DOCKET NO. W-354, SUB 400

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

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WITNESS SUMMARY –
DYLAN D'ASCENDIS – INITIAL AND REBUTTAL TESTIMONY

3   **Summary of Initial Testimony:**   My name is Dylan D'Ascendis. I am partner with
4   ScottMadden and I offer expert testimony on behalf of investor-owned utilities on issues
5   involving rate of return and class cost of service. I've testified in over 100 proceedings
6   before 35 regulatory jurisdictions.

7   I am a graduate of the University of Pennsylvania, where I received a Bachelor of Arts
8   degree in Economic History, and I also hold a Masters of Business Administration from
9   Rutgers University with a concentration in Finance and International Business. I'm a
10 Certified Rate of Return Analyst and a Certified Valuation Analyst.

11 My direct testimony recommends that the Commission authorize Carolina Water Service
12 an opportunity to earn a rate of return on equity of 10.45% for the base period and a rate
13 of return on equity of 10.70% percent for the 3 years of the multi-year rate plan. This is
14 based on Carolina Water's test year capital structure which consists of a target capital
15 structure of 50.00% long-term debt and 50.00% common equity, at an embedded long-
16 term debt cost rate of 4.64%, and my recommended common equity cost rate which is
17 10.45% in the base year and 10.70% during the WSIP period.

18 I derived my range of common equity cost rates by applying market-based common
19 equity models such as the discounted cash flow, or DCF model, the capital asset pricing
20 model, or CAPM, and the risk premium model, or RPM, to a group of publicly-traded water
21 utilities and a proxy group of non-regulated companies comparable in total risk to the
22 water utility group. Applying multiple market-based common equity models to the
23 companies comparable in risk to the regulated utilities is consistent with the principles of
24 fair rate of return established in the *Hope* and *Bluefield* Supreme Court cases. This is
25 especially important regarding the corresponding risk standard which mandates that an
26 authorized return on common equity for a utility be commensurate with returns on
27 investments in other enterprises having corresponding risk.

28 However, no proxy group of companies can be identical in risk to any one single company,
29 including Carolina Water. Therefore, adjustments must be made to the market results of
30 the proxy group to reflect any type of risk difference between the proxy group and the
31 Company. Through my selection criteria I selected seven water utility companies with
32 similar risk. I then applied the DCF, the CAPM, and the risk premium model to the group
33 of water utility companies and the group of the non-utilities that are comparable in risk

1	to the water proxy group. After reviewing the results of the models, I concluded that the
2	indicated ROE for the Utility Proxy Group ranged from 9.85% to 10.85% in the Base Year
3	and from 9.85% to 11.14% during the 3-year WSIP period, before any adjustment for risk
4	differences between the Company and the proxy group. To determine if there was any
5	risk difference due to size, I compared the market capitalization of Carolina Water to the
6	median market capitalization of the utility proxy group then calculated an average size
7	premium for the utility proxy group. I found that a 0.92% upward size adjustment would
8	be justified, but conservatively applied a 0.10% upward size adjustment to Carolina
9	Water's indicated range of common equity cost rates.
10	I also considered whether the existence of a multi-year rate plan such as the WSIP
11	affected a utility's risk and therefore its cost of equity. Risk can be defined as volatility in
12	revenues and earnings. I noted that, while a multi-year rate plan better matches future
13	revenues to future expenses, it does not affect volatility of revenues or resulting earnings.
14	Therefore, I do not believe a downward adjustment to Carolina Water's return on equity
15	would be appropriate in this case. This is particularly true because the WSIP, while not
16	affecting volatility of earnings, does cap earnings via the upward banding on return on
17	equity, through which overearnings are credited to customers. At the same time, the
18	WSIP does not contain a symmetrical debit to customers if the utility underearns below
19	the ROE band.
20	Applying the 10-basis point size adjustment to the indicated ROE based on the proxy
21	group results in a range of ROEs from 9.95% to 10.95% for the Base Year and 10.13% to
22	11.24% during the 3-year WSIP period. Given these ranges, an ROE of 10.45% during the
23	Base Year and 10.70% during the WSIP period are appropriate for Carolina Water.
24	**Summary of Rebuttal Testimony**: My rebuttal testimony responds to the direct
25	testimony of Mr. John R. Hinton of the Public Staff and updates my recommended cost of
26	common equity analysis with data as of October 14, 2022. My updated analysis confirms
27	the Base Year cost of equity of 10.45% and WSIP plan years' cost of equity of 10.70%. I
28	would note, however, that these are conservative cost of equity recommendations, as
29	there has been an upward trend in the ROE model results since my initial testimony.
30	Also, in my rebuttal testimony I address several concerns that I have with Mr. Hinton's
31	analysis. Specifically, I disagree with Mr. Hinton's application of the DCF and risk premium
32	models, his failure to reflect the Company's smaller size relative to his proxy group in his
33	ROE recommendation, and his proposal to lower the Company's ROE if the WSIP multi-
34	year rate plan is approved. I also respond to Mr. Hinton's criticisms of my initial testimony.
35	Key points in my rebuttal testimony are as follows:
36	▪ The economy is currently in an inflationary environment, and inflation affects
37	all costs, including a company's cost of equity.

- Mr. Hinton uses and combination of historical and forecasted growth rates, but empirical evidence supports the superiority of using analysts' forecasts of earnings as the best predictor of growth to use in the DCF model. If Mr. Hinton would have used forecasted growth rates, his mean and median DCF model results would be 10.0% and 10.8%, respectively. Accordingly, Mr. Hinton's indicated DCF cost rate of 9.00% is severely understated.

- Mr. Hinton exclusively uses current interest rates in his risk premium analysis. Because cost of capital and ratemaking are prospective in nature, he should also consider projected interest rates in his risk premium model, consistent with his use of projected growth rates in his DCF analysis.

- Mr. Hinton uses annual authorized returns and interest rate data in his risk premium model. It is preferable to use such data on a case-by-case basis, because some years have more rate case decisions than others, and years with fewer cases then garner unreasonable weighting. In addition, using annual averages ignores changes that occur during the year in interest rates and authorized returns.

- Mr. Hinton failed to use a comparable earnings analysis to check his results, although he did perform such an analysis in other recent cases. A comparable earnings analysis similar to the methodology he employed in recent cases indicates that his recommended ROE of 9.45% is woefully inadequate.

- Mr. Hinton fails to give consideration to Carolina Water's smaller size in his cost of equity analyses.

- Mr. Hinton's proposed 20 basis point reduction to Carolina Water's return on equity if the WSIP is approved is unreasonable because the WSIP is not unique relative to his proxy group. Cost of equity is a comparative analysis, so if similar mechanisms are used by proxy group utilities, the comparative risk is zero. For example, Mr. Hinton's proxy group includes California utilities, where multi-year rate plans are common; and utilities in states where fully forecasted test years are common. Further, no utility's credit rating has been upgraded upon approval of a multi-year rate plan.

For all the reasons stated in my direct and rebuttal testimonies, I conclude that 10.45% and 10.70% returns on equity for Carolina Water Service for their Base Year and WSIP plan years, respectively, should be authorized by the Commission in this proceeding.