Exhibit No.:
Issue: *Rate of Return*
Witness: *David Murray*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Rebuttal of Supplemental Testimony*
Case No.: *WR-2015-0301*
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MISSOURI PUBLIC SERVICE COMMISSION

COMMISSION STAFF DIVISION

OPERATIONAL ANALYSIS

FINANCIAL ANALYSIS

REBUTTAL OF SUPPLEMENTAL TESTIMONY

OF

DAVID MURRAY

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2015-0301

Staff Ex 25

Jefferson City, Missouri
February 2016

REBUTTAL OF SUPPLEMENTAL TESTIMONY

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Q. Please state your name.

A. My name is David Murray.

Q. Are you the same David Murray who prepared the Rate of Return Section of the Staff's Cost of Service Report and rebuttal testimony in this case?

A. Yes, I am.

Q. What is the purpose of this testimony?

A. The purpose of this testimony is to respond to Scott W. Rungren's Supplemental Testimony filed on February 10, 2016.

Q. Do you and Mr. Rungren agree that there have been no specific studies on the impact an alternative rate design may have on a water utility company's cost of capital?

A. Yes. Mr. Rungren correctly indicates that both he and Staff are not aware of any specific studies quantifying the impact of alternative rate making mechanisms on water utilities' cost of common equity.

Q. Does Mr. Rungren believe any consideration should be given to the allowed ROE if an alternative rate design is implemented?

A. No.

Q. Why?

A. Mr. Rungren seems to defer to Missouri-American Water Company's (MAWC) Rate of Return Witness, Roger A. Morin, on the issue of whether an adjustment should be made to the allowed ROE to consider an alternative ratemaking mechanism that stabilizes revenues. Staff addressed Dr. Morin's position in its rebuttal testimony in this case.

Q. What is the main issue Staff had with Dr. Morin's position?

A. Dr. Morin's testimony as it relates to an adjustment to the allowed ROE contradicts the methodologies he uses to estimate the base allowed ROE, which has a much bigger impact on a fair and reasonable revenue requirement. Dr. Morin justifies his use of arithmetic averages to estimate the cost of equity by emphasizing that investors are very much focused on the annual volatility in earnings when determining a required return. However, when considering a ratemaking mechanism that would reduce this annual volatility, he explains away any consideration by indicating that he has already considered this through his selection of comparable companies that have other mechanisms that reduce volatility of earnings.

Q. Mr. Rungren indicates that because there have not been any significant studies on the impacts of alternative rate designs on water utilities, the "Commission should continue to look to the capital markets to inform them of a utility's cost of capital and evaluate the impact of a Revenue Stabilization Mechanism in the utility's subsequent rate case using a comparable group of utilities." Is this practical?

A. No. Because MAWC is not a stand-alone entity with debt securities at least traded over the counter, it is impossible to observe any changes in the prices of MAWC's capital. Any changes to MAWC's regulatory rate mechanisms would have a fairly small impact on American Water's overall business risk. The only way the impact of any such mechanism on a utility's cost of capital could possibly be measured is if it were applied to all of American Water's subsidiaries, which won't happen. Even then, it would still be a matter of judgement.

Q. Can this be done by selecting a comparable group of companies that have the same mechanism?

A. No. As Staff stated in the report it filed on June 16, 2015, the number of publicly-traded water utility companies is already very small for purposes of estimating a generic cost of equity for the industry. Therefore, it is next to impossible to find a sufficient size of sample companies that can be controlled for rate mechanisms similar to that which MAWC is proposing. Additionally, most often these companies will have several subsidiaries with varying rate mechanisms that also make it impossible to isolate for this one specific proposal.

Q. What did Staff propose to do in its rebuttal testimony in this case to consider any potential mechanisms that may reduce earnings volatility?

A. Staff recognized that rating agencies would view such a mechanism favorably when assessing MAWC's business risk. However, as Staff discussed extensively in its direct and rebuttal testimony in this case, MAWC is not viewed as a stand-alone company. Therefore, rating agencies do not publish any analysis specific to MAWC. Consequently, Staff assumed from a hypothetical perspective that such a mechanism may support a one notch improvement to MAWC's credit rating (the smallest improvement possible), if it were rated on a stand-alone basis. Because debt costs are tangible and identifiable, Staff believed this was a reasonable way to give some consideration to the risk-reducing impact of the proposed Revenue Stabilization Mechanism.

Q. How has Staff approached the introduction of these type of rate mechanisms in the past?

A. As Staff stated in its report, in two 2006 gas rate cases (Case Nos. GR-2006-0387 and GR-2006-0422), Staff simply suggested the Commission authorize an ROE in the lower half of its range to give this consideration. In a subsequent gas rate case for MGE, Case No. GR-2009-0355, Staff recommended the Commission authorize an allowed ROE in the lower half of Staff's range. In support of its recommendation, Staff cited comments from a Goldman Sachs' report that indicated a 40 basis point lower allowed ROE in return for a straight-fixed variable rate design was supportive of Atmos Energy Corp.'s stock price.

Q. Is either approach acceptable?

A. Yes. Because any adjustment is very much a matter of judgment, either approach is acceptable. Staff chose to use the credit rating adjustment approach in this case because it uses quantifiable and objective debt cost differences as a proxy for cost of equity differences. Additionally, in the past when a subject company's credit rating (The Empire District Electric Company) differed from the average of the proxy group, Staff has recommended debt cost differentials be used as a proxy for a cost of equity adjustment.

Q. Does this conclude your Rebuttal Testimony to MAWC's Supplemental Testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water Company's Request for Authority to Implement a General Rate Increase for Water and Sewer Service Provided in Missouri Service Areas	))))	Case No. WR-2015-0301

AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

COMES NOW DAVID MURRAY and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing REBUTTAL OF SUPPLEMENTAL TESTIMONY; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

David Murray

DAVID MURRAY

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 18th day of February, 2016.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin

Notary Public