ORANGE AND ROCKLAND UTILITIES, INC.

YUKARI SAEGUSA/COST OF CAPITAL
UPDATE/REBUTTAL – ELECTRIC & GAS

1 Q. Please state your name.
2 A. Yukari Saegusa.
3 Q. Have you previously submitted testimony in this
4 proceeding?
5 A. Yes. I previously submitted direct testimony on
6 behalf of Orange and Rockland Utilities, Inc. ("Orange
7 and Rockland," "O&R" or "Company") in these
8 proceedings.
9 Q. What is the purpose of your update and rebuttal
10 testimony?
11 A. My testimony (1) provides an update to the Company's
12 recommended capital structure and cost of capital and
13 (2) responds to certain statements contained in the
14 direct testimony of the New York State Department of
15 Public Service Staff ("Staff") Finance Panel
16 ("Panel").
17 **UPDATE**
18 **Capital Structure and Cost of Capital**
19 Q. Has the Company prepared an updated rate of return
20 required exhibit?

1 A. Yes. The document entitled "ORANGE AND ROCKLAND
2 UTILITIES, INC. & SUBSIDIARIES RATE OF RETURN REQUIRED
3 FOR THE RATE YEAR – Thirteen Month Average Ending
4 December 31, 2019," is set forth as Exhibit__(YS-2)
5 Capitalization LTD – 2019_June Update.
6 Q. Please describe any updates to projected changes in
7 O&R's long-term debt and how such changes have been
8 incorporated into the required rate of return for the
9 Rate Year (*i.e.*, calendar year 2019).
10 A. The Company expects to issue the following debentures:
11 • During the Linking Period (*i.e.*, April 1, 2018
12 through December 31, 2018): $150 million of
13 Debentures, Series A 2018, 4.650% to be issued
14 September 2018 (subject to Board of Directors
15 approval), due September 2048 with a partial
16 delayed funding. $125 million of the Series A
17 2018, 4.650% Debentures will be funded in
18 September 2018 with the remaining $25 million
19 being funded in November 2018.

1 • During the Rate Year: $125 million of Debentures,
2 Series A 2019, 5.100% to be issued September
3 2019, due September 2049.
4 Q. What is the updated, stand-alone capital structure for
5 O&R?
6 A. As set forth in Exhibit__(YS-2) Capitalization LTD –
7 2019_June Update, the Company's forecasted capital
8 structure for the thirteen months ending December 31,
9 2019 is as follows:
10 • 50.98% long-term debt;
11 • 0.80% customer deposits; and
12 • 48.22% common stock equity.
13 Q. Are you requesting that the capital structure, upon
14 which the revenue requirements are calculated in the
15 contemporaneous rate filings, use an equity ratio of
16 48.00%?
17 A. Yes, for purposes of calculating the revenue
18 requirements in these proceedings, the Company is
19 proposing to use a 48.00% common stock equity
20 component.

1 Q. Is the Company waiving its rights to a reasonable
2 common stock equity ratio?
3 A. No, it is not. Although the requested common stock
4 equity component is slightly lower than the actual
5 equity ratio, the Company is willing to accept a 48%
6 equity ratio in an effort to limit the contested
7 issues in this proceeding. As I discuss below, in
8 light of the projected reductions to cash flow caused
9 by the Tax Cuts and Jobs Act of 2017 ("TCJA"), the
10 rating agencies have suggested remedies such as a
11 higher equity ratio may be appropriate for utilities
12 impacted by the law.
13 Q. What are you proposing for the Company's cost of debt?
14 A. We propose a 5.21% cost of debt for the Rate Year.
15 This cost of debt includes an update for (i) Blue Chip
16 Financial Forecasts publication of the 30-year
17 Treasury rate (*i.e.*, 3.30% in 2018 and 3.74% in 2019)
18 and (ii) spread to 30-year Treasuries of 135 basis
19 points ("bps") based on guidance from knowledgeable
20 underwriters for debt issued during the Linking Period

1 and Rate Year (see, Exhibit__(YS-2) Capitalization LTD
2 – 2019_June Update).
3 Q. Using this forecasted capital structure and cost of
4 long-term debt and the return on equity ("ROE"), what
5 overall rate of return results?
6 A. The overall rate of return is 7.35% as shown on
7 Exhibit__(YS-2) Capitalization LTD – 2019_June Update.
8
9 **REBUTTAL**
10 Q. Please describe how your rebuttal testimony is
11 organized.
12 A. My rebuttal testimony is organized as follows. First,
13 I address the Panel's discussion of the capital
14 structure and their calculation of a hypothetical
15 equity ratio. Second, I comment on various credit
16 quality and rating agency issues. Third, I discuss
17 the Panel's proposal to impose ring-fencing triggers
18 on the Company. Fourth, I discuss the Panel's
19 proposed adjustment to the Company's debt costs.
20 Fifth, I discuss Staff's Discounted Cash Flow ("DCF")
21 methodology for determining equity returns. Sixth, I

1 discuss Staff's Capital Asset Pricing Model ("CAPM")
2 methodology for determining equity returns.
3 Seventh, I address Staff's discussion on flotation
4 costs. Eighth, I discuss certain comments made by
5 Staff regarding the New York State regulatory
6 environment. I conclude with a discussion of the
7 overall impacts of the Panel's testimony.
8

9 **CAPITAL STRUCTURE**

10 Q. What was Staff's conclusion regarding the use of the
11 Company's stand-alone capital structure and how did it
12 arrive at its conclusion?
13 A. The Panel concluded that the Company's proposal to use
14 its stand-alone capital structure is reasonable.
15 Staff based its conclusion on (1) an analysis of the
16 parent company's (*i.e.*, Consolidated Edison, Inc.
17 ("CEI")) financing practices, (2) its determination
18 that the Company has demonstrated both the willingness
19 and the ability to manage its consolidated equity
20 component to its rate authorized levels and (3) its
21 assessment that the authorization of a 48.00% common

1 equity ratio will be sufficient to maintain the
2 Company's financial integrity and allow the Company to
3 continue to attract capital at favorable terms.
4 Q. How did Staff evaluate CEI's financing practices?
5 A. Staff evaluated CEI's financing practices by
6 calculating the average equity ratio of CEI's non-
7 utility businesses.
8 Q. What did Staff conclude with its evaluation?
9 A. Staff concluded that CEI's non-utility businesses have
10 been financed reasonably due to the consistent support
11 of higher common equity ratios at the non-utility
12 businesses when compared to the utilities over the
13 past five years.
14 Q. Do you agree with Staff's contention that a 48.00%
15 equity ratio will be sufficient to maintain the
16 Company's financial integrity and allow the Company to
17 continue to attract capital at favorable terms?
18 A. No. The Company believes a 48.00% equity ratio, along
19 with Staff's recommended return on equity, may not be
20 sufficient to maintain the Company's financial

