

The Narragansett Electric Company
d/b/a Rhode Island Energy

APPLICATION FOR APPROVAL
OF A CHANGE IN ELECTRIC AND
GAS BASE DISTRIBUTION RATES

Rhode Island Energy's Responses to
the Seventh Set of Data Requests from the
Division of Public Utilities & Carriers

Book 3 of 3

February 20, 2026

Submitted to:
Rhode Island Public Utilities Commission
Docket No. 25-45-GE

Submitted by:



Rhode Island Energy™
a PPL company

Division 7-10
Cost of Equity

Request:

Reference is made in Mr. Nowak's testimony states that he considers the results of multiple models to ensure reasonableness. a. Did Mr. Nowak perform any quantitative statistical analysis—such as a Correlation Coefficient calculation or a Common Factor Analysis—to measure the degree to which the outputs of his DCF model and his CAPM model move in unison? b. If yes, please provide the workpapers showing this calculation. c. If no, on what empirical basis does Mr. Nowak claim that these two methodologies provide “unique” or 'independent' estimates of the Cost of Equity, given that they share a primary input variable?

Response:

- a. As a preliminary matter, the analysis that is the subject of this request is not relevant to Mr. Nowak's cost of capital analysis in this proceeding. Notwithstanding, Mr. Nowak did not perform this analysis. The DCF and CAPM models are unique analyses that cost of capital practitioners commonly use. Numerous public utilities commissions have relied on these analyses to set the cost of equity capital in utility regulatory proceedings. A correlation coefficient calculation or similar statistical analysis on the outputs of the DCF and CAPM models is not relevant to establishing the appropriate cost of equity capital. Mr. Nowak's approach in using multiple models recognizes that the different approaches are subject to different assumptions, inputs, and limitations. A determination as to whether the results from two models are correlated at a given point is not relevant; no single model, or pair of models, can accurately measure the cost of equity at all times under all market conditions. It is for that reason that analysts are inclined to gather and evaluate as much relevant data as can reasonably be obtained when estimating the cost of equity and apply reasoned judgment in interpreting those results. As a practical matter, to Mr. Nowak's knowledge, no cost of capital practitioner has performed such an analysis in any case in which Mr. Nowak has participated.
- b. Please see the response to subpart a.
- c. The DCF model and CAPM analysis do not share a primary input variable, as Mr. Nowak explains on pages 28 through 35 of his pre-filed direct testimony (Book 7, Bates pages 31 through 38). The Constant Growth DCF and CAPM estimates are based on two distinct approaches. Although it may appear that these analyst earnings growth rate projections are the same input on the surface, they are for different universes of companies. In particular, the analyst earnings growth rate projections that Mr. Nowak uses in his DCF model pertain to the companies in the proxy group, whereas the analyst earnings growth

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rate projections that Mr. Nowak uses in his CAPM analysis are for the S&P 500 companies used as one component of the calculation of the Market Risk Premium.

Division 7-11
Cost of Equity

Request:

Did Mr. Nowak perform a sensitivity analysis to determine the conditional probability that his CAPM result would be 'Low' (e.g., below 9%) if his DCF result was 'High' (e.g., above 11%), or vice versa? a. If Mr. Nowak did not perform this test, does he possess any mathematical evidence to rebut the suggestion that a 'High' result in the DCF model mathematically necessitates a 'High' result in the CAPM model due to the shared Analyst Growth input?"

Response:

As a preliminary matter, the analysis that is the subject of this data request is not relevant to Mr. Nowak's cost of capital analysis in this proceeding. Notwithstanding, Mr. Nowak did not perform this analysis. As explained in the Company's response to data request Division 7-10, the presumption that Mr. Nowak's DCF model and CAPM analysis have a "shared Analyst Growth input" is incorrect. The variability of individual proxy company DCF results may depend on the analyst growth rates, but the variability of individual proxy company CAPM results depends on the difference in Beta coefficient estimates, not analyst growth rates.

Division 7-12
Cost of Equity

Request:

Did Mr. Nowak perform a "Variance Attribution" analysis to determine what percentage of the final COE result in *each* of his four models is driven by the specific assumption regarding future analyst growth rates? a. If Mr. Nowak did not quantify this attribution, how did he determine that his final recommendation relies on a 'range of models' rather than predominantly relying on a single variable (Analyst Growth) repeated four times?"

