

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Aqua Illinois, Inc.)
) Docket No. 11-0436
Proposed general increase in water and)
sewer rates)

Surrebuttal Testimony of

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October 11, 2011



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1 **I. INTRODUCTION**

2 **Q. Are you the same Harold Walker who previously submitted testimony in this**
3 **proceeding?**

4 A. Yes.

5 **Q. What is the purpose of your surrebuttal testimony?**

6 A. The purpose of my testimony is to respond to the rebuttal testimony of Illinois Commerce
7 Commission (“Commission”) Staff (“Staff”) witness Sheena Kight-Garlich.
8 Specifically, I respond to Ms. Kight-Garlich’s testimony that addresses AQUA’s cost of
9 common equity. My surrebuttal testimony also is supported by AQUA Exhibit 15.1,
10 which is composed of six Schedules.

11 **II. SUMMARY OF CONCLUSIONS**

12 **Q. Please summarize your comments on Ms. Kight-Garlich’s rebuttal testimony.**

13 A. I respectfully disagree with Staff’s proposed return on equity (“ROE”) of 9.43%.¹ Staff’s
14 proposed ROE is entirely unreasonable and should not be accepted by the Commission.
15 First, Staff’s proposal is fundamentally flawed, as I describe again, below. Second, while
16 Staff claims it has properly looked at AQUA’s risk in this proceeding, Staff did not, nor
17 could it, explain how the Company’s risk has been reduced so dramatically as to merit the
18 remarkable departure from historical, Commission-approved ROEs of 10.40% to 10.71%
19 for other water and sewer utilities. (Aqua Ex. 11.0, 11:225-226). As I described in
20 rebuttal testimony, in the last 35 years, the Commission only has adopted a lower ROE

¹ Staff witness Kight-Garlich updated her cost of common equity estimate and stated the cost of equity for her Water Group increased 21-basis points and the cost of equity for her Utility Group increased 12-basis points (Staff Ex. 8.0, 13:227). However, she was silent on whether she was updating her recommendation to 9.51% to reflect the increase in cost rate.

21 for a water or sewer utility on one occasion, under circumstances dissimilar to those
22 present in this proceeding. For reasons unexplained, Staff's proposal for AQUA is a
23 significant departure from recent cases before the Commission. Indeed, Staff offers no
24 explanation, and there is none, to justify an ROE proposal that is 97-basis points to 128-
25 basis points *less* than the Commission-approved ROE for a similarly situated water
26 utilities. This departure and break from prior Commission decisions negatively penalizes
27 AQUA as compared to other water utility companies.

28 Specifically, the Commission should not accept Ms. Kight-Garlich's ROE
29 proposal because:

- 30 • Staff's rebuttal testimony proves that using the same water sample group that
31 Staff used in other rate cases would not necessitate including companies that are
32 less similar in risk to AQUA;
- 33 • Staff abandons the weighting of a Utility Group's ROE from the past rate cases;
- 34 • it is a dramatic change in the DCF model utilized;
- 35 • Staff's analysis places undue reliance on only Zacks projected growth rates;
- 36 • Staff places undue reliance on short term recent economic conditions in
37 determining a long term sustainable growth of the economy;
- 38 • Staff places undue reliance on "spot date" interest rates and dividend yields;
- 39 • Staff places sole reliance on one model to estimate the cost of equity;
- 40 • Staff's analysis clearly fails a comparison test of other Commission authorized
41 returns;
- 42 • Staff's assumed growth rate is at odds with the facts that Staff's Water Sample
43 group has been growing by more than two-times the rate of the growth of the
44 economy for the past 30 years;
- 45 • Staff's Water Sample group will prospectively grow at a higher rate than the
46 economy as long as mandated capital improvements are required and
47 consolidation and acquisitions occur;
- 48 • Staff fails to acknowledge that AQUA has, historically, significantly under-
49 earned compared to its authorized ROE, which suggests the Company will only

- 50 earn a ROE of 6.63% if authorized a 9.43% ROE;
- 51 • Staff’s proposal conflicts with the precepts of a fair rate of return, including the
52 capital attraction standard, and the financial integrity standard;
- 53 • Staff’s position completely fails to consider the importance to the Company’s
54 customers and the State concerning the investment of \$165.4 million in this
55 State’s economy since 2000, and the disincentives resulting from being authorized
56 a ROE of only 9.43%;
- 57 • Staff ’s position fails to recognize the likely result of financial capital fleeing the
58 State as a direct reaction to the Company being authorized a ROE of only 9.43%;
59 and
- 60 • Staff’s position disregards the importance of regulatory stability, the importance
61 of reasonable ROEs and other regulatory signals that are analyzed by the entities
62 responsible for providing capital for future investments: investment advisory
63 firms, credit rating agencies, and investors.

64 Finally, my testimony examines and refutes Ms. Kight-Garlich’s alleged
65 criticisms of my rebuttal analysis. As I describe later in this testimony, these claims are
66 baseless and should be rejected.

67 **Q. How does Staff’s recommended ROE impact AQUA and its customers?**

68 A. Staff’s proposal for AQUA is a significant and unexplained departure from recent cases
69 before the Commission. Staff’s proposed ROE will have a significant negative impact on
70 AQUA and its customers. First, Staff’s ROE would place AQUA at a competitive
71 disadvantage in the capital markets, making it more difficult and costly to obtain the
72 capital necessary to finance future infrastructure improvements. If AQUA is unable to
73 compete to obtain capital at competitive rates, or unable to obtain capital through the
74 market, AQUA’s ability to continue to offer reliable service will be put at risk. Such a
75 result does not benefit customers or AQUA’s regional economy. Second, Staff’s
76 proposal disregards recent Commission decisions and upends traditional notions of
77 regulatory certainty. Staff offers no basis, and there is none, to abandon the use of

78 sample groups and weightings of their cost rates that the Commission historically has
79 employed for water and sewer utilities. In short, disregard for regulatory certainty makes
80 it virtually impossible for a small water company to properly plan for future investments
81 in its infrastructure and discourages AQUA from acquiring troubled systems to support
82 the Commission’s goals². Quite simply, when appropriate return on investment is
83 lacking, it discourages investment. This result benefits no one, and contradicts long-
84 standing notions of sound regulatory policy.