1 integrity and allow the Company to continue to attract
2 capital at favorable terms.
3 Q. How does Staff justify its recommended equity ratio of
4 48.00%?
5 A. Staff justifies its recommendation of a 48.00% equity
6 ratio by saying:
7
8 For close to a decade, the Commission has
9 consistently found that an authorized common
10 equity ratio for O&R of 48.00% was sufficient…
11
12 Staff has not presented any evidence as to why a
13 48.00% equity ratio is optimal. The Company believes
14 the appropriate equity ratio should consider
15 prevailing market conditions and be adjusted as those
16 market conditions change. It is unclear how Staff is
17 able to justify adjustments to nearly all aspects of
18 ratemaking including the cost of debt and the cost of
19 equity and all the component inputs that go into
20 calculating theses cost rates as market conditions
21 change, but determine that a static 48.00% equity

1 ratio is as optimal today as it was nearly a decade
2 ago.
3 Q. Are there any inconsistencies with Staff's views of
4 optimal capital structures?
5 A. Yes. Staff applies a different standard when
6 evaluating the capital structure of CEI's non-utility
7 businesses. It has been Staff's practice to evaluate
8 CEI's financing practice by comparing the equity ratio
9 of CEI's non-utility businesses with the most up-to-
10 date equity ratios that are typical of "A" rated
11 industrial issuers. Most recently in Cases 16-E-0060
12 and 16-G-0061, Staff relied on an S&P publication
13 titled, "2013 Adjusted Key U.S. and European
14 Industrial and Utility Financial Ratios" to source a
15 69.3% median equity ratio for "A" rated industrial
16 issuers. In Case 13-E-0030, Staff referenced an S&P
17 publication titled, "2011 Adjusted Key U.S. and
18 European Industrial and Utility Financial Ratios" to
19 source a median equity ratio for "A" rated industrial
20 issuers of 66.2%. This would imply that from 2013 to
21 2016, Staff expected CEI to increase the equity ratio

1 at its non-utility businesses by 3.1% as market
2 conditions changed and companies adjusted their
3 capital structures for those changes.
4 Q. What analysis has Staff presented to support the
5 appropriateness of a 48.00% equity ratio in the
6 current market environment?
7 A. None.
8
9 **Credit Quality and Rating Agency Issues**
10 Q. Have there been significant developments that would
11 suggest that a 48.00% equity ratio may no longer be
12 adequate?
13 A. Yes. The passage of the TCJA in December 2017 is
14 expected to negatively impact the Company's cash flows
15 and financial metrics.
16 Q. Have the rating agencies taken any actions on the
17 Company's credit ratings subsequent to the passage of
18 the TCJA?
19 A. Yes. As discussed in my direct testimony, on January
20 19, 2018, Moody's changed the Company's ratings
21 outlook from "Stable" to "Negative" along with 23

1 other regulated utilities and utility holding
2 companies (see Exhibit__(YS-13)). Moody's explained
3 their action by saying:
4
5 Today's action primarily applies to companies
6 that already had limited cushion in their rating
7 for deterioration in financial performance, will
8 be incrementally impacted by changes in the tax
9 law and where we now expect key credit metrics to
10 be lower for longer.
11
12 Q. What are the primary drivers of the Company's already
13 weak financial position?
14 A. The Company's financial position is largely a function
15 of its allowed ROE and the percentage of ratebase on
16 which it is allowed to earn an equity return. As
17 discussed in my direct testimony, the rates of allowed
18 return granted in New York are well below those in
19 other states. The low allowed ROE determinations have
20 made the Company's financial position more susceptible
21 to external factors such as tax reform.

1 Q. Did Moody's ratings action in response to the passage
2 of the TCJA impact any other New York utilities?
3 A. Yes. Out of the 24 entities that had their ratings
4 outlooks revised downward, 17 were utility operating
5 companies (or were affiliated financing vehicles).
6 And of these 17 utility operating companies (or
7 affiliated financing vehicles), 4 were New York
8 utilities. The fact that nearly 25 percent of the
9 utility operating companies that had their ratings
10 outlooks revised downward were New York utilities
11 offers further evidence that New York's low ROEs leave
12 utilities in New York in weaker financial positions.
13 Q. Which credit metric has the rating agencies focused on
14 in their assessment of the Company's financial
15 position?
16 A. The rating agencies are most focused on the funds from
17 operations to total debt ("FFO/Debt") credit metric.
18 Q. Have any of the rating agencies forecasted the impact
19 of the TCJA on FFO/Debt ratios?
20 A. Yes. Moody's calculated that the TCJA will dilute
21 utility FFO/Debt ratios by an average of 150-250 bps

1 with some utilities faring better and other utilities
2 faring worse.
3 Q. Has Moody's forecasted the impact of the TCJA on O&R's
4 FFO/Debt ratio?
5 A. Yes, in a January 2018 report titled, "Orange and
6 Rockland Utilities, Inc. – Update following negative
7 outlook" (see Exhibit__(YS-14), Moody's published a
8 12-18 month forward view that forecasts a decrease in
9 the Company's FFO/Debt ratio from 19%-21% in August
10 2017 to 15%-17% in January 2018. Taking the midpoint
11 of Moody's August 2017 and January 2018 forward views,
12 we can infer that Moody's expects an approximately 400
13 basis point decrease in the Company's FFO/Debt ratio.
14 It is important to note that Moody's stated that
15 FFO/Debt "below 17% for a sustained period of time" is
16 one of two factors that could lead to a credit rating
17 downgrade. As shown in the excerpt below taken from
18 Moody's January 2018 O&R report, two of the four
19 credit metrics under the financial strength category
20 imply a "Baa" rating for the Company. These two

1 metrics make up 20% of the weighting in determining
2 the Company credit ratings.

Exhibit 4

Regulated Electric and Gas Utilities Industry Grid [1][2]	Current LTM 9/30/2017		Moody's 12-18 Month Forward View As of Date Published [3]	
Factor 1 : Regulatory Framework (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Legislative and Judicial Underpinnings of the Regulatory Framework	A	A	A	A
b) Consistency and Predictability of Regulation	A	A	A	A
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	Aa	Aa	Aa	Aa
b) Sufficiency of Rates and Returns	A	A	A	A
Factor 3 : Diversification (10%)				
a) Market Position	Ba	Ba	Ba	Ba
b) Generation and Fuel Diversity	N/A	N/A	N/A	N/A
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	5.6x	A	4.5x - 5x	A
b) CFO pre-WC / Debt (3 Year Avg)	19.8%	A	15% - 17%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	15.2%	A	11% - 14%	Baa
d) Debt / Capitalization (3 Year Avg)	47.6%	A	45% - 50%	A
Rating:				
Grid-Indicated Rating Before Notching Adjustment		A2		A3
HoldCo Structural Subordination Notching	0	0	0	0
a) Indicated Rating from Grid		A2		A3
b) Actual Rating Assigned		A3		A3

[1]All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2]As of 9/30/2017(L);
3]This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Source: Moody's Investors Service

3

4 Q. What is the second factor for a potential credit
5 ratings downgrade by Moody's?

6 A. Moody's lists "less regulatory support for cost
7 recovery" as the other factor that could lead to a
8 downgrade.

9 Q. Did any of the other rating agencies express a view of
10 the magnitude of the potential deterioration in the
11 Company's credit profile from passage of the TCJA?

