

Exhibit No.:
Issues: Capital Structure
Witness: William D. Rogers
Exhibit Type: Rebuttal
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2011-0337
SR-2011-0338
Date: January 19, 2012

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2011-0337
CASE NO. SR-2011-0338**

DIRECT TESTIMONY

OF

WILLIAM D. ROGERS

ON BEHALF OF

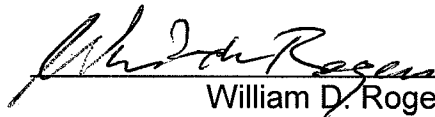
MISSOURI-AMERICAN WATER COMPANY

**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) RATES FOR WATER AND SEWER) SERVICE)	CASE NO. WR-2011-0337 CASE NO. SR-2011-0338
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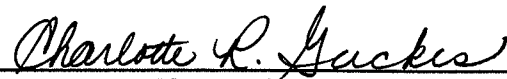
AFFIDAVIT OF WILLIAM D. ROGERS

William D. Rogers, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Rebuttal Testimony of William D. Rogers"; that said testimony and schedules were prepared by him and/or under his direction and supervision; that if inquires were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge.



William D. Rogers

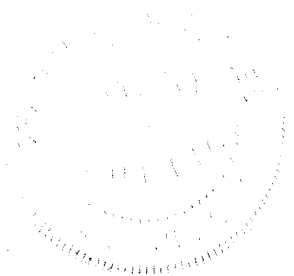
State of New Jersey
County of Camden
SUBSCRIBED and sworn to
Before me this 17th day of January 2012.



Notary Public

My commission expires:

CHARLOTTE R. GUCKES
Notary Public of New Jersey
My Commission Expires:
October 27, 2013



1 **REBUTTAL TESTIMONY**

2
3 **WILLIAM D. ROGERS**

4
5 **WITNESS INTRODUCTION AND PURPOSE**

6
7
8 **Q. PLEASE STATE YOUR NAME, EMPLOYER, AND BUSINESS ADDRESS.**

9 A. My name is William D. Rogers; and, I am employed by American Water Works
10 Service Company, Inc. (the "Service Company"), a subsidiary of American Water
11 Works Company ("AWW") as Vice President and Treasurer of AWW. I am also
12 the President of Service Company. My business address is 1025 Laurel Oak
13 Road, Voorhees, New Jersey 08043.

14
15 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.**

16 A. I hold an MBA in accounting and finance from Duke University. I am also a
17 distinguished graduate of the U.S. Military Academy with a bachelor's degree in
18 engineering and economics. Before beginning my finance career, I served on
19 active duty as an engineer and officer in the United States Army for six years,
20 honorably discharged with the rank of captain.

21
22 **Q. PLEASE SUMMARIZE YOUR WORK EXPERIENCE.**

23 A. Prior to joining AWW in 2010, I was the chief financial officer for NV Energy, an
24 investor-owned utility in Las Vegas serving 1.5 million electric and gas
25 customers, with annual revenues of approximately \$3.3 billion. I previously
26 served as vice president of finance, risk and tax, as well as corporate treasurer
27 for NV Energy. Before joining NV Energy, I was a managing director in capital
28 markets within the investment banking divisions of Merrill Lynch and JPMorgan
29 Chase, successively, in New York.

30
31 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

32 A. The purpose of my testimony is to address why use of the AWW capital structure
33 as a surrogate for the Missouri American Water Company ("MAWC") capital

1 structure in setting rates as recommended by Staff witness Matthew Barnes is
2 inappropriate. I will also explain why the use of the actual MAWC capital
3 structure is appropriate and should be utilized in rate setting. Specifically, the
4 objective of my testimony is to explain that each regulated subsidiary of AWW,
5 including MAWC, is responsible for developing a capital structure that reflects its
6 risk profile. Additionally, I will explain the source of long-term indebtedness
7 currently held by AWW.

8
9 **Q. HOW DOES AWW'S MANAGEMENT REVIEW AND MANAGE THE**
10 **FINANCIAL RISKS OF MAWC, AS WELL AS REVIEW THE PERFORMANCE**
11 **OF MAWC?**

12 A. On an annual basis, each of AWW's subsidiaries prepares a three to five year
13 forecast and annual budget for review and approval by AWW's management.
14 The subsidiaries develop their forecast based upon their distinct operating
15 environment and risk profile and integrate that into the broader AWW corporate
16 strategy. MAWC follows the same process as other AWW subsidiaries. MAWC
17 and AWW together mitigate operational and business risk issues through, in part,
18 capital investment and budgeting policies, capital structure, and establishing
19 performance metrics. MAWC presents its performance against the MAWC
20 annual budget, performance metrics, and financial forecast at regularly
21 scheduled quarterly business performance reviews and interim reviews as
22 appropriate. Financial performance of MAWC is based upon the financial
23 statements of MAWC under generally accepted accounting principles ("GAAP").
24 For instance the return on equity of MAWC is the earnings of MAWC divided by
25 the owners' equity in MAWC. The GAAP financial statements of each subsidiary
26 provide a consistent, transparent and well defined manner in which to evaluate
27 period to period performance, performance relative to plan, and performance
28 across subsidiaries on a comparative basis.