85 **Q. Given the flaws in Staff’s ROE analysis, what is your proposed solution?**

86 A. My analysis continues to support an ROE of 11.10% for AQUA. (See Walker Dir.,
87 AQUA Ex. 5.0). However, the Company has opted to cap its ROE request at 10.90% and
88 this is the level of ROE the Company proposes the Commission adopt. In my direct
89 testimony, I used several models to help me in formulating my recommended common
90 equity cost rate including discounted Cash Flow (“DCF”), Capital Asset Pricing Model
91 (“CAPM”) and Risk Policy (“RP”). Based upon the results of my entire analysis, I
92 conclude AQUA’s current common equity cost rate is 11.10% and the current range of
93 common equity cost for AQUA is 10.9% to 11.2%, which is close to Ms. Kight-
94 Garlisch’s range of common equity cost rate for her Utility Group of 10.30% to 10.59%
95 (see Schedule 4). Staff has not provided any new evidence or explanation that supports

² “The Commission has continued its efforts to reduce the number of small utilities. Small utilities, due to their limited number of customers, typically have difficulties generating sufficient revenues to maintain the system and to hire employees with the necessary expertise to function efficiently as an investor-owned utility. The Commission has found that, in most cases, customers receive better service from larger utilities due to the economies of scale. The Commission has promoted acquisitions or mergers of small systems by larger municipal and investor-owned utilities to take advantage of these economies of scale. . . This type of activity was evident during 2010:

□□ In January, the Commission approved a joint petition allowing Aqua Illinois, Inc. to acquire the wastewater collection and treatment system of Ellwood Greens Utility Corporation, a small investor-owned sewer utility in DeKalb County (Docket No. 09-0335).” (Illinois Commerce Commission *Annual Report On Electricity, Gas, Water And Sewer Utilities* 2010, 1/28/11, page 20)

96 her recommendation that the cost of equity, ROE, has changed drastically from the
97 averaged 10.71% ROE authorized for other water and sewer utilities over the last 30
98 months. Instead, Staff offers a mechanical analysis without considering real world
99 consequences. AQUA, its customers, and Illinois' economy is likely to suffer the brunt
100 of the impact that adoption of Staff's unreasonable recommendation will have as
101 financial capital flees the State.

102 At a minimum, the Commission should determine that AQUA's ROE is no lower
103 than 9.77%. While the evidence shows that there are many reasons why AQUA's ROE
104 should be even higher – as described later in this testimony - the 9.77% figure represents
105 the lowest end of the range for a reasonable ROE. This result adopts Staff's overall
106 approach, but adjusts the weighting of the sample groups consistent with what both Staff
107 and AQUA each determined was reasonable in AQUA's 2010 rate case, and which the
108 Commission approved. Here, Staff offers no reasonable explanation why it fails to
109 employ such a weighting in this proceeding. Consequently, the Commission should
110 adopt no lower than a 9.77% ROE for AQUA.

111 **III. RESPONSE TO MS. KIGHT-GARLISCH'S REBUTTAL TESTIMONY**

112 **Q. What is Ms. Kight-Garlich proposed ROE for AQUA?**

113 A. In Ms. Kight-Garlich's direct testimony she recommends a 9.09% to 10.12% range of
114 return on common equity with a specific recommendation of 9.43%. Staff's direct
115 testimony recommendation is based on giving two-thirds weight to the lower end of her
116 cost rate range, 9.09%, or Staff's Water Sample, and giving one-third weight to the upper
117 end of her cost rate range, 10.12%, or Staff's Utility Sample.

118 In Ms. Kight-Garlich's rebuttal testimony she updated her common equity cost
119 estimates, changed the companies contained in her sample groups, and changed her DCF
120 methodology. In Ms. Kight-Garlich's rebuttal testimony she stated the cost of equity for
121 her Water Group increased 21-basis points and the cost of equity for her Utility Group
122 changed 12-basis points (Staff Ex. 8.0, 13:227). However, Staff was silent on whether
123 she was updating her recommendation to 9.51% to reflect the increase in cost rate and
124 whether she was still advocating her original 2/3 weighting to Staff's Water Sample and
125 1/3 weighting to Staff's Utility Sample.

126 Further, in Staff's Rebuttal Testimony she updated her common equity cost
127 estimates, both including and excluding American Water Works Company ("AWK") in
128 her Water Sample. She stated the inclusion of AWK increased the Water Sample's DCF
129 to 9.23% and produced a Water Sample's CAPM of 9.44%. Based upon her original 2/3
130 weighting to Staff's Water Sample and 1/3 weighting to Staff's Utility Sample, the
131 inclusion of AWK results in an updated cost of common equity of 9.55% for Staff based
132 on her Rebuttal Testimony and methodology.

133 As stated previously, Ms. Kight-Garlich was silent on whether she was still
134 advocating her original 2/3 weighting to Staff's Water Sample and 1/3 weighting to
135 Staff's Utility Sample. In December 2010, AQUA was authorized a return on equity of
136 10.03% for their Kankakee division.³ It should be noted that I use the acronym
137 "AQUA2010" to refer to that rate case. In AQUA2010, the Staff and the Company
138 agreed that the evidence demonstrated the sample group of water utilities was small and,
139 thus, prone to measurement errors. Consequently, AQUA and Staff agreed that the

³ Order in Docket No. 10-0194 from December 2, 2010.

140 evidence showed that a revised weighting of Staff's Water Sample Group and Utility
141 Sample Group to the following: 1/3 weighting to Staff's Water Sample and 2/3 weighting
142 to Staff's Utility sample because "Aqua and Staff agree and stipulate that the cost of
143 common equity estimates for smaller samples are prone to more measurement error."⁴
144 Despite this agreement on these facts in that proceeding, Staff offers no explanation now
145 to explain its departure to an admittedly flawed weighting proposal.

146 Further, IAWC was recently authorized a return on equity of 10.38% in
147 April 2010.⁵ It should be noted that I use the acronym "IAWC2009" to refer to this rate
148 case. In the IAWC2009 rate case, Staff's Utility Group was given 100% weighting.
149 Again, despite these facts in that proceeding, Staff offers no explanation now to explain
150 its departure to an admittedly flawed weighting proposal.

151 Schedule 1 summarizes the changes in Staff's cost rate estimates from her Direct
152 Testimony to her Rebuttal Testimony. Schedule 1 also summarizes the impact of
153 changing the weighting between the sample groups' cost rates to be consistent with both
154 Staff and the Commission's findings in IAWC2009 and AQUA2010. As shown on
155 Schedule 1, using the weighting from AQUA2010 indicates a cost of common equity of
156 9.77% based on the Staff's cost of common equity estimate contained in her Direct
157 Testimony, a 9.74% cost of common equity based on the Staff's cost of common equity
158 estimate contained in her Rebuttal Testimony, and a 9.76% cost of common equity based
159 on the Staff's cost of common equity estimate contained in her Rebuttal Testimony when
160 AWK is included in the sample group.

⁴ Order in Docket No. 10-0194, pg. 20.

⁵ Order in Docket No. 09-0319 from April 13, 2010.