Response:

As a preliminary matter, the analysis that is the subject of this data request is not relevant to Mr. Nowak's cost of capital analysis in this proceeding. Notwithstanding, Mr. Nowak did not perform this analysis. A "Variance Attribution" analysis can be useful when explaining period-over-period changes or variance to forecast. It is not useful when analyzing the cost of equity capital. Further, the presumption that "future analyst growth rates" are used in "each of [Mr. Nowak's] four models" is not correct; the Risk Premium and Expected Earnings models do not use this input. Additionally, as explained in the Company's response to data request Division 7-10, the presumption that Mr. Nowak's DCF model and CAPM analysis have a "single variable (Analyst Growth)" is incorrect. Finally, Mr. Nowak's prefiled direct testimony describes the benefits of using multiple models (*see* pages 23 and 27, Book 7, Bates pages 26 and 30), none of which would change as a result of an Analysis of Variance.

Division 7-13
Cost of Equity

Request:

Reference is made to the Total Market Return (or Market Risk Premium) estimate utilized in Mr. Nowak's CAPM analysis.

- a. Did Mr. Nowak decompose this projected return into its constituent components: (1) Dividend Yield, (2) Earnings Growth, and (3) Change in Valuation Multiple (P/E Ratio expansion/contraction)?
- b. If yes, please provide the specific basis point contribution assigned to each component.
- c. If no, does Mr. Nowak assume that the Price-to-Earnings (P/E) ratio of the S&P 500 will remain constant in perpetuity at its current level, or does his model implicitly assume a continuous expansion of that multiple?"

Response:

- a. As a preliminary matter, the "Change in Valuation Multiple (P/E Ratio expansion/contraction)" is not part of the Constant Growth DCF model that Mr. Nowak used to estimate the market capitalization-weighted total market return for the S&P 500 Index. As can be seen in Equation [2] (page 28) of Mr. Nowak's pre-filed direct testimony (Book 7, Bates page 31), the Constant Growth DCF model includes dividend yield and growth rate terms; it does not include a "Change in Valuation Multiple" term. Notwithstanding, please see Schedule JCN-5; line [1] has the estimate of the S&P 500 dividend yield and line [2] has the estimate of the S&P 500 growth rate.
- b. Please see the response to subpart a.
- c. Please see the response to subpart a.

Division 7-14
Cost of Equity

Request:

To test the reasonableness of the long-term growth assumptions underlying his Total Market Return, did Mr. Nowak calculate the implied P/E ratio of the S&P 500 (or his specific proxy group) at the end of a 10-year or 20-year forecast horizon? a. Please confirm whether Mr. Nowak performed a calculation to determine if his projected equity returns would mathematically require the S&P 500 to trade at a P/E multiple exceeding 30x, 50x, or higher by the end of the projection period. b. If Mr. Nowak did not perform this 'terminal valuation check,' on what basis does he conclude that the future stock prices implied by his return expectations are grounded in fundamental economic reality rather than speculative valuation expansion?"

Response:

As a preliminary matter, the analysis that is the subject of this request is not relevant to Mr. Nowak's cost of capital analysis in this proceeding. Notwithstanding, Mr. Nowak did not calculate the implied P/E ratio of the S&P 500 (or his specific proxy group) at the end of a 10-year or 20-year forecast horizon. Further, as explained in the Company's response to data request Division 7-13, the Constant Growth DCF model does not include a term that measures the change in the implied P/E ratio.

- a. As a preliminary matter, the analysis that is the subject of this request is not relevant to Mr. Nowak's cost of capital analysis in this proceeding. In addition, Mr. Nowak's referenced analysis is not a projected equity return, but rather an estimate of investors' required returns based on current market data and earnings growth estimates. Notwithstanding, Mr. Nowak did not perform a calculation to determine if his projected equity returns would mathematically require the S&P 500 to trade at a P/E multiple exceeding 30x, 50x, or higher by the end of the projection period. Further, to the extent that the S&P 500 were to trade at a higher P/E multiple, Mr. Nowak's CAPM cost of equity capital estimate would be conservative because the dividend yield (and consequently the market return and market risk premium) would be lower due to higher stock prices. That is, a constant P/E ratio is one of the key assumptions of the Constant Growth DCF model. As such, if the P/E ratio is not sustainable, then using historical stock prices will tend to understate the forward-looking cost of equity as companies revert to sustainable valuation levels.
- b. The request is unclear as to what "future stock prices" are implied by Mr. Nowak's analysis. As described in subpart a, Mr. Nowak's analysis is not an expected return, but rather it is an estimate of investors' required returns based on current market data and earnings growth estimates. As such, the question is not relevant to Mr. Nowak's cost of

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capital analysis in this proceeding. As described in Mr. Nowak's pre-filed direct testimony at page 35 (Book 7, Bates page 38), the analysis is consistent with the approach adopted by the Federal Energy Regulatory Commission and widely used by cost of capital practitioners.