12 A. Yes, Fitch Ratings in a March 2018 report
13 (Exhibit__(YS-15)) believes that it will lead to:

1

2 …weakening leverage metrics by 0.4x-0.5x compared
3 with prior estimates

4

5 Fitch calculates the leverage metric as adjusted
6 leverage to funds from operations which is essentially
7 the inverse of Moody's calculation. Taking the
8 inverse of Fitch's leverage metric to make it
9 comparable to Moody's calculation, a 0.4x-0.5x change
10 to the Company's expected "low 4.0x" leverage ratio
11 would imply an approximately 270 to 300 bps decrease
12 in the Company FFO/Debt ratio.

13 Q. Based on the analysis and commentary presented by the
14 rating agencies, do you have confidence that Staff's
15 recommended ROE and equity ratio will allow the
16 Company to maintain its financial integrity?

17 A. No I do not. In Consolidated Edison Company of New
18 York's ("CECONY") 2007 electric rate case (Case 07-E-
19 0523) Staff made similar assertions concerning the
20 ability of CECONY to maintain its credit ratings in
21 the face of Staff's recommendations.

1 Q. Was Staff correct in their assertion?
2 A. They were not. S&P, in a report titled, "Consolidated
3 Edison, Inc. Downgraded To 'A-' from 'A' on Rate
4 Decision", dropped the entire CEI group by one notch
5 in March 2008; Fitch, in a report titled "Fitch
6 Downgrades Con Ed of NY & Con Ed Inc. to 'A' on Rate
7 Decision; On Watch Negative", dropped the entire CEI
8 group by two notches in March 2008. Moody's placed
9 the entire CEI group on Negative Outlook in March
10 2009.
11 Q. Did Staff make assertions concerning the ability of
12 CECONY to maintain its then-current credit ratings in
13 the Company's 2008 electric rate case?
14 A. Yes, Staff stated that their capital structure
15 recommendations should be adequate to maintain ratings
16 for the CECONY's senior unsecured debt obligations
17 within their respective 'A' categories.
18 Q. Was Staff correct in their assertion?
19 A. No. In June 2009, on the heels of the Commission's
20 rate order in CECONY's 2008 electric rate case,

1 Moody's dropped the ratings of the CEI and its
2 affiliates by two notches (*i.e.*, from 'A1' to 'A3').
3 Q. Do you have any reason to believe that Staff's ability
4 to predict credit ratings has improved?
5 A. No, I do not. The Panel's belief that allowed returns
6 on book equity and the proportion of equity in the
7 Company's capital structure as the central
8 determinants, does not fully consider the importance
9 debt rating agencies will place on cash flow coverages
10 and actual earned returns and results from operations.
11 These effects will again put the Company's credit
12 ratings at risk.
13 Q. Have the rating agencies offered their views on what
14 could potentially mitigate the negative impact of tax
15 reform and preserve credit quality?
16 A. Yes. Moody's, in its January 2018 report referenced
17 above, states (see Exhibit__(YS-13)):
18
19 Potential regulatory offsets to tax-related cash
20 leakage could include: accelerated cost recovery
21 of certain regulatory assets or future

1 investment; changes to the equity layer or
2 allowed ROEs in rates, and other actions.
3
4 S&P, in a report titled, "U.S. Tax Reform: For
5 Utilities' Credit Quality, Challenges Abound" (see
6 Exhibit__(YS-16)), states:
7
8 Regulators must also recognize that tax reform is
9 a strain on utility credit quality, and we expect
10 companies to request stronger capital structures
11 and other means to offset some of the negative
12 impact
13
14 Q. Given the negative impact of tax reform on the
15 Company's financial position, why has the Company not
16 requested a higher equity ratio?
17 A. It has been the Company's practice to manage the
18 equity component of its capital structure to its rate
19 authorized levels of 48.00%. We have also sought to
20 limit the number of contested issues in this
21 proceeding.

1 Q. Are there other options available to the Commission to
2 mitigate the negative cash flow impact of tax reform?
3 A. Yes, in addition to a higher equity layer, the Company
4 believes authorizing a fair and reasonable ROE, such
5 as that recommended by Company witness VanderWeide,
6 would help mitigate the negative impact of the TCJA.
7
8 **Ring-Fencing Triggers**
9 Q. Does O&R have any restrictions in place that protect
10 it from the activities of its non-utility affiliates?
11 A. As mentioned by the Panel, O&R already has ring-
12 fencing measures in place as a result of its 1999
13 merger with CEI. The measures are restrictive and
14 provide adequate protection in that the regulated
15 utility will not pay out more than 100% of income
16 available for dividends calculated on a two-year
17 rolling average basis; the debt of the regulated
18 utility must be raised directly by the utility
19 operating company and not the holding company; and,
20 the regulated utility, without prior permission from
21 the Commission, will not make loans to, guarantee the

1 obligations of, or pledge its assets as security for
2 indebtedness to the holding company or any affiliate.
3 Q. Has O&R had any issues complying with these
4 restrictions?
5 A. No. O&R has complied with these restrictions and
6 according to Staff (p. 26) has a "good track record"
7 and has "not had any issues complying with the
8 restrictions". Further, O&R's ratings have never been
9 impaired due to any issues directly related to the
10 holding company or financing of the non-regulated
11 businesses. Given that restrictions are already in
12 place and that over the last 20 years, O&R has not
13 violated them, the adoption of the ring fencing
14 triggers is excessive.
15 Q. Was the acceptance of the ring-fencing triggers in the
16 CECONY 2016 electric and gas rate case an admission
17 that there is a prospective need to be concerned about
18 the impact to O&R from the growth of the non-utility
19 businesses?
20 A. No. The acceptance of the ring fencing triggers in the
21 CECONY 2016 electric and gas rate case was done in the

1 context of settlement proceedings, during the course
2 of confidential negotiations in which there were a
3 number of contested issues, and give and take on all
4 sides. Although CECONY ultimately accepted the ring
5 fencing triggers, this does not signify that O&R is
6 willing to accept (or indeed that there is a need for)
7 these ring fencing triggers.
8 Q. Do any of the other New York utilities have
9 prospective ring-fencing measures or triggers in
10 place?
11 A. The ring fencing measures put in place for all the
12 other New York utilities, were imposed by the
13 Commission in the context of an acquisition.
14 Q. How does the rationale for ring fencing the other New
15 York utilities differ from the logic underlying
16 Staff's recommendation for O&R?
17 A. Ring fencing of other New York utilities resulted from
18 their acquisition by larger companies, all domiciled
19 in foreign countries, where the New York utilities
20 comprised a very small proportion of their overall
21 diversified business models. In these situations, the

1 risk of a contagion from potentially riskier
2 businesses, including those outside the US, to the
3 smaller New York operations resulted in conditions
4 which motivated a perceived need by Staff to impose
5 ring fencing conditions. CEI's New York utilities
6 comprise nearly all of the company's net income as
7 compared with the other holding companies that own New
8 York utilities – National Grid, Fortis, and Iberdrola.
9 Over a three-year average (2013-2016), O&R and CECONY
10 comprise 94% of CEI's net income versus 6-13% for the
11 other utilities. The logic of ring fencing CEI's
12 utilities would turn the logic on its head, protecting
13 the primary business of the company from a very small
14 scale portion of the business. Given the limited
15 scope of CEI's non-utility businesses, the greatest
16 risk to the credit of the utilities comes from the
17 utilities themselves rather than any secondary
18 businesses. Ring fencing O&R does not align with the
19 rationale in every other instance of ring fencing in
20 New York.
21 Q. Please describe CEI's non-utility business risk.