29
30 **Q. ARE THERE ADVANTAGES TO MAWC AND ITS CUSTOMERS OF**
31 **PROVIDING PERFORMANCE INCENTIVES IN ORDER TO ACHIEVE**
32 **FINANCIAL OBJECTIVES?**

1 A. Yes. MAWC and AWW must attract capital from third parties (e.g., banks, fixed
2 income investors, equity investors) in order to provide for the cash liquidity and
3 capital investment needs of the company. Although there is no certainty to earnings
4 or cash flow, an investor does value greater certainty in earnings in cash flow
5 delivered by the company. The improved certainty in earnings supports a price for
6 common stock, resulting in greater ability to issue new common equity and maintain
7 the strength of AWW's balance sheet. The improved certainty of cash flow provides
8 improved certainty of interest coverage, resulting in stronger debt credit ratings and
9 greater access to the bank lending, commercial paper and debt capital markets. The
10 stronger credit ratings and greater access reduce the cost of debt and the weighted
11 average cost of capital. In turn, this reduces costs of investments made by MAW on
12 behalf of the customer.

13
14 In order to improve access to capital markets, to insure availability of funds to deliver
15 for our customers and invest on behalf of customers, and to lower the cost of
16 financing, MAWC and AWW provide incentives to certain employees who have
17 specific goals related to earnings and cash flow. These incentives align the interests
18 of the customers, employees and investors.

19

20 **Q. ARE THE BUSINESS RISKS OF MAWC THE SAME AS THOSE OF AWW OR**
21 **OTHER AWW SUBSIDIARIES OPERATING IN REGULATED AND MARKET**
22 **BASED BUSINESSES?**

23 A. No. Each subsidiary of AWW has its own distinct business risk. For example,
24 each subsidiary has differences in sources of water supply, relations with
25 employees represented under collective bargaining agreements, density of
26 customers served, state utility regulation, state environmental and other
27 regulation, administration of different types of tariffs, state and local economic
28 conditions, and age of infrastructure. AWW's business and financial risk profile,
29 on the other hand, is derived from the portfolio of risks from its investments in
30 regulated subsidiaries and market based operations. As such AWW's risk profile
31 does not mirror the risk profile of any one of its regulated subsidiaries.

32

33 **Q. DO REGULATORY ADJUSTMENTS TO MAWC'S AUDITED FINANCIAL**

1 **STATEMENTS UNDER GAAP IMPACT MANAGEMENT’S DECISIONS**
2 **CONCERNING THE LEVEL OF CAPITAL IN MISSOURI?**

3 A. Yes. An element of AWW’s decision regarding investment in a subsidiary is the
4 expected return on that investment based upon GAAP equity in that subsidiary.
5 AWW management looks to equity content and capital structure of each
6 subsidiary, including MAWC; management does not adjust its measure of returns
7 based upon regulatory adjustments to other than the subsidiary’s GAAP equity
8 and capital structure. If the earnings returns relative to the GAAP equity are
9 consistently below the allowed return on that equity or sub par relative to AWW’s
10 targeted return for the investment in that subsidiary, then AWW management will
11 naturally question the level of discretionary investment in that subsidiary..

12
13 **Q. HOW DOES MAWC SET ITS CAPITAL STRUCTURE?**

14 A. MAWC sets its capital structure based upon the operating and financial risks of
15 MAWC. MAWC management presents its capital structure and financing plan to
16 the MAWC board for its review and approval. This is an iterative process in that
17 MAWC concurrently consults with AWW management during the development of
18 its targeted capital structure.

19
20 **Q. HOW DOES MAWC SET ITS SHORT TERM BORROWING AUTHORITY?**

21 A. MAWC reviews its short term borrowing needs with its management and then
22 seeks approval from its board. MAWC consults with AWW’s treasury team to
23 better understand seasonal working capital needs, capital markets timing, and
24 timing of cash from operations relative to capital investment at MAWC. Once
25 approved by MAWC, AWW’s treasury team integrates MAWC’s short term
26 borrowing needs with other AWW subsidiary borrowing needs.

