



**NORTH CAROLINA
PUBLIC STAFF
UTILITIES COMMISSION**

August 12, 2019

Ms. Janice Fulmore, Deputy Chief Clerk
North Carolina Utilities Commission
4326 Mail Service Center
Raleigh, North Carolina 27699-4300

Re: Docket No. G-9, Sub 743 – Application for General Rate Increase

Dear Ms. Fulmore:

In connection with the above-captioned docket, I transmit herewith for filing on behalf of the Public Staff the Settlement Testimony and Exhibit of John R. Hinton, Director, Economic Research Division.

By copy of this letter, we are providing copies to all other parties of record.

Sincerely,

/s/ Elizabeth D. Culpepper
Staff Attorney
elizabeth.culpepper@psncuc.nc.gov

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BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NO. G-9, SUB 743

In the Matter of)	
Application of Piedmont Natural Gas)	SETTLEMENT
Company, Inc., for an Adjustment of)	TESTIMONY OF
Rates, Charges, and Tariffs Applicable)	JOHN R. HINTON
to Service in North Carolina,)	PUBLIC STAFF – NORTH
Continuation of its IMR Mechanism,)	CAROLINA UTILITIES
Adoption of an EDIT Rider, and Other)	COMMISSION
Relief)	

**PIEDMONT NATURAL GAS COMPANY, INC.
DOCKET NO. G-9, SUB 743**

**SETTLEMENT TESTIMONY OF JOHN R. HINTON
ON BEHALF OF THE PUBLIC STAFF –
NORTH CAROLINA UTILITIES COMMISSION**

August 12, 2019

1 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND**
2 **PRESENT POSITION.**

3 A. My name is John R. Hinton. My business address is 430 N. Salisbury
4 Street, Dobbs Building, Raleigh, North Carolina. I am Director of the
5 Economic Research Division of the Public Staff – North Carolina
6 Utilities Commission (Public Staff).

7 **Q. ARE YOU THE SAME JOHN R. HINTON THAT FILED DIRECT**
8 **TESTIMONY AND EXHIBITS ON RATE OF RETURN ON JULY 19,**
9 **2019?**

10 A. Yes, I am.

11 **Q. WHAT IS THE PURPOSE OF YOUR SETTLEMENT TESTIMONY**
12 **IN THIS PROCEEDING?**

13 A. The purpose of my settlement testimony is to support the stipulation
14 between Piedmont Natural Gas Company, Inc. (Piedmont or the
15 Company) and the Public Staff (Settlement), as it relates to the cost
16 of capital to be used in setting rates in this proceeding.

1 **Q. WHAT IS THE COST OF CAPITAL IN THE SETTLEMENT?**

2 A. The Public Staff and the Company have agreed to a 7.14% cost of
3 capital in this proceeding. The overall cost rate is comprised of a
4 9.70% rate of return on common equity (ROE), a 2.72% cost rate of
5 short-term debt, a 4.41% cost rate of long-term debt which is
6 combined with a capital structure consisting of 52.00% common
7 equity, 0.85% short-term debt, and 47.15% long-term debt.

8 **Q. WHAT IS YOUR EXPERIENCE WITH AND UNDERSTANDING OF**
9 **SETTLEMENTS IN SIMILAR GENERAL RATE CASE**
10 **PROCEEDINGS?**

11 A. It has been my experience that settlements are generally the result
12 of good faith “give and take” and compromise-related negotiations
13 among the parties to utility rate proceedings. Settlements, as well as
14 the individual components of the settlements, are often achieved by
15 the respective parties’ agreements to accept otherwise unacceptable
16 individual aspects of individual issues in order to focus on other
17 issues. Settlements sometimes result in a “global” resolution of all
18 the issues that would otherwise be litigated in a rate proceeding, and
19 are sometimes restricted to resolution of one or more individual
20 issues. The Settlement in this proceeding is global with respect to
21 the contested issues identified by the Public Staff.

