

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of)	
Aqua Ohio, Inc. to Increase Its Rates and)	Case No. 16-0907-WW-AIR
Charges for Its Waterworks Service.)	

**SUPPLEMENTAL DIRECT TESTIMONY OF
DYLAN W. D'ASCENDIS
ON BEHALF OF AQUA OHIO, INC.**

- ☐ Management policies, practice and organization
- ☐ Operating income
- ☐ Rate base
- ☐ Allocations
- ☒ Rate of return
- ☐ Rates and tariffs
- ☐ Other

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1 **Supplemental Direct Testimony of**
2 **Dylan W. D'Ascendis**

3 **I. INTRODUCTION**

4 **Q1. Please state your name, occupation and business address.**

5 A1. My name is Dylan W. D'Ascendis. I am a Director at ScottMadden, Inc. My business
6 address is 3000 Atrium Way, Suite 241, Mt. Laurel, New Jersey 08054.

7 **Q2. Are you the same Dylan W. D'Ascendis who previously submitted prepared direct**
8 **testimony in this proceeding?**

9 A2. Yes, I am.

10 **Q3. Have you prepared schedules that support your supplemental testimony?**

11 A3. Yes. They are included in the exhibit attached to my testimony, as Schedule DWD-S1.

12 Unless otherwise noted, all Schedules referenced in this Supplemental Testimony will be
13 from this Exhibit.

14 **II. PURPOSE**

15 **Q4. What is the purpose of this testimony?**

16 A4. The purpose of this testimony is to comment upon Aqua Ohio, Inc.'s (Aqua Ohio or the
17 Company) Objections to the Public Utilities Commission of Ohio (PUCO or the
18 Commission) Staff Report concerning rate of return.

19 **III. TESTIMONY IN SUPPORT OF AQUA OHIO'S OBJECTIONS**

20 **Q5. Did you review the rate of return section of the Staff Report in this case as well as**
21 **Aqua Ohio's Objections to the report?**

22 A5. Yes, I did. I will comment upon each objection in turn.

1 **IV. OBJECTION NO. 26**

2 **Q6. Please explain why Aqua Ohio objects to Staff’s selected proxy group (Objection**
3 **26).**

4 A6. By limiting itself to a criterion of greater than \$1 billion market capitalization, Staff has
5 excluded four companies which are closer in size, and therefore risk, to Aqua Ohio than
6 the four companies in its proxy group. More correctly, Connecticut Water Service, Inc.
7 (Connecticut), Middlesex Water Company (Middlesex), SJW Corporation (San Jose), and
8 York Water Company (York), which are included in the “Water Utility” group in the
9 Value Line Investment Survey (*Value Line*) Standard Edition. Aqua Ohio’s estimated
10 market capitalizations, based upon the average market-to-book ratios of the proxy group
11 including the eight water companies I used and Staff’s proxy group of four water
12 companies at April 29, 2016, was \$240.227 million and \$247.139 million respectively.
13 The market capitalization for Connecticut was \$526.289 million, Middlesex was
14 \$593.511 million, San Jose was \$701.343 million, and York was \$379.887 million.
15 While all of these companies have higher market capitalizations than Aqua Ohio, all are
16 below the greater-than-\$1-billion Staff criterion. Thus, all of these companies are closer
17 in size to Aqua Ohio than any of Staff’s four selected water companies.

18 Given the basic financial principal of risk and return, namely that investors require
19 a greater return as compensation for bearing greater risk, it is necessary to reflect Aqua
20 Ohio’s greater risk due to its smaller size relative to either proxy group in an adjustment
21 to the common equity cost rate recommendation.

1 **Q7. Is there a way to quantify a business risk adjustment due to Aqua Ohio's greater**
2 **business risk due to its small size relative to either Staff's proxy group of four water**
3 **companies or your proxy group of eight water companies?**

4 A7. As discussed in my Direct Testimony, at page 32, line 11 through page 34, line 7, an
5 indication of the magnitude of a business risk adjustment based upon size can be derived
6 from the *Duff & Phelps 2016 Valuation Handbook: Guide to Cost of Capital* size risk
7 premium study.

