adjustment ranging from 47 basis points for the barometer group and 111 basis points for PSC is in order. The midpoint of this range approximates 80 basis points.

We find that a financial risk adjustment is indeed necessary to reconcile the divergence between PSWC's market and book values. This is particularly true in light of the significant turbulence currently being experienced by the stock market. We find merit to the alternative proposal presented in PSWC's Exceptions cited above. Specifically, an 80 basis point adjustment to the 9.90 percent recommendation of ALJ Chestnut is appropriate. We, accordingly, find that a 10.70 percent common equity cost rate assures the continued financial stability of PSWC and takes into account PSWC's efficiency, effectiveness, and adequacy of service. *See* 66 Pa. C.S. §523 (a).

Moreover, we find that even in the absence of a financial risk adjustment applied to the unadjusted DCF results, the record in this proceeding still supports a cost of common equity allowance of 10.70 percent. For example, the RP, CAPM and CE analyses performed by PSWC's rate of return witness all yielded results in excess of 10.70 percent for the cost of common equity. While the Commission does not rely primarily on these alternative methods of determining the company's cost of common equity, this testimony further supports the reasonableness of the 10.70 percent cost of common equity we have allowed in this proceeding.

Based on our analysis of the record, we conclude that PSWC's cost of common equity of 10.70 percent is reasonable and appropriate under the circumstances in this proceeding. The following table summarizes our determinations concerning PSWC's capital structure, cost of debt, cost of preferred stock, and cost of common equity, as well as the resulting weighted costs and overall rate of return:

Capital Structure	Ratio	Cost Rate	Weighted Cost

Debt	52.26%	7.01%	3.66%
Common Equity	47.74%	10.70%	5.11%
	100.00%		8.77%

10. That upon Commission approval of the tariffs filed in response to the instant Opinion and Order, the proceeding at Docket No. R-00016750, including R-00016750C0001 through R-00016750C0091, shall be marked closed.

BY THE COMMISSION,

James J. McNulty

James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: July 18, 2002

ORDER ENTERED: August 1, 2002

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held January 16, 2004

Commissioners Present:

Terrance J. Fitzpatrick, Chairman
Robert K. Bloom, Vice Chairman
Glen R. Thomas
Kim Pizzingrilli
Wendell F. Holland

Pennsylvania Public Utility Commission	:	R-00038304
Gary D. A. Lewis	:	R-00038304C0001
Richard Sanderman	:	R-00038304C0002
John Ross	:	R-00038304C0003
Brian Carr	:	R-00038304C0004
Elaine Ziegler	:	R-00038304C0005
Irwin A. Popowsky, Consumer Advocate	:	R-00038304C0006
Randy and Bonnie Reich	:	R-00038304C0007
Cecil J. Hartman	:	R-00038304C0008
Natalie Kerr	:	R-00038304C0009
Thomas B. Aunkst	:	R-00038304C0010
Jeannie Weaver	:	R-00038304C0011
John D. Eisenhard	:	R-00038304C0012
Kevin M. Aldrich	:	R-00038304C0013
David R. Erali	:	R-00038304C0014
Jamie Denunzio	:	R-00038304C0015
Steven Maga	:	R-00038304C0016
Gary E. Pickel	:	R-00038304C0017
Richard Dewees	:	R-00038304C0018
Randy Piersol	:	R-00038304C0019
Laurence Wagner	:	R-00038304C0020
Ann Katcavage	:	R-00038304C0021
William D. and Loretta J. Hawkins	:	R-00038304C0022
Emmanuel Cooper	:	R-00038304C0023
Frank Lesnefsky	:	R-00038304C0024
Robert M. East, Jr.	:	R-00038304C0025
Peter Nahrgang	:	R-00038304C0026

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VII. Rate of Return

It is well settled that a public utility is entitled to an opportunity to earn a fair rate of return on the value of its property which is dedicated to public service. *Pennsylvania Gas & Water Company v. Pennsylvania Public Utility Commission*, 341 A.2d 239 (Pa. Cmwlth. 1975). This is consistent with longstanding decisions by the United States Supreme Court, including *Bluefield Water Works and Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 690-93 (1923), and *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944).

A utility's rate of return has been defined as follows:

> [t]he *rate of return* is the amount of money a utility earns, over and above operating expenses, depreciation expense and taxes, expressed as a percentage of the legally established net valuation of utility property, the rate base. Included in the 'return' is interest on long-term debt, dividends on preferred stock, and earnings on common stock equity. In other words, the return is that money earned from operations which is available for distribution among the capital. In the case of common stockholders, part of their share may be retained as surplus. The rate-of-return concept merely converts the dollars earned on the rate base into a percentage figure, thus making the item more easily comparable with that in other companies or industries.

(P. Garfield and W. Lovejoy, *Public Utility Economics*, (1964), at 116).

In determining what is a fair rate of return, we have traditionally considered the utility's capital structure in conjunction with its costs of debt, preferred stock, and common equity, as will be discussed below.

A. Capital Structure

The following is a summary of the Parties' positions regarding PAWC's capital structure:

Capital Structure	Company(1) %	OTS(2) %	OCA(3) %
Long-term Debt	56.82	56.82	52.15
Short-term Debt			4.67
Preferred Stock	.98	.98	.98
Common Equity	42.20	42.20	42.20
Total Capital	100.00	100.00	100.00

(1) PAWC Exhibit 9-A, Schedule 1, at 1.
(2) OTS Exhibit No.1, Schedule 1.
(3) OCA Statement 5, Schedule JRW-1, at 1.

PAWC's position is based on the use of a capital structure at the end of the future test year, December 31, 2003. PAWC chose the capitalization ratios tabulated above because these ratios are indicative of those that it will maintain to finance its claimed rate base during the period that new rates will be in effect. The OTS accepts the capital structure proposed by PAWC because, according to the OTS, it protects the interests of all Parties to the instant proceeding and is, therefore, acceptable for ratemaking purposes.

The OCA alleges that PAWC's proposed capital structure does not accurately represent the source of its capital. Specifically, the OCA maintains that the record evidence as developed in this proceeding shows a consistent and ongoing pattern of short-term debt usage by PAWC to finance projects other than Construction Work in

Progress (CWIP), so that short-term debt must comprise a portion of PAWC's capital structure. (OCA Main Brief at 108).

The ALJ, noting that the Commission in prior cases rejected the identical arguments raised by the OCA, recommended the adoption of PAWC's proposed capital structure anticipated at the end of the future test year. Specifically, the ALJ indicated that, although PAWC utilizes short-term debt on an on-going basis, it has used, and will continue to use, short-term debt to support construction activities (CWIP as well as plant placed in service between rate cases), the acquisition of other water and wastewater systems, and other short-term borrowing needs. (R.D. at 61). It is the ALJ's position that the capital structure to be employed in this proceeding consists of 56.82% long-term debt, .98% preferred stock and 42.20% common equity. This is the capital structure that PAWC will employ at the end of the future test year, December 31, 2003, and comports with the position of the OTS.

We note that no Party excepted to the recommendation of ALJ Weismandel on the capital structure issue. We are persuaded that PAWC has demonstrated in the record that it uses its non-CWIP short-term debt for a number of purposes other than to finance its rate base, such as the support of plant placed in service between rate cases and to finance the acquisition of other water and wastewater systems and to meet other short-term borrowing needs. Moreover, in *Pennsylvania Public Utility Commission v. Pennsylvania Suburban Water Company,* 219 PUR4th.272 (2002), we rejected a virtually identical proposal by the OCA to include short-term debt in the capital structure. We, therefore, adopt the recommendation of the ALJ regarding capital structure.

B. Cost of Debt

Regarding its cost of debt, PAWC's claimed cost of long-term debt for this proceeding is 6.15 percent. (PAWC Exh. 9-A at 1). No Party contested this cost rate.

