exhibit DJD-21, page 1

[4] Exhibit DJD-22, page 1

Particularly in the case of Account 380 Plastic Services, witness Garrett disregards significant portions of the OLT curve completely. His mathematical fitting criteria truncates the curve at age 37.5 with 84 percent surviving as he computes the OLT in Exhibit DJD-21, page 1. While I agree, less weight should be given to points at the bottom of the curve compared to other points along the curve, this data should not be completely excluded from the analysis. *Depreciation Systems* provides authoritative guidance as to what part of the curve to match:

> After plotting the observed curve, the analyst should first visually match the plotted data to make an initial judgment about the type curve that may be good fits. The analyst also must decide which points or section of the curve

> should be given the most weight. Points at the end of the curve are often based on fewer exposures and may be given less weight than the points based on larger samples. The weight placed on those points will depend on the size of the exposures. Often the middle section of the curve (that section ranging from approximately 80 percent to 20 percent surviving) is given more weight than the first and last sections. This middle section is relatively straight and is the portion of the curve that often best characterizes the survivor curve.[5]

Witness Garrett has provided no authority in support of his position to disregard entire segments of the observed life table curves. By ignoring results from the 80 to 20 percent surviving period, his methodology runs counter to academic guidance.

SUBJECT MATTER EXPERTS

Q. You state earlier that witness Garrett did not incorporate information from SMEs in his recommendations.

[5] F.K. Wolf and W. C. Fitch, *Depreciation Systems*, at 46–47 (1994) (emphasis added).

Why do you take issue with this?

A. Witness Garrett makes no indication in his testimony, exhibits, or workpapers that he reviewed or incorporated any information from Company experts in his life recommendations. Information provided by SME's on the specific plant and equipment being studied is of critical importance in the depreciation study process. In its 1996 edition of the publication *Public Utility Depreciation Practices*, NARUC advises against strict reliance on historical data and fitting, stating:

> Depreciation analysts should avoid becoming ensnared in the historical life study and relying solely on mathematical solutions. The reason for making an historic life analysis is to develop a sufficient understanding of history in order to evaluate whether it is a reasonable predictor of the future. The importance of being aware of circumstances having direct bearing on the reason for making an historical life analysis cannot be understated. The analyst should become familiar with the physical plant under study and its operating environment, including

talking with the field people who use the equipment being studied.[6]

For instance, witness Garrett ignores important information for Account 385-Industrial and Measuring Equipment. My interview notes state, that

> "Meters for these stations are in the meter account. This consists of all other assets serving the customer. They would be more parallel to a DRS than to a city gate. The environment where the industrial M&R stations are set is harsher than most DRS and they would have a slightly shorter life than the DRS."

Witness Garrett's recommendation of 41 years ignores this crucial information.

REASONABLENESS TEST

Q. You stated above that witness Garrett did not consider the life characteristics that would be normal or expected for similar assets found across North America. Why is this problematic?

[6] NARUC, *Public Utility Depreciation Practices*, at 126 (1996) (emphasis added).

A. The lives witness Garrett selected for the four accounts at issue are beyond what would reasonably be expected for the mix and types of assets within these accounts. Witness Garrett fails to take into account the shorter life expectations for individual retirement units (assets) within each account as compared to his recommendations. A summary of retirement units by account is presented in Exhibit No. __ (DAW-2), Document No. 3. If the majority of the dollars in a particular account are associated with assets that have projected lives between 20 and 40 years, an overall life for the account of 60 years for that account will not be reasonable. This is true even if mathematical curve matching on historical data for that account over the last 80 years mechanically produces a 60 year overall life. Simply recommending the output of a statistical model without validating against operational realities or reasonable norms is not an accurate way to set asset lives.

<u>**ACCOUNT LEVEL DISCUSSION**</u>

Account 378 – Measuring and Regulating Equipment

Q. Please describe you and witness Garrett's recommendations for Account 378- Measuring and Regulating Equipment?

A. I recommend increasing the existing service life for Account 378, which is currently 31 R1, to a 40 R1.5. This represents an increase of nine years. Witness Garrett proposes 46 R1, which is an increase of 15 years over the existing and six years beyond my recommendation. At December 31, 2018, the average age of survivors in this account is 9.07 years and the average age of retirements in this account is 20.70 years. This information demonstrates that this is a young account with little retirement experience for the majority of the assets.

Q. Do you agree with witness Garrett's basis for proposing a 46 R1 Curve?

A. No. There are a number of reasons I disagree with witness Garrett on the life for this account. First, witness Garrett does not appear to factor in the life expectations for specific assets in this account as communicated by Company SMEs. My interview notes on this account indicate the following factors that influence the life of this account:

> "They would expect a shorter life for DRS than for City Gates. They are more likely to be relocated and changed due to capacity

needs, and road improvement needs than the gates. The existing 31 years seems short operationally. DRS are on the side of the road in many cases. They are in the process of reviewing all of the DRS and will be replacing many of the DRS over the next few years. There were a number that were retired when moving away from low pressure areas."[7]

Second, witness Garrett's life analysis is flawed as discussed in an earlier section. Thus, his life analysis graphs are flawed as well.

Third, as also discussed earlier, witness Garrett only examines one band for his proposal. In contrast, I used five different placement and experience bands as shown in my workpapers. As stated in NARUC's *Public Utility Depreciation Practices*, it is important to look at different placement bands and experience bands:

"Placement bands may be used to show the effects and technological and material changes, whereas experience bands are used the show the effects of business and

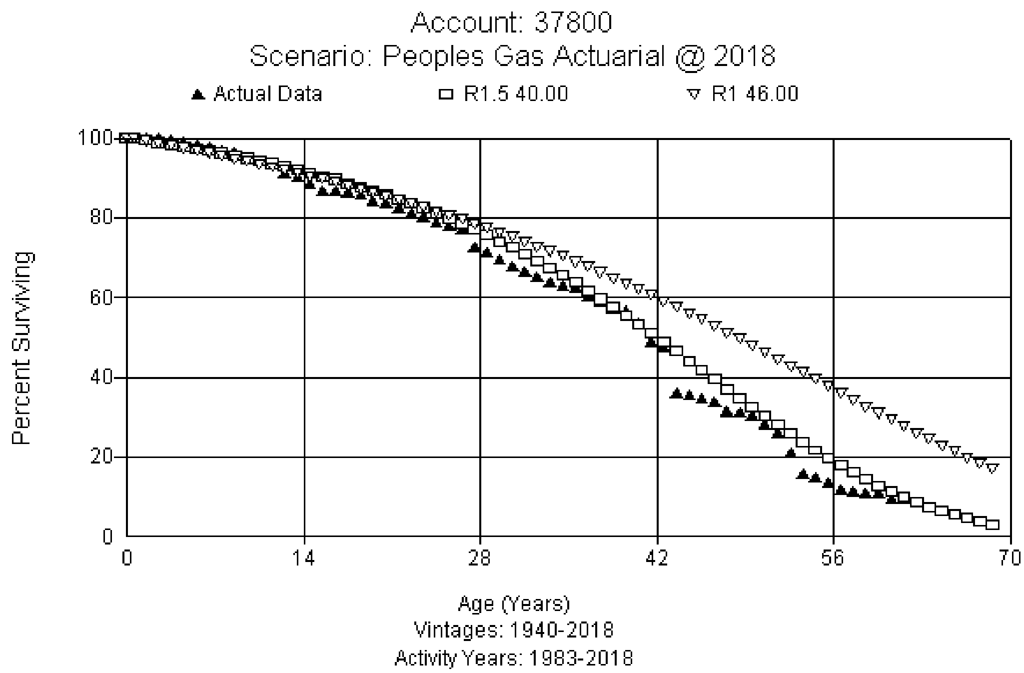
[7] Watson Direct Workpapers, Interview Notes.

> operational changes. Such banding is necessary because the analyst does not have access to a database wherein each factor (e.g., change in materials/technology or operational environment) is held constant.”[8]

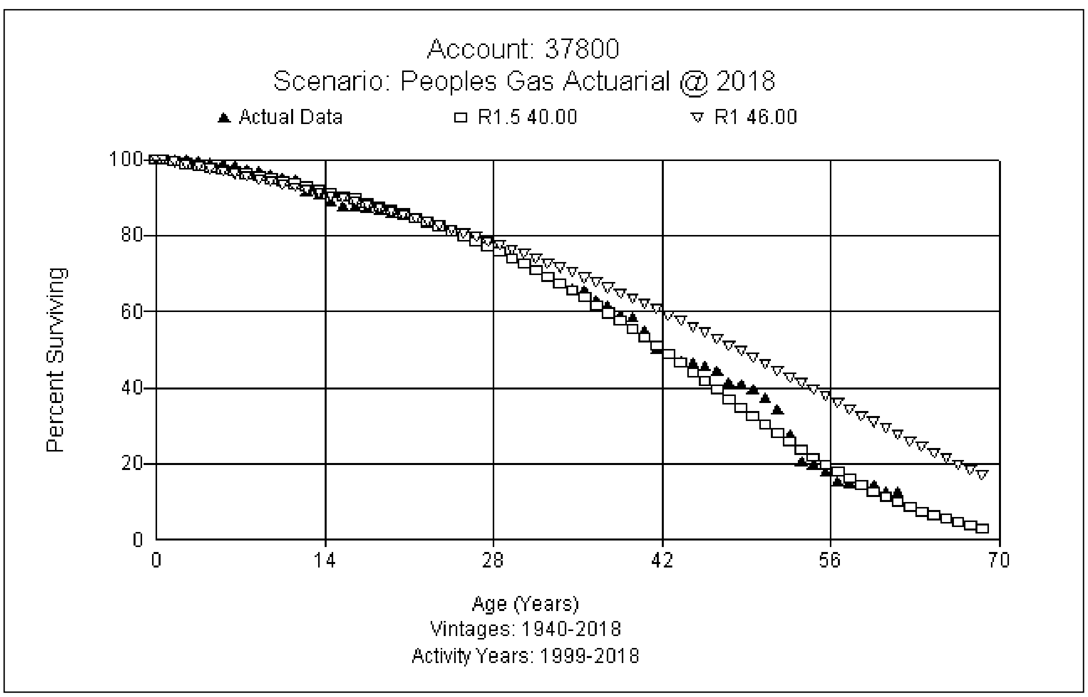
Q. What does a visual comparison over multiple bands show when correcting the previously discussed errors in witness Garrett’s analysis?

A. Below are graphs over various placement and experience bands. The dark triangles represent the observed life table, the rectangles represent the Company’s proposal, and the slanted triangles show witness Garrett’s proposal. The first graph shows the period 1940–2018 for the placement and correct 1983-2018 experience band with both my recommendation and that of witness Garrett. My recommendation is clearly a better match.