Division 7-15
Cost of Equity

Request:

Is Mr. Nowak aware of the financial concept of Valuation Mean Reversion, which suggests that high starting P/E ratios tend to contract toward their long-term historical average over time, creating a headwind for future equity returns? a. Did Mr. Nowak perform a sensitivity analysis to determine the impact on his Total Market Return if the S&P 500 P/E ratio were to revert to its historical average (approximately 16x–18x) over the next decade? b. If Mr. Nowak did not test for valuation contraction, does his recommendation implicitly assume that current valuation multiples will persist indefinitely?"

Response:

Mr. Nowak is aware of the financial concept of Valuation Mean Reversion. As explained in the Company's response to data request Division 7-14, if a starting P/E ratio were to be elevated, then Mr. Nowak's CAPM cost of equity estimate would be conservative because the dividend yield (and consequently the market return and market risk premium) would be lower due to higher stock prices.

- a. As a preliminary matter, the analysis that is the subject of this request is not relevant to Mr. Nowak's cost of capital analysis in this proceeding. Notwithstanding, Mr. Nowak did not perform a sensitivity analysis to determine the impact on his Total Market Return if the S&P 500 P/E ratio were to revert to its historical average (approximately 16x–18x) over the next decade. As explained in the Company's response to data request Division 7-14, if a starting P/E ratio were to be elevated, then Mr. Nowak's CAPM cost of equity estimate would be conservative because the dividend yield (and consequently the market return and market risk premium) would be lower due to higher stock prices.
- b. As described in the Company's response to data request Division 7-14, a constant P/E ratio is one of the key assumptions of the Constant Growth DCF model. As such, if the P/E ratio is not sustainable, then using historical stock prices will tend to understate the forward-looking cost of equity as companies revert to sustainable valuation levels.

Division 7-16
Cost of Equity

Request:

Hypothetically, if Mr. Nowak's DCF model assumes an earnings growth rate (e.g., ~10%) that is lower than his calculated Cost of Equity (e.g., ~12%–15%), does he agree that for an investor to realize that higher 15% return, the market valuation multiple (P/E ratio) must mathematically expand every year? a. Does Mr. Nowak consider a model that relies on perpetual P/E multiple expansion to be a reliable method for setting utility rates, given that P/E ratios cannot expand to infinity?"

Response:

As a preliminary matter, Mr. Nowak's calculated cost of equity for Rhode Island Energy is not "~12%–15%" as posed in the request. The response assumes that this data request refers to the estimated market returns of 15.36 percent and 11.72 percent shown on Schedule JCN-5. Notwithstanding, Mr. Nowak does not agree with the proposition stated in the request, as explained in the Company's response to data request Division 7-14.

- a. The implication that Mr. Nowak's CAPM or DCF models rely on a "perpetual P/E multiple expansion" is incorrect, as explained in the Company's response to data request Division 7-14, because a constant P/E ratio is one of the key assumptions of the Constant Growth DCF model. Accordingly, the question is irrelevant because neither model relies on perpetual P/E multiple expansion.

Division 7-17
Cost of Equity

Request:

Reference is made to Mr. Nowak's reliance on consensus or individual analyst Earnings Per Share (EPS) growth rate projections as a primary input of his calculation of the overall market return of 12% to 15%. Regarding the specific analyst forecasts utilized in your proxy group analysis:

- a. Evaluation of Methodology: Did Mr. Nowak review the specific underlying financial models (e.g., discounted cash flow, relative valuation multiples, etc.) utilized by the individual analysts to generate their EPS growth forecasts? If yes, please summarize the prevailing methodologies identified.
- b. Review of Assumptions: Did Mr. Nowak identify and evaluate the specific macroeconomic assumptions (such as projected GDP growth, inflation rates, or interest rates) embedded within these analyst forecasts to ensure they are consistent with the long-term economic outlook utilized in Mr. Nowak's own testimony?
- c. Quantification of Uncertainty: Did Mr. Nowak investigate whether the analyst reports relied upon provide a 'confidence interval,' 'margin of error,' or 'probability weighting' for their projected growth rates? If so, how was this range of uncertainty incorporated into your analysis?
- d. Disclaimers: Is Mr. Nowak aware of any language in the analyst reports or data services he relied upon that guarantees the accuracy of these projections, or do they explicitly disclaim liability for actual results differing from forecasts?

Response:

- a. The Company's response assumes that the "overall market return of 12% to 15%" refers to the market returns of 15.36 percent and 11.72 percent shown on Schedule JCN-5. Mr. Nowak relies on analyst earnings growth rate projections from *Value Line*. *Value Line* does not provide details on the specific underlying financial models that its analysts use. Nonetheless, as described in Mr. Nowak's pre-filed direct testimony at page 31 (Book 7, Bates page 34), academic studies suggest that investors base their investment decisions on analysts' expectations of growth in earnings from sources like *Value Line*. In Mr. Nowak's experience, *Value Line* is regularly used and referenced by numerous investors, cost of capital practitioners, and regulators when setting a utility's allowed return on equity ("ROE").
- b. Please see the response to subpart a.