(OTS Statement 1 at 8; OCA Statement 5, Schedule JRW-1 at 1). As a result, and finding it reasonable, appropriate and in accord with the evidentiary record, we will adopt the ALJ's recommendation of the 6.15 percent cost of long-term debt proposed by PAWC. Since we recommend the exclusion of short-term debt from our recommended capital structure, we shall accordingly exclude the 1.42 percent cost of short-term debt recommended by the OCA.

C. Cost of Preferred Stock

PAWC's claimed cost of preferred stock for this proceeding is 8.08 percent. (PAWC Exh. 9-A at 1). No Party contested this cost rate. (OTS Exh. 1, Schedule No. 1; OCA Statement 5, Schedule JRW-1 at 1). As a result, we will adopt the ALJ's recommendation to adopt the 8.08 percent cost of preferred stock proposed by PAWC since it is reasonable and in accord with the evidence.

D. Cost of Common Equity

The following table summarizes the cost of common equity claims made, and methodologies used, by the Parties in this proceeding:

Methodology	Company(1)	OTS(2)	OCA(3)
		%	%
Discounted Cash Flow Range (DCF)	10.53-12.09	9.25-10.03	8.4
Risk Premium Model (RPM)	11.75-12.00		6.7
Capital Asset Pricing Model (CAPM)	14.69-15.39		
Comparable Earnings Method (CEM)	14.20		
Recommendation	11.75	10.00	8.40

(1) Company Statement 9, at 4

(2) OTS Statement 1, at 19

(3) OCA Statement 5, at 29

1. Positions of the Parties

PAWC, after applying four of the above cited and widely recognized market-based models to market data for its barometer group of water utilities, and its barometer group of gas distribution utilities, arrived at an 11.75 percent cost of common equity recommendation. PAWC's water barometer group consists of three water utilities with actively traded common stock. These water utilities appear in the Water Utility Industry section of the *Value Line Investment Survey*. (PAWC Exh. 9-A, Schedule 3 at 2). PAWC's gas barometer group consists of ten gas distribution utilities with actively traded common stock which engage in similar business lines. These gas distribution utilities appear in the Gas Distribution Utility Industry section of the *Value Line Investment Survey*. (PAWC Exh. 9-A, Schedule 3 at 7).

PAWC contended that the above cited common equity cost rate models, used *in tandem*, are based on the premise that no one method or model of the cost of equity can be applied in an isolated manner. According to PAWC, informed judgment must be used to take into consideration the relative risk traits of the firm. It is for this reason that PAWC uses more than one method to measure its cost of common equity. (PAWC Statement 9 at 22). It should be noted that PAWC's recommended range of DCF common equity cost rates of 10.53 to 12.09 percent, calculated from its water and gas groups, include 78 and 83 basis point upward adjustments respectively, to *reconcile* the divergence between the market and book value of the common equity. (PAWC Statement 9 at 36).

Specifically, PAWC calculated recent six-month average dividend yields of its barometer groups which it basically increased by (1+.5) the respective growth rates to reach a 3.75 percent dividend yield for its water group and a dividend yield of 5.01 percent for its gas distribution group. The 3.75 percent dividend yield + 6.00 percent growth rate = 9.75 percent DCF result is subsequently increased by 78 basis points to 10.53 percent for its water group. The 5.01 percent dividend yield + 6.25 percent growth rate = 11.26 percent DCF result is subsequently increased by 83 basis points to 12.09 percent for its gas distribution group.

The average of PAWC's DCF results (10.53 percent + 12.09 percent/2 = 11.31 percent) and its risk premium results (11.75 percent + 12.00 percent/2 = 11.88 percent) approximates PAWC's recommended 11.25 percent to 11.75 range of market based cost rates of common equity, excluding comparable earnings which is not market based. We note that PAWC also excludes its CAPM calculation in formulating its recommendation. From this range, PAWC chooses 11.75 percent, which recognizes the alleged exemplary performance of PAWC's management. (PAWC Statement 9 at 4-5).

The OTS relied solely on the DCF method to arrive at its 10.00 percent recommended cost rate of common equity. The OTS applied the DCF method to its barometer group of water utilities whose stock is actively traded. The OTS' barometer group consists of seven publicly traded water utilities that have at least two sources of analysts' forecasts of earnings growth, and are not the announced subject of an acquisition. (OTS Statement 1 at 11). Specifically, the OTS averaged the spot dividend yield and the 52-week average dividend yield of its barometer group to reach a 3.28 percent composite dividend yield. It then added its 6.75 percent growth rate recommendation to the 3.28 percent dividend yield to reach a 10.03 percent DCF recommendation for its barometer group.

Next, the OTS averaged the spot dividend yield and the 52-week average dividend yield of PAWC's three water utility barometer group, which is a subset of the aforementioned OTS group, to reach a 3.45 percent composite dividend yield. The OTS then added its 5.75 percent growth rate recommendation to the 3.45 percent dividend yield to reach a 9.20 percent DCF recommendation for PAWC's barometer group. The OTS chose 10.00 percent as its recommended cost rate of common equity from its recommended range of 9.25 percent to 10.00 percent. OTS reasoned that since PAWC's common equity ratio is estimated at only 42.20 percent as of December 31, 2003, as opposed to the 46.70 percent and 44.96 percent common equity ratios of its barometer groups, PAWC faces more financial risk than either of the groups. (OTS Statement 1 at 19.).

The OCA relied upon the DCF method and the Risk Premium method to produce common equity cost rates of 8.4 percent and 6.7 percent, respectively. The OCA then chose 8.4 percent as its common equity cost rate recommendation because it primarily employs the DCF model to estimate its common equity cost rate. (OCA Statement 5 at 29). Specifically, the OCA employed the latest 2-month composite dividend yield of 3.3 percent to develop the DCF dividend yield for its barometer group. Next, in order to account for dividend growth in the period in which rates will be in effect, the OCA adjusted the 3.3 percent dividend yield by one-half the expected dividend growth rate of 5.00 percent or 2.50 percent. The OCA's DCF result is thereby 3.3 percent x 1.025 +5.00 percent = 8.4 percent. (OCA Statement 5 at 24).

To develop its Risk Premium result, the OCA used the risk-free Treasury securities over an 18-month period to arrive at a rate of 4.0 percent as the risk-free rate. The OCA then derived a risk premium range from the data of its barometer group, which ranged from 1.96 percent to 4.10 percent. Using the average of 2.69 percent, the OCA concluded that the indicated rate of return of its risk premium approach is 4.0 percent +2.69 percent = 6.7 percent. As cited above, the OCA subsequently recommended an 8.4 percent common equity rate of return based on its DCF methodology. (OCA Statement 3 at 29).

2. ALJ's Recommendation

Based on his review, evaluation and analysis of the record, regarding the cost of common equity, the ALJ recommended that we afford PAWC the opportunity to earn a rate of return on common equity of 10.0 percent. The ALJ was of the view that PAWC has not met its burden of proof that a 78 basis point adjustment is appropriate to compensate PAWC for a market price per share to book value per share ratio (M/B) in excess of 1.0. Additionally, the ALJ did not agree with PAWC's proposal for a positive adjustment factor in recognition of the exemplary performance of its management.

3. Exceptions

PAWC excepts to the ALJ's recommended 10.0 percent common equity cost rate, contending that such a recommendation is exclusively based upon the 10.0 percent DCF result of the OTS. As such, PAWC argues that PAWC's cost rate for common equity is substantially understated for primarily three reasons.

First, PAWC argues that we have been considering other common equity methodologies in the quarterly earnings reports submitted by Pennsylvania's jurisdictional utilities and in establishing the cost of equity for Distribution System Improvement Charge (DSIC) purposes. (PAWC Exc. at 5).