8 As shown on Exhibit No. 1, Schedule DWD-8, I derived an indicated size
9 premium of 2.58% based on the relative size between Aqua Ohio and my proxy group of
10 eight water companies. On Schedule DWD-S1, I calculate the indicated size premium
11 based on the relative size of Aqua Ohio to Staff's proxy group of four water companies.
12 Because the Company's common stock is not publicly traded, I have assumed that if it
13 were, the common shares would be selling at the same market-to-book ratio as the
14 average market-to-book ratio for Staff's proxy group of four water companies, 278.9%,
15 on April 29, 2016. Hence, the Company's market capitalization is estimated at \$247.139
16 million based upon the average market-to-book ratio of Staff's proxy group of four water
17 companies. In contrast, the market capitalization of the average water company in the
18 Staff's group of four companies was \$5.355 billion on April 29, 2016, or 21.7 times the
19 size of Aqua Ohio's estimated market capitalization, respectively, as shown on page 1 of
20 Schedule DWD-S1.

21 Therefore, it is necessary to upwardly adjust Staff's range of common equity cost
22 rates of based upon their proxy group to reflect Aqua Ohio's greater risk due to its
23 smaller relative size. As shown on page 1 of Schedule DWD-S1, because Aqua Ohio
24 falls between the 9th and 10th size deciles and Staff's proxy group falling between the 3rd

1 and 4th size deciles, the indicated size premium spreads between the Company and Staff's
2 proxy group is 3.15%.

3 In view of the foregoing, while an upward adjustment of 0.25%, as I originally
4 recommended, to reflect Aqua Ohio's greater business risk due to its smaller size relative
5 to the eight water companies is warranted, an even larger adjustment is warranted relative
6 to Staff's proxy group. Since Staff's proxy group is approximately two times larger than
7 my proxy group, based upon average market capitalization, an appropriate adjustment to
8 a common equity cost rate based upon the market data of Staff's proxy group would be
9 approximately 0.50% (or two times 0.25%).

10 **V. OBJECTION NO. 27**

11 **Q8. Please explain why Aqua Ohio objects to Staff's application of the Discounted Cash**
12 **Flow (DCF) model (Objection 27)?**

13 A8. Aqua Ohio objects to Staff's application of the DCF model because their inputs cause the
14 model to understate the cost of common equity. First, Staff incorrectly uses the sum of
15 the last four quarterly dividends for the calculation of its dividend yield, and not the most
16 current dividend multiplied by four. The use of historical dividends runs counter to the
17 prospective nature of the cost of equity and ignores existing expectations for each proxy
18 company's dividend payments. Typically, since most utility companies raise dividend
19 payments instead of lowering them over time, Staff's use of historical dividends serves to
20 understate the DCF model results.

21 Second, Staff gives undue weight to Value Line growth rates, giving 50% weight
22 compared with 25% weight to Reuters and Yahoo growth rates, respectively. Since all of
23 the publications referenced above are in the public domain and are investor-influencing,
24 one should consider all sources equally. Staff's uneven weighting of the prospective

1 growth rates lowers the indicated common equity cost rate for three out of the four proxy
2 companies used by Staff in their analysis.

3 **Q10. Please summarize Aqua Ohio's objections to Staff's rate of return conclusions.**

4 A10. For all the reasons given above, Staff's rate of return conclusions, including the
5 recommended return on equity ranging from 9.36% to 10.38% is understated for two
6 reasons: (1) Staff's proxy group does not reflect the increased relative business risk faced
7 by Aqua Ohio due to its smaller size relative to Staff's proxy group; and (2) Staff's
8 incorrect application of the DCF.

9 **Q11. Does this end your supplemental testimony?**

10 A11. Yes.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Supplemental Direct Testimony was served by electronic mail this 19th day of December, 2016 to the following:

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Summary: Text Supplemental Direct Testimony of Dylan W. D'Ascendis, CRRA, CVA electronically filed by Ms. Rebekah J. Glover on behalf of Aqua Ohio, Inc.