

Exhibit No. _____
Issues: Debt Financing
Witness: Martin W. Moore
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Sponsoring Party: Elm Hills Utility Operating
Company, Inc
File Nos.: WR-2020-0275
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Missouri Public Service Commission

Surrebuttal Testimony

of

Martin W. Moore

On Behalf of

Elm Hills Utility Operating Company, Inc

December 2, 2020

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**SURREBUTTAL TESTIMONY OF
MARTIN W. MOORE
ELM HILLS UTILITY OPERATING COMPANY, INC.**

WITNESS INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Martin W. Moore, 1650 Des Peres Road, Suite 303, St. Louis, MO 63131.

Q. WHAT IS YOUR POSITION WITH ELM HILLS UTILITY OPERATING COMPANY, INC. (ELM HILLS OR COMPANY)?

A. I am the Chief Financial Officer and Treasurer of Elm Hills.

Q. ARE YOU THE SAME MARTIN W. MOORE THAT PROVIDED DIRECT TESTIMONY AND REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. Yes.

PURPOSE

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. I will respond to certain aspects of the Rebuttal Testimony of Office of the Public Counsel (OPC) witness David Murray, as it relates to debt costs.

LOAN TYPE

Q. YOU PREVIOUSLY DESCRIBED CSWR/ELM HILLS' EFFORTS TO SECURE FINANCING. IN HIS REBUTTAL TESTIMONY (P. 2, LINES 3-5), OPC WITNESS MURRAY STATES THAT IN HIS OPINION THE PROPOSED ELM HILLS LOANS "ARE MORE APPROPRIATE FOR A COMPANY THAT IS JUST STARTING ITS CONSTRUCTION PROJECTS AND EXPECTS TO NEED CONTINUED FINANCING TO PROVIDE CAPITAL AS THE CONSTRUCTION

1 **PROJECTS PROGRESS.” FIRST, IS CONSTRUCTION COMPLETED FOR**
2 **ELM HILLS, AS SUGGESTED BY MR. MURRAY?**

3 A. No. On June 30, 2020, pursuant to the Commission’s order in Case No. SM-2020-
4 0146, Elm Hills acquired the sewer systems and assets of Central Rivers
5 Wastewater Utility, Inc. (Central Rivers). Those systems and assets are not a part
6 of this rate case.

7 **Q. WILL THE CENTRAL RIVERS SYSTEMS AND ASSETS REQUIRE**
8 **ADDITIONAL CONSTRUCTION?**

9 A. Yes. Those Central Rivers systems will require updates and improvements to
10 bring the systems into compliance with Missouri Department of Natural Resources
11 environmental compliance. Thus, it would be erroneous to assume that Elm Hills’
12 construction projects have been completed.

13 **Q. HAVING SAID THIS, IS IT ELM HILLS’ INTENTION TO SECURE LONG-TERM**
14 **DEBT?**

15 A. Yes. As I stated in my previous testimony, it is the intention of Elm Hills to request
16 from the Commission approval to secure long-term financing to refinance the
17 current, Commission-approved, debt with a new third-party bank facility along the
18 lines of the structure described in the two letters of intent (LOI) received to date.

19 **Q. DOES THIS INVOLVE MORE THAN JUST ELM HILLS?**

20 A. Yes. CSWR is in discussions with many banks to support its national operations
21 and the bank solicitation materials we have presented to prospective lenders are
22 appropriate for those discussions.

1 **Q. DO YOU BELIEVE THAT THE DISCUSSIONS ARE APPROPRIATE FOR THE**
2 **SITUATION FACING ELM HILLS AND OTHER CSWR SUBSIDIARIES?**

3 A. Yes. Mr. Murray's inference that the structure described in the presentation
4 materials provided to the banks was in some way inappropriate for Elm Hills is
5 short sighted, inaccurate and continues to demonstrate Mr. Murray's lack of first-
6 hand experience in negotiating and securing senior credit facilities.

7 **Q. WHAT EXPERIENCE DOES MR. MURRAY HAVE IN NEGOTIATING AND**
8 **SECURING SENIOR CREDIT FACILITIES?**

9 A. None. In its response to Elm Hills' data request 7.2, OPC stated as follows:

10 Mr. Murray has not negotiated, helped negotiate, or been involved in
11 a commercial debt financing transaction since 2000. Mr. Murray's
12 role as a utility industry regulator is to review utility companies'
13 proposed financing transactions and then make recommendations
14 regarding such proposed financing transactions.