1 A. CEI’s non-utility business risk is designed to be
2 largely consistent with the utility risk. For Con
3 Edison Development (“CED”), the utility-scale
4 renewable investments have long-term power purchase
5 agreements (“PPAs”) with investment grade
6 counterparties. The PPAs have been approved under the
7 counterparties’ respective regulatory regimes.
8 Further the PPAs are agreements enforceable under
9 contract law for their term, which is significantly
10 longer than a regulated utility’s rate plan.
11 Con Edison Transmission’s (“CET”) investments consist
12 of investments in gas and electric transmission which
13 are mostly Federal Energy Regulatory Commission
14 (“FERC”) regulated. S&P, in an August 7, 2017 report
15 titled, “Consolidated Edison Inc. Ratings Affirmed
16 Following Consistent First-Half Operating Results;
17 Outlook Remains Stable” (see Exhibit__(YS-17)), views
18 the FERC style regulation as “partially mitigating
19 risks associated with the company’s non-utility
20 businesses”.

1 While Staff concludes that these businesses are
2 "substantially" riskier than our utility operations,
3 these risks are mitigated by the regulatory and
4 contractual protections, our approach to financing
5 these businesses, and the cash flow diversification
6 they provide. Staff's portrayal of these businesses
7 as "substantially" riskier strongly overstates the
8 rating agency view. S&P in the report referenced
9 above, for example, simply refers to these businesses
10 as "relatively higher-risk" in comparison the
11 utilities.
12 Q. What has been the approach to financing the solar
13 generation business at CED?
14 A. CED's solar generation projects have been financed in
15 the project debt market, when possible, with debt that
16 is non-recourse to CED's parent, CEI, as well as
17 CECONY and O&R. Non-recourse, project debt financing
18 has the benefit of insulating the creditworthiness of
19 CEI, CECONY and O&R, as well as the creditworthiness
20 of all other entities in the organization, from the
21 risk of individual solar generation projects. Project

1 debt investors lend to the solar generation projects
2 based solely on the specific project's risk and
3 projected future cash flows. These investors have no
4 recourse to seek payment from CEI, CECONY or O&R if a
5 project is unable to meet its debt service
6 obligations.

7 Q. What other evidence does the Company have that CEI has
8 financed its non-utility businesses in a manner
9 commensurate with the risk of the businesses?

10 A. CEI has financed its investments at CET in a manner
11 commensurate with the risk of the business. For
12 example, CET has a 45.7% investment in New York
13 Transco, LLC ("NY Transco"). NY Transco is financed
14 with approximately 53% equity and 47% debt, consistent
15 with its allowed FERC capital structure.
16 Additionally, CET's investments in Mountain Valley
17 Pipeline ("MVP") and Stagecoach Gas Services LLC
18 ("Stagecoach") maintain target capital structures of
19 approximately 50% equity and 50% debt.

20 Q. Please summarize CEI's approach to financing its non-
21 utility businesses.

1 A. As discussed in the examples above, CEI's approach to
2 financing its non-utility businesses has been to
3 finance them in a manner commensurate with the risk of
4 the individual businesses. The intent of this
5 approach, beyond following good corporate finance
6 practice, is to isolate the risks of the non-utility
7 businesses from the regulated utilities and thus
8 protect the creditworthiness of the regulated
9 utilities.
10 Q. What was Staff's basis for recommending ring-fencing
11 triggers?
12 A. Staff has recommended ring-fencing triggers on a
13 prospective basis due to investments made by CEI and
14 statements by S&P and Moody's outlining respective
15 parameters as to when the scale of the non-utility
16 businesses could conceivably pose a threat to the
17 credit quality of the overall organization. Staff
18 cited the non-utility investments as "sizeable".
19 Q. Do you agree with Staff's position regarding the need
20 for ring-fencing triggers?

1 A. No. First, Staff has provided no analysis on the need
2 for ring-fencing triggers. Instead, Staff's arguments
3 are predicated on their projection of how
4 significantly the non-utility businesses will grow and
5 the pressure such growth would have on the credit
6 quality of the entire organization. Staff's
7 suggestion that CEI's non-utility businesses will grow
8 significantly in the near future, based solely on an
9 extrapolation of investment activities, amounts to
10 mere speculation.
11 CEI has no set target for the growth of its non-
12 utility businesses, but instead evaluates potential
13 investments opportunistically. Additionally, even if
14 CEI's non-utility businesses were to grow
15 significantly in the near future, one would have to
16 assume that CEI would abandon its practice of
17 financing growth in a manner commensurate with the
18 risk of the non-utility businesses, in order to accept
19 Staff's argument that the credit quality of the entire
20 organization would be pressured.

1 As Staff acknowledges, to date, CEI has financed its
2 non-utility businesses in a manner commensurate with
3 the risk of the non-utility businesses resulting in an
4 equity ratio at CEI's non-utility businesses that
5 exceeds that of the regulated utilities. In its
6 direct testimony the Panel states (p. 25), "We
7 acknowledge the Company's good track record of
8 adhering to the restrictive provisions currently in
9 place and of safely deploying capital to date".
10 Second, regarding the size of the non-utility
11 businesses, the scale of the non-utility businesses
12 remains relatively small as percentage of the total
13 organization and below the thresholds established by
14 Moody's and S&P. Based on the expected growth of the
15 non-utility businesses disclosed in CEI's 2017 10-K
16 filing, the contribution by CEI's non-utility
17 businesses by 2020 will not come close to the
18 thresholds set by the rating agencies. Also, in CEI's
19 long-range plan financial outlook, which is publicly
20 available, the proportion of the utility businesses

1 and the CED and CET businesses remain largely the same
2 in 2025 on an earnings per share basis.
3 Finally, as noted above, O&R already has ring-fencing
4 measures in place which provide sufficient protection
5 to the company which have not been violated in over 20
6 years.
7 Q. How did the rating agencies react to CEI's investments
8 in MVP and Stagecoach?
9 A. Moody's and S&P concluded that the small size of the
10 investments in MVP and Stagecoach and the conservative
11 manner in which they were financed did not warrant a
12 change in their views on CEI's credit rating. S&P, in
13 an April 26, 2016 report (see Exhibit__(YS-18)),
14 commented on the Stagecoach investment as not
15 affecting the ratings and outlook of CEI because of
16 its small size. Moody's, in an April 22, 2016 credit
17 opinion report (see Exhibit__(YS-19)), commented on
18 the Stagecoach investment by saying that the
19 investment:
20

1 …is not a substantial credit driver because it is
2 too small of an investment. This is especially
3 the case when it's being financed in a
4 conservative manner. CEI's credit is driven by
5 the regulatory environment in New York and its
6 $43 billion utility investment in New York's
7 electric, natural gas and steam distribution
8 businesses.
9
10 Moody's also commented on the MVP investment by
11 saying:
12
13 These developments are credit positive because
14 they diversify CEI into new, stable business
15 outside its core utility operations, while
16 expanding CECONY's gas supply sources.
17
18 and,
19
20 The MVP investment will barely register a
21 financial effect on a company as large as CEI.

