

Exhibit No.:
Issues: Ability to attract funding
Witness: Cheryl D. Norton
Exhibit Type: Surrebuttal
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2017-0285
SR-2017-0286
Date: February 9, 2018

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2017-0285
CASE NO. SR-2017-0286**

**SURREBUTTAL TESTIMONY
OF
CHERYL D. NORTON
ON BEHALF OF
MISSOURI-AMERICAN WATER COMPANY**

Exhibit No. 29
Date 3/8/18 Reporter ML
File No. WR-2017-0285

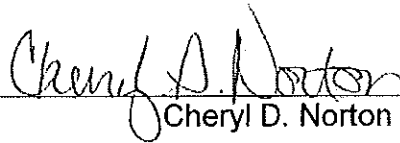
Exhibit 29
WR-2017-0285
Surrebuttal Testimony of Cheryl D.
Norton

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

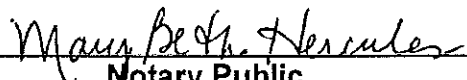
IN THE MATTER OF MISSOURI-AMERICAN)	
WATER COMPANY FOR AUTHORITY TO)	
FILE TARIFFS REFLECTING INCREASED)	CASE NO. WR-2017-0285
RATES FOR WATER AND SEWER)	CASE NO. SR-2017-0286
SERVICE)	

AFFIDAVIT OF CHERYL D. NORTON

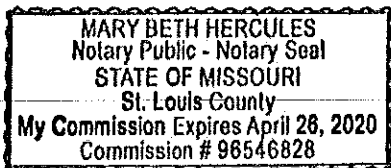
Cheryl D. Norton, being first duly sworn, deposes and says that she is the witness who sponsors the accompanying testimony entitled "Surrebuttal Testimony of Cheryl D. Norton"; that said testimony was prepared by her and/or under her direction and supervision; that if inquiries were made as to the facts in said testimony, she would respond as therein set forth; and that the aforesaid testimony is true and correct to the best of her knowledge.


Cheryl D. Norton

State of Missouri
County of St. Louis
SUBSCRIBED and sworn to
Before me this 7th day of February 2018.


Notary Public

My commission expires:



**SURREBUTTAL TESTIMONY
CHERYL D. NORTON
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2017-0285
CASE NO. SR-2017-0286**

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SURREBUTTAL TESTIMONY

CHERYL D. NORTON

I. INTRODUCTION

1

2 **Q. Please state your name business address and position.**

3 A. My name is Cheryl D. Norton, and my business address is 727 Craig Road, St. Louis,
4 MO, 63141. I am the President of Missouri-American Water Company (“Missouri-
5 American”, “MAWC” or the “Company”).

6 **Q. Have you previously submitted testimony in this proceeding?**

7 A. Yes, I previously submitted Direct Testimony.

8 **Q. What is the purpose of your surrebuttal testimony?**

9 A. The purpose of my surrebuttal testimony is to underscore how the ratemaking
10 adjustments and policies advocated by the parties in this case adversely impact the
11 Company’s ability to achieve funding levels that best serve the long-term interests of
12 its customers. As explained in the testimony of Company witness Jenkins, under
13 Missouri’s traditional ratemaking approach, Missouri-American is facing persistent
14 revenue shortfalls from declining use per customer and the need to rebuild legacy
15 infrastructure.

16 **Q. Have the Company proposals attempted to address these issues?**

17 A. Yes. Mr. Jenkins further explains how the Company’s alternative ratemaking proposals

1 (revenue stabilization mechanism (“RSM”) and future test year) are intended to, and
2 will, efficiently and effectively address those concerns. The RSM provides the
3 Company a realistic opportunity to collect its authorized revenue requirement, and the
4 future test year properly recognizes the expense levels and plant that will be serving
5 Missouri-American’s customers when the new rates take effect.

6 **Q. Are there other issues that will have a significant impact on this circumstance?**

7 A. Yes. I will also explain the likely consequences if the Commission adopts a return on
8 equity (“ROE”) that is on the order of the ROEs recommended by the Staff of the
9 Commission (“Staff”) or the Office of the Public Counsel (“OPC”). As MAWC
10 witness Bulkley explains in her rebuttal testimony, those ROE recommendations are
11 lower than all but four that any commission has authorized in recent history and are out
12 of touch with ROEs found reasonable for other American Water operating utilities and
13 with ROEs generally across the country. Furthermore, when the low ROEs are
14 combined with Staff’s recommendation to impose an equity ratio of just 43.99%, the
15 result would directly and adversely impact the Company’s ability to secure
16 discretionary funding levels that best serve the long-term interests of our customers.