15
16 See **Schedule MWM-S1**.

17
18 **Q. IN YOUR OPINION WHAT DO THE LOIs RECEIVED THUS FAR REPRESENT?**

19 A. In my opinion, the LOIs received to date are indicative of Elm Hills' and CSWR's
20 success in moving banking negotiations forward. The bank solicitation materials
21 were for discussion purposes only and those informal lender discussions led to the
22 structure and credit enhancement demands included in the resultant term sheets
23 that are favorable to Elm Hills' customers. Because he never has negotiated a
24 commercial loan transaction, it is understandable Mr. Murray does not understand
25 this is a common dynamic in credit negotiations, given the fact that lenders do not
26 have to loan borrowers money and borrowers do not have the ability to unilaterally

1 dictate terms and conditions. This is especially true for a borrower with the historic
2 operating losses and environmental challenges of Elm Hills.

3 **TERRE DU LAC DEBT AS A PROXY**

4 **Q. IN MR. MURRAY’S REBUTTAL TESTIMONY (P. 3, LINES 3-24), HE AGAIN**
5 **CITES TERRE DU LAC UTILITIES (TDL) AS AN EXAMPLE OF A UTILITY**
6 **CAPABLE OF PROCURING DEBT AT AN INTEREST RATE LOWER THAN**
7 **THAT REFLECTED IN THE LOIs RECEIVED BY CSWR AND ELM HILLS. HOW**
8 **DO YOU RESPOND?**

9 A. Mr. Murray’s assertion continues to be contrary to material facts and my financing
10 experience. It is significant that Mr. Murray’s Rebuttal Testimony acknowledges
11 that the owners of TDL (Mike Tilley, Paul Tilley and, significantly, their wives) each
12 signed unlimited personal guarantees to the bank. This is a material fact that Mr.
13 Murray seems to gloss over in his testimony. A personal guarantee from these
14 owners, in support of a utility such as TDL, which, as Mr. Murray knows is a non-
15 compliant, multiple count violator of the Missouri Clean Water Law with outstanding
16 Attorney General petitions citing numerous violations, would represent a blending
17 of business assets and personal assets for purposes of enhancing the lender’s
18 security. If the utility were unable to pay its loan and the accrued interest because,
19 for example, it is unable to pay any regulatory fines – the personal guarantees
20 provide an alternate source of funds for the bank that are completely separate from
21 the utility’s operating business assets. These additional, unlimited personal
22 guarantees would be seen as very significant for the bank and very much

1 separated this loan from a traditional, pure market condition loan to a utility, based
2 solely on the utility's assets.

3 **Q. IS THAT MIX OF BUSINESS AND PERSONAL ASSETS SIMILAR TO**
4 **ANYTHING THAT IS PROPOSED FOR ELM HILLS?**

5 A. No. It is my opinion that the TDL loan is unlike what is proposed for Elm Hills, or
6 that should be proposed for Elm Hills. Elm Hills is owned by CSWR and there are
7 no personal guarantees available to the lender to "credit enhance" the loan. Utility
8 owners should not be asked to pledge personal assets to secure credit
9 agreements, regardless of what Mr. Murray suggests. Indeed, the need for
10 personal guarantees underscores the problems small water and wastewater
11 utilities face when trying to secure debt financing: banks are reluctant or unwilling
12 to lend money based solely on the income statements and balance sheets of the
13 utilities themselves. As evidence of that fact, the banks that have provided LOIs
14 have asked that CSWR set up an intermediary entity to be the lender to Elm Hills
15 to protect the bank from potential situations like what is currently facing the TDL
16 lender.

17 **Q. DO YOU VIEW THE TRANSACTIONS DISCUSSED BY THE LOIs TO BE**
18 **"LONG TERM" FINANCING?**

19 A. Yes. The proposed three to five-year terms offered in the LOI's are "long term", by
20 definition. "long term debt" is any amount of outstanding debt a company holds
21 that has a maturity of 12 months or longer. Elm Hills believes that a three to five-
22 year term is long term and will support the business of the utility. When

1 appropriate, the utility would seek to refinance and or modify the credit facility.
2 While the Company would be happy with a longer term, we believe as years go by
3 and rates are established Elm Hills and its affiliates will be more attractive
4 candidates for financing.