Second, PAWC contends that the ALJ erred in rejecting the previously Commission-approved leverage adjustment. PAWC pointed out that we approved the leverage adjustment in *Pennsylvania Suburban, supra.* Specifically, the leverage adjustment adjusts the calculated common equity cost rate in order to compensate PAWC for the application of a market based cost rate of common equity to a book value common equity ratio. PAWC argues that since its book value common equity ratio of 42.20 percent is significantly less than its 62 percent market based common equity ratio, which reflects a market based common equity cost rate such as 10.00 percent, the equity return rate should be increased when applied to the 42.20 percent book value common equity ratio. The ensuing basis point premium compensates PAWC for the financial risk differential between the book value and the market based common equity ratios. (PAWC Exc. at 5-9).

Finally, PAWC argues that the ALJ erred by declining to adopt a positive adjustment factor to reflect its exemplary management performance. PAWC disagrees with the ALJ's characterization of its management as being inefficient because of the frequency of its rate filings. PAWC has filed eleven general rate increases in sixteen years, but it notes that in an attempt to stem the tide of base rate filings, it pioneered the development of the DSIC. PAWC continues that since the implementation of the DSIC in 1996, it has only filed one rate case every two years which, it alleges, comports with other Pennsylvania major water utilities. Finally, PAWC cites its acquisition of troubled systems, its low income customer assistance, and its responsiveness to customer concerns as reasons that it should be awarded an equity premium for exemplary management performance.

In its Reply Exceptions, the OTS rejoins that the Commission has relied upon the DCF analysis and informed judgment as the appropriate means of measuring the cost of common equity. *See e.g., Pennsylvania Public Utility Commission v. Pennsylvania-American Water Company,* Docket No. R-00016339, Order entered January 25, 2002, *Pennsylvania Public Utility Commission v. City of Lancaster,* 197 P.U.R.4th 156 (1999), *Pennsylvania Public Utility Commission v. Consumers Pennsylvania Water Company-Roaring Creek Division (Roaring Creek),* 87 Pa. P.U.C. 826 (1997), *Pennsylvania Public Utility Commission v. PECO Energy Company,* 87 Pa. P.U.C. 184, 212-213 (1997). (OTS R.Exc. at 4).

The OTS argues that PAWC's contention that since we review the results of more than one method in establishing the cost of equity for the DSIC, we must therefore, do the same in a base rate case, is entirely without merit. Specifically the OTS reasons that DSIC proceedings merely afford PAWC limited rate relief, based on infrastructure issues, between base rate proceedings. Base rate proceedings, on the other hand, require analytical scrutiny, which is only afforded by the DCF methodology. (OTS R.Exc. at 11-12).

In its Reply Exceptions, the OCA cites *Pennsylvania Public Utility Commission v. Pennsylvania Suburban Water Co.*, 219 PUR4th 272 (2002) to rebut PAWC's contention regarding our prior consideration of other cost of common equity methods. The OCA argues that in *Pennsylvania Suburban, supra*, we continued to endorse the DCF method as the preferred common equity cost rate methodology. (OCA R.Exc. at 2).

The OTS rejoins that the ALJ properly reasoned that no market to book or financial risk adjustment to the DCF findings is necessary to determine an appropriate cost of common equity. Specifically, the OTS submits that any unwarranted financial risk adjustment to compensate PAWC for the application of a market derived common equity cost rate to a book value common equity ratio will create the need for an even larger proposed adjustment in subsequent proceedings. For example, the OTS notes that in PAWC's last base rate proceeding, it indicated the need for a 60 basis point adjustment while the request in this case is for a 78 basis point adjustment.

Finally, the OTS rejoins that in its attempt to use a market based capital structure for his financial risk adjustment, PAWC's witness neglected to adjust the debt portion of the capital structure to account for the market value of each issue. (OTS R.Exc. at 14.).

The OCA excepts to the ALJ's recommended cost of common equity of 10 percent and, accordingly, submits that the common equity cost rate should be 8.4 percent. The OCA argues that the ALJ's 10.00[16] percent recommendation is excessive in light of current economic conditions. Specifically, the OCA submits that the ALJ erred by adopting a 6.75 percent growth rate for use in the recommended DCF analysis. The OCA alleges that the aforementioned DCF growth rate is excessive because the weight of the evidence favors the much lower growth rate of 5.00 percent proposed by the OCA. The OCA supports its resultant 8.4 percent cost of equity position by arguing that the lower rate is justified because the record shows that capital costs are the lowest in 40 years. For example, the OCA points to record evidence that rates on Treasury bills have dropped previously from 1995 to 2002, from 5.51 percent to 1.62 percent, respectively. (OCA Exc. at 11-12).

PAWC rejoins that the OCA's rejection of the 6.75 percent DCF growth rate recommended by the ALJ is misplaced. PAWC argues that the OCA's 5.00 percent

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[16] We note that that the ALJ basically adopted OTS' DCF result of 10.03 percent which is composed of a 3.28 percent dividend yield and a 6.75 percent growth rate. The OCA, on the other hand, recommends an 8.4 percent DCF result which is composed of a 3.38 percent dividend yield and a 5.00 percent growth rate.

recommended growth rate may have been a reasonable estimate several years ago. However, PAWC asserts that investors clearly have bid up the price of water utility stocks, and hence have accepted reduced dividend yields in anticipation of higher future growth. This is why, according to PAWC, there is no merit in the OCA's mixing of current lower dividend yields of water utility stocks with the former low dividend and earnings growth rates which were previously coupled with higher dividend yields. In other words, PAWC submits that investors are less concerned with dividend yields than they are with earnings growth and the associated stock price appreciation. (PAWC R.Exc. at 5-6).

4. Disposition

Historically, we have primarily relied on the DCF methodology in arriving at our determination of the proper cost of common equity. We have, in many recent decisions, determined the cost of common equity primarily based upon the DCF method and informed judgment. *See Pennsylvania Public Utility Commission v. Philadelphia Suburban Water Company*, 71 Pa. PUC 593, 623-632 (1989); *Pennsylvania Public Utility Commission v. Western Pennsylvania Water Company*, 67 Pa. PUC 529, 559-570 (1988); *Pennsylvania Public Utility Commission v. Roaring Creek Water Company*, 150 PUR4th 449, 483-488 (1994); *Pennsylvania Public Utility Commission v. York Water Company,* 75 Pa. PUC 134, 153-167 (1991); *Pennsylvania Public Utility Commission v. Equitable Gas Company*, 73 Pa. PUC 345-346 (1990).

We determine that the DCF method is the preferred method of analysis to determine a market based common equity cost rate. Although we agree with the ALJ's adoption of the 10.00 percent market based common equity cost rate as a starting point, we find merit in the financial risk adjustment proposed by PAWC. We note that, in *Lower Paxton Township v. Pennsylvania Public Utility Commission,* 317 A.2d 917 (Pa. Cmwlth. 1974) (*Lower Paxton Township),* the Commonwealth Court recognized that this

Commission may consider such factors that affect the cost of capital such as the utility's financial structure, credit standing, dividends, risks, regulatory lag, wasting assets and any peculiar features of the utility involved.

We are persuaded by PAWC's reasoning that a financial risk adjustment is necessary to compensate PAWC for the application of a market based cost of common equity to a book value common equity ratio. However, we find that PAWC's recommended 78 basis point adjustment is excessive. As we determined in PAWC's prior base rate case, at Docket No. R-00016339 (Order entered January 25, 2002), a 60 basis point adjustment to the market based common equity cost rate will compensate PAWC for the aforementioned application of a market based common equity cost rate to a book value common equity ratio.

PAWC indicates that a preliminary DCF calculation, which is computed using the market price of PAWC's common stock, should be adjusted to reconcile the divergence between market and book values. The indicated cost of common equity of 10 percent, therefore, reflects the barometer group's average *market* capitalization, which includes a common equity ratio of 62 percent as opposed to the recommended common equity ratio of 42.20 percent which reflects significantly more financial risk. PAWC further indicates that, when investors value a company's common stock, they employ actual market capitalization data and not book data although book capitalization is employed for ratemaking purposes.