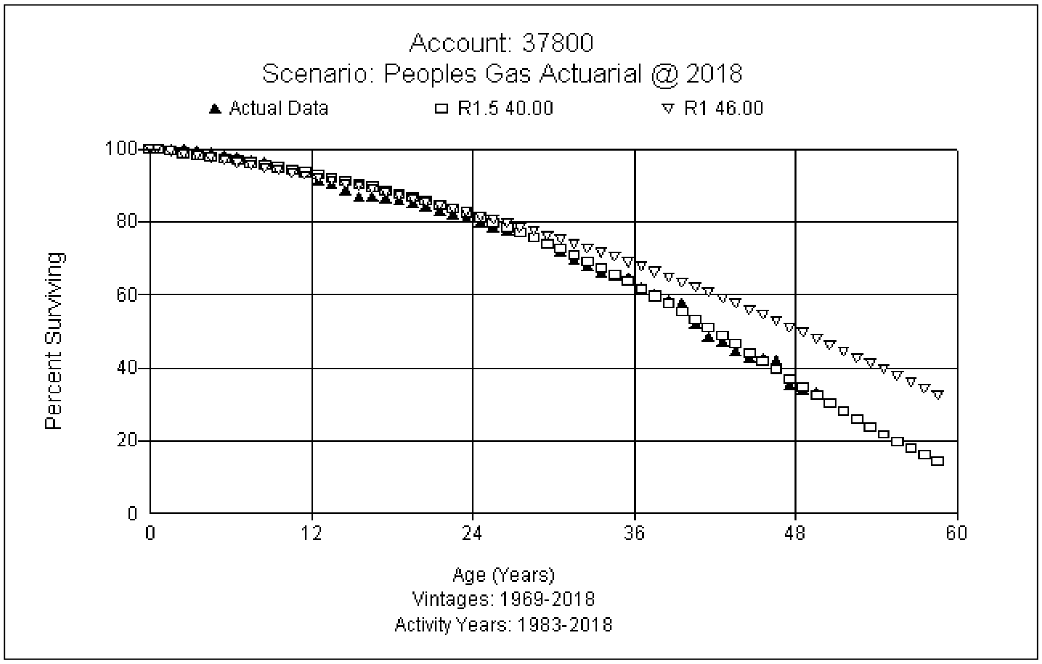
[8] NARUC, *Public Utility Depreciation Practices*, at 125 (1996).



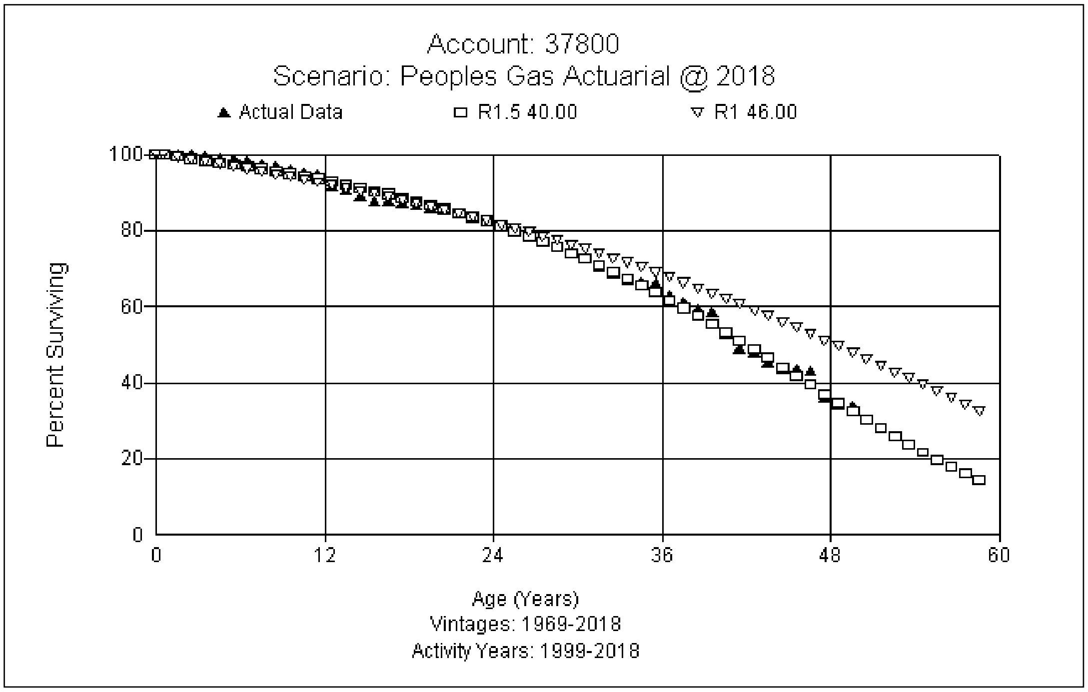
A narrower experience band of 1999-2018 with the same placement year 1940-2018 again shows the Company's proposal is a better visual match.



A change in the placement band to 1969-2018 with the experience band of 1983-2018 again shows the Company's proposal is a better visual match.



A change in the placement band to 1969-2018 with the experience band of 1999-2018 again shows the Company's proposal is a better visual match.



By selecting only one band (and having the errors discussed earlier), witness Garrett's analysis doesn't fully analyze or accurately represent the Company's historical experience.

Q. Are there other aspects that you considered in your 40 R1.5 recommendation?

A. Yes. The fit I selected was one of 21 different fits across multiple placement and experience bands, which can be found in my workpapers. There are a variety of assets with a mix of lives recorded in this account and my movement to a 40-year life is reasonable. Further, witness Garrett's data is flawed.

Q. Do you have any additional comments on the life recommendation for this account?

A. Yes. My life recommendation of 40-R1.5 recognizes both the indications in the life analysis and the Company-specific information from the SMEs. Further, my analysis recommends an *increase* of 9 years over the existing life, which translates to a 29 percent increase to the life. To move the life another six years from my recommendation is excessive. When compared to existing parameters, witness Garrett’s life represents an increase of 15 years or a 48 percent change. This level of change without operational reasons at one time is unreasonable, is not supported by the evidence, and should be rejected.

Q. How do witness Garrett’s mathematical fitting criteria appear using the historical data using the appropriate bands?

A. When using the 1940-2018 placement band and 1983-2018 experience band, the overall sum of squares difference of my recommendation is 0.1260 versus witness Garrett’s of 0.9109. It should be noted that the smaller the number, the closer the match. Using witness Garrett’s proposed 1 percent exposure criteria, the sum of squares difference is 0.0565 and 0.1879 between the Company's proposal and OPC's, respectively. See Exhibit (DAW-2), Document No. 4. Using Company history and the correct placement and experience band, the Company's proposal is the superior proposal for visual fitting as well as mathematical fitting.

Q. What life did witness Garrett recommend for this account in the recent Florida City Gas case?

A. In Docket 20170179-GU for Florida City Gas, witness Garrett recommended a 30 S3[9] life for this account. It does not seem logical that Peoples would have assets in this account that last **<u>53.3 percent</u>**[10] longer than witness Garrett's recommendation for another Florida utility.

Account 380 – Services Steel

Q. Please describe your and witness Garrett's recommendations for Account 380- Services Steel?

A. I recommend increasing the existing service life for Account 380, Services Steel, which is currently 50 R0.5, to a 52 R0.5. This represents an increase of 2 years.

[9] Docket 20170179-GU, Exhibit DJG-20 and 21.
[10] (46 – 30)/ 30 = 53.3 percent

witness Garrett proposes 57 R0.5, which is an increase of seven years over the existing and five years beyond my recommendation. At December 31, 2018, the average age of survivors in this account is 23.14 years and the average age of retirements in this account is 26.29 years. This information demonstrates the account is more mature with assets that are replaced on an ongoing basis.

Q. Do you agree with witness Garrett's basis for proposing a 57 R0.5 Curve?

A. No. There are a number of reasons I disagree with witness Garrett on the life for this account. First, witness Garrett does not appear to factor in the life expectations for specific assets in this account as communicated by Company SMEs. My interview notes on this account indicate the following factors that influence the life of this account:

> Forces of retirements are corrosion, dig-ins, and relocations. Other factors influencing the life of this account are the Company's policy to replace steel services with plastic if a main changes from steel to plastic.[11]

[11] Watson Exhibit No. __ (DAW-1), Page 87.

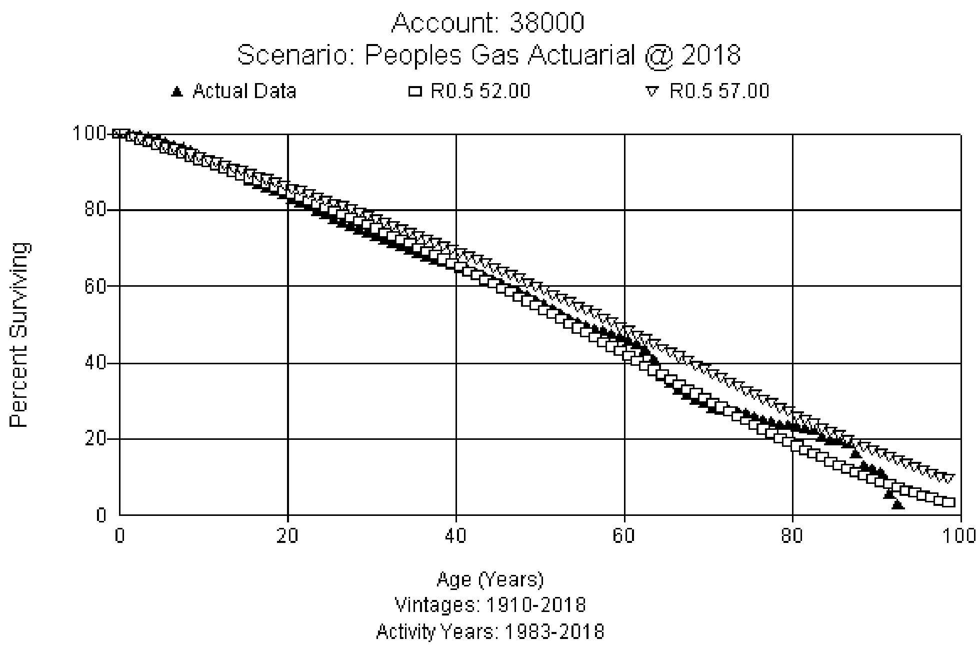
Second and third, as discussed earlier, witness Garrett's life analysis is flawed and he only examines one band for his proposal. In contrast, I used seven different placement experience bands as shown in my workpapers. As stated earlier, NARUC's *Public Utility Depreciation Practices* notes that it is important to look at different placement bands and experience bands: "Placement bands may be used to show the effects and technological and material changes, whereas experience bands are used the show the effects of business and operational changes. Such banding is necessary because the analyst does not have access to a database wherein each factor (e.g., change in materials/technology or operational environment) is held constant."[12]

Q. What does a visual comparison over multiple bands show?

A. Below are graphs over various placement and experience bands. The dark triangles represent the observed life table, the rectangles represent the Company's proposal, and the slanted triangles show witness Garrett's proposal. The graph below shows our competing selections for the period 1910–2018 for the placement band and 1983-

[12] NARUC, *Public Utility Depreciation Practices*, at 125 (1996).

2018 experience band. My recommendation is clearly a superior match.



Q. Are there other aspects that you considered in your 52 R0.5 recommendation?

A. Yes. The fit I selected was one of 25 different fits across multiple placement and experience bands, which can be found in my workpapers. There are a variety of assets with a mix of lives recorded in this account and my movement to a 52-year life is reasonable.

Q. Do you have any additional comments on the life recommendation for this account?

A. Yes. My life recommendation of 52-R0.5 recognizes both the indications in the life analysis and the Company-specific information from the SMEs. Further, my analysis recommends an *increase* of two years over the existing life, which translates to a 4 percent increase to the life. To move the life another five years from my recommendation is excessive. When compared to existing parameters, witness Garrett's life represents an increase of seven years or a 14 percent change. This level of change without operational reasons at one time is unreasonable, is not supported by the evidence, and should be rejected.

Q. How do witness Garrett's mathematical fitting criteria appear using the historical data through 2018?

A. Yes. When using the 1910-2018 placement band and the correct 1983-2018 experience band, the overall sum of squares difference of my recommendation is 0.0643 versus witness Garrett's of 0.1644. Again, the smaller the number, the closer the match. Using witness Garrett's proposed 1 percent exposure criteria, the sum of squares difference is 0.0239 and 0.0992 between the Company's proposal and witness Garrett's, respectively. See Exhibit No. __ (DAW-2), Document No. 5. Using Company history and the correct placement and experience band, the Company’s proposal is the superior proposal for visual fitting as well as mathematical fitting.