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- c. Please see the response to subpart a.
- d. Please see the response to subpart a. Additionally, Mr. Nowak is not aware of any credible publication or investor resource that “guarantees the accuracy” of its projections. Further, it is common practice for most if not all publications and investor resources to disclaim liability for using their information; *Value Line* similarly includes this language (see: <https://www.valuelibrary.com/terms-and-conditions>).

Division 7-18
Cost of Equity

Request:

Please state whether Mr. Nowak or his firm (Concentric Energy Advisors) provides specific financial advice to PPL Corporation's Board of Directors or Treasury Department regarding the pricing, timing, or structuring of actual security issuances (such as the November 2025 Exchangeable Notes or Common Equity offerings). a. If the answer is no, does Mr. Nowak agree that his role is limited to providing 'litigation' or 'regulatory' estimates of the Cost of Equity, rather than the 'transactional' estimates used to clear the market for actual capital?"

Response:

Neither Mr. Nowak nor Concentric Energy Advisors have provided specific financial advice to PPL Corporation's Board of Directors or Treasury Department regarding the pricing, timing, or structuring of actual security issuances. Mr. Nowak's role at Concentric Energy Advisors, however, is not limited to providing "litigation" or "regulatory" estimates of the Cost of Equity. He has provided cost of capital advisory services and other services, including various merger and acquisition due diligence projects, hurdle rate analysis, and, as explained on Schedule JCN-1, he "is also experienced in providing strategic direction on financing activities including bond offerings, credit rating analysis, and investor relations."

Division 7-19
Cost of Equity

Request:

In preparing his recommendation of 10.75%, did Mr. Nowak review any internal PPL Corporation presentations, Board materials, or investment banking pitch decks related to the Company's actual cost of raising equity-linked capital in the last 24 months? If yes, please identify the specific documents reviewed. If no, please explain how Mr. Nowak verified that his theoretical calculation of the Cost of Equity is consistent with the actual marginal cost of equity capital currently being secured by the Company in the open market.

Response:

As a preliminary matter, the analysis that is the subject of this request is not relevant to Mr. Nowak's cost of capital analysis in this proceeding. Notwithstanding, Mr. Nowak has not reviewed the specified internal PPL Corporation materials. In addition, there is a meaningful distinction between PPL Corporation and Rhode Island Energy. Mr. Nowak's testimony relates to the cost of equity for Rhode Island Energy, not PPL Corporation. The marginal cost of equity capital for PPL Corporation has little analytical value to the allowed return on equity ("ROE") in this case because PPL Corporation and Rhode Island Energy are two different companies (e.g., publicly traded, diversified holding company vs. Rhode Island operating utility that is not publicly traded).

Division 7-20
Cost of Equity

Request:

Is it Mr. Nowak's professional opinion that the Cost of Equity methodology used by investment bankers to price PPL's equity issuances (or equity-linked convertibles) yields a result identical to the 10.75% result produced by his regulatory ROE models? If Mr. Nowak believes the results are different, please explain why the Regulatory Cost of Equity (charged to ratepayers) should be different than the Transactional Cost of Equity (accepted by investors).

Response:

As a preliminary matter, the analysis that is the subject of this request is not relevant to Mr. Nowak's cost of capital analysis in this proceeding. Notwithstanding, Mr. Nowak has not reviewed the cost of equity methodology used in PPL Corporation's equity issuances. As explained in the Company's response to data request Division 7-19, Mr. Nowak's testimony relates to the cost of equity for Rhode Island Energy, not PPL Corporation. Because PPL Corporation and Rhode Island Energy are two different companies, comparing them has little analytical value to the allowed return on equity ("ROE") in this case.

Division 7-21
Cost of Equity

Request:

Does Mr. Nowak, as part of his professional diligence in preparing his testimony, monitor the specific terms (e.g., coupons, strike prices, yields) of the debt and equity-linked securities actually issued by PPL Corporation during the pendency of this proceeding? If no, please explain why the Company's actual cost of raising capital in the open market is not considered a relevant data point for determining the "fair" Cost of Equity. If yes, please identify the specific securities issued by PPL Corporation in the last 12 months that Mr. Nowak reviewed.