17 **II. MAWC’s ABILITY TO ATTRACT FUNDING**

18 **Q. Are you aware of the net result of Staff’s ROE recommendation?**

19 A. Yes, in her rebuttal testimony, Ms. Bulkley explained that Staff witness Smith’s
20 recommended equity ratio of 43.99 percent, in combination with his recommended
21 ROE of 9.25 percent, would provide an overall equity cost rate of 4.07 percent. She
22 noted that this is lower than all but four of the equity cost rates approved in the

1 approximately 90 rate case decisions reported by Regulatory Research Associates for
2 water utilities since 2012. Moreover, Ms. Bulkley's Chart 5 demonstrates that Mr.
3 Smith's recommended equity ratio and ROE would provide MAWC a return well
4 below the vast majority of authorized equity cost rates for water utilities since 2012.

5 **Q. Have you asked MAWC witness Bulkley to perform a similar calculation for OPC**
6 **and Missouri Industrial Energy Consumers ("MIEC") witness Gorman's overall**
7 **equity cost rate?**

8 A. Yes, Ms. Bulkley calculated Mr. Gorman's equity cost rate to be 4.50%.

9 **Q. How do these equity cost rates stack up against the equity cost rates that are in**
10 **place for your sister utility companies in the American Water system?**

11 A. Ms. Bulkley advised me that the median equity cost rate approved by regulators for the
12 regulated water utilities in the American Water system is 4.88%. Therefore, the rates
13 of return and equity ratios recommended by Messrs. Smith and Gorman, respectively,
14 would be lower than the median cost rate allowed for other American Water companies
15 by regulators. Moreover, because of the very low equity ratio recommended by Mr.
16 Smith, even though his ROE is 25 basis points higher than Mr. Gorman's, his equity
17 cost rate would place MAWC at the very bottom among the American Water regulated
18 utilities.

19 **Q. Are there other factors that exacerbate the low equity cost rates recommended by**
20 **the witnesses for Staff and OPC?**

21 A. Yes, most definitely. As Mr. Jenkins has testified, the Company has been chronically
22 unable to achieve its allowed rate of return due, in large part, to Missouri's traditional

1 regulatory policies. The use of the historical test year and the adoption of sales
2 forecasts that seem rarely to be realized have, among other policies, resulted in our
3 inability to achieve the revenue requirement determined by the Commission. If this
4 were to continue with the rejection of our future test year and revenue stabilization
5 mechanism, the effects of the low equity cost rate would be compounded by the
6 knowledge that we would be unlikely even to achieve that substandard cost rate.

7 **Q. What would the consequences be if the Commission approved such low equity cost**
8 **rates for MAWC, especially one that places MAWC at the bottom of allowed**
9 **equity cost rates?**

10 A. American Water owns the common stock of regulated water and wastewater utilities in
11 14 jurisdictions, including Missouri. A ROE that is so significantly below the returns
12 available to other American Water subsidiaries, as well as other utilities generally,
13 would directly and adversely impact the Company's ability to secure discretionary
14 funding. While American Water always ensures that each of its water and wastewater
15 utilities is afforded funding to provide safe, adequate, and reliable service, investment
16 funding is not limitless. American Water is competing with other companies and
17 industries in the marketplace for capital, and American Water's subsidiaries are
18 competing within the American Water system for discretionary allocations of
19 American Water's investment and financing capacity.

20 Discretionary allocations within American Water can be influenced by a
21 company's capital requirements, as well as by market conditions and available funds.
22 Like any rational investor, American Water considers what return it can earn when
23 considering investment opportunities. All other things being equal, American Water,

1 again, like any investor, generally favors higher-return investments over lower ones,
2 provided the investment risks are comparable. If Staff's or OPC/MIEC's
3 recommendations – compounded by Staff's low equity ratio - were adopted, the
4 Company would have the lowest authorized equity cost rate of any of American
5 Water's regulated subsidiaries—by a very wide margin. As a consequence, American
6 Water would have much less incentive to allocate discretionary funding to MAWC than
7 to its other regulated subsidiaries.