Q. What life did witness Garrett recommend for this account in the recent Florida City Gas case?

A. In Docket 20170179-GU for Florida City Gas, witness Garrett recommended a 45 S6[13] life for this account. It does not seem logical that Peoples would have assets in this account that last 26.7 percent[14] longer than witness Garrett’s recommendation for another Florida utility.

Account 380 – Plastic Services

Q. Please describe your and witness Garrett’s recommendations for Account 380-Plastic Services?

A. I recommend retaining the existing service life for Account 380-Plastic Services, which is currently 55 R1.5. Witness Garrett proposes 64 R1.5, which is an increase of nine years over the existing and my recommendation. In Peoples’ last Study filed in Docket No. 20160159-GU, witness Garrett proposed 55 R.15 and only five years later his recommendation has changed significantly. At

[13] Docket 20170179-GU, Exhibit DJG-20 and 21.
[14] (57 – 45)/ 45 = 26.7 percent

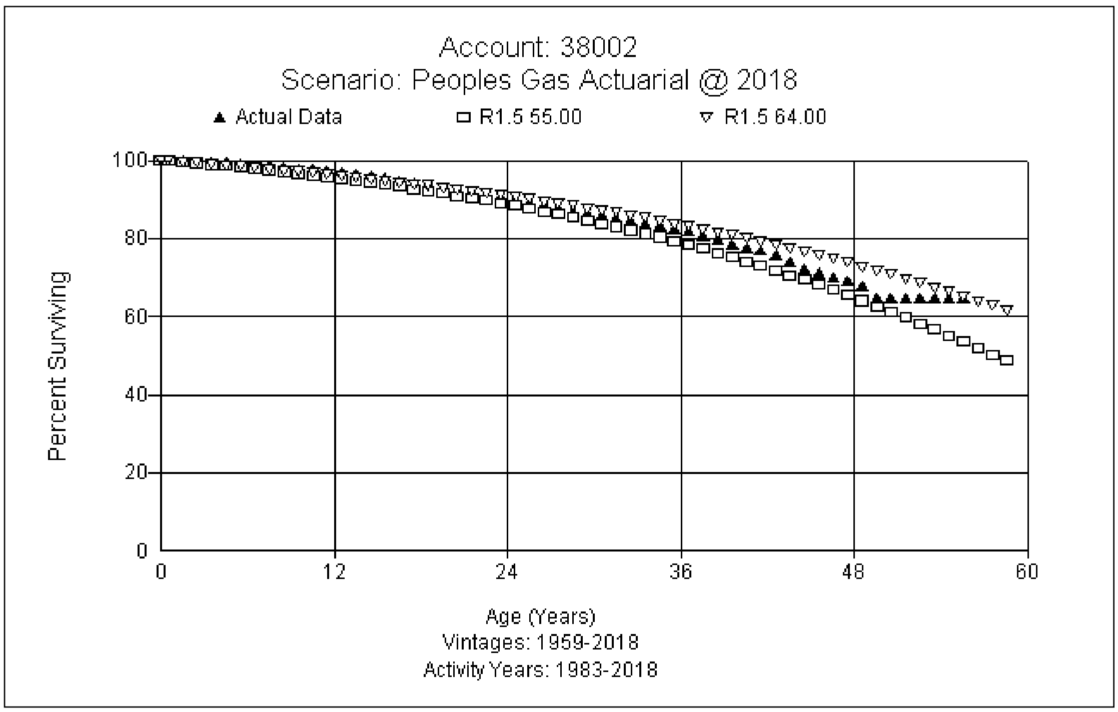
December 31, 2018, the average age of survivors in this account is 11.74 years and the average age of retirements in this account is 16.28 years. This information demonstrates that this is a young account with little retirement experience for the majority of the assets.

Q. Do you agree with witness Garrett's basis for proposing a 64 R1.5 Curve?

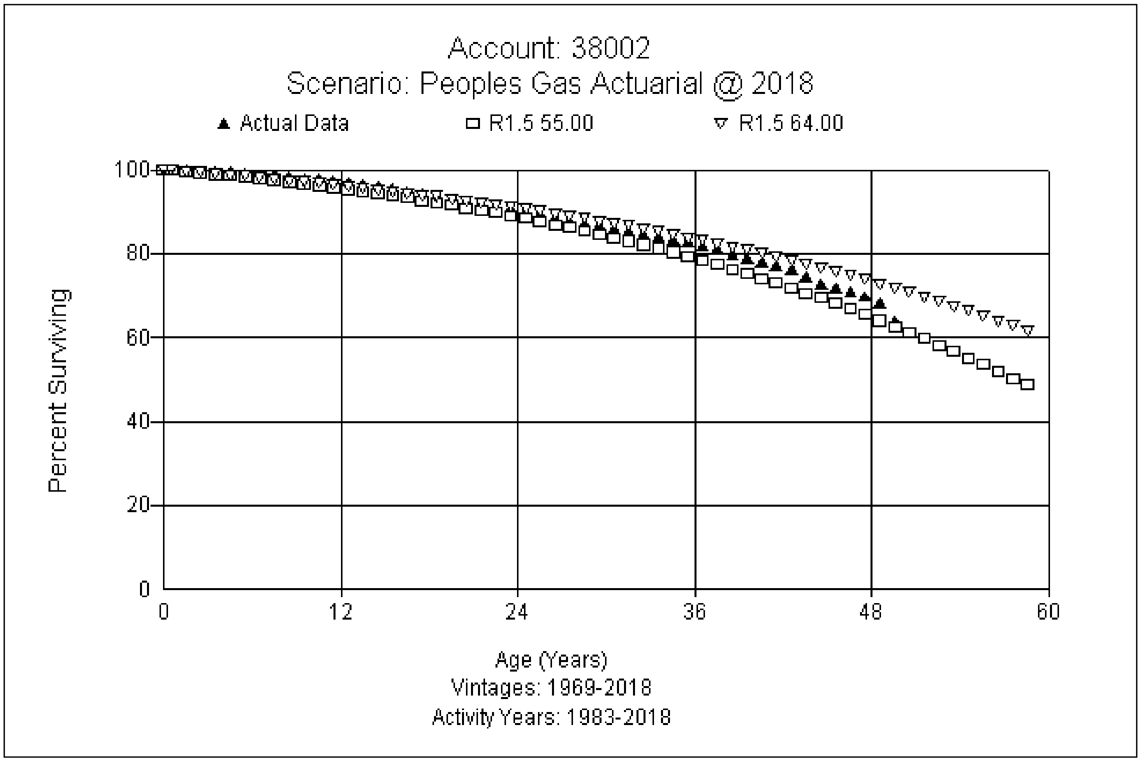
A. No. There are a number of reasons I disagree with witness Garrett on the life for this account. First, as discussed earlier, witness Garrett's life analysis is flawed. Second, as discussed earlier and as with his other accounts, witness Garrett only examines one band for his proposal. In contrast, I used eight different placement experience bands as shown in my workpapers. Third, the use of witness Garrett's 1 percent of exposure criteria models only 100 percent to 84 percent, losing valuable data in his proposed truncation.

Q. What does a visual comparison over multiple bands show?

A. Below are graphs over various placement and experience bands. The dark triangles represent the observed life table, the rectangles represent the Company's proposal, and the slanted triangles show witness Garrett’s proposal. The first graph shows Peoples’ competing recommendations over the period 1959–2018 for the placement band and the correct 1983-2018 experience band. As with other accounts, my recommendation is a better match to the Company’s actual experience.



A different placement and experience band of 1959 -2000 and 1999-2019 again shows the Company’s proposal is still a better curve match than witness Garrett’s proposal.



Q. Are there other aspects that you considered in your 55 R1.5 recommendation?

A. Yes. The fit I selected was one of 37 different fits across multiple placement and experience bands, which can be found in my workpapers. There are a variety of assets with a mix of lives recorded in this account and my retention a 55-year life is reasonable.

Q. Do you have any additional comments on the life recommendation for this account?

A. Yes. My life recommendation of 55 R1.5 recognizes both the indications in the life analysis and the Company-specific information from the SMEs. Further, my analysis recommends no change over the existing life. To move the life another nine years from my recommendation is excessive. When compared to existing parameters, witness Garrett's life represents an increase of nine years or a 14 percent change. This level of change without operational reasons at one time is unreasonable, is not supported by the evidence, and should be rejected.

Q. What life did witness Garrett recommend for this account in the recent Florida City Gas case?

A. In Docket 20170179-GU for Florida City Gas, witness Garrett recommended a 54 R2.5[15] life for this account. It does not seem logical that Peoples would have assets in this account that last 18.5 percent[16] longer than witness Garrett's recommendation for another Florida utility.

Account 385 – Measuring and Industrial Regulating Stations

Q. Please describe your and witness Garrett's recommendations for Account 385-Measuring and Industrial Regulating

[15] Docket 20170179-GU, Exhibit DJG-20 and 21.
[16] (64 – 54)/ 54 = 18.52 percent

Stations?

A. I recommend increasing the existing service life for Account 385, which is currently 32 R4, to a 37 R3. This represents an increase of five years. Witness Garrett proposes 41 R3, which is an increase of nine years over the existing and four years beyond my recommendation. At December 31, 2018, the average age of survivors in this account is 21.35 years and the average age of retirements in this account is 21.89 years. This information demonstrates that this is an account with older assets and retirements that retirement age similar to the asset of the asset.

Q. Do you agree with witness Garrett's basis for proposing a 41 R3 Curve?

A. No. There are a number of reasons I disagree with witness Garrett on the life for this account. First, witness Garrett does not appear to factor in the life expectations for specific assets in this account as communicated by Company SMEs. As stated in Exhibit No. __ (DAW-1), page 58-59 of my direct testimony, I mention factors that influence the life of this account:

Company personnel stated that meters for these stations are booked in the meter account, and that the assets in this account include all other assets needed to serve the customer Company personnel believe that the assets in this account are more similar to a distribution regulator station in account 37800 than a city gate station in account 37900. Operationally Company personnel state that the operating environment in this account is harsher than most assets in a district regulator station. Consequently, from an operational perspective, Company personnel anticipate that the life of this account would be shorter than the life of Account 37800.