5 **Q. MR. MURRAY'S REBUTTAL TESTIMONY SUGGESTS THAT "IT SIMPLY**
6 **DEFIES PLAUSIBILITY THAT CSWR CANNOT OBTAIN TERMS AT LEAST**
7 **SIMILAR TO TDL ON A LOAN FROM ENTERPRISE." (P. 7, Lines 12-13) IS**
8 **THIS SITUATION PLAUSIBLE TO YOU?**

9 A. Yes. As I previously testified, CSWR approached a number of banks regarding
10 potential lending to various CSWR entities. During one of those informal,
11 telephonic discussions, Enterprise Bank and Trust made it clear it would not be
12 interested in making a loan directly to Elm Hills because of the inherent
13 environmental risks and historically poor operational results. Regardless of
14 CSWR's volume of business transactions with Enterprise Bank, the bank has to
15 make prudent loan decisions and they chose to initially pass on making a loan.
16 While CSWR operates multiple utility operating companies whose funds pass
17 through the bank, those transactions have nothing to do with Elm Hills and its credit
18 worthiness.

19 **Q. WHAT IS A COMMERCIAL LENDER INTERESTED IN WHEN IT IS**
20 **CONSIDERING LENDING MONEY TO A BUSINESS?**

21 A. Banks look at the underlying cash flow associated with the assets to which they
22 are being asked to lend. In further discussions with the two LOI lenders, CSWR

1 was able to progress the lending discussions only after introducing the concept of
2 using an intermediary entity to be the borrower and by having CSWR agree to be
3 the guarantor on the loan. In the end, the bank is looking at the intermediary entity
4 to support the debt service through its loan to Elm Hills. And if Elm Hills were to
5 experience operational shortfalls, the bank would look to CSWR under the
6 proposed guaranty. Again, Elm Hills and CSWR are unable to procure a loan
7 under Mr. Murray's theoretical equivalency to TDL terms, as Schedule MWM-2R
8 to my Rebuttal Testimony shows.

9 **RAYTOWN WATER**

10 **Q. MR. MURRAY'S REBUTTAL TESTIMONY SUGGESTS THAT RAYTOWN**
11 **WATER COMPANY'S \$200,000 LINE OF CREDIT, WITH AN OVERALL RATE**
12 **OF 4.25%, IS IN SOME WAY INDICATIVE OF RATES AVAILABLE TO ELM**
13 **HILLS. (P. 4, LINES 9-11). DO YOU AGREE?**

14 **A.** No. My opinion continues to be that Mr. Murray's examples do not reconcile with
15 the facts surrounding Elm Hills. Elm Hills is a financially struggling utility. Raytown
16 Water has annual revenues of approximating \$4 million as compared to Elm Hills
17 \$138,000 and Raytown has significant positive cash flow versus Elm Hills
18 significant negative cash flow. Moreover, Raytown's line of credit (LOC) is short
19 term debt and less than 1/10 of the amount needed by Elm Hills to provide safe,
20 reliable, and compliant water and sewer services to its customers.
21 Mr. Murray appears to assert that because one party got a loan, all parties should
22 be able to get similar terms and conditions, regardless of the vast disparity in the

1 financial statements, credit worthiness and physical condition of the assets of the
2 underlying businesses. That assertion is simply not based in fact in the
3 marketplace. Each lender has different credit thresholds, different relationships
4 with borrowers/owners, different motivating factors in making credit decisions.
5 Some banks simply do not want to lend to distressed industries or environmentally
6 challenging industries.

7 **ELM HILLS SITUATION IN REGARD TO DEBT COSTS**

8 **Q. IN MR. MURRAY'S REBUTTAL TESTIMONY, HE OFFERS ANOTHER**
9 **ASSUMPTION THAT ELM HILLS "COULD BE CAPITALIZED WITH OVER**
10 **100% DEBT AT 7X EBITDA" AND LATER SAYS THAT "EVEN AT 5X EBITDA,**
11 **ELM HILLS' CAPITAL STRUCTURE COULD BE SUPPORTED BY UP TO 82%**
12 **OF DEBT CAPITAL". (P. 5, LINES 1-16). HAVE CSWR AND ELM HILLS**
13 **IDENTIFIED ANY LENDER WILLING TO MAKE SUCH A LOAN?**

14 **A.** No. Elm Hills welcomes Mr. Murray's assistance in identifying and negotiating
15 such a loan. Elm Hills currently has negative EBITDA, which no party in this case
16 contests. Mr. Murray continues to make creative, fanciful and in the end
17 unreasonable arguments that do not have a real-life basis within the commercial
18 lending market. It is my experience that lenders are not actively seeking loans with
19 distressed entities without significant attention to credit enhancement (guarantees
20 or collateral offered).