Response:

As a preliminary matter, the analysis that is the subject of this request is not relevant to Mr. Nowak's cost of capital analysis in this proceeding. Notwithstanding, Mr. Nowak does not monitor this information for PPL Corporation. As explained in the Company's response to data request Division 7-19, PPL Corporation and Rhode Island Energy are two different companies; so, comparing them has little analytical value to the allowed return on equity ("ROE") in this case. As described in pages 23 to 27 of Mr. Nowak's pre-filed direct testimony (Book 7, Bates pages 26 to 30), the proxy group companies were selected to reflect the broad set of risks that investors consider when investing in a U.S. regulated electric and gas utility such as Rhode Island Energy. PPL Corporation is not a proxy company. Further, the referenced terms related to debt securities are of limited analytical value with respect to estimating the cost of equity. Additionally, Mr. Nowak emphasizes that using his analytical models (i.e., DCF, CAPM, Risk Premium, and Expected Earnings), coupled with a thorough review of Rhode Island Energy's business risks, is the appropriate approach to estimate the cost of equity for Rhode Island Energy.

Division 7-22
Cost of Equity

Request:

Does Mr. Nowak agree with the financial principle that the Implied Cost of Capital embedded in a company's market transactions (such as the pricing of Convertible Bonds or Secondary Equity Offerings) provides an empirical reality check on theoretical ROE models? If Mr. Nowak agrees, did he calculate the implied cost of capital for PPL's November 2025 Exchangeable Notes to check the reasonableness of his 10.75% recommendation? If Mr. Nowak disagrees, please explain why a theoretical model (like the CAPM) should be given more weight than the actual price at which sophisticated investors are willing to provide capital to the Company.

Response:

As a preliminary matter, the analysis that is the subject of this request is not relevant to Mr. Nowak's cost of capital analysis in this proceeding. Notwithstanding, in the case of Rhode Island Energy, Mr. Nowak does not agree. As explained in the Company's response to data request Division 7-19, Rhode Island Energy is not a publicly traded company; so, any market transactions of its ultimate parent, PPL Corporation, would be of little analytical value. As described in the Company's response to data request Division 7-21, the proxy group companies were selected to reflect the broad set of risks that investors consider when investing in a U.S. regulated electric and gas utility such as Rhode Island Energy, and PPL Corporation is not a proxy company. As such, a theoretical model (like the CAPM) allows for cost of equity comparisons for proxy group companies which possess a set of business and operating characteristics similar to Rhode Island Energy's operations and thus provide a reasonable basis for estimating the Company's ROE. This approach is consistent with the standard established in *Bluefield Waterworks & Imp. Co. v. Public Service Commission of W. Va.*, 262 U.S. 679 (1923), and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), that a public utility should have the opportunity to earn returns similar to other enterprises with corresponding risks (*see* Mr. Nowak's pre-filed direct testimony, pages 6 through 7, Book 7, Bates pages 9 through 10).

Division 7-23
Cost of Equity

Request:

Please state whether Mr. Nowak or his firm (Concentric Energy Advisors) provides specific financial advice to PPL Corporation's Investment Committee, Benefits Committee, or Board of Directors regarding the determination of the Expected Long-Term Rate of Return on Assets (EROA) for the Company's defined benefit pension plans. If the answer is no, does Mr. Nowak agree that his role is limited to providing litigation or regulatory estimates of the Cost of Equity, rather than the fiduciary estimates used to manage the Company's actual retirement assets? If the answer is yes, please identify the specific EROA recommendation Mr. Nowak provided to the Committee for the most recent fiscal year, and explain any variance between that figure and the 10.75% ROE requested in this proceeding.

Response:

Neither Mr. Nowak nor Concentric Energy Advisors provides specific financial advice to PPL Corporation's Investment Committee, Benefits Committee, or Board of Directors regarding the determination of the Expected Long-Term Rate of Return on Assets (EROA) for the Company's defined benefit pension plans. Further, there is a meaningful distinction between expected and required returns. The expectation that an asset will return a given amount is fundamentally different than the return required by investors to take on the risks associated with the investment. Expected returns are forecasts of future performance, whereas required returns represent an opportunity cost, and are equal to the returns investors require to be compensated for taking on the risks of ownership. See also the Company's response to data request Division 7-18. Additionally, pension returns are of little relevance to estimating a utility's cost of equity capital because pension return assumptions are designed to fund employee pension liabilities, not investor requirements for equity returns. A pension fund asset manager will match the expected returns available from various asset classes to the expected liabilities that must be funded, whereas an investor seeking to maximize his risk adjusted return will invest in a security only if the expected return is equal to or greater than the required return.

Division 7-24
Cost of Equity

Request:

In preparing his recommendation, did Mr. Nowak review the Expected Return on Equity assumptions disclosed in the most recent Form 10-Ks of the companies included in his Proxy Group? a. Please confirm whether the average expected return on *equity* assets reported by these Proxy Group companies for pension accounting purposes is generally lower than the Cost of Equity results produced by Mr. Nowak's DCF and CAPM models. b. If Mr. Nowak's calculated Cost of Equity (e.g., 10.75%) is significantly higher than the return these same companies expect to earn on their own equity portfolios (often 7.0%–8.5%), please explain why a regulated utility requires a higher return than the professional asset managers at these utility companies expect to earn from the stock market.