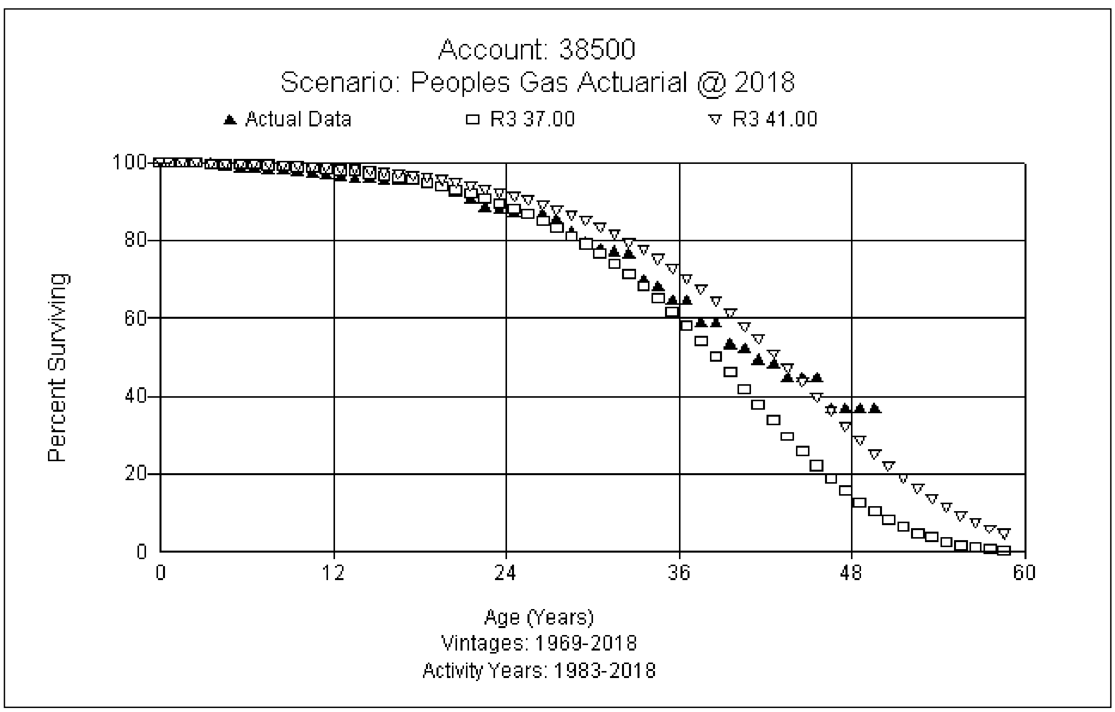
Second, as, with other accounts, witness Garrett only examines one band for his proposal. In contrast, I used seven different placement and experience bands as shown in my workpapers.

Third, the use of an incorrect experience band distorts the observed life table results.

Finally, the use Company history as shown below validates the superiority of the Company’s proposal compared to witness Garrett’s.

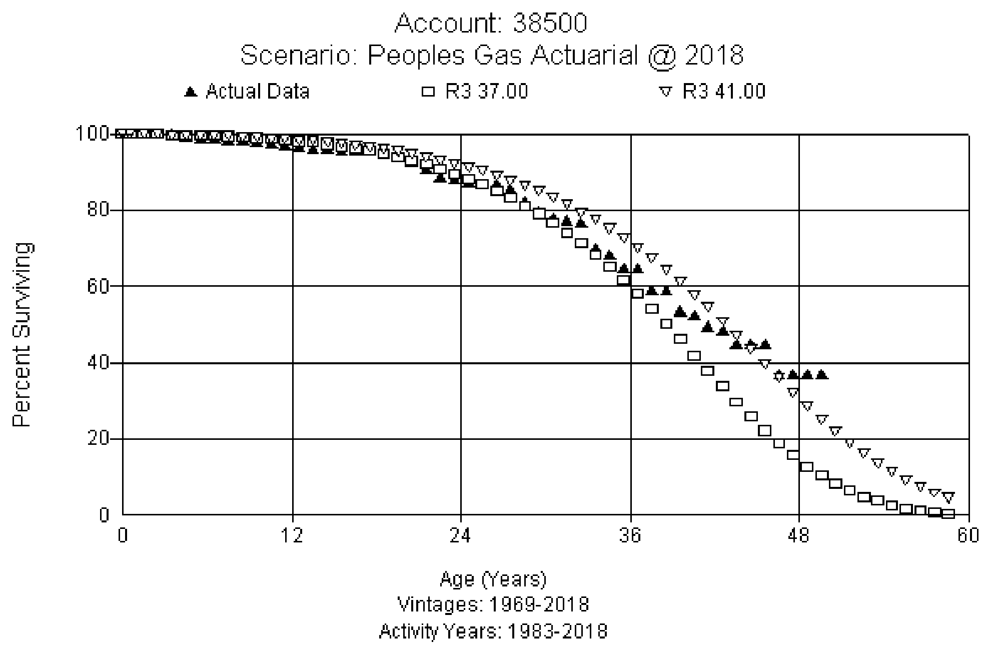
Q. What does a visual comparison over multiple bands show?

A. Below are graphs over various placement and experience bands. The dark triangles represent the observed life table, the rectangles represent the Company’s proposal, and the slanted triangles show witness Garrett’s proposal. The first graph shows the period 1958–2018 for the placement band and 1983-2018 experience band.



Cleary the Company’s proposed 37 R3 is a better visual choice over all points.

A shorter placement band of 1969-2018 and experience band of 1983-2018 below also again affirms the Company's proposal is a better fit of the activity in this account.



Q. Are there other aspects that you considered in your 37 R3 recommendation?

A. Yes. The fit I selected was one of 26 different fits across multiple placement and experience bands, which can be found in my workpapers. There are a variety of assets with a mix of lives recorded in this account and my movement to a 37-year life is reasonable.

Q. Do you have any additional comments on the life recommendation for this account?

A. Yes. My life recommendation of 37 R3 recognizes both the indications in the life analysis and the Company-specific information from the SMEs. Further, my analysis recommends an *increase* of five years over the existing life, which translates to a 16 percent increase to the life. To move the life another seven years from my recommendation is excessive. When compared to existing parameters, witness Garrett's life represents an increase of 9 years or a 28 percent change. This level of change without operational reasons at one time is unreasonable, is not supported by the evidence, and should be rejected.

Q. How does witness Garrett's mathematical fitting criteria appear using the historical data through 2018?

A. Yes. When using the 1958-2018 placement band and a correct 1983-2018 experience band, the overall sum of squares difference is a closer 0.0416 for my recommendation than the 0.4313 for witness Garrett's. Using witness Garrett's proposed 1 percent exposure criteria, the sum of squares difference is 0.0100 and .0606 between the Company's proposal and witness Garrett's as well. See my Exhibit No. (DAW-2), Document No. 6. Using Company history and the correct placement and experience band, the Company's proposal is the superior proposal for visual fitting as well as mathematical fitting.

Q. What life did witness Garrett recommend for this account in the recent Florida City Gas case?

A. In Docket 20170179-GU for Florida City Gas, witness Garrett recommended a 37 R2[17] life for this account. It does not seem logical that Peoples would have assets in this account that last 10 percent longer than witness Garrett's recommendation for another Florida utility.

NET SALVAGE

Q. What accounts are being challenged by witness Garrett?

A. Witness Garrett has recommended changes in life for six accounts in the distribution function.[18] Table 4 shown below is a summary of the plant accounts: the Company's existing and proposed net salvage percentages and OPC's proposed net salvage percentages.

[17] Docket 20170179-GU, Exhibit DJG-20 and 21.
[18] Direct Testimony of David J. Garrett, page 102.

Table 4 – Summary by Proposed-Life Parameters by Account

Acct		Approved Net Salvage percent	Company Proposed Net Salvage percent	OPC Proposed Net Salvage percent
376	Mains Steel	-40	-60	-50
376	Mains Plastic	-25	-40	-33
380	Services Steel	-100	-150	-125
380	Services Plastic	-55	-80	-68
382	Meter Install	-20	-30	-25
384	House Regulator Install	-20	-30	-25

Q. What is the basic premise of witness Garrett's opposition to your net salvage recommendations?

A. Witness Garrett and I agree on the analysis methods and I believe that witness Garrett has acknowledged the significant cost of removal being incurred by Peoples, which has resulted in much more negative net salvage when comparing to the existing net salvage percentages. However, witness Garrett's opposition is based on his belief that the magnitude of the net salvage changes too substantial.[19] Witness Garrett does not mention that Peoples has not made changes to its net salvage

[19] Direct Testimony of David J. Garrett, 101: 15-17.

parameters for these almost all of these six accounts since Florida Docket 20110232, nearly 10 years ago. The Company’s last depreciation study in 2016 retained the existing net salvage parameters for those accounts.[20]. Hence, the changes in net salvage rates are needed to align capital recovery for People’s assets. Another factor witness Garrett fails to consider is that the goal of setting depreciation rates is to recover remaining investment and future removal cost over the remaining life of the assets. The trends toward higher negative net salvage need to be reflected in the Company’s proposed rates so as not to create intergenerational inequities. Also, my net salvage proposals for numerous Peoples’ accounts are still moderated when compared to actual experience.

Q. Do you have any other comments on witness Garrett’s overall net salvage approach before discussing the individual accounts at issue?

A. Yes. Witness Garrett’s proposal for net salvage for all six of the accounts is to arbitrarily halve the increase I recommend. He does not provide any other metrics or

[20] In the Company’s last case in Docket 201600159-GU, witness Garrett’s proposal and the settlement agreement adopted based on his recommendations which left net salvage parameters at existing levels with the exception of Account 376-Steel Mains.

analysis to show how his proposals compare to Peoples' actual experience. In the following sections I will provide a brief summary of the account net salvage and present some tables and graphs that will provide explanation and detail to support Peoples' proposals for the accounts in which witness Garrett and I disagree.

Q. What factors are causing removal costs to increase?

A. Many factors are causing an increase in removal cost for distribution plant including: the increase in labor cost due to the longer lives of assets, changes in safety and environmental requirements, requirements of working in urban areas, and overall contract labor cost increases.[21] All these factors are inextricably bound causing an increase in removal cost for each of the accounts discussed above. From this perspective, it is not remarkable that the cost to remove from service (and properly dispose of, when appropriate) steel mains and services, plastic mains and services, meter installations and house regulator installations and other assets are increasing.

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[21] Direct Testimony Dane A. Watson, Exhibit No. __ (DAW-1), page 65-67.

Q. How have actual removal costs changed for these accounts over time?

A. The tables and graphs for each of the accounts discussed above provide clear evidence that over time, the Company is experiencing increasingly negative net salvage (caused by increasing removal cost) while the approved net salvage rate has not changed in a number of years. Clearly, the level of negative net salvage and increasing removal cost differs from the currently approved levels and while numerous Peoples' proposed net salvage percentages are a significant increase in negative net salvage, it is warranted and should be approved.

A. Account 376-Steel Mains

Q. Will you summarize the proposals regarding net salvage for Account 376-Steel Mains?

A. Yes. The approved net salvage is a -40 percent. In earlier years, the Commission had higher negative net salvage embedded in Peoples' rates for this account. From 1996-2006, the approved net salvage rate for this account was -45 percent. From 2006-2011, the approved net salvage rate was -50 percent. From, 2011 to 2016, the approved net salvage rate changed to negative 40 percent. Witness Garrett is proposing to arbitrarily halve my recommended change and recommends a -50 percent net salvage instead of my proposed is a -60 percent. My proposed net salvage percentage is a gradual movement that the Commission has approved in the past.

Q. Can you demonstrate that the net salvage for Account 376-Steel Mains is moving more negative?

A. Yes. The information below was extracted from the net salvage analysis provided in Exhibit No. __ (DAW-1), Appendix D of my direct testimony. These are Peoples' moving average net salvage percentages for the past 10 years.