1 **OPC ASSUMPTIONS**

2 **Q. MUCH OF YOUR TESTIMONY HAS ADDRESSED THE MANY FAULTY**
3 **ASSUMPTIONS MADE BY OPC WITNESS MURRAY IN REGARD TO HIS**
4 **RECOMMENDATIONS. WOULD YOU SUMMARIZE THOSE FAULTY**
5 **ASSUMPTIONS AND ELM HILLS' RESPONSES?**

6 **A.** Yes. In the following table, I have attempted to provide a list of those assumptions
7 contrasted with the reality within which Elm Hills must function.

8

OPC FAULTY ASSUMPTIONS	ELM HILLS RESPONSE
Terre Du Lac Utility Company's (TDL) cost of debt is a good proxy for Elm Hills because the companies are similarly situated. (Murray Direct, pp. 3-4).	TDL's cost of debt is irrelevant to Elm Hills' cost of debt as the financial characteristics of the companies are completely different. Additionally, TDL used non- utility or property as security. Most importantly, CSWR and Elm Hills have applied to the same lender and been denied financing. (Moore Rebuttal, p. 3-6; Cox Rebuttal, p. 10-12; Moore Surrebuttal)
The financial results of Elm Hills' sister companies (Hillcrest UOC, Raccoon Creek UOC, and Indian Hills UOC) support a cost of debt for Elm Hills that is below 5 percent. (Murray Direct, p. 4)	The financial results of other utility operating companies have no bearing on Elm Hills' cost of debt. More importantly, Mr. Murray's analysis ignores the losses borne by the affiliated companies prior to when rates are set. (Moore Rebuttal, p. 13-16)
Standard & Poor's credit metrics support a credit rating for Elm Hills of BBB+ to A-, which indicates a "strong" business risk profile. (Murray Direct, pp. 6-8)	S&P has done no credit rating of Elm Hills and could not do such a credit rating because the agency cannot do a future hypothetical bond rating. If S&P did a bond rating on Elm Hills (which S&P would not, because Elm Hills' asset and revenue size), the

	hypothetical bond rating would be in the junk bond territory. (Moore Rebuttal, p. 10-11)
It is likely Sciens is capitalizing its investment in CSWR and its affiliates with a proportion of debt greater than 50 percent. (Murray Direct, p. 10)	CSWR has been equity financed and any debt relevant to Elm Hills rate making would require Commission approval. The source of funds to make that equity investment is irrelevant to the determination of a fair return on an equity investment in a company with Elm Hills' risk profile.
Private equity investors frequently use current and expected EBITDA amounts to determine how much debt lenders would be willing to provide. Based on past experience for leveraged buyouts, lenders may be willing to provide an initial amount of debt equal to 6-8 times EBITDA. (Murray Direct, p. 12; Murray Rebuttal, p. 5)	A utility investor is entitled to earn a return on equity commensurate with return on investments in other enterprises having corresponding risks. The source of capital invested as equity is irrelevant to that determination. (Moore Surrebuttal)
On a pro-forma basis, Elm Hills could support 100% of its capital structure at 7x EBITDA. (Murray Direct, p. 12; Murray Rebuttal, p. 5)	Banks do not support debt based solely on pro-forma results when historical results are negative. Mr. Murray has no real world experience and has identified no source for Elm Hills to secure such 'supposed' capital. (Moore Surrebuttal).
The most likely "capitalization situation" for Sciens' investment in CSWR is 80 percent debt. (Murray Direct, p. 13)	CSWR is equity financed as Mr. Murray knows. The source of funds used to make that investment is irrelevant.
Based on his assumption that Sciens' investment in CSWR is funded with 80 percent debt, Murray calculates an internal Rate of Return on the investment of 21.65 percent. (Murray Direct, p. 14; Schedule DM-D-14) [No	As long as the return on equity and rate of return established by the Commission are fair and reasonable based on applicable constitutional standards, the internal rate of return of each individual investor is irrelevant.