We agree that a financial risk adjustment is proper. Accordingly, we find that, in order to place the computed DCF result on a consistent basis with the greater financial risk, inherent in PAWC's book value-derived capital structure ratios, a 60 basis point financial risk adjustment above our 10 percent representative DCF common equity cost rate recommendation is warranted.

We further conclude that the record in this proceeding does not support any further upward adjustments. Under the circumstances, we find that the cost of common equity of 10.60 percent is reasonable, appropriate and in accord with the record evidence.

The following table summarizes our determinations concerning PAWC's capital structure, cost of debt, cost of preferred stock, and cost of common equity, as well as the resulting weighted costs and overall rate of return:

Capital Structure	Ratio	Cost Rate	Weighted Cost
Debt	56.82%	6.15%	3.50%
Preferred Stock	0.98%	8.08%	.08%
Common Equity	42.20%	10.60%	4.47%
	100.00%		8.05 %

X. Conclusion

We have carefully reviewed the record as developed in this proceeding, including the ALJ's Recommended Decision and the Exceptions filed thereto. PAWC initially requested an overall revenue increase of $64,946,533, or about 18.2%. (PAWC Initial Brief at 3). With adjustments to the cost of debt and in various other areas, PAWC's final claim here, as of its correspondence dated October 20, 2003, and attached tables, was for a revenue increase of $59,246,159, or about 16.6%. The ALJ recommended an allowable revenue increase in the amount of no more than $26,174,845. (Table 1 attached to the R. D.). The ALJ also recommended that the increase be spread among the rate classes in accordance with the Stipulation which had been reached thereon, a copy of which was attached to the Recommended Decision.

Based on our review, evaluation, and analysis of the record evidence, we have adopted different conclusions than the ALJ in two key areas by allowing the deferred security costs, as adjusted herein, and by concluding that a cost of common equity of 10.6% is reasonable, appropriate and in accord with the record evidence. The resulting allowable revenue increase is $34,314,15, or about 9.5%. As such, the Exceptions filed by the various Parties hereto, are granted or denied, as discussed *supra*. Accordingly, the ALJ's Recommended Decision is adopted only to the extent that it is consistent with this Opinion and Order.

XI. ORDER

THEREFORE; IT IS ORDERED:

1. That the Exceptions filed by the Office of Consumer Advocate on December 17, 2003, to the Recommended Decision of Administrative Law Judge Wayne L. Weismandel herein, are denied.

2. That the Exceptions filed by Pennsylvania-American Water Company on December 17, 2003, to the Recommended Decision of Administrative Law Judge Wayne L. Weismandel herein, are granted or denied, consistent with this Opinion and Order.

3. That the Recommended Decision of Administrative Law Judge Wayne L. Weismandel herein, issued on December 2, 2003, is adopted only to the extent that it is consistent with this Opinion and Order, and rejected in other regards.

4. That the Pennsylvania-American Water Company shall not place into effect the rates contained in Supplement 141 to Tariff Water–Pa. P.U.C. No. 4, which have been found to be unjust, unreasonable and, therefore, unlawful.

5. That the Pennsylvania-American Water Company is hereby authorized to file tariffs, tariff supplements, or tariff revisions containing rates, provisions, rules and regulations, consistent with the findings here, to produce revenues not in excess of $392,181,547.

6. That Pennsylvania-American Water Company's tariffs, tariff supplements, or tariff revisions may be filed upon less than statutory notice, and pursuant

to the provisions of 52 Pa. Code §§ 53.31 and 53.101, may be filed to be effective for service rendered on and after the date of entry of the instant Opinion and Order.

7. That Pennsylvania-American Water Company shall file detailed calculations with its tariff filing, which shall demonstrate to this Commission's satisfaction that the filed rates comply with the proof of revenue, in the form and manner customarily filed in support of compliance tariffs.

8. That Pennsylvania-American Water Company shall comply with all directives, conclusions and recommendations contained in the instant Opinion and Order that are not the subject of individual ordering paragraphs as fully as if they were the subject of specific ordering paragraphs.

9. That the Stipulation Concerning Rate Structure And Rate Design filed in this case on October 28, 2003, be, and hereby is, approved, and incorporated herein by reference as though set forth in full.

10. That Pennsylvania-American Water Company shall allocate the authorized increase in operating revenues to each customer class and rate schedule within each class in accordance with the Stipulation Concerning Rate Structure And Rate Design filed in this case on October 28, 2003, and in the manner prescribed in this Opinion and Order.

11. That Pennsylvania-American Water Company, as it has agreed to do, expand the benefits available to eligible low-income customers by increasing the existing low-income customer discount from 20% to 50%.

12. That Pennsylvania-American Water Company, as it has agreed to do, continue its regular meetings with designated representatives of A Pocono Country Place

Property Owners Association and commence a similar program of regular meetings with designated representatives of Saw Creek Estates Community Association, Inc.

13. That the Complaints filed by the various participants to this proceeding at Docket Numbers R-00038304C0001 through R-00038304C0171, inclusive, are, to the extent they have not been previously marked closed, sustained in part and dismissed in part, consistent with this Opinion and Order.

14. That the Pennsylvania Public Utility Commission's inquiry and investigation in Docket Number R-00038304 is terminated and the record closed.

BY THE COMMISSION,

James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: January 16, 2004

ORDER ENTERED: January 29, 2004

**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held July 23, 2004

Commissioners Present:

Terrance J. Fitzpatrick, Chairman
Robert K. Bloom, Vice Chairman
Glen R. Thomas
Kim Pizzingrilli
Wendell F. Holland

Pennsylvania Public Utility Commission	R-00038805
	R-00038805C0001-
v.	R-00038805C0086
	P-00032025
Aqua Pennsylvania, Inc. (formerly Pennsylvania Suburban Water Company)	

VIII. Rate of Return

A. Introduction

It is well settled that a public utility is entitled to an opportunity to earn a fair rate of return on the value of its property which is dedicated to public service. *Pennsylvania Gas & Water Company v. Pennsylvania Public Utility Commission*, 341 A.2d 239 (Pa. Cmwlth. 1975). This is consistent with longstanding decisions by the United States Supreme Court, including *Bluefield Water Works and Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 690-93 (1923), and *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944).

A utility's rate of return has been defined as follows:

> [t]he *rate of return* is the amount of money a utility earns, over and above operating expenses, depreciation expense and taxes, expressed as a percentage of the legally established net valuation of utility property, the rate base. Included in the 'return' is interest on long-term debt, dividends on preferred stock, and earnings on common stock equity. In other words, the return is that money earned from operations which is available for distribution among the capital. In the case of common stockholders, part of their share may be retained as surplus. The rate-of-return concept merely converts the dollars earned on the rate base into a percentage figure, thus making the item more easily comparable with that in other companies or industries.

(P. Garfield and W. Lovejoy, *Public Utility Economics*, (1964), at 116)

In determining a fair rate of return, we have traditionally considered the utility's capital structure in conjunction with its costs of debt, preferred stock, and common equity. The Parties' recommendations in this matter are discussed in detail below.

B. Capital Structure

1. Positions of the Parties

AP's proposed Capital Structure is as follows:

Long-term Debt	50.57%
Common Equity	49.43%
Total Capital	100.00

(AP St. 4 at 20-21)

AP argues that the proposed debt/equity ratio is indicative of that needed to finance its claimed rate base during the time period that the rates are expected to be in effect. AP contends that the Commission has accepted this ratio in several prior rate proceedings. We note that no Party opposed AP's proposed Capital Structure.

2. ALJ's Recommendation

The ALJ recommended adoption of AP's proposed Capital Structure.