1 **Q. DID YOU PARTICIPATE IN THE NEGOTIATIONS LEADING UP**
2 **TO THE SETTLEMENT IN THIS PROCEEDING?**

3 A. Yes, I participated in the negotiations leading up to the Settlement.

4 **Q. PLEASE COMMENT ON THE SETTLEMENT CAPITAL**
5 **STRUCTURE AND HOW IT DIFFERS FROM YOUR ORIGINALLY**
6 **FILED POSITION.**

7 A. The Settlement recommendation of 52.00% for the equity ratio
8 contains more equity than I recommended in my previously filed
9 testimony. In large part, the difference between my recommended
10 capital structure and that of the Company witnesses relates to the
11 inclusion of current maturities of long-term debt that is retiring within
12 12 months. Another difference is that my recommended capital
13 structure takes into account the impact of the \$300 million equity
14 infusion from Duke Energy Corporation which increased the monthly
15 balances of common equity. While I believe the regularity of current
16 maturities shown in Page 2 of Exhibit JRH-2, as well as, the
17 Company's historical capitalization demonstrate that this form of
18 capital should be considered as permanent capital for ratemaking, I
19 maintain that the Settlement capitalization ratios are reasonable.

20 **Q. DO YOU AGREE THAT THE COST OF CAPITAL COMPONENTS**
21 **OF THE PROPOSED SETTLEMENT ARE REASONABLE WITHIN**
22 **THE CONTEXT OF THE OVERALL SETTLEMENT?**

1 A. Yes I do. As with other settlements, the Settlement cost of capital
2 components in this proceeding represent a compromise by both
3 parties in an effort to reach agreement. Furthermore, the Settlement
4 cost of capital components are the result of good faith negotiations
5 and compromises.

6 I note that it remains my position that, should this be a fully litigated
7 proceeding, I would continue to recommend a capital structure with
8 49.21% common equity, 0.85% short-term debt, and 49.94% long-
9 term debt, a ROE of 9.13%, a cost of short-term debt of 2.72%, and
10 a cost of long-term debt of 4.41%. However, given the benefits
11 associated with entering into a settlement, it is my view that the cost
12 of capital components of the Settlement are a reasonable resolution
13 of otherwise contentious issues.

14 **Q. PLEASE EXPLAIN WHY THE PROPOSED CAPITAL STRUCTURE**
15 **RATIO IS REASONABLE.**

16 A. The average common equity ratio for natural gas utilities approved
17 from the start of January 1, 2016, to June 30, 2019, is 51.47%¹ which
18 is supportive of the Settlement common equity ratio. The Settlement
19 capitalization ratios include a 0.85% ratio of short-term debt capital

¹ This calculation excludes the decisions of four states – Arkansas, Florida, Indiana, and Michigan – because these jurisdictions include deferred taxes and other non-capital items in the approved capital structure. As such, the approved equity ratios are not comparable to North Carolina ratemaking and will bias the average equity ratio downward.

1 that is reflective of the Company's balance of gas inventory and a
2 47.15% ratio of long-term debt.

3 **Q. DOES THE SETTLEMENT CAPITAL STRUCTURE COMPORT**
4 **WITH CAPITAL STRUCTURES APPROVED BY THIS**
5 **COMMISSION IN RECENT RATE CASES?**

6 A. Yes, the last natural gas rate case was the 2016 Public Service
7 Company of North Carolina, Inc. (PSNC), rate case where the North
8 Carolina Utilities Commission (Commission) approved a capital
9 structure containing 52.00% common equity. In addition, recent
10 Commission-approved common equity ratios for other regulated
11 utilities support the reasonableness of the Settlement common
12 equity ratio, as shown below:

Company	Docket	Order Date	NCUC Approved Equity Ratio
PSNC	G-5, Sub 565	10/26/2016	52.00%
DENC	E-22, Sub 532	12/22/2016	51.75%
DEP	E-2, Sub 1142	2/23/2018	52.00%
DEC	E-7, Sub 1146	6/22/2018	52.00%

13 **Q. PLEASE COMMENT ON THE SETTLEMENT, PARTICULARLY**
14 **AS IT RELATES TO THE RATE OF ROE.**

15 A. The Company and Public Staff have fundamentally different views of
16 current market conditions and the current cost of capital. Neither
17 party convinced the other to change its view of the cost of capital
18 issues, but the Public Staff and Piedmont have found a way to bridge

1 their differences which results in a reasonable Settlement ROE.

2 **Q. HOW DOES THE SETTLEMENT 9.70% ROE COMPARE TO THE**
3 **RESULTS OF THE ANALYTICAL MODELS USED BY YOU AND**
4 **BY THE COMPANY?**

5 A. The Settlement ROE of 9.70% is slightly higher than the upper end
6 of my range of estimated cost rates for common equity of 8.63% to
7 9.64%, as shown in Exhibit JRH-8 to my originally filed testimony.
8 Likewise, the Settlement 9.70% ROE is noticeably lower than the
9 lower end of the Company's recommended range of 10.00% to
10 11.00%.² The impact of the compromises can be seen through the
11 Company's revenue requirement which increases by \$1.4 million
12 when the ROE increases from 9.64% to 9.70%; as compared to a
13 decrease of \$7.1 million when the Company's original 10.00% ROE
14 proposal is decreased to 9.70%.