<p>similar calculations were made assuming different levels of debt]</p>	
<p>The loans offered by American Bank and Enterprise bank are more similar to construction financing and are not appropriate for a company like Elm Hills at this stage of its development. (Murray Rebuttal, p. 2)</p>	<p>Elm Hills has more construction to do as it recently acquired Central Rivers' wastewater treatment plants, all of which have pollution compliance issues with MDNR and require upgrades. Regardless, Elm Hills desires to secure long-term financing subject to Commission approval. (Moore Surrebuttal)</p>
<p>The interest rates offered to Elm Hills are too high because Raytown Water was able to obtain a \$200,000 LOC for Prime + 1%. (Murray Rebuttal, p. 4)</p>	<p>Raytown and Elm Hills are not similar; Raytown has revenue greater than \$4 million, compared to Elm Hills' \$138K. Raytown's LOC is short term debt and less than 1/10 of the amount needed by Elm Hills to provide safe, reliable, and compliant water and sewer services to its customers. (Moore Surrebuttal).</p>
<p>Because TDL, a distressed utility with past (and current) environmental issues and can obtain low cost debt financing, Elm Hills, a distressed utility with past environmental problems, should be able to do so as well. (Murray Rebuttal, p. 4)</p>	<p>TDL was able to secure loans by offering the lender unlimited personal guarantees from the owners and their spouses. The lender has specifically told Elm Hills/CSWR on multiple occasions it is unwilling to make loans to Elm Hills/CSWR or any other investor-owned water and sewer utility. (Moore Rebuttal, p. 4-6; Cox Rebuttal, p. 7-8). Lenders are not anxious to make loans to distressed utilities, which is another of his continued unfounded assumptions.</p>
<p>Given its monthly cash flows with Enterprise Bank, Elm Hills should be able to negotiate a much better loan rate. (Murray Rebuttal, p. 7)</p>	<p>The monthly cash flows of Elm Hills' parent company CSWR has no bearing on Enterprise Bank's evaluation of the financial operations and supporting assets at Elm Hills. Rather, the bank looks to cash flow and</p>

	credit worthiness of the assets of the underlying utility. The consolidated cash flow of CSWR has no bearing on the rate case at Elm Hills. (Moore Surrebuttal).
CoBank financing is available to Elm Hills. (Murray Rebuttal, p. 8)	CSWR has responded that CoBank has been unwilling to loan CSWR funds as testified by Mr. Cox. There is no support for Mr. Murray's assumption. (Cox Surrebuttal)

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CONCLUSION

Q. BASED ON YOUR EXPERIENCE IN COMMERCIAL LENDING TRANSACTIONS AND YOUR REVIEW OF ALL THE TESTIMONY FILED IN THIS CASE, WHAT DEBT COST DO YOU BELIEVE THE COMMISSION SHOULD USE TO SET RATES FOR ELM HILLS?

A. The best evidence as to the current cost of debt for Elm Hills is the Company's testimony regarding rates it has been offered by two well established banks: American Bank and Enterprise Bank. As reflected in the LOI's attached to my direct testimony, and as I have explained in my direct, rebuttal, and surrebuttal testimony, nine percent (9%) is the lowest rate at which any commercial lender has expressed a willingness to lend money to Elm Hills. So, if the Commission believes it must specify a cost of debt for Elm Hills in this case, it should be no lower than nine percent (9%). But as the Company has made clear in all its testimony, we're not asking the Commission to specify a cost of debt. Instead, we're asking the Commission to approve the revenue requirement agreed to by Elm Hills and Staff and memorialized in the *Nonunanimous Disposition Agreement Regarding*

1 *Disposition of Small Utility Revenue Increase.* If the Commission approves that
2 revenue requirement (which specifies a cost of debt within a range of 7.50% to
3 8.00%), it need not specify a cost of debt in this proceeding.

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

5 A. Yes.

RESPONSE TO DATA REQUEST

TO: Dean Cooper
FROM: Missouri Office of the Public Counsel
DATE: November 23, 2020
RE: Response to Elm Hills Utility Operating Company, Inc.'s Seventh set of data requests

- 7.2 Identify each commercial debt financing transaction Mr. Murray has negotiated, helped negotiate, or been involved in since 2000. For each transaction so identified:
- a. Identify all parties involved in the negotiation/transaction.
 - b. Describe, in as much detail as possible, Mr. Murray's role in the negotiation/transaction and on whose behalf he was involved.
 - c. Describe the outcome of the negotiation/transaction, including the agreed interest rate and what security the lender required for each loan.

Response: Mr. Murray has not negotiated, helped negotiate, or been involved in a commercial debt financing transaction since 2000. Mr. Murray's role as a utility industry regulator is to review utility companies' proposed financing transactions and then make recommendations regarding such proposed financing transactions.