1

2 Q. How do the rating agencies currently view the non-
3 regulated investments?
4 A. Moody's, in a January 2018 report titled,
5 "Consolidated Edison, Inc. – Update following negative
6 outlook" (see Exhibit__(YS-20)), states that the non-
7 regulated investments increase the business risk
8 profile of the company, but "remain a small portion of
9 the company".
10 Moody's also states:
11

> 12 these investments do offer a mild amount of
> 13 asset, cash flow, geographic and jurisdictional
> 14 diversity, since the preponderance of the
> 15 company's financial performance is governed by a
> 16 single regulatory authority - the NYPSC. These
> 17 businesses offer CEI alternative investment
> 18 platforms that can be amplified should changing
> 19 customer and regulatory preferences threaten the
> 20 monopoly nature of the utility's revenue model.

21

1 and

2

3 Moreover, these businesses generate contracted
4 revenue, another credit positive. CEB, in
5 particular, has long-term contracts with credit
6 worthy counterparties, which we view as a low
7 risk investment. Furthermore, CEI has maintained
8 an even mix of debt and equity in financing these
9 operations, which has helped to maintain its
10 consolidated financial profile. Lastly, the
11 company has utilized relatively little holding
12 company debt to execute these investments - a
13 significant credit benefit compared to industry
14 peers that can have over 25% of consolidated debt
15 existing at the holding company; by contrast, CEI
16 has under 10%.

17

18 Q. Has Staff presented any evidence demonstrating that
19 O&R's ratings were negatively impacted by the non-
20 utility businesses and that ring-fencing triggers are
21 necessary?

1 A. No. Staff did not present testimony demonstrating
2 that the ratings of Con Edison were negatively
3 impacted by CEI's non-utility businesses or that ring-
4 fencing triggers are warranted.
5 Q. Please summarize your thoughts on why Staff's
6 recommendation of ring fencing triggers is unnecessary
7 for O&R.
8 A. The imposition of ring-fencing triggers is premature
9 because: (1) O&R already has ring-fencing measures in
10 place for 20 years and the Company has not violated
11 them, (2) The non-utility businesses have been
12 financed in a manner commensurate with the risk of the
13 businesses, (3) The scale of the CEI non-utility
14 businesses will remain relatively small as a
15 percentage of the total organization and well below
16 the thresholds set by the rating agencies, and (4)
17 O&R's ratings have not been negatively impacted by the
18 non-utility businesses.
19
20 **Cost of Debt Adjustments**

1 Q. Do you agree with Staff's recommendation to adjust the
2 requested cost rate of the long-term debt component of
3 O&R's capitalization from 5.24% to 5.16% in the Rate
4 Year?
5 A. I do not. I disagree with both the recommendation's
6 (1) reliance on the most recent actual Treasury yield
7 as opposed to the forecasted Treasury yield, and (2)
8 use of an estimate of 1.25% for the required spread,
9 which is added to the Treasury yield to arrive at the
10 cost rate for new long-term debt issuance.
11 Q. Why do you disagree with the recommended reliance on
12 the most recent actual Treasury yield?
13 A. As stated in my direct testimony, the most recent
14 actual Treasury yield is not the most accurate
15 indicator of future long-term interest rates. A
16 forecast of future interest rates, such as the
17 consensus estimates contained in *Blue Chip Financial*
18 *Forecast*, better reflects O&R's anticipated cost of
19 long-term debt. *Blue Chip Financial Forecast* is a
20 reasonable effort by expert economists, employing the
21 economic tools available to them, as well as their own

1 experience, to forecast interest rates. The mean
2 forecast as developed by approximately 40 professional
3 prognosticators provides a sounder basis for setting
4 long-term interest rates one to three years forward
5 than a single data point observed on a single day as
6 Staff recommends, particularly during the current
7 period of increased volatility in fixed income
8 markets.
9 Q. Does the evidence Staff cites support their
10 recommendation of reliance on current Treasury yields?
11 A. No. Staff's evidence may support the conclusion that
12 accurately forecasting interest rates is a challenging
13 undertaking; however, their evidence does not conclude
14 that current rates are the best predictor of future
15 rates. Moreover, Staff has consistently relied on
16 academic research that is 20 to 30 years old. It is
17 clear from the contemporary expert literature that
18 economists continue to refine their approach to
19 interest rates and have proven out successful
20 forecasting methodologies that achieve greater,
21 statistically-significant, accuracy relative to the

1 "random walk" approach Staff advocates (*i.e.*, using
2 current rates).
3 More recent academic research has shown that the
4 "random walk" less accurately predicts future Treasury
5 yields than interest rate forecasting, particularly as
6 rates are forecast further out into the future. Frank
7 den Butter and Pieter Jansen's paper "Beating the
8 Random Walk: A Performance Assessment of Long-term
9 Interest Rate Forecasts" (see Exhibit__(YS-21)) first
10 written for the Tinbergen Institute in 2008 and
11 published in 2012 in the journal, *Applied Financial*
12 *Economics*, recognizes the value of expert economists
13 in developing interest rate forecasts. Den Butter and
14 Jansen find merit in expert forecasts, since they
15 combine econometric methods with judgment and
16 expertise. In their study, a combination of expert
17 consensus forecasts and forecasts calculated by
18 structured interest equations was found more accurate
19 than the random walk on a 12-month forecast horizon.
20 As den Butter and Jansen wrote, the combination of

1 “relevant leading macroeconomic variables and of
2 (tacit) expert knowledge seems to pay off.”
3 Other economists have demonstrated economic
4 forecasting to be more accurate than the random walk
5 and built upon one another, including Diebold and Li
6 in their “Forecasting the term structure of government
7 bond yields” (*Journal of Econometrics 2006*) (see
8 Exhibit__(YS-22)) and Dick van Dijk et al. in
9 “*Forecasting Interest Rates with Shifting Endpoints*”,
10 a Tinbergen Institute research paper later published
11 in the *Journal of Applied Econometrics* in 2013 (see
12 Exhibit__(YS-23)). As Van Dijk writes of their
13 proposed forecasting methodology, which relies on an
14 application of inflation, trends especially for
15 forecasting at long horizons and forecasting long-
16 maturity interest rates this method gives substantial
17 gains in out-of-sample predictive performance,
18 relative to the forecasts of Diebold and Li (2006) or
19 random walk predictions, that are both economically
20 and statistically significant.