Response:

Most, if not all, of the proxy group companies Mr. Nowak analyzed do not disclose expected return on equity assumptions in SEC Form 10-Ks. Further, expected returns on equity must be evaluated in the context in which they are provided and are not necessarily reflective of investors' required returns. As such, Mr. Nowak did not review this information.

- a. Please see above response.
- b. Please see above response.

Division 7-25
Cost of Equity

Request:

Reference is made to the Total Market Return (or Market Risk Premium) utilized in Mr. Nowak's CAPM analysis. a. Did Mr. Nowak check whether his projected Total Market Return (e.g., 12%–15%) is consistent with the Capital Market Assumptions (CMAs) used by PPL Corporation's external investment consultants to value the pension plan's liabilities? b. If the Company's pension consultants project a long-term equity return significantly lower than Mr. Nowak's projection, on what basis does Mr. Nowak contend that his litigation-driven projection is more accurate than the fiduciary-driven projections of global asset managers?

Response:

- a. As a preliminary matter, Mr. Nowak assumes that the reference in the request to "Total Market Return (e.g., 12%–15%)" refers to the market returns of 15.36 percent and 11.72 percent shown on Schedule JCN-5. The analysis that is the subject of this request is not relevant to Mr. Nowak's cost of capital analysis in this proceeding. As explained in the Company's response to data request Division 7-23, pension returns are of little relevance to estimating a utility's cost of equity capital. Underlying Capital Market Assumptions must be evaluated in the context in which they are provided and are not necessarily reflective of investors' required returns.
- b. Please see response to subpart a. As described in the Company's response to data request Division 7-23, there is a meaningful distinction between expected and required returns. A pension manager's assumption for an expected return has little relevance in determining the returns investors require to be compensated to take on the risks of ownership.

Division 7-26
Cost of Equity

Request:

Reference is made to the 10.29% earnings growth rate (or similar consensus forecast) utilized in Mr. Nowak's DCF analysis of the S&P 500.

- a. Did Mr. Nowak calculate the specific weighted contribution to this aggregate growth rate derived from the so-called "Magnificent Seven" companies (Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta, and Tesla)?
- b. If yes, please state what percentage of the total weighted average growth rate is attributable to just these seven companies.
- c. If no, does Mr. Nowak agree that his Total Market proxy is heavily skewed by the idiosyncratic growth prospects of a small number of mega-cap technology firms?

Response:

- a. The weighted contribution to the aggregate growth rate is shown on Schedule JCN-5 for each of the respective "Magnificent Seven" companies.
- b. Please see response to subpart a.
- c. Mr. Nowak does not agree that his "Total Market proxy is heavily skewed by the idiosyncratic growth prospects of a small number of mega-cap technology firms." If an investor invests in the total market (i.e., the S&P 500), they receive the return of the market, inclusive of these "Magnificent Seven" companies. Not including them would introduce bias to the market risk premium because it would be based only on a subset of the market. In addition, the Beta coefficient estimates that Mr. Nowak uses in his CAPM analysis would similarly be biased because they are calculated based on the proxy company's risk as compared to the total market, not a subset of the market. Further, excluding a handful of companies amounts to arbitrary exclusion of data and ignores the fact that the approximately 500 companies that comprise the S&P 500 are frequently in flux, with some companies joining, and others leaving, the index each year.

Division 7-27
Cost of Equity

Request:

Is Mr. Nowak aware that even though he considered “a subset of S&P 500 companies with growth rates that are between 0 and 20 percent” this still includes companies with significant exposure to AI, such as Alphabet (12% projected growth), Microsoft (12.5% projected growth), Apple (10% projected growth), and Meta (18% projected growth)?

Response:

Mr. Nowak is aware that those companies are included in his Schedule JCN-5. Given that the Market Risk Premium is intended to reflect the broad market, and the market includes companies with “AI Exposure,” it is appropriate to include such companies.

For additional explanation, please also see the Company's response to data request Division 7-26 subpart c.

Division 7-28
Cost of Equity

Request:

To test whether his Total Market Return estimate is representative of the broader economy or merely a reflection of the current Artificial Intelligence (AI) investment cycle: a. Did Mr. Nowak perform a sensitivity analysis where he excluded the Magnificent Seven (or the Information Technology sector) from his S&P 500 DCF calculation? b. If yes, please provide the resulting Cost of Equity for the S&P 493 (the market excluding these seven firms). c. If the return for the S&P 493 is significantly lower (e.g., closer to 8%–9%), please explain why it is appropriate to set utility rates based on a dataset dominated by AI-driven volatility rather than the industrial and utility sectors that more closely resemble the Company.