161 Schedule 1 also shows the result of using the weighting from IAWC2009
162 indicates a cost of common equity of 10.12% based on the Staff's cost of common equity
163 estimate contained in her Direct Testimony, and a 9.97% cost of common equity based on
164 the Staff's cost of common equity estimate contained in her Rebuttal Testimony, both
165 including and excluding AWK in the sample group.

166 **Q. Did Ms. Kight-Garlich use similar cost rate models in both her Direct Testimony**
167 **and her Rebuttal Testimony?**

168 A. No. She used a single-stage or constant growth DCF in her Direct Testimony but
169 switched to a multi-stage DCF in her Rebuttal Testimony. Accordingly, the changes in
170 the cost rate estimates from her Direct Testimony to her Rebuttal Testimony summarized
171 on Schedule 1 reflect her change in DCF methodologies.

172 Ms. Kight-Garlich claimed she switched DCF methodologies because she
173 believed the updated growth rates used in her DCF were no longer sustainable. This
174 claim, however, is based on nothing more than speculation, as Ms. Kight-Garlich did not
175 provide any proof that investors believe the updated published growth rates contained in
176 her Rebuttal Testimony are not sustainable. I find it interesting that her Water Sample
177 updated published growth rates contained in her Rebuttal Testimony are 230-basis points
178 higher than they were in here Direct Testimony, and yet she remains silent on changing
179 her cost rate recommendation for AQUA. Similarly, Ms. Kight-Garlich's Utility Sample
180 updated published growth rates contained in her Rebuttal Testimony are 61-basis points
181 higher than they were in her Direct Testimony, and yet, again, she remains silent on
182 changing her cost rate recommendation for AQUA.

183 Page 2 of Schedule 2 summarizes the changes in Staff's cost rate estimates from
184 Direct Testimony to Rebuttal Testimony that would have occurred had there been no

185 switch in DCF methodologies. As shown on Page 2 of Schedule 2, using the weighting
186 from Staff's Direct Testimony indicates a cost of common equity of 10.05% when Staff's
187 constant growth DCF is used. Page 2 of Schedule 2 also summarizes the impact of
188 changing the weighting between the sample groups' cost rates to be consistent with both
189 Staff and the Commission's findings in IAWC2009 and AQUA2010. As shown on Page
190 2 of Schedule 2, using the weighting from AQUA2010 indicates a cost of common equity
191 of 10.11% when staff's constant growth DCF is used, and a 10.17% cost of common
192 equity when staff's constant growth DCF is used.

193 As mentioned previously, when Staff updated the common equity cost estimates
194 in Rebuttal Testimony, these estimates both included and excluded AWK in the Water
195 Sample. When AWK is included in Staff's Water Sample, the updated published growth
196 rates contained in her Rebuttal Testimony are 260-basis points higher than they were in
197 Direct Testimony, and yet Staff fails to adjust its cost rate recommendation for AQUA.
198 Based upon Ms. Kight-Garlich's original 2/3 weighting to Staff's Water Sample and 1/3
199 weighting to Staff's Utility Sample, the inclusion of AWK results in an updated cost of
200 common equity of 10.14% for Staff based on their Rebuttal Testimony and a constant
201 growth DCF methodology as shown on Page 2 of Schedule 2. Page 2 of Schedule 2 also
202 summarizes the impact of changing the weighting between the sample groups' cost rates
203 to be consistent with both Staff and the Commission's findings in IAWC2009 and
204 AQUA2010. As shown on Page 2 of Schedule 2, using the weighting from AQUA2010
205 indicates a cost of common equity of 10.15% when AWK is included and Staff's constant
206 growth DCF is used, and a 10.17% cost of common equity when AWK is included and
207 Staff's constant growth DCF is used.

208 It is certainly debatable whether a constant growth DCF, like the model used in
209 Staff's Direct Testimony, should be used, or whether a multi-stage DCF, like the model
210 used in Staff's Rebuttal Testimony, should be used. What is not debatable, however, is
211 that if one finds that growth rates have increased by 230-basis points to 260-basis points,
212 that common equity cost rates have not increased as well. It appears that Staff changed
213 its DCF methodology to mask the obvious increase in common equity cost rates.

214 **Q. In Staff's Rebuttal Testimony, Ms. Kight-Garlich states that American Water**
215 **Works Company, or AWK, should not be included in the Water Sample because**
216 **their published betas are based on three years of data. Is this a valid reason for her**
217 **not to include AWK in her Water Sample?**

218 A. No. In determining cost of capital in a rate making setting, we are tasked with estimating
219 investors' required returns, not Staff's required return. Further, contrary to Staff's
220 Rebuttal Testimony regarding business cycles, AWK betas reflect data for the same
221 number of business cycles reflected in the betas for the companies contained in Staff's
222 sample groups. AWK has published betas by both sources (*i.e.*, Zacks and Value Line)
223 of information utilized by Staff for beta determination. Neither Zacks nor Value Line
224 caution investors that AWK's beta may be may be under-stated or over-stated due to the
225 amount of price data available. Both Zacks and Value Line believe there is sufficient
226 data to determine AWK's beta as evident by their publishing betas for AWK.

227 It is simply not correct to assume that investors rely only upon the Staff's
228 calculated betas when other well-known published sources of beta from Zacks and Value
229 Line are available. Investors, analysts, and other public utility commissions rely upon a
230 wide range of sources of beta. Accordingly, stock prices reflect a wide range of sources

231 of beta. It is just not practical or realistic to believe stock prices only reflect the betas
232 calculated by Staff when other well-known published sources of beta are available.

233 Additionally, it is rather odd that Staff voices a concern over using three years of
234 price data to determine beta when Staff's entire risk analysis, or "Principal Component
235 Analysis Scores" also is based on three years of data. After all, the results of Staff's
236 "Principal Component Analysis Scores" are the sole basis of their weighting scheme
237 applied to their sample groups common equity cost rate.

238 **Q. Do you have any comments on Ms. Kight-Garlich sustainable growth or long-term**
239 **growth reflected in her DCF used in her Rebuttal Testimony?**

240 A. Yes. Ms. Kight-Garlich's long term growth reflected in her DCF used in her Rebuttal
241 Testimony uses the estimated growth rate for long-term GDP. However, her estimate is
242 based on only 15 years to 20 years of data⁶, not the sustainable growth required by the
243 multi-stage DCF model. Ms. Kight-Garlich's GDP growth rate forecast is incorrect
244 because it is based on erroneous assumptions that are inconsistent with actual historical
245 growth for the U.S. economy. For example, none of the sources relied upon by Staff
246 reflect any business cycles. Ms. Kight-Garlich testifies to the importance of business
247 cycles in her Rebuttal Testimony stating, "a longer measurement period should be used as
248 a more complete business cycle will include both rising and falling markets, reducing
249 measurement error."⁷

250 Additionally, part of Ms. Kight-Garlich estimate of future inflation is negatively
251 skewed by the artificially low interest rates resulting from the government's attempted
252 expansionary money policies. Specifically the 10-year and 30-year U.S. Treasury

⁶ Staff used EIA forecast for the period 2021-2035 and Global Insight forecast for the period 2021-2041.