1 It is clear that the "random walk" has been a stop-
2 gap, rather than serving itself as a model of
3 explanatory power. A reliance on no-change
4 forecasting is not well-founded because economic
5 forecasting has rebutted the presumption of the
6 "random walk" as the appropriate default.
7 Q. Much of the academic research indicates the accuracy
8 of forecasts relative to the "random walk" improves
9 with longer time horizons. Staff has stated that the
10 Company's analysis "does not take into consideration
11 that the length of time in which these cost rates are
12 forecasted is actually only a period of approximately
13 13 months." Do you agree with this assessment?
14 A. No. First, the Company's reliance on forecasted rates
15 aligns with the intended time horizon of these
16 forecasts. We rely primarily on the twice-yearly
17 publication of *Blue Chip's* long-range forecasts. At
18 the time of the Company's Preliminary Update, the *Blue*
19 *Chip* was published in December 2017. We are using
20 these forecasts to set cost rates up to 25 months in
21 advance. Even if the Panel's recommendation to update

1 cost rates in December 2018 is adopted, we would then
2 rely on December 2018 *Blue Chip* forecasts to set rates
3 up to 13 months in advance. Forecasting 13 months
4 into the future is squarely within the time horizon in
5 which the academic literature indicates economic
6 forecasting is more accurate than the "random walk".
7 Current Treasury yields are an inadequate substitute
8 for forecasted yields over the time horizon
9 contemplated.
10 Q. Do you believe the Panel's assessment of economists'
11 track record in recent years in forecasting interest
12 rates fairly portrays the accuracy of relying on
13 forecasted rates in the current interest rate
14 environment?
15 A. No. Staff references interest rate forecasts from
16 rate cases that occurred during the final years of
17 unprecedented and historic intervention by the Federal
18 Reserve (the "Fed") in US monetary policy following
19 the 2008 financial crisis. The reversal of this
20 intervention transpired very slowly, starting with the
21 tapering of Fed bond purchases in late 2013. But

1 while expectations surfaced of higher interest rates
2 as the Fed tightened monetary policy, it was not until
3 2018 that rising inflation and constrained labor
4 market conditions ultimately translated into
5 meaningfully elevated interest rates. While past
6 forecasts during the recovery from the historic
7 financial crisis might have understated the pace of
8 increase of interest rates, 2018 has marked a turning
9 point in the acceleration of Treasury yields. The
10 regime shift away from accommodative monetary policy
11 is now evident, placing us in a rising and volatile
12 interest rate environment as the shift moves forward.
13 Q. What has been the performance of Treasury yields since
14 the beginning of 2018?
15 A. Year-to-date, the 10-year Treasury yield has risen
16 20.7% and the 30-year Treasury yield has risen 11.4%,
17 as of June 1, 2018. Following the second hike this
18 year of the target range for the Federal Funds Rate on
19 June 13, 2018 and with another two hikes anticipated
20 in 2018 and three hikes in 2019 based on the forecasts
21 of the Federal Open Market Committee, continued upward

1 movement in interest rates is expected, which will
2 raise the cost of borrowing for O&R.
3 Q. You also mentioned that Treasury yields have been
4 characterized by increased volatility in the current
5 market environment. Why is that important?
6 A. To the extent Staff's recommendation to use current
7 rates in setting future rates is implemented, the
8 volatility in the fixed income markets will impact the
9 rate that is set. In a highly volatile market, there
10 is a risk of artificially locking-in a yield that is
11 reflective of economic and geopolitical headlines
12 rather than the fundamentals espoused in a long-range
13 consensus forecast. As the Fed has tightened monetary
14 policy, interest rates have been highly volatile, with
15 macroeconomic data points that influence Fed
16 policymaking (*e.g.*, inflation and unemployment)
17 driving large day-to-day swings in Treasury yields as
18 the market speculates on Fed decisions. For example,
19 during the week of May 28, the 10-year Treasury rose
20 4.3% from its intra-week low in reaction to the May
21 non-farm payroll report. This followed a 9.1% decline

1 from the week prior, presumably generated by the May
2 Federal Open Markets Committee ("FOMC") meeting
3 minutes release, which was preceded by a 4.7% intra-
4 week increase the week before, likely on the release
5 of strong April retail sales figures.
6 Rate volatility has been further amplified by the
7 market's ongoing synthesis of changes in fiscal and
8 trade policy. The anticipated increase in Treasury
9 supply caused by expanded Federal deficit spending,
10 particularly after enactment of the TCJA, has driven
11 market volatility around Treasury auctions. The
12 impact is compounded by the Fed's simultaneous
13 shrinking of its own balance sheet. In addition, the
14 proposed imposition of tariffs on US trading partners,
15 has led to market speculation on the potential scope
16 of a trade war and the impact on US economic growth.
17 Taking account of the volatility generated by
18 monetary, fiscal and trade policy decisions, as well
19 as other areas of geopolitical uncertainty, Staff's
20 recommendation to rely on a point estimate of Treasury
21 yields in a highly volatile market environment poses

1 risk relative to a systematically-composed forecasted
2 consensus view.
3 Q. Do you have any other concerns with Staff's
4 recommendation to use current interest rates in
5 setting the cost rate for long-term debt?
6 A. Yes. Reliance on current interest rates in setting
7 cost rates is inconsistent with the Commission's
8 overall approach to establishing cost of service. The
9 principle embedded in the regulatory construct makes
10 use of a forecasted test year and relies on
11 projections for many elements of the revenue
12 requirement. To choose current interest rates in
13 setting long-term debt cost rates is inconsistent with
14 that principle and with other aspects of Staff's
15 recommendation.
16 Q. If the Commission does not adopt your request for the
17 use of forecasted interest rates in determining the
18 cost rate for long-term debt, would you accept a true
19 up as an alternative mechanism to account for expected
20 changes in interest rates?

1 A. Yes. I believe reliance on current interest rates will
2 inadequately reflect our cost of issuing new long-term
3 debt. A true-up would allow us to defer for future
4 recovery the incremental costs I anticipate we will
5 incur in issuing long-term debt during the Linking
6 Period and Rate Year. Without either using forecasted
7 long-term rates reflecting long-tenored maturities, or
8 employing deferral accounting, it also risks the
9 Company issuing shorter-tenored maturities, which
10 introduces refinancing risk.
11 Q. Why do you disagree with Staff's recommendation to
12 adopt a spread of 125 bps over the Treasury yield to
13 arrive at the cost rate?
14 A. Staff's recommendation of a 125 bps spread is based on
15 the median spread for O&R as provided by financial
16 institutions active in underwriting utility bond
17 issuances, furnished as part of the Company's
18 Preliminary Update. However, in the Preliminary
19 Update, the Company indicated a more appropriate
20 spread would be 130 bps. The Company's methodology
21 for determining an appropriate spread for an O&R 30-