8 **Q. So is the concern about attracting money from investors, or what is best for**
9 **customers?**

10 **A.** Both, this is about aligning customer and shareholder interests. We have a multi-
11 decade-long investment need that is funded up-front by shareholders and lenders and
12 recovered from customers over a 40 plus-year time frame. American Water is acutely
13 aware that utility statutes and regulatory schemes vary from state to state; regulatory
14 commissions have different policies, administrative procedures, and precedents; and
15 these differences affect American Water's investment decisions. Investors have
16 choices. The choices investors make must necessarily consider the returns available
17 on invested capital. When investors have an incentive to invest, they will, and when
18 they do not, they won't. Imposing extraordinarily low shareholder returns may have
19 the temporary effect of lowering rates, but that practice ultimately imposes long-term
20 costs that cannot be measured in dollars alone. Discouraging discretionary funding
21 that serves the long-term interests of customers, in the name of “protecting” those
22 customers, ultimately harms the constituency the policy is meant to help. It is well-
23 recognized that a reasonable ROE and equity ratio is necessary to align both customer

1 and investor interests. This results in a stronger and more reliable water system for
2 both current and future customers, reduces the need for general rate cases, lessens the
3 occurrence of customer “rate shock,” supports the maintenance and improvement of
4 essential infrastructure, ensures safety and reliability, and allows for more efficient,
5 streamlined regulation.

6 **Q. What is your role in securing capital for MAWC?**

7 A. Part of my job involves making the case to American Water for investment in Missouri.
8 Every affiliate employs someone in a capacity comparable to mine, and part of that
9 person’s job is to make the case for investment in their respective state. Because the
10 collective need for capital inevitably exceeds the resources available from American
11 Water, the various states are effectively competitors. This type of competition is
12 healthy because it forces the utilities to identify and develop projects that produce the
13 greatest benefits at the least cost. But it is competition nonetheless, and the utility’s
14 authorized ROE is a factor that definitely influences capital investment decisions.

15 **Q. Are you suggesting that American Water will cut-off investment to MAWC if the**
16 **Commission adopts equity cost rate recommendations that place it among the**
17 **worst performing in the American Water system?**

18 A. I am not saying that at all. As I said previously, the Company will fulfill its duty to
19 provide safe, adequate, and reliable service. MAWC continues to make the necessary
20 investments in developing and maintaining adequate sources of supply, treatment,
21 pumping, transmission and distribution facilities, as well as to comply with applicable
22 environmental laws and regulations (Safe Drinking Water Act, the Clean Water Act,

1 etc.).

2 **Q. Where does the Commission’s approach make a difference?**

3 A. The manner in which a utility complies with regulatory standards is generally a matter
4 of management’s business judgment—for example, whether capital investment now is
5 more cost effective over the long term than annual maintenance expenditures. Good
6 business practice dictates that the utility invest in its system at a level that is more than
7 the bare-minimum acceptable regulatory standards, but less than a level that suggests a
8 rate base with unnecessary facilities. Between these extremes lies a vast range of
9 acceptable business judgment.

10 **Q. How does this work in practice?**

11 A. When an investor is confronted with the choice of investing in Missouri at 4.07% equity
12 cost rate or, for example, nearby Iowa or Illinois, at a 5.00% and 4.88% equity cost
13 rates, respectively, the disparity in available returns will necessarily steer the allocation
14 of discretionary capital in a way that requires MAWC to manage operations toward the
15 “bare minimum” end of the acceptable range. By doing so, capital is freed-up for
16 jurisdictions with higher equity cost rates to operate toward the other end of the range.
17 The equity cost rate that Staff is recommending would put MAWC in a subordinate
18 position, resulting in capital funding at a level necessary to maintain only adequate
19 service, and certainly not optimal service. And it would surely put me at a distinct
20 competitive disadvantage against my colleagues as we vie for investment by American
21 Water.

22 **Q. Have you quantified the range of what would be considered a “bare minimum”**

1 **level of capital investment versus a level that begins to suggest imprudence?**

2 A. I have not, and I do not believe anyone else can, either. There are simply too many
3 variables to consider in deciding whether a utility is spending too much or too little.
4 These judgments are typically made in hindsight based on whether the decision was
5 reasonable, given what was known, or should have been known, at the time the decision
6 was made. My point is not to establish that there is a definite, quantifiable figure for
7 what is “too much” or “too little.” I am simply trying to stress the point that authorized
8 ROEs, equity ratios, and the resultant equity cost rates have a very real influence in
9 how capital allocation decisions are made in the real world. And it is my firm belief
10 that Staff’s ROE and equity ratio recommendation in this case ignores that reality, as
11 does Mr. Gorman’s extremely low 9.0% equity cost recommendation.