⁷ (Staff Ex. 8.0, 2-3:39-41)

253 Inflation-Protected Securities, or TIPS, and the 10-year and 30-year U.S. Treasury rates
254 used by Ms. Kight-Garlich are some of the lowest, or even the lowest rates, ever
255 reported⁸, reflective of world governments' money policies amidst the ongoing financial
256 crisis and market turmoil. For example, Ms. Kight-Garlich's 2.4% inflation rate, based
257 on recent money policies, compares to the actual long term GDP inflation rates that have
258 averaged 3.0% over the last 80 years.

259 Similarly, Ms. Kight-Garlich's real GDP growth rate of 2.6% is much lower than
260 the actual real long term growth rate of 3.4% over the last 80 years. Ms. Kight-Garlich
261 combines her estimate of inflation and real GDP growth to produce a 4.8% nominal GDP
262 growth rate, which is considerably lower than the 6.59% nominal GDP growth rate over
263 the last 80 years. In my direct testimony I explained why investors believe the long-term
264 growth of the economy is between 6.09% and 6.34%. Further, it is my understanding the
265 Commission has recently rejected the methodology utilized by Staff in estimating the
266 expected long-term overall rate of growth for the economy.

267 The Commission finds problems with how . . . GDP growth rate
268 forecast is calculated because it is based on assumptions that are
269 inconsistent with actual historical growth for the U.S. economy. . .
270 It is reasonable to believe that future real growth and inflation will
271 both be 3% and therefore a 6% growth rate is a more reasonable
272 proxy for investor's long-term expectations.⁹

273 I believe that the nominal GDP growth rate of 6.09% to 6.34% I estimated is
274 based on general economic conditions that investors may expect for water utilities in the
275 very long run, as is required in the DCF model. However, as the Commission stated, it is

⁸ A review of all historical monthly rates available from the Federal Reserve indicates the rates used by Staff to be lower than any monthly rates since 1953, reported through the end of September 2011.

⁹ Docket No. 10-0467, Order at 153 (May 24, 2011).

276 certainly reasonable to believe that future real growth and inflation will each be 3% and
277 therefore, a 6% growth rate is a reasonable proxy for investor's long-term expectations.

278 The difference between the Staff's 4.8% and the Commission's 6.0% nominal
279 GDP growth rate is extremely important to investors. For example, using the
280 Commission's 6.0% nominal GDP growth rate instead of the Staff's 4.8% growth would
281 result in the size of the U.S. economy being much larger than the Staff's theoretical
282 economy, or about:

- 283 • 12% larger in 10 years;
- 284 • 25% larger in 25 years;
- 285 • 77% larger in 50 years;
- 286 • 212% larger in 100 years; and
- 287 • 874% larger in 200 years.
- 288

289 **Q. Can you estimate what Staff's recommendations from her Rebuttal Testimony**
290 **would be if she used a multi-stage growth model reflecting a "more reasonable**
291 **proxy for investor's long-term expectations" for growth of the economy of 6.0%, as**
292 **determined by the Commission, in her DCF?**

293 A. Yes. On Schedule 3, I calculated a multi-stage growth or three-stage growth model
294 reflecting a "more reasonable proxy for investor's long-term expectations" for growth of
295 the economy of 6.0%. All of the data utilized comes from Staff's Rebuttal Testimony
296 with the exception of the 6.0% long-term growth of the economy that was recently
297 determined by the Commission. As shown on Schedule 3, I calculated a multi-stage
298 growth DCF for each of Staff's groups based on Staff's spot 9/16/11 data.

299 A comparison of the estimated cost rates based on a multi-stage DCF employing
300 the 6.0% long-term growth of the economy that was determined by the Commission
301 shows it produces a more reasonable indicated cost of equity for the Water Group

302 10.02%, and is 10.05% when AWK is included. The indicated cost of equity for the
303 Utility Group is shown to be 10.59%.

304 **Q. What information is shown on Schedule 4?**

305 A. Schedule 4 shows the end result of including the results of Staff's Rebuttal Testimony
306 multi-stage DCF corrected to include the 6.0% long-term growth of the economy that was
307 recently determined by the Commission, and based on the weightings recommended by
308 Staff in the current case, the weightings used in AQUA2010, and the weightings used in
309 IAWC2009.

310 As stated previously, Staff recommends in the current case a 1/3 weighting to
311 Staff's Utility sample and 2/3 weighting to Staff's Water sample. In AQUA2010, the
312 Staff and the Company determined that the evidence supported a 2/3 weighting to Staff's
313 Utility sample and 1/3 weighting to its Water sample. The Commission concurred. In
314 IAWC2009, Staff recommended utilizing a weighting of 100% given to Staff's Utility
315 sample and, again, the Commission concurred.

316 As shown on Schedule 4, using the weighting from Staff's Direct Testimony
317 indicates a cost of common equity of 9.97%, a 10.21% cost of common equity based on
318 the weighting from AQUA2010, and a 10.45% cost of common equity based on the
319 weighting from IAWC2009. Further, when AWK is included in the sample groups, the
320 indicated cost of equity for the Utility Group using the weighting from Staff's Direct
321 Testimony indicates a cost of common equity of 9.98%, a 10.22% cost of common equity
322 based on the weighting from AQUA2010, and a 10.45% cost of common equity based on
323 the weighting from IAWC2009.

324 **Q. How do you respond to Ms. Kight-Garlich's growth rate contentions (Staff Ex. 8.0,**
325 **5:90-6:111) based on her "BxR" comparison?**

326 A. Ms. Kight-Garlich's growth rate comments focus on an illogical comparison. She tries
327 to show that my long-term growth of the economy of 6.08% from my Direct Testimony is
328 not sustainable based on a "BxR" comparison.¹⁰ However, the retention rates cited by
329 Ms. Kight-Garlich of 29% and 43% are abnormally low due to the comparison
330 companies' low return rates on book common equity, shown on Schedule 6. In reality,
331 earnings per share or EPS growth rate reflecting changes in return rates on book common
332 equity (ROE) over time will greatly exceed book value growth as a result of increasing
333 the comparable companies' currently low earnings, to the higher levels projected to be
334 achieved by Value Line (i.e., occurring when ROEs increase from 9.0% to 11.4%-12.0%
335 for the Water Group over various holding periods).