1 year bond issuance (1) uses measureable new issue
2 spread estimates for an index-eligible CECONY 30-year
3 bond and (2) adds a size/liquidity premium. This
4 accounts for the fact that in the public or 144A
5 market, a bond issuance greater or equal to $300
6 million is eligible for inclusion in the Bloomberg
7 Barclays bond index, which greatly enhances a bond's
8 liquidity from a trading perspective. Given the size
9 of the contemplated O&R bond issuances in 2018 and
10 2019, the bonds would not be index eligible if issued
11 in the public bond market.
12 At the time of the Preliminary Update, spread
13 estimates for an index-eligible CECONY 30-year bond,
14 were approximately 110 bps. We added a 20 bps premium
15 to the 110 bps, to arrive at the 130 bps spread. The
16 20 bps premium is the current premium associated with
17 non-index eligible bond issuances.
18 We have provided evidence of this premium from
19 investment banks in Exhibit__(YS-24). The updated data
20 would indicate a spread requirement for a 30-year bond

1 issuance by O&R of the size contemplated of at least
2 135 bps.
3
4 **Discounted Cash Flow Methodology**
5 Q. Does Staff's DCF methodology for estimating equity
6 returns produce fair returns on the book equity
7 invested in the Company during the Rate Year?
8 A. No, it does not. Because Company witness VanderWeide's
9 rebuttal identifies and discusses several of the
10 problems with the Staff's application of the DCF
11 methodology, I will confine my comments to Staff's
12 over-reliance on its particular version of DCF.
13 Q. In defending Staff's reliance on its DCF methodology,
14 Staff quotes (p. 66) the Commission's Order in Case
15 06-E-1433:
16
17 …the method offers the significant benefit of
18 reliance on readily available, objective data to
19 measure an indicator of real importance to
20 investors.

1 Q. Does Staff's DCF methodology rely on observable,
2 objective data?
3 A. The DCF methodology for estimating returns on equity
4 is heavily dependent on factors such as dividend
5 growth estimates, for both the near-term and the
6 distant future which are neither observable nor
7 objective. Staff's dividend growth estimates are
8 based on a single source, *Value Line*. This firm is
9 one among many providers of financial estimates, and
10 Staff has not provided any evidence that *Value Line's*
11 estimates are better researched, more historically
12 accurate, or more closely followed by institutional
13 investors than any other source.
14 The long-term dividend growth estimates are based on a
15 method which requires an estimate of rate of return,
16 which is then used to calculate a rate of return,
17 without regard for whether the input rate of return is
18 consistent with the calculated rate of return which
19 results.
20 There is no reason to believe that the DCF
21 methodology, and, in particular, Staff's version of

1 this methodology, is inherently superior to other
2 methodologies for estimating fair returns to book
3 equity capital.
4
5 **Capital Asset Pricing Model Methodology**
6 Q. Please comment on Staff's CAPM analyses.
7 A. I direct you to the rebuttal testimony of Company
8 witness VanderWeide in which he identifies various
9 flaws with Staff's CAPM analyses.
10
11 **Flotation Costs**
12 Q. Staff has indicated they cannot recommend an
13 adjustment to ROE for recovery of anticipated equity
14 issuance costs due to an inability to confirm whether
15 or not the equity issuance would actually take place.
16 Is the Company able to provide additional information
17 to support the linkage between the projected equity
18 infusion into O&R in March 2019 of $50 million and
19 equity issuance by CEI?
20 A. CEI does not disclose the timing of external equity
21 issuance due to the impact such timing information may

1 have on CEI's market equity price and since such
2 timing may vary based on market conditions. Further,
3 as a practice, CEI provides financing guidance in
4 February on any equity financing needs for the year.
5 Any equity issuance planned for the Rate Year would
6 therefore not be disclosed any earlier than February
7 2019.
8 In February 2018, we provided public equity issuance
9 guidance for 2018 of up to $450 million, in addition
10 to equity issued under CEI's dividend reinvestment,
11 employee stock purchase and long-term incentive plans.
12 To date the issuance has not been completed.
13 CEI has a track record of announcing financing
14 guidance consistent with our forecasted external
15 financing needs. As indicated in Exhibit__(YS-25), in
16 both 2016 and 2017, CEI issued external equity
17 consistent with the financing guidance we provided to
18 investors.
19 Our practice has been to infuse equity into O&R with
20 externally-raised equity. As noted in my response to
21 Staff interrogatory DPS-35-601, item 4, the forecasted

1 $50 million equity infusion is linked to equity
2 issuance by CEI. However, due to the factors above,
3 the anticipated timing of that issuance cannot be
4 disclosed and remains subject to market conditions.
5 Information about any planned CEI 2019 equity issuance
6 will be disclosed with CEI's financing guidance in
7 February 2019.
8 The need for the $50 million equity infusion and
9 general timing of the infusion is based on the 48%
10 equity ratio that is the basis of O&R's current rate
11 plans. While the timing of the equity infusion is
12 generally based on capital structure considerations
13 and the external equity issuance timing takes into
14 consideration exogenous factors such as market
15 conditions, each equity infusion into the utilities is
16 linked to equity issuance by CEI.
17

18 **New York Regulatory Environment**

19 Q. Does Staff's conclusion (p. 106) that investors would
20 have "minimal concern" with an authorized ROE in the

1 "mid-8% range" align with the expectations of utility
2 equity investors?
3 A. No. The 9% ROE currently authorized for O&R is among
4 the lowest in the country as shown in Exhibit__ (YS-8)
5 of my direct testimony. An authorized ROE in the mid-
6 8% range would be well outside the mainstream for
7 equity investors, despite their awareness of New
8 York's formulaic approach. Wolfe's equity research
9 analyst, Steve Fleishman, the currently top-ranked
10 utility research analyst by Institutional Investor,
11 referred to the 8.6% recommendation by Staff as "weak"
12 in his June 3, 2018 publication (see Exhibit__(YS-
13 26)). Guggenheim Securities' equity research analyst
14 Shahriar Pourreza referred to it as "punitive" (see
15 Exhibit__(YS-27)). And away from O&R, when New York
16 has implemented authorized ROEs in the mid-8% range,
17 the investor community has reacted quite strongly. On
18 May 4, 2017, Jefferies' research analyst commented on
19 National Fuel Gas's authorized 8.7% ROE (see
20 Exhibit__(YS-28)):
21

1 This is the lowest ROE authorization for a US gas
2 utility in at least the last 30 years & falls ~80
3 bps below the 2016 national average
4 authorization.
5
6 and
7
8 The NY PSC's authorization of the nation's lowest
9 gas utility ROE compounds the perceived risks for
10 investment in the state. As NY residents and tax
11 payers, we are alarmed by these developments as
12 considerations such as regulatory risk are
13 central to those with capital when determining
14 whether to invest in NY or elsewhere.
15
16 Q. Is Staff's evidence indicating that investors view New
17 York regulation as constructive and that Staff's
18 recommended ROE will allow O&R to continue to attract
19 capital on attractive terms, consistent with the
20 perception of equity research analyst's opinion of New
21 York utility regulation?