3. Disposition

No Party excepts to the ALJ's recommendation on this issue. Finding the ALJ's recommendation to be reasonable, appropriate and in accord with the record evidence, it is adopted.

C. Cost of Debt

1. Positions of the Parties

Regarding its cost of debt, AP's claimed cost of long-term debt for this proceeding is 6.60 percent. (AP St. 4 at 21). No Party contested this cost rate.

2. ALJ's Recommendation

The ALJ recommended adoption of AP's 6.60% cost of long-term debt.

3. Disposition

No Party excepts to the ALJ's recommendation on this issue. Finding the ALJ's recommendation to be reasonable, appropriate and in accord with the record evidence, it is adopted.

D. Cost of Common Equity

1. Summary

The following table summarizes the cost of common equity claims made, and methodologies used, by the Parties in this proceeding:

Methodology	Company(1) %	OTS(2) %	OCA(3) %
Discounted Cash Flow Range (DCF)	10.40	9.50	9.82
Risk Premium Model (RPM)	11.25		
Capital Asset Pricing Model (CAPM)	12.24		8.22-9.37
Comparable Earnings Method (CEM)	14.80		
Modified Earnings Price Ratio			7.64-8.95
Market to Book Ratio			9.57-9.80
Recommendation	11.75%	9.50%	9.25%

(1) AP Statement 4.

(2) OTS Statement 1, at 22.

(3) OCA Statement 2, at 29.

2. Positions of the Parties

AP, after applying four of the above cited and widely recognized market-based models to market data for its corporate parent AP, f/k/a Philadelphia Suburban Corporation (PSC), a barometer group of water utilities and a barometer group of gas distribution utilities, arrived at an 11.75% cost of common equity recommendation. AP's water barometer group consists of three water utilities with actively traded common stock. These water utilities appear in the Water Utility Industry section of the *Value Line Investment Survey*. (AP Exh. 4-A, Sch. 3 at 2). AP's gas barometer group consists of ten gas distribution utilities with actively traded common stock which engage in similar business lines. These gas distribution utilities appear in the Gas Distribution Utility Industry section of the *Value Line Investment Survey*. (AP Exh. 4-A, Sch. 3 at 7).

AP contended that the above cited common equity cost rate models, used *in tandem*, are based on the premise that no one method or model of the cost of equity can be applied in an isolated manner. According to AP, informed judgment must be used to take into consideration the relative risk traits of the firm. It is for this reason that AP uses more than one method to measure its cost of common equity. (AP St. 4 at 22). It should be noted that AP's recommended range of DCF common equity cost rates of 10.53 to 12.09 percent, calculated from its water and gas groups, include 64 and 67 basis point upward adjustments respectively, to reconcile the divergence between the market and book value of the common equity. (AP. St. 4 at 35).

Specifically, AP calculated recent six-month average dividend yields of its barometer groups which it basically increased by (1+.5) to incorporate the respective growth rates, to reach a 2.48% dividend yield for AP, a 3.44% dividend yield for its water group and a dividend yield of 4.54% for its gas distribution group. The 2.48% dividend yield + 9.25% growth rate results in an 11.73% DCF result that is subsequently increased by 202 basis points to 13.75% for AP. The 3.44% dividend yield + 5.75% growth rate results in a 9.19% DCF result that is subsequently increased by 64 basis points to 9.83% for its water group. The 4.54% dividend yield + 5.75% growth rate results in a 10.29% DCF result that is subsequently increased by 67 basis points to 10.96% for its gas distribution group. (AP St. 4 at 36)

According to AP, the average of the DCF, Risk Premium and CAPM equals 11.30% for the water and gas barometer groups, and 12.75% for the corporate parent. From this range, AP chooses 11.75 percent, which recognizes the alleged exemplary performance of AP's management. (AP St. 4 at 4-5).

The OTS relied solely on the DCF method to arrive at its 9.5% recommended cost rate of common equity. The OTS applied the DCF method to its barometer group of water utilities whose stock is actively traded. The OTS' barometer group consists of seven publicly traded water utilities that have at least two sources of analysts' forecasts of earnings growth, and are not the announced subject of an acquisition. (OTS St. 1 at 10). Specifically, the OTS averaged the spot dividend yield and the 52-week average dividend yield of its barometer group to reach a 3.06% composite dividend yield. It then added its 6.75% growth rate recommendation to the 3.06% dividend yield to reach a 9.81% DCF recommendation for its barometer group.

Next, the OTS averaged the spot dividend yield and the 52-week average dividend yield of AP's three water utility barometer group, which is a subset of the aforementioned OTS group, to reach a 3.32% composite dividend yield. The OTS then added a 5.5% growth rate recommendation to the 3.32% dividend yield to reach an 8.82% DCF recommendation for AP's barometer group. The OTS chose 9.5% as its recommended cost rate of common equity from its recommended range of 8.82% to 9.81%, reasoning that since AP's common equity ratio is estimated at only 42.20% as of June 30, 2003, as opposed to the 55.28% common equity ratios of its seven company barometer group, AP faces less financial risk than the group. (OTS St. 1 at 21-22).

The OCA relied upon the DCF method and the CAPM, Modified Earnings Price Ratio (MEPR) and Market to Book (MTB) methods to its group of three water utilities with actively traded common stock which appear in the Water Utility Industry section of the *Value Line Investment Survey,* and a group of gas companies followed by *Value Line.* (OCA St. 2 at 20-21). The application of the three aforementioned methods produces common equity cost rates of between 9.53 and 9.82% for DCF, 8.22% to 9.37% for CAPM, 7.64% to 8.95% for MEPR, and from 9.57% to 9.80% for MTB. The OCA then chose 9.25% as its common equity cost rate recommendation, because it primarily employs the DCF model to estimate its common equity cost rate. (OCA St. 5 at 29).

3. ALJ's Recommendation

Based on her review, evaluation and analysis of the record, regarding the cost of common equity, the ALJ recommended that we afford AP the opportunity to earn a rate of return on common equity of 10.0 percent. The ALJ found that the Commission favors the DCF method to determine the cost of equity capital. However, the ALJ also noted that in the most recent rate proceeding involving Pennsylvania-American Water Company (PAWC), at Docket No. R-00038304 (Opinion and Order entered January 29, 2004), the Commission stated that although the DCF method is the preferred method of analysis to determine cost of equity, it is also appropriate to consider other factors. These factors include, but are not limited to, the utility's capital structure, credit standing, dividends, risks, regulatory lag, wasting assets and any peculiar features of the utility involved.

The ALJ noted further that, in the PAWC case, the Commission made an adjustment to the market based DCF rate to account for the application of a market based common equity cost rate to a book value common equity ratio. The ALJ opined that in the instant matter, a reasonable market based DCF range was between 9.19% and 10%. The ALJ concluded that a market based, DCF return which accounts for the adjustment for market to book common equity would be 10.0%. (R.D. at 86).

4. Exceptions and Replies

AP excepts to the ALJ's recommended 10.0% common equity cost rate, contending, *inter alia*, that such a recommendation results from an excessive reliance on the DCF result. AP also contends that the ALJ improperly ignores the other equity cost determinations it has employed in the past, such as Risk Premium, CAPM and comparable earnings. AP asserts that the OTS' DCF equity cost range of 9.5-10.0% was understated, and that the growth rates employed in those OTS-sponsored recommendations were seriously outdated. AP contends that the growth rates for three companies in its barometer group had increased significantly since its direct testimony was filed. AP adds that the ALJ did take into account rising interest rates in her recommended 10% equity return.

AP furthermore contends that the ALJ's recommended rate of return gives no consideration to its outstanding management performance. Section 523 of the Code, 66 Pa. C.S. §523, directs the Commission to consider the efficiency, adequacy, and effectiveness of service in setting just and reasonable rates. AP contends in this regard that its management performance merits a reward for efficiency, based upon its record for excellent water quality, for cost containment, regionalization and acquiring small, troubled water companies. (AP Exc. at 4-10).