336 Recently in the Order in Docket 10-0467, entered on May 24, 2010, the
337 Commission stated, "The Commission agrees with ComEd" that Staff "improperly
338 employs a 'spot date' approach in its CAPM analysis as well as a 'b times r' sustainable
339 growth argument – both of which this Commission has recently rejected." (Order at pg
340 152) The "BxR" growth argument has been rejected by the Commission in numerous
341 prior cases including Docket Nos. 93-0301, 94-004, Docket 94-0065 and in Docket 09-
342 0306.

343 A counter example using Staff's own ROE recommendation illustrates the failing
344 of the "B x R" growth argument. Based on the average retention rate in her Water Group
345 Sample of 31.46%, shown on Schedule 6, and her 9.28% estimated cost of equity for the

¹⁰ The "B x R" (pronounced "*b times r*") growth rate calculation is sometimes called the "sustainable" growth method or "internal growth". It assumes that a company's growth comes only from its retention of earnings ("B") multiplied by its return on equity ("R"). The "B x R" method assumes that "B" and "R" remain constant, which is not realistic. The "B x R" method measures growth of book value not stock price. Growth in book value is meaningless given today's relatively high market-to-book ratios and therefore, "B x R" growth is not a good surrogate for investors' growth expectations.

346 Water Group, the implied "B x R" growth rate is 2.92% ($31.46\% \times 9.28\% = 2.92\%$).
347 Adding that growth rate to the adjusted dividend yield range from Staff's group of 3.58%
348 ($3.48\% \times 1.0292 = 3.58\%$) produces an estimated cost of equity of only 6.50% (3.58%
349 yield + 2.92% growth = 6.50% ROE) for Staff's Water Group.¹¹ Obviously, this approach
350 is inconsistent with Staff's own 9.28% estimated cost of equity for the Water Group
351 recommendation and it clearly demonstrates why the "B x R" approach has been rejected.
352 Ms. Kight-Garlich's testimony based on this approach should also be rejected.

353 **Q. Ms. Kight-Garlich testifies that, "expanding a sample would necessitate including**
354 **companies that are less similar in risk to the target utility." (Staff Ex. 8.0, 3:57-58).**
355 **She adds that, "although five companies is a small sample, the Water Sample is**
356 **more similar to Aqua in terms of risk." (Id. at 3:61-63). Do you agree with**
357 **Ms. Kight-Garlich?**

358 A. I agree that five companies is a small sample especially in light of how the Staff
359 mechanistically computes common equity cost rates, which includes sole use of Zacks
360 growth rates and suffers from the combined impact of selecting small water utilities that
361 security analysts thinly cover¹². However, I do not agree that expanding Staff's sample
362 would necessitate including companies that are less similar in risk to AQUA. Further, as
363 mentioned previously, Staff's entire risk analysis, or "Principal Component Analysis
364 Scores" is based on only three years of data and the results of Staff's "Principal

¹¹ The results for Staff's Utility Group are even worse at -12.47%. The Utility Group Sample (-161.38%) and her 9.97% estimated cost of equity for the Water Group, the implied "B x R" growth rate is -16.09% ($-161.38\% \times 9.97\% = -16.09\%$). Adding that growth rate to the adjusted dividend yield range from her group of 3.62% ($4.32\% \times 83.91 = 3.62\%$) produces an estimated cost of equity of only -12.47% (3.62% yield + -16.09% growth = -12.47% ROE) Obviously, this approach is inconsistent with Staff's own 9.97% estimated cost of equity for the Utility Group.

¹² As shown on Schedule 2 of Aqua Ex.11.1, four of Staff's Water Group companies have only one security analyst providing a growth rate estimate. On average, Staff's Water Group's DCF reflects a growth rate projection from only 1.2 analysts. Staff's Utility Group's DCF reflects a growth rate projection from twice as many security analysts per company on average, as cover Staff's Water Group.

365 Component Analysis Scores” are the sole basis of Staff’s weighting scheme applied to
366 their sample groups’ common equity cost rate.

367 **Q. Is Ms. Kight-Garlich’s argument that growth rates that are not updated daily**
368 **affect their usefulness correct?**

369 A. No. Publishers and vendors of projected growth rates provide their projections in varying
370 forms on a subscription basis. The frequency and format of an update of projected
371 growth rates will generally impact the cost of subscription. However, the frequency and
372 format of the updates do not impact their usefulness since investors ultimately rely upon
373 the published projected growth rates. Therefore, since investors rely upon the published
374 projections, they are reflected in stock prices.

375 **Q. Is Ms. Kight-Garlich testimony that value lines’ market return used in your CAPM**
376 **is based on a DCF correct?**

377 A. No. Value Line’s market return is based on a published numerical value. Value Line
378 does not perform a DCF-based cost of equity estimate to determine their published
379 numerical value. Moreover, I did not use a DCF-based cost of equity model to determine
380 the market return component of my CAPM analysis. In the current proceeding,
381 Ms. Kight-Garlich is the only witness to employ a DCF-based cost of equity estimated
382 market return component in her CAPM analysis.

383 **Q. Do you have any more comments regarding Ms. Kight-Garlich testimony on**
384 **CAPM?**

385 A. Yes. Ms. Kight-Garlich’s Rebuttal Testimony CAPM estimate is too low because she
386 mismatches the CAPM inputs for the risk-free rate (i.e., from a recent “spot date” time
387 period) and the market risk premium from the time period used in her Direct Testimony.

388 This mismatch appears to produce a low estimate of the common equity cost rate.

389 Additionally, Staff's updated CAPM uses a "spot date" for determining her risk-free rate
390 or U.S. Treasury bond yield. The U.S. Treasury bond yield used by Staff is one of the
391 lowest, if not the lowest, U.S. Treasury bond yield ever reported. Accordingly, Staff's
392 CAPM is negatively skewed by the artificially low interest rates resulting from the
393 government's attempted expansionary money policies and is reflective of world
394 governments' money policies amidst the ongoing financial crisis and market turmoil.

395 Since October 2008, the Federal Reserve has been monetizing US Treasury debt.
396 The Federal Reserve, with effectively unlimited money at its disposal, intervenes at any
397 time it wishes, in whatever volume it wishes, to make sure that Treasury bond and bill
398 prices and yields are exactly what the Fed wants them to be. The US Treasury bond
399 market, and mortgage market, has become an artificial market with no connection to
400 objective risk and interest rates. The Federal Reserve's current holdings of US Treasury
401 debt and Federal agency debt is \$2.160 trillion higher than it was at the beginning of
402 October 2008. Additionally, the Federal Reserve holds additional US Treasury debt in a
403 special account for various foreign central banks called the "Custody Account" to assist
404 the Federal Reserve in its monetary policies. The "Custody Account" has increased by
405 \$1.184 trillion since the beginning of October 2008.