1 A. No. While the research analysts applaud certain
2 elements of New York utility regulation, including the
3 ability to earn ROEs that are authorized, the actual
4 authorized ROE itself remains a standard and highly-
5 visible measure on which the average rational investor
6 in a competitive market allocating scarce capital can
7 and does compare utilities. Based on this measure,
8 New York continues to underperform.
9 Further, Staff conflates equity investor perceptions
10 with those of the fixed income market, primarily
11 quoting from rating agency commentary on New York
12 regulation. Staff cites New York as a "creditor-
13 friendly jurisdiction" (p. 157). UBS equity analyst
14 Dan Ford regularly compares regulatory quality across
15 investor-owned utilities. Ford ranks New York in his
16 "Tier 3" category out of five tiers, similar to the
17 RRA rankings. When translated into a weighted-average
18 regulatory ranking for CEI itself, the company ranks
19 25 out of 30 companies in UBS's utility coverage
20 universe (see Exhibit__(YS-29)). CEI does not benefit
21 from the regulatory diversification of our peers which

1 places us in a relatively weaker position in the eyes
2 of equity investors, even with an average regulatory
3 construct in New York. As Ford writes, "we
4 incorporate the relationship between quality
5 regulations directly into our valuation framework."
6 Q. What other evidence did Staff attempt to present to
7 support their idea that the Company and investors have
8 minimal concern with regard to an authorized ROE in
9 the mid-8% range?
10 A. Staff cited CEI Board of Directors' increasing of
11 CEI's quarterly dividends on January 18, 2018 from
12 $0.69 to $0.715 as conveying optimism with respect to
13 future cash flows in the current low ROE and interest
14 rate environment.
15 Q. Do you agree with Staff statement?
16 A. No. In the 10-year period from 2007-2017, CEI grew
17 its annual dividend by a compounded annual growth rate
18 of 1.75%, below that of the rate of inflation, 1.85%,
19 in the U.S. as reported by the Bureau of Labor
20 Statistics (Exhibit__(YS-30)). Staff writes in their
21 testimony:

1
2 …rational utility investors expect the growth in
3 future dividends to generally track the changes
4 in output, or growth in the overall economy, as
5 measured by growth in the nominal Gross Domestic
6 Product (GDP) (p. 78).
7
8 and
9
10 Therefore, it would not be unreasonable for
11 investors in the market as a whole to expect
12 their future dividends to generally keep pace
13 with overall inflation, as well as, to reflect
14 productivity gains similar to those expected for
15 the economy as a whole (p. 84).
16
17 Q. How does CEI’s dividend growth compare with that of
18 Staff’s proxy group?
19 A. From 2007-2017, Staff’s proxy group grew dividends per
20 share by an average of 4.55% per year and a median of
21 3.40% per year, well above CEI’s 1.75% growth rate

1 (see Exhibit__(YS-31)). To summarize, CEI's dividend
2 growth rate over the last 10 years has lagged the
3 dividend growth rate of Staff's proxy peers, the GDP
4 growth rate and the inflation rate.
5 Q. Despite your agreement that New York utilities tend to
6 earn their authorized ROEs, do you agree with Staff's
7 position that New York utilities have outperformed
8 other jurisdictions on this measure?
9 A. No. Staff, in their Exhibit__ (FP-35), seeks to
10 demonstrate that on the basis of book return on
11 equity, O&R has outperformed the average utility
12 operating company. This data understates the central
13 tendency of the sample set. Specifically, the
14 reliance on book measures disregards the many
15 differences between regulatory accounting and book
16 accounting. Among others, a number of the utilities
17 include high levels of goodwill on their balance
18 sheets. Utilities do not typically earn a return on
19 goodwill and these balances produce artificially low
20 book equity returns. For example, for two of the
21 lowest ROEs in the exhibit, Jersey Central Power &

1 Light ("JCPL") and Southern Company Gas ("Southern
2 Gas"), have large goodwill balances from prior mergers
3 which clouds ROE. At year-end 2017, JCPL had common
4 equity of $3.19 billion of which $1.81 billion was
5 associated with goodwill. Similarly, at Southern Gas
6 common equity was $9.02 billion but with goodwill of
7 $5.97 billion. Adjusted for the removal of goodwill
8 from the balance sheet, both JCPL and Southern Gas
9 book ROEs rise approximately 500 bps.
10 Q. Dis you find any other flaws in Staff's return on
11 equity analysis?
12 A. Yes. As discussed earlier, Staff compares ROEs
13 calculated on a SEC basis against ROEs calculated
14 using regulatory accounting. ROEs calculated on a SEC
15 basis are not directly comparable to regulatory ROEs.
16 For example, Staff's Exhibit__(FP-35) calculates O&R's
17 2014 earned ROE as 9.64% on a SEC basis. But on a
18 regulatory basis, O&R's earned ROE was only 8.60%.
19 Thus Staff's statement that the Company has not only
20 met, but exceeded its allowed returns is based on a

1 flawed comparison of ROEs calculated under two
2 different bases.
3 Q. What other flaws did you find with Staff's analysis?
4 A. I noted numerous data points for the proxy peers' ROEs
5 that showed unusually low or even negative ROEs.
6 Staff took the data at face value and performed no
7 further analysis to determine why some of these ROEs
8 appeared to be unusually low or even negative. For
9 example, Staff's data shows that Public Service
10 Company of New Mexico ("PSCNM") had a ROE of 0.00% in
11 2015. Upon further analysis, it appears that, in
12 2015, PSCNM had a one-time charge related to the
13 closing of a coal plant. As another example, Staff's
14 analysis showed Mississippi Power Company as having a
15 ROE of -120.34% in 2017. This figure is skewed by a
16 $3.4 billion write-off of the Kemper County energy
17 facility by Mississippi Power Company in 2017. It is
18 typical corporate finance practice to exclude the
19 effects of one-time or extraordinary items from
20 earnings in order to get a true sense of the ongoing
21 earnings of a company. There are many other unusually

1 low and negative ROEs in Staff's data set which likely
2 suffer from the same issue of one-time or
3 extraordinary adjustments. These types of errors will
4 tend to reduce the average ROEs of the proxy group and
5 therefore invalidate Staff's arguments.
6 Q. What conclusion do you draw from Staff's analysis?
7 A. I believe the numerous flaws in Staff's analysis calls
8 the validity of the results into question.
9
10 **SUMMARY**
11 Q. Please summarize your rebuttal testimony concerning
12 Staff's comments on allowed returns and risk.
13 A. In my rebuttal testimony I have identified numerous
14 flaws in Staff's testimony as it does not present a
15 complete analysis of the Company. Staff's direct
16 testimony offers returns that are at the lower bound
17 for the industry. Staff's low recommended ROE along
18 with other factors contained in its presentation
19 further increase the regulatory risk faced by the
20 Company. As the Panel stated (p. 9) in its direct
21 testimony, a fair rate of return for a regulated

1 utility is one that enables it to provide safe and
2 adequate service to its customers, while at the same
3 time assuring it continuing support in the capital
4 markets for both its debt and equity securities, at
5 terms that are reasonable given the company's risk.
6 Staff's proposal regarding rate of return fails to
7 comply with this criteria.

8 Q. Does this conclude your rebuttal and update testimony?

9 A. Yes.