The OTS also excepts to the ALJ's recommendation, arguing that the return on equity should not exceed 9.5 percent. The OTS also asserts that the ALJ did not consider the reduction in financial risk resulting from AP's capital structure, which is comprised of a smaller portion of debt than any of the barometer group companies. Based on those factors, the OTS contends that a lower level of return on equity is justified in this matter. (OTS Exc. at 14-16).

The OCA also excepts to the ALJ's recommendation on this issue, arguing that the ALJ's recommended level is excessive in light of current conditions. The OCA argues that the common equity cost rate should be 9.25 percent, pointing out that the ALJ's recommendation does not take into account the post-tax effect on dividend yields, the recent decline in interest rates, or the current level of yields for 10-year Treasury Bonds. The OCA points out that interest rates are at a 45-year low, and that the market-to-book adjustment to the DCF result was not based upon sound financial theory. The use of debt and not equity raises the financial risk of a firm. (OCA Exc. at 1-7).

The Parties also filed Reply Exceptions. AP argues therein that the ALJ erroneously concluded that AP's debt/equity ratio is less than the water barometer group, because the figures in question related to different time periods and are misleading. Specifically, AP points out that the 49.43% common equity ratio was taken from its projected capitalization at June 30, 2004, while the 44.9% barometer group figure relates to the period ending December 31, 2002. AP also argues that interest rates are no longer declining, and, citing OTS' observation, it expects the "Aaa" corporate bond yield to increase to 7.6%from the current level of 5.70%. (AP R.Exc. at 6).

In its Reply Exceptions, the OTS rejoins that AP's argument regarding outdated growth rates lacked legitimacy because a proper DCF analysis would require updated dividend yields before any change in the recommendation could be made. AP made no effort to update either its dividend yields or its growth rates. (OTS R.Exc. at 3-7).

The OCA, in its Reply Exceptions, asserts that AP's claim for equity return is excessive, pointing out that the ALJ did not consider an upward adjustment for the market to book ratio. The OCA recommends that the Commission deny AP's claim in this regard. Additionally, the OCA counters AP's argument regarding the use of methodologies other than DCF, contending that the use of other methodologies by the ALJ would have resulted in an equity return recommendation lower than the 10.0% recommended by the ALJ. (OCA R.Exc. at 1-7).

5. Disposition

We have often relied on the DCF methodology and informed judgment in arriving at our determination of the proper cost of common equity. *See Pennsylvania Public Utility Commission v. Philadelphia Suburban Water Company*, 71 Pa. PUC 593, 623-632 (1989); *Pennsylvania Public Utility Commission v. Western Pennsylvania Water*

Company, 67 Pa. PUC 529, 559-570 (1988); *Pennsylvania Public Utility Commission v. Roaring Creek Water Company*, 150 PUR4th 449, 483-488 (1994); *Pennsylvania Public Utility Commission v. York Water Company,* 75 Pa. PUC 134, 153-167 (1991); *Pennsylvania Public Utility Commission v. Equitable Gas Company*, 73 Pa. PUC 345-346 (1990).

In *Lower Paxton Township v. Pennsylvania Public Utility Commission,* 317 A.2d 917 (Pa. Cmwlth. Ct. 1974) (*Lower Paxton Township),* the Court recognized that the Commission may consider factors which affect the cost of capital, such as the utility's financial structure, credit standing, dividends, risks, regulatory lag, wasting assets and any peculiar features of the utility involved. Here, as in *PAWC,* we are guided by the spirit and intent of *Lower Paxton.*

The ALJ recommended a 10.0% cost of equity, relying too heavily on the DCF methodology. However, the ALJ failed to sufficiently consider the other standard financial models, including Comparable Earnings, the Risk Premium Model, and the CAPM, as checks upon the reasonableness of the DCF results. *See generally*, *PA P.U.C. v. Pennsylvania Suburban Water Company,* 219 PUR 4th 272 (2002).

Furthermore, the ALJ's recommendation does not fully reflect consideration of a number of other factors in the record. First, as discussed, *supra,* in AP's Exceptions, AP's 49.43% common equity ratio was taken from its projected capitalization at June 30, 2004, while the 44.9 per cent barometer group figure relates to the period ending December 31, 2002. We agree that the ALJ failed to consider the latest available data in considering AP's financial risk.

Next, we find that AP has offered evidence that "Aaa" corporate bond yield is expected to increase to 7.6 percent, from the current level of 5.7 percent. (AP R.Exc.

at 1-7). We are of the opinion that the evidence proffered by the OTS and the OCA on this issue does not rise to a level such as to refute AP's evidence.

We are also persuaded by AP's reasoning that a financial risk adjustment is necessary to compensate it for the application of a market based cost of common equity to a book value common equity ratio. We note that preliminary the DCF calculation, which is computed using the market price of AP's common stock, should be adjusted to reconcile the divergence between market and book values[11]. Additionally, when investors value a company's common stock, they employ actual market capitalization data, and not book data, although book capitalization is employed for ratemaking purposes.

We also find that the ALJ did not give sufficient weight to the quality of AP's management performance in the areas of:

i) Water quality;

ii) Customer service;

iii) Low income customer assistance; and

iv) Regionalization efforts –AP has been keenly responsive to existing and prospective regional water supply problems. Its acquisitions of portions of profoundly-troubled National Utilities, Inc. (NUI) systems exemplifies its efforts.

AP's acquisition of NUI is particularly noteworthy because long-suffering customers of NUI now have the benefit of AP's caliber of service. This is due, in large part, to AP's commitment to resolving problems of that troubled water company, and to

[11] *See Pa. P.U.C. v. Pennsylvania-American Water Co.*, 2002 Pa. PUC LEXIS 1; *Pa. P.U.C. v. Philadelphia Suburban Water Co.*, 219 PUR 4th 272 (2002); *Pa. P.U.C. v. Pennsylvania-American Water Co.*, 231 PUR 4th 277 (2004).

its perseverance in completing this challenging acquisition.[12] The record offers two glaring examples -- namely:

a) Former NUI customers of the Harvey's Lake system sent a letter to Aqua to thank them for taking over the system. They state:

> Although we know that it will be a long process to correct problems created by neglected [*sic*] for so many years, their efforts have already made a significant difference. For the first time in five years, we have had water on the Fourth of July and can fill a washing machine in less than 20 minutes.[13]

b) A newspaper article entitled *New Water Company Fixes Leak in a Jiffy*,[14] described the frustrating saga of a customer's attempt to get a leak repaired in NUI's Midway Manor system. The leak was described as a pond "forming atop a domestic water line which in the past has been a source of breaks and headaches for Burgess and her neighbors in Midway Manor."[15] A NUI repairman told Ms. Burgess that no chlorine could be found in the water [so presumably it was not the company's main which was the source of the leak] and that the problem was accumulated rainwater runoff. After the water continued to accumulate, and further calls to NUI produced no solution, an Aqua manager made a service call and repaired the company water line, since Aqua had just taken over the system. Apparently, NUI had not alerted Aqua to the still pending service complaint. Aqua's White Haven division manager was quoted as concluding:

---

[12] That AP took on the challenge of acquiring NUI is common knowledge among Commission staff, affected parties, and water industry individuals who assisted with the numerous attempts to solve the NUI dilemma over the past decade or so.

[13] Letter from Barbara and Bruce Leggat dated July 22, 2002. (Aqua Direct Testimony, St. 1-7; Section 2; Sch. 3, at 1).

[14] *Dallas Post*, July 11, 2002. (Aqua Direct Testimony, St. 1-7; Section 2; Sch. 3, at 2,3).

[15] *Ibid.*, at 2.