Response:

- a. Mr. Nowak has not performed this sensitivity analysis. *See also* the Company's response to data request Division 7-26 subpart c.
- b. Please see the response to subpart a.
- c. Please see the response to subpart a. Further, the Market Risk Premium is not intended to reflect industrial and utility sectors, but rather the broad market, inclusive of companies exposed to AI investments. The Beta coefficient applied to the Market Risk Premium in the context of the CAPM adjusts for utility risk that more closely resembles Rhode Island Energy.

Division 7-29
Cost of Equity

Request:

Does Mr. Nowak believe that the earnings growth expected from the rapid adoption of Generative AI by companies like Nvidia and Microsoft is a relevant proxy for the long-term earnings growth of a regulated electric and gas distribution utility in Rhode Island? a. If no, why did Mr. Nowak utilize a Total Market approach that mathematically captures this AI-specific growth premium without making a downward adjustment to reflect the lower risk and lower growth profile of a regulated utility?

Response:

Mr. Nowak has not included these "Generative AI" companies in his proxy group; his proxy group consists of regulated utility companies, as explained on pages 23 through 27 of his pre-filed direct testimony (Book 7, Bates pages 26 through 30). Please also see the Company's response to data request Division 7-26 subpart c. Such companies are included in the calculation of the Market Risk Premium. As described in the Company's response to data request Division 7-28, the Market Risk Premium is not intended to reflect industrial and utility sectors, but rather the broad market, inclusive of companies exposed to AI investments. The Beta coefficient applied to the Market Risk Premium in the context of the CAPM adjusts for utility risk that more closely resembles Rhode Island Energy. Accordingly, the model incorporates a downward adjustment through the Beta coefficient to account for the lower risk profile of a regulated utility such as Rhode Island Energy under current market conditions.

Division 7-30
Cost of Equity

Request:

Reference page 9, lines 18-21, of Mr. Nowak's Direct Testimony it states that "The ratemaking process is premised on the principle that, in order for investors and companies to commit the capital needed to provide safe and reliable utility services, a utility must have a reasonable opportunity to recover the return of, and the market-required return on, its invested capital."

- a. Should an authorized ROE of a utility company always be set equal to a utility company's market-required return on its invested capital? Please explain.
- b. Do regulatory principles allow a Commission to authorize an ROE that is higher than a utility company's market-required return on its invested capital? Please explain.
- c. Please explain what other criteria the Commission should consider when determining the appropriate authorized ROE for Rhode Island Energy other than its market-required return on its invested capital.

Response:

- a. As explained on page 9 of Mr. Nowak's pre-filed direct testimony (Book 7, Bates page 12), "The ratemaking process is premised on the principle that, for investors and companies to commit the capital needed to provide safe and reliable utility services, the utility must have the opportunity to recover invested capital and the market-required return on that capital." Additionally, as Mr. Nowak explains in his pre-filed direct testimony, the regulatory principles established in *Bluefield Waterworks & Imp. Co. v. Public Service Commission of W. Va.*, 262 U.S. 679 (1923), and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), "require that utilities receive a fair rate of return sufficient to attract needed capital to maintain important infrastructure for customers at reasonable rates," (at page 6, Book 7, Bates page 9) and underscore that "the authorized ROE for a public utility should allow the utility to attract investor capital at a reasonable cost under current and foreseeable economic and financial conditions." (at page 10, Book 7, Bates page 13). As such, it is important that a fair and reasonable ROE be set that allows Rhode Island Energy to attract capital in both current and foreseeable market conditions, as Mr. Nowak has done through his use of four analytical models (i.e., DCF, CAPM, Risk Premium, and Expected Earnings) which are used to estimate the cost of equity. Mr. Nowak's recommended authorized ROE for Rhode Island Energy is based on an estimate of Rhode Island Energy's market-required return on equity capital.
- b. Please see response to subpart a.

Division 7-30, page 2

- c. Please see response to subpart a. Additionally, as Mr. Nowak explains on page 44 of his pre-filed direct testimony (Book 7, Bates page 47):

[n]otwithstanding the care taken to establish a risk-comparable group of companies and to consider multiple analyses, market expectations with respect to future risks and growth opportunities will vary from company to company. Therefore, the Company's business risks also must be taken into consideration when determining where the Company's cost of equity falls within the range of results. As discussed in more detail below, I considered Rhode Island Energy's size compared to the proxy companies; the Company's regulatory risk relative to the proxy group companies, including the regulatory framework in which the Company operates and the regulatory mechanisms available to the Company relative to those available to the proxy companies; and Rhode Island Energy's heightened weather risk compared to the proxy group.

Division 7-31
Cost of Equity

Request:

Did Mr. Nowak do an analysis to determine if the company's requested regulatory capital structure will lead to the lowest possible rates for consumers? For example, did Mr. Nowak conduct a cost-benefit analysis to determine if Rhode Island's rates would be higher or lower if Rhode Island's regulated capital structure had a common equity ratio of 50% (or any other common equity ratio instead of the proposed 57% common equity ratio)? If yes, please explain. If not, please provide said analysis.