406 Over the past month, the Federal Reserve began "Operation Twist." Under
407 "Operation Twist," the Federal Reserve began buying \$400 billion of long-dated or long-
408 term US Treasury debt, financed by selling short-term US Treasury debt with three years
409 to go or less. The goal of "Operation Twist" is to try to drive long-term rates lower,
410 which the Federal Reserve thinks will help the mortgage market. Further, not only has
411 the Federal Reserve been buying long-term US Treasury debt to reduce interest rates,
412 their member banks have been borrowing at 0% and using those proceeds to buy long-

413 term US Treasury debt. This entire process has created an artificial demand for the US
414 Treasury debt themselves, and easily drives interest rates artificially lower and deceives
415 investors into believing US Treasury debt are safe with wide demand. In fact, the long-
416 term Treasury Bonds yield has been far below the prevailing Price Inflation rate for a
417 while. This fact has resulted in the entire capital system suffering from the Federal
418 Reserve's grand distortion.

419 Staff's recommended cost of common equity fails to consider the ongoing effects
420 of the recent financial crisis. Staff's CAPM estimation is more aligned with the
421 artificially low, government policy-induced interest rates than with the market cost of
422 equity capital. I believe it is inappropriate and unfair to set AQUA's cost of equity based
423 on a short-lived blip in bond interest that the data shows to have been strikingly atypical.
424 Staff's updated CAPM is 28-basis points to 37-basis points lower than the CAPM
425 contained in Staff's Direct Testimony due almost entirely to her use of a "spot date"
426 interest rate that is one of lowest, if not the lowest U.S. Treasury bond yield ever
427 reported.

428 Since October 2008, the capital markets have been rather chaotic. I believe the
429 market turmoil is possibly the worst since the 1929 Great Depression because there have
430 been numerous bankruptcies in the financial sector, striking declines in equity valuations,
431 and an overall unsteadiness in the economy, both domestic and foreign, during the last
432 three years.

433 **Q. Do you have any comments regarding Staff's testimony that AQUA's ability to**
434 **access capital is not based on its assets, earnings, and cash flow?**

435 A. Yes. Ms. Kight-Garlich believes that since AQUA's parent company, Aqua America,
436 raises all external equity capital, access to and the ability to attract common equity capital

437 is based upon the resources of Aqua America. The capital attraction standard, a precept
438 of a fair rate of return, requires that the entity, AQUA, be able to attract capital at all
439 times. Moreover, the financial integrity standard, another precept of a fair rate of return,
440 requires the return assures confidence in the financial soundness of the AQUA, not its
441 parent company.

442 A sole shareholder like Aqua America prefers that a utility subsidiary must
443 exhibit the ability to attract the capital it requires as a prerequisite to the initiation to
444 warrant new common equity investment. AQUA is dedicated to providing the best
445 possible water service at a reasonable cost consistent with adequate compensation for
446 investors. The ability to attract needed capital is dependent upon consistently achieving
447 adequate earnings, which result from providing exceptional quality water and service for
448 customers through the state operating companies.

449 The level of an authorized return on equity provides an indication, or lack thereof,
450 of regulatory support for the utilities that a commission regulates. It provides a familiar
451 benchmark that can be compared from one utility to another. To retain existing capital
452 and to attract new capital, the authorized rate of return on common equity must be high
453 enough to satisfy investors' requirements at all times; including periods of economic
454 uncertainty.

455 A company's authorized ROE is fundamental to its ability to attract capital and
456 finance construction.

457 Whether generated by the regulated or deregulated side of the
458 business, profitability is critical for utilities because of the need to
459 fund investment-generating capacity, maintain access to external
460 debt and equity capital, and make acquisitions. Profit potential and
461 stability is a critical determinant of credit protection. A company
462 that generates higher operating margins and returns on capital also
463 has a greater ability to fund growth internally, attract capital

464 externally, and withstand business adversity. Earnings power
465 ultimately attests to the value of the company's assets, as well. In
466 fact, a company's profit performance offers a litmus test of its
467 fundamental health and competitive position.

468 Accordingly, the conclusions about profitability should confirm the
469 assessment of business risk, including the degree of advantage
470 provided by the regulatory environment.¹³

471 Credit rating agencies regard regulation as a prime determinant of credit quality
472 especially when a utility has a large construction program.

473 Regulation is the most critical aspect that underlies regulated
474 integrated utilities' creditworthiness. Regulatory decisions can
475 profoundly affect financial performance. Our assessment of the
476 regulatory environments in which a utility operates is guided by
477 certain principles, most prominently consistency and predictability,
478 as well as efficiency and timeliness. For a regulatory process to be
479 considered supportive of credit quality, it must limit uncertainty in
480 the recovery of a utility's investment. They must also eliminate, or
481 at least greatly reduce, the issue of rate-case lag, especially when a
482 utility engages in a sizable capital expenditure program.¹⁴

483 **Q. Do you have any additional insights regarding Staff's testimony that AQUA's ability**
484 **to access capital is not based on its assets, earnings, and cash flow?**

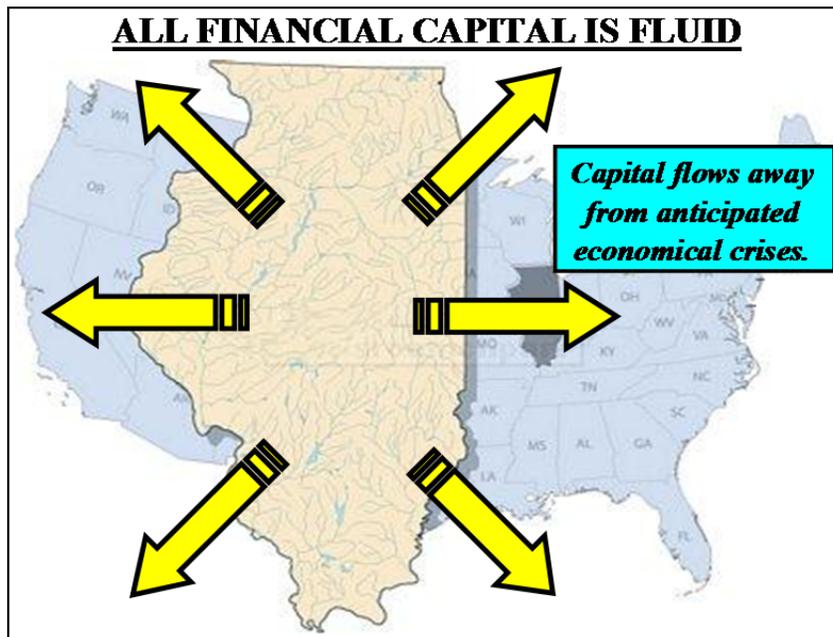
485 A. Yes. Financial capital flows away from anticipated economic crises. Everything is not
486 just driven by interest rates, cash flow or earnings. Financial capital is global, and that
487 means it freely moves in and out of our economy and all economies. Therefore, the price
488 of financial capital is never determined solely by simplistic domestic issues, but by global
489 issues. Globally, we are in a debt crisis, or more precisely, an international debt crisis.