> "It was pretty obvious to us that there was a leak. . . We're in the middle of a drought, and there was a lot of water in the yard, and there was a high rate of water coming out of the pump house. . . It seems like that is all we have been doing (since taking over NUI) is repairing leaks in the water lines."[16]

Based upon the foregoing factors and those identified by the ALJ, all supported by the evidentiary record, we shall allow a cost of equity of 10.60%.

In a broader sense, aside from the record evidence, this company's performance fosters economic development, which has resulted in benefits to the state, the economy, and to the overall quality of life. The Distribution System Improvement Charge ("DSIC") has led to additional jobs, while enabling the much-needed acceleration of the rehabilitation of aging infrastructure, resulting in a safer and more reliable quality of service for the communities that it serves. Through a strong balance sheet, Aqua has been able to acquire utilities both in this state and throughout the country. These acquisitions serve to significantly increase economies of scale to the benefit of all of the company's ratepayers, while vastly improving service for the previously troubled systems' ratepayers.

The following table summarizes our determinations concerning AP's capital structure, cost of debt, cost of preferred stock, and cost of common equity, as well as the resulting weighted costs and overall rate of return:

Capital Structure	Ratio	Cost Rate	Weighted Cost
Debt	50.57%	6.60%	3.34%
Common Equity	49.43%	10.60%	5.23%
	100.00%		8.57 %

16 *Ibid.*, p. 3

Accordingly, the Exceptions of the OCA and the OTS on this issue are denied. AP's Exceptions are granted, in part, and denied, in part, consistent with the above discussion.

17. That the Petition to Intervene filed by the Office of Trial Staff is granted to the extent consistent with this Opinion and Order, and is otherwise denied.

18. That the Petition to Intervene filed by Upper Dublin Township, Montgomery County, is granted to the extent consistent with this Opinion and Order. That the Formal Complaint filed by Upper Dublin Township, Montgomery County, at Docket No. R-00038805C0084, is dismissed.

19. That the Petition filed by Aqua Pennsylvania, Inc., at Docket No. P-00032025, is denied and dismissed in its entirety.

20. That the Pennsylvania Public Utility Commission's inquiry and investigation in Docket No. R-00038805, *et al.*, is terminated and the record closed.

BY THE COMMISSION,

James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: July 23, 2004

ORDER ENTERED: August 5, 2004

KENTUCKY POWER COMPANY
American Electric Power
FIRST SET OF DATA REQUESTS OF
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
Case No. 2005-00341

Question No. 5

Please provide copies of all source documents relied upon by Mr. Moul in preparation of his Appendices and Financial Exhibit and all Schedules.

Response

Many of the supporting documentation involving Mr. Moul's Appendices and Financial Exhibit have been provided in response to data requests of other parties (e.g., the Commission Staff and AG). Other materials, such as Annual Reports to Stockholders, yields on Treasury obligations, etc., can be obtained on the internet.

Witness: Paul R. Moul

KENTUCKY POWER COMPANY
American Electric Power
FIRST SET OF DATA REQUESTS OF
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
Case No. 2005-00341

Question No. 6

Please provide the growth rates for the individual companies in Mr. Moul's Electric group that comprise the averages shown on Schedules 6 and 7. Provide copies of all source documentation for the individual company growth rates.

Response

The individual company growth rates were provided as an attachment to the response to AG First Set Data Request, Item No. 226. A copy of the source documentation is attached.

Witness: Paul R. Moul

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Earnings Estimates

AMEREN CORPORATION (AEE)

Sector: Public Utilities

Industry: Electrical Utilities

Last Updated: June 18, 2005

Buy 2.85 Sell
1 2 3 4 5

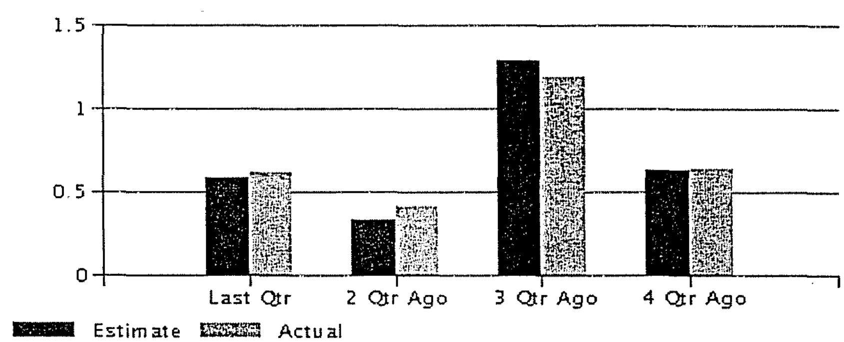
First Call Consensus Rec: Hold

The Analyst Company Sentiment is POSITIVE

Analyst Sentiment is determined by a quantitative company scoring model that scores company level sentiment based on analyst earnings revisions. The scoring model considers the following factors: analyst experience, magnitude of the revision, proximity of the revision to the actual earnings report date, range of estimates, historic stock performance following a given analyst's prior revisions, and market capitalization of the company.

Overview			
Exchange	New York Stock Exchange	5 Year Growth	-1.24
52 Week Range	42.00 - 55.28	5 Year Stability	61.01
Current PE	17.60	Annual Dividend	2.54
Beta	0.41	*All prices displayed in local currency	

Reported Quarters



	Current	Last Quarters	2 Quarters Ago	3 Quarters Ago	4 Quarters Ago
Estimate	0.74	0.59	0.34	1.29	0.64
Actual	-	0.62	0.42	1.20	0.65
Surprise%	-	4.73	23.53	-7.26	0.93
Surprise $ Amt	-	0.03	0.08	-0.09	0.01

Consensus EPS Estimates

Period	Report Date	# of Estimates	Mean	High	Low	Median
Q1	Jun 05	5	0.74	0.78	0.70	0.75
Q2	Sep 05	4	1.36	1.40	1.34	1.35
Q3	Dec 05	4	0.38	0.43	0.30	0.39
Q4	Mar 06	1	0.64	0.64	0.64	0.64
FY1	Dec 05	12	3.07	3.12	3.05	3.05
FY2	Dec 06	11	3.24	3.31	3.20	3.25
LTG	-	7	3.36	6.00	1.50	3.00

Earnings Momentum

	06/2005	09/2005	12/2005	03/2006
# Estimates Up/Down - 1 Week	0/ 0	0/ 0	0/ 0	0/ 0
# Estimates Up/Down - 1 Month	0/ 0	0/ 0	0/ 0	0/ 0
Current Mean Estimate	0.74	1.36	0.38	0.64
Mean 1 Month Ago	0.75	1.37	0.36	0.64
Mean 3 Months Ago	0.74	1.38	0.36	0.62

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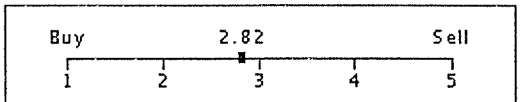
Earnings Estimates

DTE ENERGY COMPANY (DTE)

Sector: Public Utilities

Industry: Electrical Utilities

Last Updated: June 18, 2005



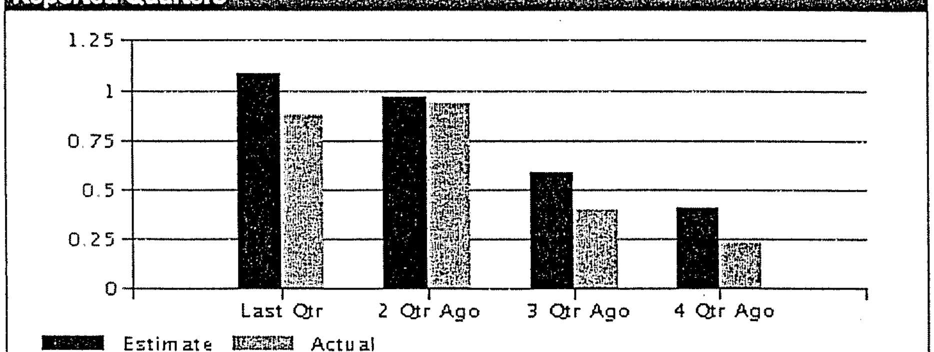
First Call Consensus Rec: Hold

The Analyst Company Sentiment is NEUTRAL

Analyst Sentiment is determined by a quantitative company scoring model that scores company level sentiment based on analyst earnings revisions. The scoring model considers the following factors: analyst experience, magnitude of the revision, proximity of the revision to the actual earnings report date, range of estimates, historic stock performance following a given analyst's prior revisions, and market capitalization of the company.