Response:

As a preliminary matter, the analysis that is the subject of this request is not relevant to Mr. Nowak's cost of capital analysis in this proceeding. Notwithstanding, Mr. Nowak has not performed the requested analysis. Mr. Nowak notes that, in general, it is to the benefit of both the Company and customers to seek the lowest reasonable weighted average cost of capital that will allow the Company to attract capital to maintain critical infrastructure to provide safe and reliable service to customers. As Ms. Burgos explains on page 4 of her pre-filed direct testimony (Book 8, Bates page 7), Rhode Island Energy's targeted capital structure "optimizes the mix of debt and equity financing that balances the appropriate amount of risk and minimizes its weighted cost of capital, while maintaining credit metrics that support its strong investment-grade credit ratings."

Reducing a company's equity ratio and increasing debt levels increases financial risk, which may lead to a credit rating downgrade and comparatively increase the cost of debt and ultimately the cost of capital customers pay in rates. All else equal, financing costs for companies with lower credit ratings are higher than those with higher credit ratings. As such, a cost-benefit analysis of the capital structure would require several assumptions that would limit the analytical value of the conclusions.

Division 7-32
Cost of Equity

Request:

Reference page 41, lines 13-17, where Mr. Nowak writes, "Because the Expected Earnings model provides an accounting-based approach that relies on investment analysts' projections of earnings on book equity, it affords the benefit of analyst insights, knowledge, and expertise in interpreting a given company's earnings prospects in the context of current market conditions."

- a. Is it correct that the Expected Earnings used by Mr. Nowak largely reflect the authorized returns granted by other regulatory commissions? If yes, please explain how comparing model results to a peer group of regulated decisions constitutes an independent test of the true cost of equity in the open capital market. If no, please explain how by not simply testing Mr. Nowak's recommendation against other regulators' decisions, rather than testing whether it aligns with investor requirements?

Response:

As a preliminary matter, Mr. Nowak emphasizes that his Expected Earnings analysis was used as a benchmark analysis, not a primary analysis in determining Rhode Island Energy's cost of equity range and recommended ROE. Notwithstanding, Mr. Nowak disagrees with this contention because the proxy company projected ROEs from *Value Line* serve as the basis of his Expected Earnings analysis. Although *Value Line*'s projections likely are informed by authorized ROEs, they are not limited to authorized ROEs because a company's ability to earn its authorized ROE may be affected by several factors. Additionally, as explained on page 7 of Mr. Nowak's pre-filed direct testimony (Book 7, Bates page 10), *Bluefield Waterworks & Imp. Co. v. Public Service Commission of W. Va.*, 262 U.S. 679 (1923), and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), established the standard that a utility should be granted the opportunity to earn a return that is commensurate with the return on other investments of similar risk. Therefore, it is reasonable to consider the returns that investors expect to earn on the common equity of the companies in the proxy group as a benchmark for a fair and reasonable return because that is the expected earned ROE that an investor will consider in determining whether to purchase shares in a company or to seek alternative investments with a better risk/reward profile.

Division 7-33
Cost of Equity

Request:

On page 5, lines 20-22, Mr. Nowak says his testimony considers “the influence capital market conditions exert over the results of the DCF, CAPM, and Risk Premium models.”

- a. Did Mr. Nowak use the long-term U.S. GDP growth rate (approx. 4%) as a control variable or limit when assessing the reasonableness of the 10.29% earnings growth rate used in his S&P 500 analysis?
- b. If Mr. Nowak's S&P 500 growth rate exceeds GDP growth by more than double, what specific test did he apply to determine that this divergence was reasonable and sustainable?

Response:

- a. No. The long-term U.S. GDP growth rate is not an appropriate variable or limit to use to assess the reasonableness of the market return used in the CAPM analysis. For example, the “approx. 4%” figure (which is undefined and unsourced) is lower than the current and projected 30-year Treasury bond yields (*see* Figure 5 in Mr. Nowak's pre-filed direct testimony, Book 7). An earnings growth rate that is lower than the risk-free rate fails the test of economic logic and is therefore not a reasonable “limit” on the market return used in the CAPM analysis.
- b. Section IV of Mr. Nowak's pre-filed direct testimony (Book 7) analyzed current capital market conditions. Mr. Nowak concludes that “[i]nvestors continue to face interest rate pressures and uncertainty, as the Federal Reserve continues its response to broad economic concerns. Long-term interest rates remain substantially higher than the historical lows of 2020 and are expected to remain elevated looking forward.” (at page 23, Book 7, Bates page 26).