¹³ Standard & Poor's Ratings Services, Criteria, *Utilities: Key Credit Factors: Business And Financial Risks In The Investor-Owned Utilities Industry*, 11/26/08, pgs 8-9.

¹⁴ Standard & Poor's Ratings Services, Criteria, *Utilities: Key Credit Factors: Business And Financial Risks In The Investor-Owned Utilities Industry*, 11/26/08, pg 7.

490 This means that capital can fly internationally in an instant to perceived quality. This
491 flight is often referred to as flight to quality.

492 Financial capital is fluid and seeks and finds an appropriate return for a given
493 level of risk. If a government or a company puts an extra layer of risk over the top, the
494 capital will not remain there and there may be cascading effects on seemingly unrelated
495 entities.



496
497 **Figure 1**

498 Financial capital is fluid. It can flow from one company to another company,
499 from one region to another region. A rate decision that departs from prior rulings,
500 particularly where there is no rational support for the departure, injects regulatory
501 uncertainty into the marketplace. A company can lose their investors, as well as make
502 seemingly unrelated companies lose their investors, when there has been no real change
503 in circumstances, yet a decision breaks from past rulings. The rate decision in this
504 proceeding will impact all utility companies that are regulated in Illinois. Similar
505 occurrences also happen in local economies as a result of controversial decision; financial

506 capital flees cities, counties, states and countries just to avoid taxes. A similar occurrence
507 may result if Staff's unreasonable low ROE is authorized in these proceedings.

508 **Q. Does Ms. Kight-Garlich address the company's history of under-earning its**
509 **authorized ROE?**

510 A. No, her testimony fails to consider this important issue. Further, based on Staff's
511 response to AQUA DR 17, I do not think Staff is aware, or if Staff is, Staff does not think
512 the Company's likelihood of under-earning is significant. In response to this data
513 request, Staff provided a very telling response regarding Staff's opinion on whether the
514 Company would likely under-earn their authorized ROE. Staff's response to AQUA DR
515 17 is attached as Schedule 5 to this testimony.

516 The *Hope*¹⁵ and *Bluefield*¹⁶ decisions establish that utilities are entitled to the
517 opportunity to earn a fair return on their investment that is commensurate with the returns
518 **earned** by other firms of comparable risk. Schedule 6 shows AQUA has experienced the
519 lowest return on equity (ROE) when compared to Staff's sample groups companies over
520 the last several years. Clearly if two identically risky companies were authorized the
521 same ROE but one operated in a regulatory environment where the likelihood of under-
522 earning is significant, then that company would find it harder to attract capital as
523 compared to the entity with less regulatory lag and attrition.

524 Schedule 6 shows AQUA has experienced the greatest regulatory lag and attrition.
525 The Commission should consider the likelihood of under-earning when determining
526 AQUA's cost of capital. Since total risk to an investor is the probability that an investor

¹⁵Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 391 (1944).

¹⁶Bluefield Water Works & Improvement Company v. P.S.C. of West Virginia, 262 U.S. 679 (1923).

527 will not receive a sufficient return on their investment, a low authorized rate of return,
528 such as that advocated by Staff, combined with the likelihood of under-earning will
529 significantly impact AQUA's ability to attract capital and maintain its credit.

530 **Q. Ms. Kight-Garlich questions the usefulness of observing recent Commission**
531 **authorized ROE for other water utilities. Why do you believe it is useful to consider**
532 **recent Commission-authorized ROE for other water utilities?**

533 A. Capital markets do not operate in a vacuum, and neither should the Commission when
534 evaluating a reasonable cost of equity for a utility. While the cost of equity analysis
535 should focus on financial merits of the utility in question, the Commission should, and
536 does, realize that AQUA competes with capital with other regulated and unregulated
537 entities. For this analysis, it would be naïve to think that the investment community does
538 not review comparable Commission decisions on ROE issues. Second, in my opinion,
539 considering recent Commission-authorized ROEs for other water utilities is a means of
540 meeting the comparable standard, a precept of a fair rate of return and, ultimately,
541 provides a test to measure the reasonableness of result. Over the last 30 months, the
542 Commission has authorized ROEs for water and sewer utilities that average 10.71%. The
543 10.71% relates to authorized ROEs for 24 water and sewer utilities. Eighteen of the
544 aforementioned 24 water and sewer utilities, or 75% of the companies, are subsidiaries of
545 either AQUA or IAWC. Accordingly, I believe this fact proves AQUA is at least similar
546 in overall risk to the companies whose authorized ROEs were observed in my rebuttal
547 testimony. Further, I believe it is reasonable to conclude that AQUA may have more
548 overall risk than IAWC.

549 Wall Street and major credit rating agencies believe regulation and an adequate
550 level of authorized ROE is critical to a company's ability to attract capital. An investor's

551 advisory report¹⁷ published by Janney Montgomery Scott LLC had the following
552 information regarding the roll of regulation and an adequate level of authorized ROE play
553 in capital attraction:

554 Regulation can make or break a utility. As such, we believe it is
555 imperative to follow the regulatory nuances at the state level across
556 the water utility sector. (pg 1)

557 ***When we evaluate the regulatory climate of a state, we focus on***
558 ***three key items: consistency of regulatory treatment, allowed***
559 ***ROE, and efforts to minimize the effects of regulatory lag.*** (pg 4)

560 We view 10.0% as floor, and take a negative view on allowed
561 returns below that level, as we believe it is more difficult for
562 utilities sub-par returns to attract investment and generate earnings
563 growth. Conversely, we believe ROEs of 10.5% or higher provide
564 a more attractive incentive for utilities to allocate capital
565 expenditure dollars, and for investors to provide equity capital.
566 (pg 5)

567 Another investor's advisory report¹⁸ published by Robert W. Baird & Co. stated
568 the following information regarding regulation and an adequate level of authorized ROE
569 play in capital attraction:

570 **Regulation can “make or break” potential utility investment**
571 **returns.** . . . When evaluating state regulatory climates, we focus on
572 three key items: consistency of regulatory decisions, authorized
573 ROE, and regulatory practices utilized to minimize regulatory lag.
574 (pg 1)

575
576 **Importance of ROEs.** A key outcome from the rate case
577 proceeding is the allowed return on equity, since it sets investor
578 expectations for equity returns. . . Investors view a 10.0%
579 authorized ROE as an acceptable floor. Authorized ROEs
580 materially below that level are typically viewed negatively by
581 investors. Since authorized ROEs are easily comparable across

¹⁷ Janney Montgomery Scott LLC, *Industry Report, Water Utility Sector*, February 24, 2009. The bolding and italicization is contained in the report.

