

CASCADE NATURAL GAS CORPORATION
Washington Utility & Transportation Commission
2006 Rate Case Data Request

WUTC Staff Request No. 22

Date prepared: April 14, 2006

Preparer: Rick Davis

Telephone: (206) 381-6883

WUTC STAFF DATA REQUEST NO. 22:

Re: Witness Roger Morin

Regarding the statement on page 39, lines 12-13, please indicate if Dr. Morin is aware of any "evidence" that challenges the use of analysts' forecasts of earnings as an indicator of stock price performance and/or cost of capital estimation.

Response:

See response to Request No. 21. Several studies have observed that security analysts are subject to behavioral biases, and their forecasts tend to be optimistic. See for example Dugar, A. and Nathan, S., "The Effect of Investment Banking Relationships on Financial Analysts' Earnings Investment Recommendations," *Contemporary Accounting Research* 12 (1995), pp. 131-160. The magnitude of the optimism bias for large rate-regulated companies in stable segments of an industry is likely to be very small. Empirically, the severity of the "optimism" problem is unclear for regulated utilities, if a problem exists at all. It is interesting to note that Value Line forecasts for utility companies made by independent analysts with no incentive for over- or understating growth forecasts are not materially different from those published by analysts in security firms with incentives not based on forecast accuracy, and may in fact be more robust. If the "optimism" problem exists at all, it can be circumvented by relying on multiple-stage DCF models that substitute long-term economic growth for analysts growth forecasts in the second and/or third stages of the model and/or by relying on alternative cost of equity estimation models such as the CAPM.