12 **Q. What type of capital projects would be at risk if the Commission authorized a 4.07**
13 **percent equity cost rate resulting from a low equity ratio?**

14 A. I cannot provide a line-by-line description of every planned project and how it would
15 be affected. What I can say is that investment decisions would have to be re-evaluated.
16 The internal competition for capital with affiliates is difficult enough without being
17 saddled with the lowest equity cost rate in the American water system, which would
18 simply render the Company uncompetitive in relation to its affiliates.

19 **Q. You have discussed the internal competition for capital MAWC faces with respect**
20 **to its affiliates. Does the Company also face external competition?**

21 A. We do. One of our growth strategies is system acquisitions. There are many water and
22 sewer systems scattered throughout the state, many of which are in dire straits, both

1 financially and operationally. The acquisition of these systems is usually viewed as a
2 “win-win,” due to the ability of the acquiring companies to invest in these systems and
3 turn them around. If an investor has an opportunity to fund a competitor and earn a
4 higher equity cost rate than ours, that investor will most likely invest in the more
5 attractive option – in this case, our competitor. Similarly, with an equity cost rate that
6 is substandard, it is unlikely that I could recommend MAWC should make any
7 additional investment to acquire troubled water or sewer systems in Missouri.

8 **Q. Would a 4.07 equity cost rate attract the level of capital investment needed to**
9 **address the aging infrastructure replacement issue discussed by MAWC witness**
10 **Bruce Aiton?**

11 A. Not likely. As with most other water utilities, Mr. Aiton shows just how much the need
12 to replace aging infrastructure outpaces our available resources. This is a national
13 issue, and mustering the \$1.7 trillion in investment needed to address the issue is no
14 small feat, even in the best of times. I cannot imagine a scenario where MAWC would
15 be able to attract the capital necessary to boost its rate of infrastructure replacement to
16 the level that will be needed, when utilities with the same need can offer returns and
17 equity cost rates far superior to those that MAWC can offer.

18 **Q. If the Company cuts back capital investment to a level supported by a 4.07 equity**
19 **cost rate, who would be harmed?**

20 A. Everyone: the Company, American Water, customers, and the Missouri economy. The
21 Company currently invests between \$90 and \$180 million annually in system
22 improvements and infrastructure. We’ve directly invested \$1.2 billion in capital

1 between 2007 and 2017 in the State of Missouri. For example, over 142 miles of new
2 water mains have been installed in the last three years. This level of investment in
3 Missouri has tremendous statewide impacts including jobs, spending on goods and
4 services, system reliability and improved customer service. In conjunction with our
5 investment, we are highly focused on safety, diversity and the customer experience.
6 The Company's occupational recordable injury rate was 72% better than the industry
7 average as reported by the Bureau of Labor Statistics for 2017 and continues to
8 positively trend. Just under 43 percent of the people we hired in 2017 are diverse. The
9 Company increased its certified diverse sourceable spend over eight times from 2013
10 to 2017 increasing from 3.82% (\$3.8M) to 32.18% (\$54.4M). The Company ranked in
11 the top third in customer satisfaction among water companies in the Midwest in the
12 inaugural 2016 - 2017 J.D. Power Water Study and has reduced customer complaints
13 at the PSC by over 20% since 2014. Could the Company have spent less? Perhaps.
14 Would it have achieved these milestones if it had? Absolutely not. The Commission
15 is being asked to authorize an equity cost rate that is the lowest in our system. Such a
16 decision would have regrettable consequences, starting with the unraveling of the
17 benefits achieved through investment that got the Company to where it is today.

18 **Q. What do you want the Commission to do?**

19 **A.** I obviously want the Commission to adopt the Company's ROE recommendation, but
20 I am not submitting this testimony to either attack or defend any witness's methods or
21 recommendation. I simply want the Commission to understand the very real
22 consequences of adopting a ROE and equity ratio that together are so out of step with
23 reality and returns awarded in other jurisdictions

1 Q. Does this conclude your Surrebuttal Testimony?

2 A. Yes, it does.