27
28 **Q. HOW DOES MAWC MAKE DECISIONS TO REDEEM AND REFINANCE ITS**
29 **DEBT?**

30 A. MAWC reviews redemption and refinancing opportunities based upon its
31 issuance of bonds with existing redemption provisions, capital markets advice
32 from AWW’s treasury team, and the forecasted interest expense savings and net
33 present value creation from a redemption and refinancing. MAWC’s financial

1 management and AWW's treasury team work collaboratively to assess
2 opportunities and then to refinance when and as appropriate.

3
4 **Q. WHAT ARE THE ROLES OF AMERICAN WATER CAPITAL CORPORATION**
5 **(“AWCC”) AND THE CORPORATE TREASURY STAFF OF AWC IN MAWC**
6 **REFINANCING?**

7 A. AWCC is one mechanism available to MAWC to assist in achieving its
8 refinancing objectives. Through its economies of scale and portfolio diversity,
9 AWCC is able to achieve lower interest rates on debt capital and greater
10 availability of financial liquidity for the portfolio of AWW companies versus each
11 company endeavoring to establish its own bank lines of revolving credit,
12 commercial paper borrowings, and distinct, smaller debt offerings. AWW's
13 treasury staff executes the external financing (i.e., external to AWW on a
14 consolidated basis) on behalf of MAWC's decision to borrow.

15
16 **Q. WHAT IS THE HISTORY OF THE DEBT FINANCING AT THE AWW HOLDING**
17 **COMPANY LEVEL?**

18 A. At year end 2010 there was \$1.164 billion of long term debt at the holding
19 company level. This debt is legacy debt in RWE's plan of financing when it
20 purchased AWW and then prepared for the public offering of AWW's common
21 equity in 2007, with such sales occurring in 2008 and 2009. At the beginning of
22 2007 AWW's holding company had \$1.75 billion of preferred stock issued to an
23 affiliate of RWE. During 2007 that \$1.75 billion of preferred stock was refinanced
24 with \$1.75 billion of debt whereby an RWE affiliate was the lender. That debt
25 was subsequently reduced through contribution of equity and the remaining debt
26 was refinanced in the capital markets, eliminating RWE or its affiliates as lenders
27 to AWW. The proceeds of the borrowings by AWW were never used as a source
28 for equity or debt capital contributions to AWW subsidiaries, including MAWC.
29 Excluding the borrowings that were never used to fund AWW subsidiaries would
30 result in a restated AWW capital structure that is approximately 50% equity and
31 50% debt.

32
33 **Q. DOES AWW GUARANTEE THE DEBT OF AWCC, MAWC OR ANY OTHER**

1 **SUBSIDIARY?**

2 A. No. AWW’s holding company does not financially guarantee the debt or other
3 obligations of any subsidiary, including MAWC and AWCC.

4
5 **Q. DOES MAWC GUARANTEE THE OBLIGATIONS OF AWW OR ANY OTHER**
6 **AFFILIATE OF MAWC?**

7 A. No. MAWC does not guarantee the debt or other obligations of any AWW
8 affiliate including the debt and obligations of AWW and AWCC.

9
10 **Q. DOES ANY SUBSIDIARY OF AWW GUARANTEE THE DEBT OR OTHER**
11 **OBLIGATIONS OF AWCC, AWW, OR ANY OTHER SUBSIDIARY OF AWW?**

12 A. No. AWW’s holding company subsidiaries do not guarantee the debt of AWCC,
13 AWW, or affiliate “sister” companies. The financial obligations of subsidiaries,
14 including MAWC to AWW affiliates are limited only to those direct borrowings
15 under promissory notes from AWCC.

16
17 **Q. DO YOU REGARD THE SUBSIDIARIES AS FINANCIALLY DISTINCT AND**
18 **INDEPENDENT ENTITIES?**

19 A. Yes, AWW’s management evaluates the risks, returns, performance, and
20 financial structure of each subsidiary on a distinct and independent basis.
21 Therefore, the appropriate capital structure for ratemaking purposes at each
22 subsidiary is the capital structure of that subsidiary.

23
24 **Q. COULD YOU PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY?**

25 A. Yes. Each regulated subsidiary of AWW, including MAWC, is responsible for
26 developing a capital structure that reflects its risk profile. Therefore, the
27 appropriate capital structure for ratemaking purposes is the capital structure of
28 MAWC, not AWW whose capital structure is reflective of a different risk profile.
29 Additionally, AWW has not taken on long-term indebtedness as a source of
30 equity capital for MAWC. The long-term indebtedness currently held by AWW
31 was issued to refinance legacy debt associated with the RWE divestiture. If the
32 Commission should ultimately determine that the AWW capital structure should
33 be utilized in setting MAWC rates, it should recognize that certain funds were not

1 available for MAWC support and adjust the AWW capital structure ratio
2 accordingly.

3

4 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

5 A. Yes.