Table 5: Account 376-Steel, Net Salvage 2009-2018

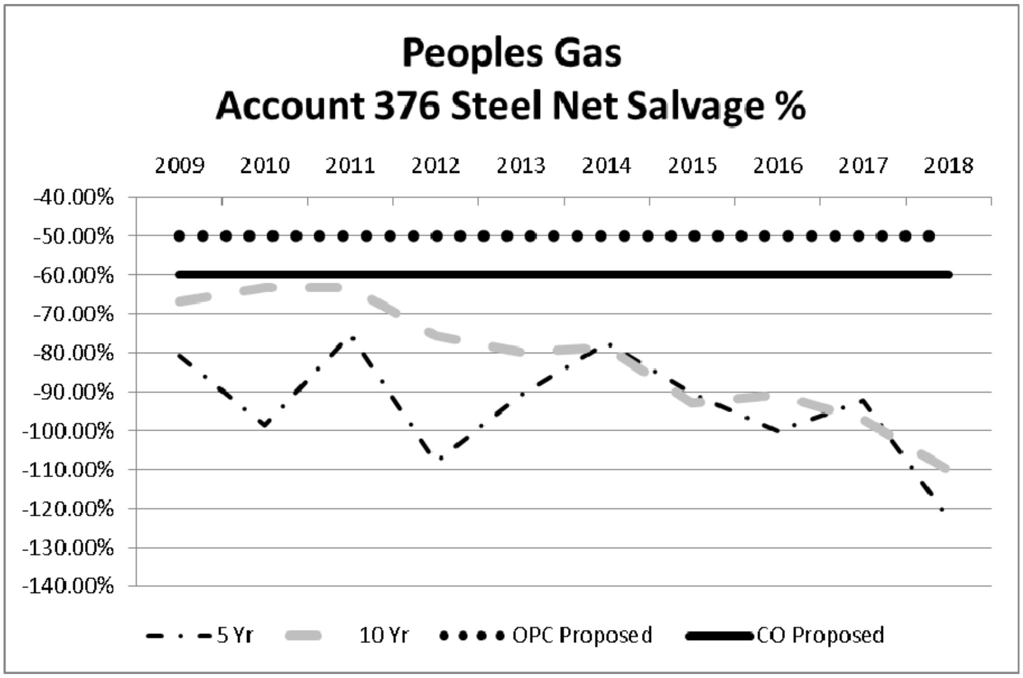
376 Steel Year	Net Salv. %	2- yr Net Salv. %	3- yr Net Salv. %	4- yr Net Salv. %	5- yr Net Salv. %	6- yr Net Salv. %	7- yr Net Salv. %	8- yr Net Salv. %	9- yr Net Salv. %	10- yr Net Salv. %
2009	-275%	-183%	-120%	-133%	-81%	-85%	-71%	-71%	-68%	-67%
2010	-38%	-99%	-104%	-87%	-99%	-71%	-75%	-65%	-66%	-63%
2011	-52%	-46%	-76%	-82%	-75%	-84%	-66%	-70%	-63%	-63%
2012	-320%	-113%	-85%	-107%	-108%	-98%	-104%	-83%	-85%	-76%
2013	-53%	-115%	-87%	-75%	-91%	-94%	-87%	-93%	-77%	-80%
2014	-84%	-71%	-98%	-86%	-77%	-89%	-91%	-86%	-91%	-79%
2015	-107%	-94%	-82%	-101%	-90%	-83%	-92%	-94%	-90%	-93%
2016	-98%	-102%	-95%	-86%	-100%	-92%	-86%	-93%	-94%	-91%
2017	-116%	-108%	-107%	-100%	-92%	-103%	-96%	-90%	-96%	-97%
2018	-401%	-187%	-150%	-137%	-123%	-112%	-121%	-112%	-105%	-110%

Q. How should the Commission interpret and correlate the information in the above table to witness Garrett’s and Peoples’ proposals on net salvage?

A. First and foremost is that even 10 years ago, the net salvage indications were nearly at or above -60 percent. Between 2011-2016, the approved net salvage percentage was -60 percent. This is the most telling and important information for the Commission, in that the approved -40 percent was about a third to one half of the Company’s experience 10 years ago. Peoples’ net salvage proposal for this account is a necessary step to help increase that recovery and reduce the deferral of recovery.

Q. Is there anything else that would assist the Commission in evaluating the net salvage proposals for Account 376-Steel Mains?

A. Yes. The graph below illustrates Peoples’ net salvage experience over the past 10 years. The solid black line is my proposed -60 percent, which is above (less negative) than the more recent 5 and 10 year averages.



This further supports the idea that my recommendation includes the gradualism that witness Garrett espouses. While it is a significant change, my proposed -60 percent has been consistently experienced by Peoples over the most recent 10 years and should be approved.

B. Account 376-Plastic Mains

Q. Will you summarize the proposals regarding net salvage for Account 376-Plastic Mains?

A. Yes. The approved net salvage is a -25 percent, which has been the same since 2011. Witness Garrett is proposing to arbitrarily halve my recommended change and move the net salvage to -33 percent. My proposal is a -

40 percent.

Q. Can you demonstrate that the net salvage for Account 376 Plastic Mains is moving more negative?

A. Yes. The information below was extracted from the net salvage analysis provided in Exhibit No. __ (DAW-1), Appendix D of my direct testimony. These are Peoples' moving average net salvage percentages for the past 10 years.

Table 6: Account 376-Plastic Net Salvage 2009-2018

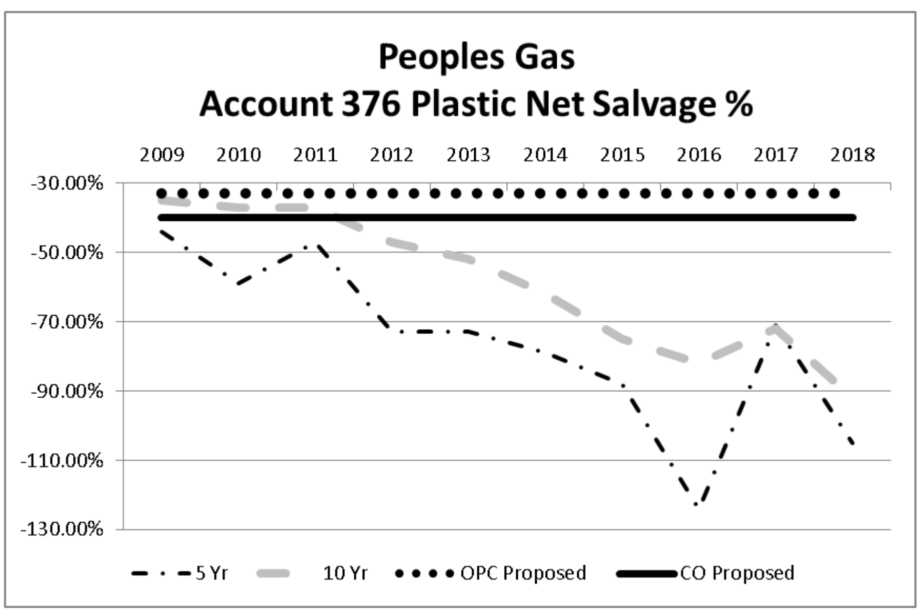
376 Plastic Year	Net Salv. %	2- yr Net Salv. %	3- yr Net Salv. %	4- yr Net Salv. %	5- yr Net Salv. %	6- yr Net Salv. %	7- yr Net Salv. %	8- yr Net Salv. %	9- yr Net Salv. %	10- yr Net Salv. %
2009	-84%	-63%	-51%	-57%	-44%	-39%	-35%	-35%	-35%	-35%
2010	-71%	-80%	-64%	-53%	-59%	-46%	-42%	-37%	-38%	-37%
2011	-32%	-41%	-55%	-52%	-47%	-51%	-43%	-40%	-36%	-37%
2012	-527%	-85%	-82%	-83%	-73%	-64%	-67%	-57%	-52%	-47%
2013	-53%	-103%	-70%	-70%	-73%	-67%	-61%	-64%	-56%	-52%
2014	-134%	-75%	-111%	-80%	-79%	-80%	-74%	-67%	-69%	-62%
2015	-125%	-128%	-90%	-115%	-88%	-87%	-87%	-80%	-73%	-75%
2016	-149%	-138%	-137%	-106%	-124%	-100%	-98%	-96%	-90%	-82%
2017	-31%	-59%	-69%	-75%	-71%	-81%	-73%	-73%	-74%	-72%
2018	-464%	-85%	-98%	-102%	-105%	-95%	-105%	-94%	-93%	-92%

Q. How should the Commission interpret and correlate the information in the above table to witness Garrett's and Peoples' proposals on net salvage?

A. First and foremost is that even 10 years ago, the net salvage indications were nearly at or above -40 percent for most bands. This is the most telling and important information for the Commission, in that the approved -25 percent is much lower than the Company's experience. Peoples' net salvage proposal for this account is a necessary step to help increase that recovery and reduce the deferral of recovery.

Q. Is there anything else that would assist the Commission in evaluating the net salvage proposals for Account 376-Plastic Mains?

A. Yes. The graph below illustrates Peoples' net salvage experience over 10 years. The solid black line is my proposed -40 percent, which is above (less negative) than the more recent 5 and 10 year averages.



This further supports the idea that my recommendation includes the gradualism that witness Garrett espouses. While it is a significant change, my proposed -40 percent has been consistently experienced by Peoples over the most recent 10 years and should be approved.

C. Account 380-Steel Services

Q. Will you summarize the proposals regarding net salvage for Account 380-Steel Services?

A. Yes. The approved net salvage is a -100 percent, which has been in place since 2011. From 2006-2011, the approved net salvage for this account was -90 percent. witness Garrett recommends -125, whereas my proposal is a -150 percent.

Q. Can you demonstrate that the net salvage for Account 380-Steel Services is moving more negative?

A. Yes. The information below was extracted from the net salvage analysis provided in Exhibit No. __ (DAW-1), Appendix D of my direct testimony. These are Peoples' moving average net salvage percentages for the past 10 years.

Table 7: Account 380-Steel Net Salvage 2009-2018

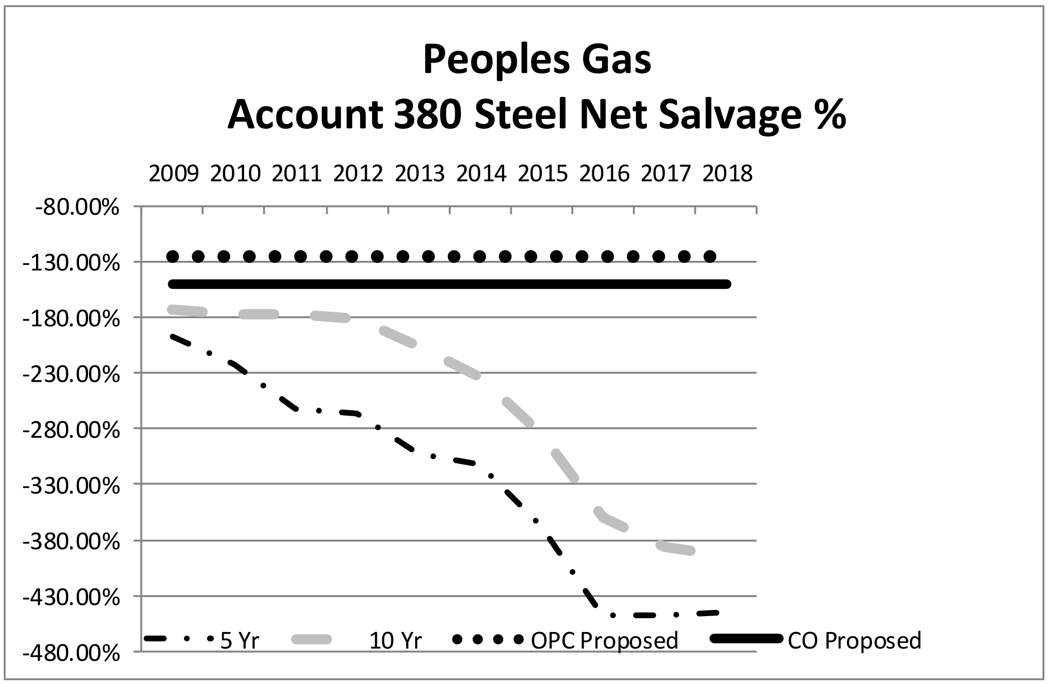
380 Steel Year	Net Salv. %	2- yr Net Salv. %	3- yr Net Salv. %	4- yr Net Salv. %	5- yr Net Salv. %	6- yr Net Salv. %	7- yr Net Salv. %	8- yr Net Salv. %	9- yr Net Salv. %	10- yr Net Salv. %
2009	-351%	-312%	-268%	-214%	-197%	-184%	-177%	-173%	-174%	-173%
2010	-337%	-345%	-318%	-276%	-223%	-204%	-190%	-183%	-178%	-178%
2011	-169%	-242%	-282%	-283%	-262%	-218%	-202%	-189%	-182%	-178%
2012	-192%	-180%	-224%	-260%	-266%	-254%	-216%	-201%	-189%	-182%
2013	-375%	-322%	-285%	-293%	-303%	-300%	-280%	-241%	-222%	-207%
2014	-367%	-372%	-337%	-308%	-312%	-317%	-312%	-291%	-253%	-234%
2015	-541%	-463%	-430%	-397%	-368%	-366%	-364%	-354%	-326%	-285%
2016	-667%	-597%	-524%	-480%	-448%	-419%	-412%	-407%	-393%	-360%
2017	-353%	-473%	-495%	-468%	-447%	-426%	-404%	-400%	-397%	-386%
2018	-380%	-367%	-435%	-459%	-445%	-433%	-416%	-400%	-397%	-394%

Q. How should the Commission interpret and correlate the information in the above table to witness Garrett’s and Peoples’ proposals on net salvage?