¹⁸ Robert W. Baird & Co., *Utilities: Initial Publication of Bairds' Regulatory Toolkit*, September 20, 2011. The bolding is contained in the report.

582 state jurisdiction, we believe it is more difficult for utilities to raise
583 capital in a sub-par ROE environment, potentially keeping
584 infrastructure investment and EPS growth below peers. (pg 3)

585
586 **A company’s ability to earn its allowed ROE is equally**
587 **important.** Timely rate relief to cover allowed costs, and
588 surcharge mechanisms that allow utilities to “catch up” between
589 regular rate cases can be critical factors in helping a utility earn its
590 allowed return. (pg 3)

591
592 Similarly, an investor’s research report¹⁹ published Fitch Ratings Ltd had the
593 following information regarding the roll of regulation and an adequate level of authorized
594 ROE play in capital attraction:

595 **Fitch Updates Its Evaluation:** In this Special Report, Fitch
596 Ratings updates its evaluation of trends in utility authorized returns
597 on equity (ROEs). The analysis summarizes rate case
598 determinations over an 18-month period, ending June 30, 2011.

599 **Modestly Lower Trend Continues:** Based on a review of
600 103 electric and gas rate case outcomes that occurred over the 18-
601 month period, Fitch observed that the average ROE authorized is
602 approximately 10.2%. In a prior report, dated March 22, 2010,
603 Fitch determined that the average authorized ROE for 41 rate case
604 decisions over a 15-month period was 10.5%.

605 **ROEs Remain Above 10%:** Fitch concludes that the long-
606 term downward trend of authorized ROEs is stabilizing at or near
607 current levels, with no indications that the trend will reverse. This
608 conclusion is supported by industry data collected over the last five
609 years which produced a range for the average authorized ROE of
610 approximately 10.2%–10.5%. (pg 1)

611
612 **Outcomes Vary by Region:** Fitch noted that ROEs varied,
613 depending on their regions. Authorized ROEs were lowest in the
614 northeast region, with the median authorized ROE at 10.0%. In the
615 Midwest region, the median authorized ROEs were highest, at
616 10.3%. Authorized ROEs in the southern and western regions were
617 in line with the median authorized ROE for the dataset, near
618 10.2%. (pg 1)

619
620 Fitch views the inclusion of rate design components to mitigate
621 regulatory lags as supportive of a stronger credit profile. By
622 contrast, fixed-income investors question the adequacy of lower

¹⁹ Fitch Ratings Ltd., Fitch Evaluates Utility ROE Trends, August 17, 2011.

623 authorized ROEs to cushion bondholders from credit deterioration,
624 and utility-management teams view the lower authorized ROEs as
625 insufficient. Lower authorized ROEs constrain profitability and
626 limit financing flexibility, making the utilities more reliant on
627 external financing sources and vulnerable to higher interest costs.
628 Weak internal cash generation, higher interest costs, and weaker
629 interest coverage measures can lead to lower credit ratings and
630 poor market performance for utility debt. (pg 3)

631
632 Fitch observed a 10 bps differential between the median authorized
633 ROE for utilities rated ‘A’ and utilities rated ‘BBB’, with the
634 higher authorized ROE level associated with lower issuer default
635 rating (IDR). However, given the small sample size and limited
636 period of review, Fitch does not deem this differential to be
637 meaningful. (pgs 3-4)

638
639 **Q. Ms. Kight-Garlich references a 9.56% ROE in Docket Nos. 11-0059/11-0141/11-**
640 **0142 (cons.) in support of her recommended ROE. (Staff Ex. 8.0, 9:167-172). Do**
641 **you have any comments regarding this testimony?**

642 A. Yes. In short, the docket to which she cites is inapposite to this proceeding. In Docket
643 Nos. 11-0059/11-0141/11-0142 (Cons.), the proposed order recently issued in the rate
644 cases for Great Northern Utilities, Inc., Camelot Utilities, Inc., and Lake Holiday Utilities
645 Corporation adopts Staff’s recommended ROE of 9.56%. First, while I am not an
646 attorney, it is my understanding that a proposed order has no effect. Rather, a
647 Commission Order controls. Second, together these companies serve about 2,700
648 customers. Third, unlike this proceeding, Staff used a balanced 50%/50% weighting of
649 the estimated cost rates of the Water Group and the Utility Group in reaching their
650 recommended ROE rather than the 1/3 -2/3 weighting that Staff used here.

651 If the Utilities, Inc. proceeding offers any insight, it begs the question: How can
652 Staff be applying a different ROE methodology and proposing a different ROE? Staff,
653 however, fails to address that point in testimony.

654 **Q. Do you have any other comments regarding Ms. Kight-Garlich's Rebuttal**
655 **Testimony?**

656 A. Yes. Ms. Kight-Garlich shows an A+ credit rating for AQUA on Schedule 8.07 and
657 notes that is the "implied Credit rating of sister company." The referenced "sister
658 company" is Aqua Pennsylvania, Inc., the largest subsidiary of Aqua America. Aqua
659 Pennsylvania was authorized to earn an 11.0% return on equity in 2008 based a fully
660 litigated case and is estimated to have been authorized to earn 10.7% return on equity in
661 2010 based on a "black box settlement." AQUA does not have an A+ credit rating.
662 AQUA's bonds are privately placed with insurance companies and have a rating
663 equivalent of A based on a NAIC²⁰ rating of 1. I believe AQUA's credit rating will likely
664 be reduced if Staff's recommended return on equity of 9.43% is adopted by the
665 Commission.

666 **VI. CONCLUSION**

667 **Q. Does this conclude your surrebuttal testimony?**

668 A. Yes.

²⁰NAIC or National Association of Insurance Commissioners is an organization of the chief insurance regulatory officials of the 50 states, the District of Columbia and the five U.S. territories. The NAIC's objective is to assist state insurance regulators in protecting consumers and helping maintain the financial stability of the insurance industry by offering financial, actuarial, legal, computer, research, market conduct and economic expertise.