15 **Q. HOW DOES THE SETTLEMENT 9.70% ROE COMPARE WITH**
16 **ROEs APPROVED BY OTHER PUBLIC UTILITY COMMISSIONS**
17 **AND RECENT DECISIONS BY THIS COMMISSION?**

18 A. The most recently published average ROE for natural gas utilities for
19 the first half of 2019 is 9.63%³, which is supportive of the Settlement.
20 The approved median ROE in these same 2019 cases is 9.70%.

² Docket No. G-7, Sub 743, Prefiled Direct Testimony of Robert B. Hevert, page 4.

³ S&P Global Market Intelligence, RRA Regulatory Focus, July 22, 2019.

1 However, one cannot make a simple comparison of approved ROEs
2 with public utility commissions without consideration of the inherent
3 risks within the type of utility, rates of returns available from other
4 comparable risk investments, and other considerations that may
5 warrant a ROE premium or discount. The following table contains
6 ROEs recently approved by the Commission in natural gas and
7 electric utility general rate cases in combination with the average
8 ROEs as reported in RRA Regulatory Focus Major Rate Case
9 Decisions. Given that the investor risk profiles of PSNC and
10 Piedmont are very comparable, more weight should be ascribed to
11 this decision. As such, the two basis point spread between the
12 Commission's approved ROE with PSNC's 2016 rate case and the
13 2016 fourth quarter average ROE of 9.68% is close to the seven
14 basis point spread from this Settlement 9.70% ROE and the 9.63%
15 average natural gas utility ROE approved thus far in 2019.

Company	Docket	Order Date	NCUC- Approved ROE	RRA's Average ROE	Basis Point Spread
PSNC	G-5, Sub 565	10/26/2016	9.70%	9.68% ⁴	2
DENC	E-22, Sub 532	12/22/2016	9.90%	9.77% ⁵	13
DEP	E-2, Sub 1142	2/23/2018	9.90%	9.68% ⁵	22
DEC	E-7, Sub 1146	6/22/2018	9.90%	9.68% ⁵	22

⁴ S&P Global Market Intelligence, RRA Regulatory Focus, July 29, 2019, average ROE for gas utilities for fourth quarter 2016.

⁵ S&P Global Market Intelligence, RRA Regulatory Focus, January 31, 2019, annual average ROE for vertically electric utilities.

1 **Q. IS THE 9.70% ROE AND THE 52.00% EQUITY RATIO A**
2 **REASONABLE RESULT?**

3 A. Yes. The Settlement 7.14% overall cost of capital is reasonable as
4 shown in Settlement Exhibit JRH-1. The higher percentage of equity
5 capital and the higher ROE contribute to increasing the pre-tax
6 interest coverage ratio to 4.1. As previously noted, the Settlement
7 overall cost of capital represents a reasonable middle ground
8 between the original positions of the Public Staff and the Company.
9 In addition, the agreement on the Settlement 9.70% ROE and on
10 capital structure occurred in the context of various other
11 compromises by both parties on other issues.

12 **Q. DOES THIS CONCLUDE YOUR SETTLEMENT TESTIMONY?**

13 A. Yes, it does.

Piedmont Natural Gas
Cost of Capital and Capital Structure
as of June 30, 2019

	Amount (\$)	Ratio	Cost Rate	Weighted Cost Rate	Tax Retention Factors	Pre-Tax Cost of Capital ¹
Long-Term Debt	2,148,186,829	47.15%	4.41%	2.08%	0.9932	2.09%
Short-Term Debt	39,391,976	0.85%	2.72%	0.02%	0.9932	0.02%
Common Equity	2,123,584,913	52.00%	9.70%	5.04%	0.7650	6.59%
Total	4,311,163,718	100.00%		7.14%		8.70%

Pre-Tax Interest Coverage ratio² 4.1

Note:

¹ The pre-tax cost of debt and equity is grossed up by tax retention factors.

² Pre-Tax Interest Coverage: 4.1 times = 8.71% / (2.09%.+0.02%).