A. First and foremost is that even 10 years ago, the net salvage indications were nearly at or above -100 percent! This is the most telling and important information for the Commission, in that the approved -100 percent, which is much lower than the Company’s recent experience. Peoples’ net salvage proposal for this account is a necessary step to help increase that recovery and reduce the deferral of recovery.

Q. Is there anything else that would assist the Commission in evaluating the net salvage proposals for Account 380-Steel Services?

A. Yes. The graph below illustrates Peoples' net salvage experience over the past 10 years. The solid black line is my proposed -150 percent, which is above (less negative) than the more recent 5 and 10 year averages.



This further supports the idea that my recommendation includes the gradualism that witness Garrett espouses. While it is a significant change, my proposed -150 percent has been consistently experienced by Peoples over the most recent 10 years and should be approved. By contrast, witness Garrett's -125 percent would lie entirely above this chart and reflect none of Peoples' experience over the past decade.

D. Account 380-Plastic Services

Q. Will you summarize the proposals regarding net salvage for Account 380-Plastic Services?

A. Yes. The approved net salvage is a -55 percent, which has been the same since 2011. From 2006-2011, the approved net salvage rate for this account was -50 percent. Witness Garrett's proposal is -68 percent. My proposed is a -80 percent.

Q. Can you demonstrate that the net salvage for Account 380-Plastic Services is moving more negative?

A. Yes. The information below was extracted from the net salvage analysis provided in Exhibit No. __ (DAW-1), Appendix D of my direct testimony. These are Peoples' moving average net salvage percentages for the past 10 years.

Table 8: Account 380- Plastic Net Salvage 2009-2018

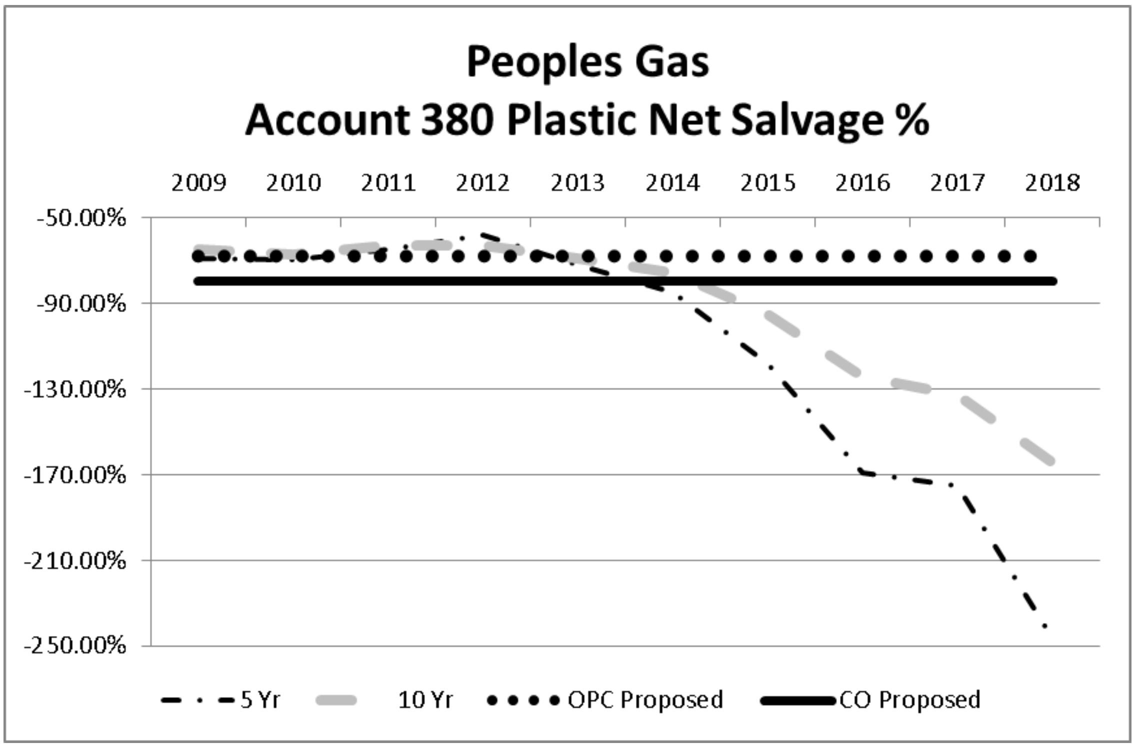
380 Plastic Year	Net Salv. %	2- yr Net Salv. %	3- yr Net Salv. %	4- yr Net Salv. %	5- yr Net Salv. %	6- yr Net Salv. %	7- yr Net Salv. %	8- yr Net Salv. %	9- yr Net Salv. %	10- yr Net Salv. %
2009	-57%	-72%	-77%	-73%	-69%	-66%	-67%	-67%	-68%	-65%
2010	-47%	-53%	-65%	-73%	-70%	-67%	-65%	-66%	-66%	-67%
2011	-30%	-37%	-44%	-55%	-65%	-65%	-63%	-62%	-63%	-63%
2012	-68%	-49%	-49%	-51%	-58%	-66%	-65%	-64%	-63%	-63%
2013	-104%	-93%	-79%	-74%	-72%	-74%	-76%	-74%	-71%	-69%
2014	-108%	-106%	-99%	-88%	-85%	-81%	-82%	-82%	-79%	-76%
2015	-331%	-173%	-143%	-131%	-118%	-112%	-106%	-105%	-100%	-95%
2016	-402%	-369%	-231%	-184%	-169%	-152%	-145%	-136%	-133%	-124%
2017	-132%	-248%	-271%	-206%	-175%	-163%	-149%	-143%	-136%	-133%
2018	-430%	-272%	-309%	-313%	-246%	-209%	-195%	-180%	-173%	-164%

Q. How should the Commission interpret and correlate the information in the above table to witness Garrett’s and Peoples’ proposals on net salvage?

A. First and foremost is that even 10 years ago the net salvage indications were nearly at or above -80 percent. This is the most telling and important information for the Commission, in that the approved -55 percent is not indicative of the Company’s recent experience. Peoples’ net salvage proposal for this account is a necessary step to help increase that recovery and reduce the deferral of recovery.

Q. Is there anything else that would assist the Commission in evaluating the net salvage proposals for Account 380-Plastic Services?

A. Yes. The graph below illustrates Peoples' net salvage experience over the past 10 years. The solid black line is my proposed -80 percent, which is above (less negative) than the more recent 5 and 10 year averages.



This further supports the idea that my recommendation includes the gradualism that witness Garrett espouses. While it is a significant change, my proposed -80 percent has been consistently experienced by Peoples over the most recent 10 years and should be approved.

E. Account 382-Meter Installations

Q. Will you summarize the proposals regarding net salvage for Account 382-Meter Installations?

A. Yes. The approved net salvage is a -20 percent, which has been the same since 2006. The approved net salvage rate for this account was -18 percent from 1996-2006. Witness Garrett proposal is -25 percent and my proposal is -30 percent.

Q. Can you demonstrate that the net salvage for Account 382 Meter Installations is moving more negative?

A. Yes. The information below was extracted from the net salvage analysis provided in Exhibit No. __ (DAW-1), Appendix D of my direct testimony. These are Peoples' moving average net salvage percentages for the past 10 years.

Table 9 Account 382 Steel Net Salvage 2009-2018

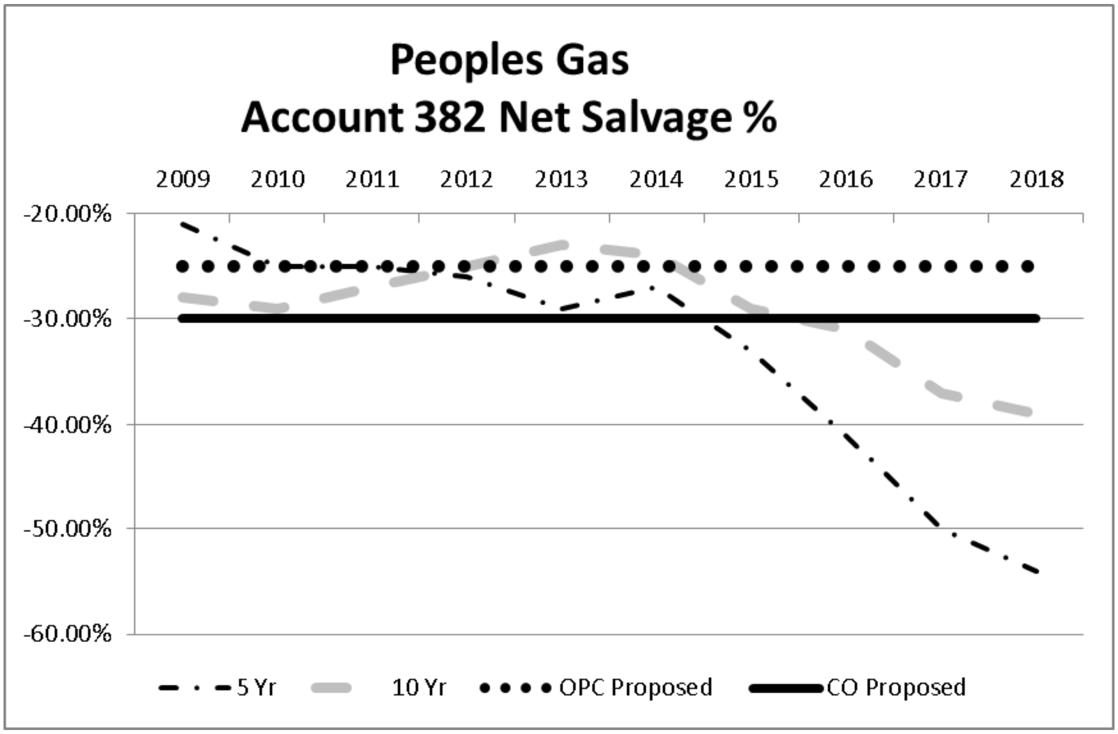
382 Year	Net Salv. %	2- yr Net Salv. %	3- yr Net Salv. %	4- yr Net Salv. %	5- yr Net Salv. %	6- yr Net Salv. %	7- yr Net Salv. %	8- yr Net Salv. %	9- yr Net Salv. %	10- yr Net Salv. %
2009	-36%	-30%	-24%	-24%	-21%	-22%	-25%	-27%	-29%	-28%
2010	-31%	-34%	-31%	-25%	-25%	-22%	-23%	-26%	-27%	-29%
2011	-22%	-26%	-29%	-28%	-25%	-25%	-22%	-22%	-25%	-27%
2012	-17%	-20%	-23%	-26%	-26%	-24%	-24%	-22%	-22%	-25%
2013	-38%	-29%	-26%	-27%	-29%	-28%	-26%	-26%	-23%	-23%
2014	-26%	-33%	-28%	-26%	-27%	-28%	-28%	-26%	-26%	-24%
2015	-66%	-46%	-43%	-37%	-33%	-33%	-33%	-32%	-29%	-29%
2016	-64%	-65%	-52%	-47%	-41%	-37%	-36%	-36%	-35%	-31%
2017	-68%	-66%	-66%	-54%	-50%	-44%	-39%	-38%	-38%	-37%
2018	-51%	-58%	-61%	-62%	-54%	-50%	-45%	-40%	-39%	-39%

Q. How should the Commission interpret and correlate the information in the above table to witness Garrett's and Peoples' proposals on net salvage?