Overview			
Exchange	New York Stock Exchange	5 Year Growth	-6.02
52 Week Range	39.31 - 48.31	5 Year Stability	40.50
Current PE	13.51	Annual Dividend	2.06
Beta	0.45	*All prices displayed in local currency	

Reported Quarters



	Current	Last Quarters	2 Quarters Ago	3 Quarters Ago	4 Quarters Ago
Estimate	0.40	1.09	0.97	0.59	0.41
Actual	-	0.88	0.94	0.40	0.23
Surprise%	-	-19.12	-2.89	-32.20	-43.21
Surprise $ Amt	-	-0.21	-0.03	-0.19	-0.18

Consensus EPS Estimates

Period	Report Date	# of Estimates	Mean	High	Low	Median
Q1	Jun 05	2	0.40	0.40	0.40	0.40
Q2	Sep 05	1	0.80	0.80	0.80	0.80
Q3	Dec 05	1	1.25	1.25	1.25	1.25
FY1	Dec 05	9	3.48	3.55	3.38	3.50
FY2	Dec 06	10	3.88	4.00	3.75	3.88
LTG	-	5	4.20	6.00	2.00	4.00

Earnings Momentum

	06/2005	09/2005	12/2005	/
# Estimates Up/Down - 1 Week	0/ 0	0/ 0	0/ 0	/
# Estimates Up/Down - 1 Month	0/ 0	0/ 0	0/ 0	/
Current Mean Estimate	0.40	0.80	1.25	
Mean 1 Month Ago	0.40	0.80	1.25	
Mean 3 Months Ago	0.40	0.75	1.20	

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Earnings Estimates

EXELON CORP (EXC)

Sector: Public Utilities

Industry: Electrical Utilities

Last Updated: June 18, 2005

Buy 2.00 Sell
1 2 3 4 5

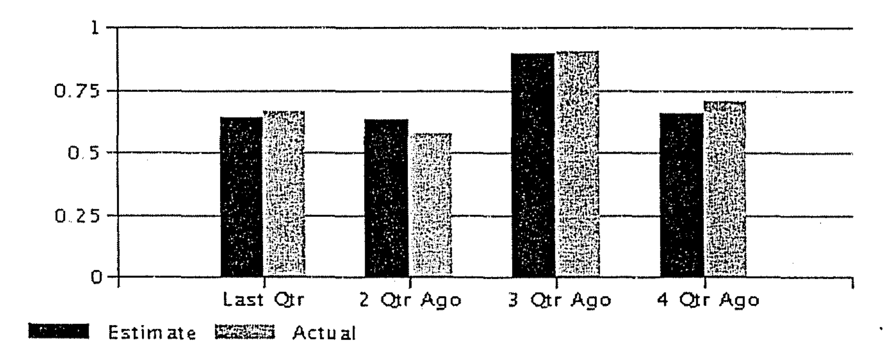
First Call Consensus Rec: Buy

The Analyst Company Sentiment is POSITIVE

Analyst Sentiment is determined by a quantitative company scoring model that scores company level sentiment based on analyst earnings revisions. The scoring model considers the following factors: analyst experience, magnitude of the revision, proximity of the revision to the actual earnings report date, range of estimates, historic stock performance following a given analyst's prior revisions, and market capitalization of the company.

Overview			
Exchange	New York Stock Exchange	5 Year Growth	9.45
52 Week Range	32.35 - 49.70	5 Year Stability	15.10
Current PE	15.56	Annual Dividend	1.60
Beta	0.59	*All prices displayed in local currency	

Reported Quarters



	Current	Last Quarters	2 Quarters Ago	3 Quarters Ago	4 Quarters Ago
Estimate	0.71	0.65	0.64	0.90	0.66
Actual	-	0.67	0.58	0.91	0.71
Surprise%	-	3.24	-8.95	1.68	7.09
Surprise $ Amt	-	0.02	-0.06	0.02	0.05

Consensus EPS Estimates

Period	Report Date	# of Estimates	Mean	High	Low	Median
Q1	Jun 05	7	0.71	0.75	0.68	0.70
Q2	Sep 05	6	1.03	1.08	1.00	1.03
Q3	Dec 05	5	0.63	0.65	0.61	0.64
Q4	Mar 06	2	0.71	0.71	0.70	0.71
FY1	Dec 05	15	3.07	3.25	2.97	3.10
FY2	Dec 06	15	3.29	3.50	2.95	3.30
LTG	-	7	5.29	6.00	5.00	5.00

Earnings Momentum

	06/2005	09/2005	12/2005	03/2006
# Estimates Up/Down - 1 Week	0/ 0	0/ 0	0/ 0	0/ 0
# Estimates Up/Down - 1 Month	0/ 0	1/ 0	0/ 0	0/ 0
Current Mean Estimate	0.71	1.03	0.63	0.71
Mean 1 Month Ago	0.71	1.02	0.64	0.71
Mean 3 Months Ago	0.71	1.03	0.63	0.65

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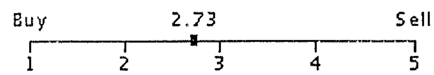
FIRSTENERGY CORP (FE)

Sector: Public Utilities

Industry: Electrical Utilities

Last Updated: June 18, 2005



First Call Consensus Rec: Hold

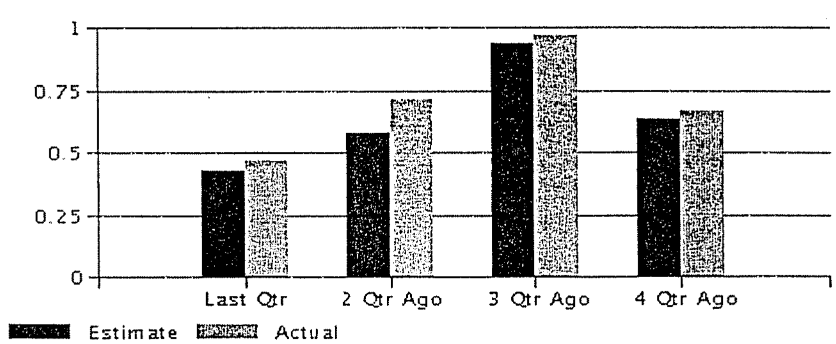
The Analyst Company Sentiment is NO RATING

Analyst Sentiment is determined by a quantitative company scoring model that scores company level sentiment based on analyst earnings revisions. The scoring model considers the following factors: analyst experience, magnitude of the revision, proximity of the revision to the actual earnings report date, range of estimates, historic stock performance following a given analyst's prior revisions, and market capitalization of the company.

Overview

Exchange	New York Stock Exchange	5 Year Growth	-3.10
52 Week Range	36.90 - 45.80	5 Year Stability	29.36
Current PE	16.02	Annual Dividend	1.65
Beta	0.57	*All prices displayed in local currency	

Reported Quarters



	Current	Last Quarters	2 Quarters Ago	3 Quarters Ago	4 Quarters Ago
Estimate	0.68	0.43	0.58	0.94	0.64
Actual	-	0.47	0.72	0.97	0.67
Surprise%	-	8.80	23.29	3.52	5.02
Surprise $ Amt	-	0.04	0.14	0.03	0.03