A. First and foremost is that even 10 years ago the net salvage indications were nearly at or above -30 percent. This is the most telling and important information for the Commission, in that the approved -20 percent was about a third to one half of the Company's experience in many recent bands. Given how long it has been since the last change in the net salvage rate for this account, Peoples' net salvage proposal for this account is a necessary step to help increase that recovery and reduce the deferral of recovery.

Q. Is there anything else that would assist the Commission in evaluating the net salvage proposals for Account 382 Meter Installations?

A. Yes. The graph below illustrates Peoples' net salvage experience over past 10 years. The solid black line is my proposed -30 percent, which is above (less negative) than the more recent 5 and 10 year averages.



This further supports the idea that my recommendation includes the gradualism that witness Garrett espouses. While it is a significant change, my proposed -30 percent has been consistently experienced by Peoples over the most recent 10 years and should be approved.

F. Account 384-House Regulator Installations

Q. Will you summarize the proposals regarding net salvage for Account 384-House Regulator Installations?

A. Yes. The approved net salvage is a -20 percent, which has been the same since 2006. The approved net salvage rate for this account was -18 percent from 1996-2006.

witness Garrett proposal is -25 percent and my proposal is -30 percent.

Q. Can you demonstrate that the net salvage for Account 384-House Regulator Installations is moving more negative?

A. Yes. The information below was extracted from the net salvage analysis provided in Exhibit No. __ (DAW-1), Appendix D of my direct testimony. These are Peoples' moving average net salvage percentages for the past 10 years.

Table 10: Account 384-Net Salvage 2009-2018

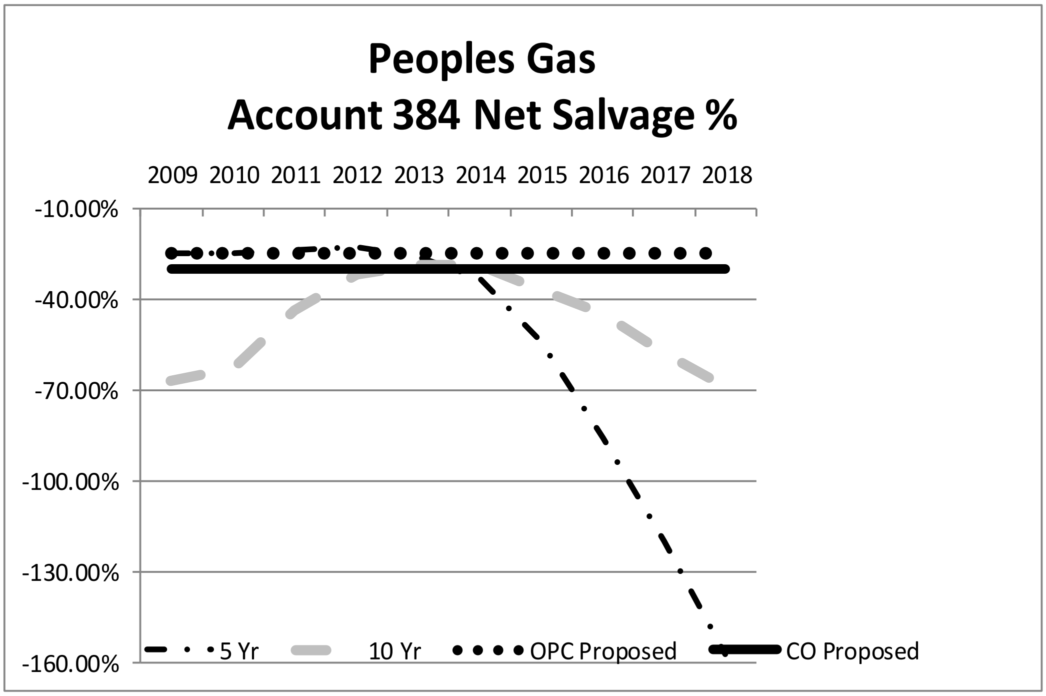
384 Year	Net Salv. %	2- yr Net Salv. %	3- yr Net Salv. %	4- yr Net Salv. %	5- yr Net Salv. %	6- yr Net Salv. %	7- yr Net Salv. %	8- yr Net Salv. %	9- yr Net Salv. %	10- yr Net Salv. %
2009	-25%	-27%	-24%	-24%	-25%	-31%	-37%	-50%	-67%	-67%
2010	-26%	-25%	-27%	-25%	-25%	-25%	-30%	-36%	-47%	-63%
2011	-19%	-22%	-23%	-25%	-24%	-24%	-24%	-29%	-34%	-44%
2012	-12%	-16%	-19%	-21%	-23%	-22%	-22%	-23%	-27%	-32%
2013	-49%	-32%	-27%	-27%	-26%	-27%	-25%	-25%	-26%	-29%
2014	-67%	-57%	-42%	-35%	-33%	-31%	-31%	-29%	-29%	-29%
2015	-214%	-124%	-90%	-69%	-54%	-49%	-45%	-42%	-37%	-37%
2016	-170%	-190%	-139%	-107%	-86%	-68%	-61%	-56%	-51%	-45%
2017	-245%	-195%	-202%	-154%	-120%	-98%	-78%	-70%	-63%	-58%

Q. How should the Commission interpret and correlate the information in the above table to witness Garrett's and Peoples' proposals on net salvage?

A. First and foremost is that even 10 years ago the net salvage indications were nearly at or above -30 percent. This is the most telling and important information for the Commission, in that the approved -20 percent was not indicative of the Company's experience in this account over the past 10 years. Given that the current net salvage rate has been unchanged since 2006, Peoples' net salvage proposal for this account is a necessary step to help increase that recovery and reduce the deferral of recovery.

Q. Is there anything else that would assist the Commission in evaluating the net salvage proposals for Account 384-House Regulator Installations?

A. Yes. The graph below illustrates Peoples' net salvage experience over the past 10 years. The solid black line is my proposed -30 percent, which is above (less negative) than the more recent 5 and 10 year averages.



This further supports the idea that my recommendation includes the gradualism that witness Garrett espouses. While it is a significant change, my proposed -30 percent has been consistently experienced by Peoples over the most recent 10 years and should be approved. By contrast, witness Garrett's -25 percent would not model Peoples' experience over the past decade.

SUMMARY

Q. Please summarize your rebuttal testimony.

A. I conducted a complete depreciation study using standard depreciation processes and methodologies that resulted in the recommended parameters and depreciation rates. My recommended life and net salvage parameters are reasonable and more aligned with other gas utility companies in the state of Florida, as discussed above. The depreciation rates, as provided in Exhibit No. __ (DAW-1), Appendices A and B of my direct testimony should be applied to Peoples' plant in-service. Witness Garrett is the only party to oppose my recommendations and resulting depreciation rates. My depreciation rates, when applied to Peoples' forecasted plant in-service balances provide fair and reasonable recovery to both Peoples and its customers and should be adopted by this Commission.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

CHAIRMAN CLARK: Staff, exhibits.

MR. SCHRADER: Staff has compiled a comprehensive exhibit list which includes the prefiled attached to the witnesses' testimony in this case, staff exhibits and discovery responses. The list has been provided to the parties, the Commissioners and the court reporter. As per the settlement, the parties have agreed to include all exhibits on the comprehensive exhibit list into the record.

Staff requests that this list be marked as the first hearing exhibit, and all other exhibits be marked as set forth in that list.

CHAIRMAN CLARK: Okay.

(Whereupon, Exhibit Nos. 1-79 were marked for identification.)

MR. SCHRADER: At this time, we ask that the Comprehensive Exhibit List, marked as exhibit No. 1, be entered into the record.

CHAIRMAN CLARK: Exhibit No. 1 is entered.

(Whereupon, Exhibit No. 1 was received into evidence.)

MR. SCHRADER: We also ask that Exhibit Nos. 2 through 79 be moved into the record as set forth in the CEL.

CHAIRMAN CLARK: Have all of the parties had an opportunity to review the exhibit list, and if so are there any objections to the entry of these exhibits into the record this morning?

Seeing none, Exhibits No. 2 through 79 are so entered.

(Whereupon, Exhibit Nos. 2-79 were received into evidence.)

CHAIRMAN CLARK: All right. Opening statements. We are going to take opening statements at this time. Per the second order modifying the OEP, each party is going to have five minutes to make their opening statements, and we are going to begin with Mr. Brown.

MR. BROWN: Thank you, Mr. Chairman and the rest of the Commissioners.

I am going to start just by talking a little bit about the procedural history of this case. As you recall the test year letter was filed on February 7th, 2020, and then in early March, the company asked for, and received, a 60-day extension in which to file its petition due to the effects of COVID-19, which at that time no one really knew how long it would last, and the hope was that it would be a brief -- brief event. That turned out obviously not to be the case, and the company was forced to go ahead and sign -- or file its petition on June 2nd, 2020. And after extensive discovery, on October 22nd, 2020, this stipulation and settlement agreement that is before the Commission was entered into by all of the intervenor parties in the case.

What's, I think, important in dealing with addressing this settlement is the fact that this case has essentially been fully litigated except for the actual hearing. There were 500 or more interrogatories propounded when one starts counting the subparagraphs and subparts of all of the discovery. There were hundreds of requests for production.

Peoples produced over 17,000 documents in this case, and there were six depositions taken of various Peoples' expert witnesses and company witnesses who would offer testimony along with the petition.

And so we come to you at this point with this case having been fully discovered, the parties and the staff being fully aware of virtually anything that has to do with this petition, and with this rate increase. And so it's not a situation where we are coming to you with a lot of issues that haven't been fleshed out and haven't been fully discovered. We are in a situation where that has taken place.

I don't want to go into all of the details of the settlement itself, but I do want to talk about just a few highlights.

Overall, the settlement ensures the company's financial stability and creates revenue predictability, which is obviously important to Peoples. But more importantly, the impact on individual customers, particularly residential customers, is fairly minimal.

For an average residential customer in the RS-2 class, which is where most of the residential customers are -- find themselves, the increase will be approximately $2.76 a month. And that includes the customer charge, the base increase in volumetric rates and the cast iron/bare steel rider equivalent, even though that's eventually going to be rolled into the base rates.

It also, as mentioned by Mr. Schrader, it resolves Peoples' COVID petition, and also sets parameters for the use of the accumulated depreciation credit which the company has.

The agreement also sets new depreciation rates for the company, and has a three-year stay-out provision, so Peoples will not be coming back before the Commission for three years. It also makes changes to the accounting treatment for the storm reserve.

So all of these things are being accomplished by this settlement, and I think that's the benefit to customers and to the public.

This agreement really is in the public interest. The terms are reasonable, and there is a lot of benefits to the public, which I just described, and other benefits contained in the agreement itself. And the testimony that has been put forward, along with the discovery, clearly and substantially provides evidence of the need for the new rates, and certainly supports the agreed amount that is in the settlement of this case -- the agreed amount of new rates that is contained in the stipulation and settlement agreement.

I do want to take a moment to thank Staff, the OPC, Staff, particularly Kurt Schrader, who I dealt with most on a day-to-day basis, Tripp Sebring and others on the staff doing a very excellent job on this. There was a lot of stuff to deal with, a lot of documents to deal with, a lot of discovery to deal with, and then we were able to work together very well.

For the OPC, Charles Rehwinkel, J.R. Kelly and Mireille Fall-Fry, and for FIPUG, Jon Moyle.

We were able to work through a lot of issues. If you recall, there were issues at the front end about the -- there were issues at the front end about the scheduling of the course of events. There were some issues about how quickly this case was coming up, and, you know, there were issues for everybody. The staff had issues; the Commission had issues timing wise; the parties had issues, but we were able to work through all of that.

And I think most importantly, once the discovery was completed, the parties were able to do a good job of evaluating the issues in this case, and making realistic assessments and evaluations of their positions, realistic evaluations of the ask itself, and what -- where issues -- where there are issues that were, you know, problematic for parties and where there weren't, and, you know, I think also there was a lot of assistance for the staff on this once this got going. So if I missed people on the staff, I think -- I mean to add Tripp Coston, among others.

Particularly after the agreement was sort of agreed to, there was a lot of work by everyone, both to come up with the numbers, to work through those numbers and answer questions and come up with an agreement. And that was all done in very short order, you know, with the hearing coming up, with discovery having been completed.

So overall, we believe this settlement is good for Peoples Gas. It is also good for Peoples' customers, and we think it is good for the citizens of Florida overall. We would ask that the Commission adopt this settlement. And as I said at the beginning, we have people available, Luke Buzard and Sean Hillary available to answer questions if the staff -- if the Commission has any questions.

So thank you for your attention.

CHAIRMAN CLARK: Thank you very much, Mr. Brown.

Ms. Fall-Fry, will you be delivering OPC's opening statement?

MS. FALL-FRY: Yes, sir.

Thank you, Mr. Chair, and good morning to the rest of the Commission.

We appreciate the great deal of efforts and consideration that all the parties have taken to get us to this point. The settlement agreement before this commission would resolve outstanding issues in three dockets.

We thank Commission Staff for bringing this to hearing so quickly, and for their indefatigable work on this case, our witnesses Andrea Crane and David Garrett, without whom we wouldn't be here, and FIPUG and Peoples Gas for their cooperation and willingness to reach a fair outcome.

As a result of the comprehensive witness testimonies and extensive discovery filed in these dockets, OPC is confident that the resolution of these dockets in the manner provided in the settlement and stipulation is in the public interest.

First, the settlement and stipulation is fair to both the ratepayers and to the company. The agreement provides sufficient revenue to allow the company to provide safe and reliable service while folding in the rates that are already reflected in the bills for upgrades made pursuant to safety regulations over the last decade, and adding mechanisms to address future changes in state and federal taxes.

Second, the settlement and stipulation promotes rate stability and predictability through the three-year rate freeze and stay-out provision.

Third, the agreed upon ROE provides the opportunity for a healthy return for the company while moving in a direction that is more in line with nationwide fiscal reality, which is a benefit for ratepayers.

Fourth, the settlement and stipulation resolves all outstanding issues related to PGS's petition for a regulatory asset related to COVID-19 expenses.

In conclusion, we believe that the settlement and stipulation, as supported by the testimony and evidence in the record, establishes rates that are fair, just and reasonable, and promotes regulatory efficiency. We, therefore, ask that the Commission should find that the settlement and stipulation is in the public interest.

Thank you.

CHAIRMAN CLARK: Thank you very much, Ms. Fall-Fry.

Mr. Moyle.

MR. MOYLE: Thank you. Thank you, Mr. Chair.

And I would like to start by echoing come some of the thank-yous that have already been said, but it's important. These rate cases have a lot of issues, a lot of coordination, and I think the parties worked well on that, as well as your staff. So the legal staff led by Kurt Schrader did a -- did a great job, as did the technical staff, and your staff participated in the depositions and the discovery process. So kudos -- kudos to your staff. PGS, Mr. Brown worked with OPC legal, and we were able to make progress. Luke Buzard did a fine job.

And, you know, during these settlement discussions, we had some discussion yesterday in the Duke solar about settlement discussions, and I just want to comment for a minute to tell you that these settlement discussions, we don't get into the details of them, but there was give and take. There was, as happens in these settlement discussions, I think robust discussion, and I think the settlement proposal before you today is fair, and FIPUG supports it and believes that it is a fair resolution.

I will just comment on a couple of provisions. The three-year set-out stay-out provides some certainty and stability for a period of time that was negotiated and that we believe is in the best interest of all the parties involved.

And I would also comment on the return on equity. Mr. Brown spent some time talking about COVID, and COVID has affected proceedings that we have at the Commission. I mean, it's noteworthy that, I think the record may reflect, that we had a couple of issues that all appear to be sorted out as we have this hearing virtually today. And I think the Commission has done a good job doing that, but it's a bit of a new situation where we are not out at the Commission and have all of the Commission there close at hand, but we have, I think, worked through that.

And one of the things that I think that COVID, I would remark on, has done is it's had an impact on our economy. The return on equity that is part of this settlement agreement, it's a midpoint under 10. And I think that is noteworthy for a few things.

One, the federal funds rate, they have -- the fed has kept interest rates very, very low. You know, I am no expert on it, but my reading of things is it's between zero and 25 basis points given the economic situation, and that that, as it represents the cost of money, has resulted in return on equities throughout the country in utility cases coming down.

And this return on equity is under 10, has come down, and was the subject of a lot of discussion, but we believe that that is a good sign and a good signal, and it's a significant reason for the support of the settlement agreement.

So, Mr. Chair, thank you. Thank you for your convening us today at a Special Agenda Conference to consider this. We hope that the Commission approves it. We would urge the Commission approve it, and think that it is a good result as a work product of the parties rolling up their sleeves, and after a lot of information, discovery, depositions, I think it's a fair resolution of the case.

I am happy to answer any questions that anybody may have.

CHAIRMAN CLARK: Thank you very much, Mr. Moyle.

I would also like to just extend a thank you on behalf of the Commission to all of the parties involved, and to our staff as well for the outstanding work that they did in reaching this settlement agreement. Looking through the terms, and looking through the specific line-by-line items, I agree. I think you guys have done a tremendous job. I know that it was a lot of work based on the early schedule that we were looking at, and the amount of work that was going to be involved in a full blown rate case was going to be enormous. One of the advantages is that cost is not passed on to the consumers, and that's something that's a positive outcome of this as well.

But I just want to say on behalf of the Commission, thank you to all of the parties for the outstanding work that you did getting this to the point for the Commission.

And with that, I will turn it over to the Commissioners for questions.

Commissioners, do you have any questions this morning?

There are no questions. Wow.

Okay. Then I believe -- where does that put us, Mr. Schrader?

MR. SCHRADER: Chairman, if the Commission finds it appropriate, then you may render a bench decision on the settlement agreement at this time, assuming the parties agree to waive post-hearing briefs.

CHAIRMAN CLARK: Have all parties agreed to waive post-hearing briefs? I am assuming they have. I have not heard otherwise.

MR. MOYLE: Yes, FIPUG has.

MS. FALL-FRY: Yes, OPC has.

CHAIRMAN CLARK: Ms. Fall-Fry agrees. Mr. Brown is nodding as well. So all parties have agreed to waive briefs.

All right. With that, Commissioners, I will entertain a motion.

Commissioner Brown.

COMMISSIONER BROWN: Thank you.

And before I make a motion, I do want to say I think the opening statements really clearly stated all. I mean, this is -- there has been a lot of discovery that has led us to this point, and I echo your comments thanking our staff and the parties for bringing us a very balanced settlement agreement that achieves the furthering the public interest and establishes fair, just and reasonable rates. It's all-encompassing with multiple components and dockets that are being resolved hereby.

And I do want to highlight a few things that I find interesting as well, just a few comments.

I do think that it does provide some rate certainty to customers, which is an excellent component of the settlement agreement.

Also, I believe that the revenue requirement is substantially less than what the petition originally requested. Again, a benefit to the customers.

The COVID-19 petition being withdrawn and deferring any costs during the term of this agreement is also a substantial benefit and impressive concession as well.

And again, the much needed storm reserve that is being increased here is going to provide much reliability to the territory.

So those are just a few things that I really am impressed with and think are in the public interest. And with that, I would move approval of the stipulation and settlement agreement for the rate increase by Peoples Gas.

CHAIRMAN CLARK: Do I have a second?

COMMISSIONER FAY: Second.

CHAIRMAN CLARK: Do I have a second?

COMMISSIONER FAY: Can you hear me?

CHAIRMAN CLARK: Thank you.

COMMISSIONER FAY: Mr. Chairman, can you hear me?

CHAIRMAN CLARK: Yes. Got you now, Commissioner Fay. And thank you very much for the second.

All right. Any discussion on the motion?

All those in favor, say aye.

Oh, commissioner Fay, I am sorry, would you like to say something.

COMMISSIONER FAY: Yeah, thank you, Mr. Chairman. Just real quick.

Commissioner Brown mentioned it, but the 20200178 docket that regulatory asked the docket be encompassed in this, I think, is a really good result, so thank the parties for working to get that closed out.

And with that said, Mr. Chairman, will we address that on a separate motion?

CHAIRMAN CLARK: Yes, we will -- yes, Commissioner, we will.

COMMISSIONER FAY: All right. Great. Well, I second.

Thank you.

CHAIRMAN CLARK: All right. Any other discussion?

On the motion, all in favor say aye.

(Chorus of ayes.)

CHAIRMAN CLARK: All opposed?

(No response.)

CHAIRMAN CLARK: And the motion carries.

All right. Are there other matters, Mr. Schrader?

MR. SCHRADER: Yes, Mr. Chairman.

The final order is expected to be issued by December 9th, 2020.

Staff also recommends that, as a result of the Commission's decision in this matter, that PAA Order No. PSC-2020-0408-PAA-GU, issued on October 22, 2020, in Docket No. 20200178-GU, be vacated and staff be authorized to close that docket administratively upon Peoples' withdrawal of its petition in that matter, pursuant to settlement agreement that the Commission has approved today.

CHAIRMAN CLARK: All right. Is there a motion to vacate the orders pending Peoples' withdrawal of the motion?

Commissioner Fay makes the motion, do I have a second?

COMMISSIONER FAY: So moved.

COMMISSIONER BROWN: Second.

CHAIRMAN CLARK: I have a second from Commissioner Brown.

Any discussion?

All in favor say aye.

(Chorus of ayes.)

CHAIRMAN CLARK: Opposed?

(No response.)

CHAIRMAN CLARK: And the motion carries unanimously.

All right. Are there any additional matters that need to be addressed before the Commission at this time?

MR. SCHRADER: Staff is aware of none, Mr. Chair.

CHAIRMAN CLARK: All right. Thank you, Mr. Schrader.

Any of the parties?

Seeing none, this hearing will stand adjourned.

We will resume at precisely 1:00 p.m. for our second hearing of the day. Thank you, see you then.

(Proceedings concluded.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

I, DEBRA KRICK, Court Reporter, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED this 8th day of December, 2020.

Debbie R Krick

DEBRA R. KRICK
NOTARY PUBLIC
COMMISSION #HH31926
EXPIRES AUGUST 13, 2024